GITC | REVIEW

VOLUME XII NUMBER 1
JUNE 2013

Editor: Milton Grundy

LONDON

CONTENTS

THE TAXATION OF JOINTLY OWNED PROPERTY

by Michael Firth

INTRODUCTION

Jointly owned property is extremely common. Trustees,[1] partners[2] and joint bank account holders are just some of the examples. Family homes are very often jointly owned as well – whether the owners are aware of it or not. Properly understanding the nature of the legal concepts involved and how the tax legislation applies is, therefore, a vital addition to the toolbox of all tax practitioners. This article seeks to explore just some of the questions that can arise, including:

- Can the income entitlements of joint owners differ from their capital entitlements?
- Is an asset made available/provided by a company if it is owned by the company and a director as joint owners?
- Can "shared" goodwill be used to move the value of goodwill without any tax charges?

The nature of jointly owned property

Logically, jointly owned property is simply a "joint" version of ordinary ownership. Whilst difficult to define, a sufficient definition of ownership for present purposes is that it consists of two basic elements: the right to enjoy the property and the right to freedom from the interference of others in that enjoyment. These rights are generally protected via the torts of conversion (chattels) and trespass (land). Of course, the owner may limit his or her rights if he or she so decides, but that, in itself, is an aspect of the original right to enjoy the property in whatever way the owner chooses.

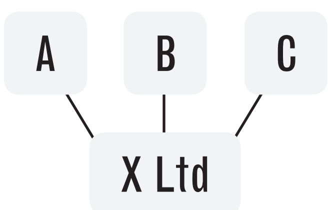
Joint ownership must, therefore, refer to the situation that exists when two or more persons enjoy these rights in the same asset, at the same time. There may also be a sense in which the enjoyment of the joint owners has to be "at the same level". Thus, we would not normally say that a landlord and a leaseholder jointly own the property, even though both have rights to enjoyment in the same asset. The simplest way of expressing this is to say that joint ownership must be joint ownership of the same interest in the asset, although this may not be quite right in all case.[3]

Two kinds of joint ownership

English law recognises two forms of joint ownership: joint tenancy and tenancy in common. It should be noted that the reference to "tenancy" in this context has nothing to do with leases. Instead, it comes from Latin, via French, and simply means "holder".[4] So when one reads or hears "joint tenant", one should understand "joint holder".

The fundamental theoretical difference between joint tenancy and tenancy in common is that, whereas joint tenants are each entitled to the whole of the asset, tenants in common are each entitled only to a share of that asset, albeit that the asset has not been divided, hence they have an "undivided share".

A helpful way to think about tenants in common is by way of an analogy with a company:[5]



Assume that X Ltd owns only one asset, a house. Assume further that A, B and C each own 1/3 of the company (three shares, one each). Each shareholder has a separate asset that they can dispose of and which is worth what a 1/3 interest in the house is worth (subject to the articles and memorandum etc.), but no shareholder has a right to any particular part of the house owned by the company. Similarly, tenants in common will own a proportion or share of the asset owned in common and can dispose of their interest, but they cannot point to any particular rooms in the house and say that they own those rooms. Their shares are undivided and this distinguishes tenants in common from, say, owners of adjacent plots land.

One consequence of the undivided share is that each tenant in common has a right to possess or control the whole of the property, but neither is entitled to exclusive possession/control as against the other. Indeed, if one tenant in common tenant carried out an act arrogating the whole asset to him or herself, he or she commits the tort of conversion.[6] In practice, the co-owners will usually have a formal or informal agreement or understanding as to how they will use the asset.

Joint tenancy, on the other hand, does not involve the concept of each joint owner being entitled to a "share" or a proportion of the whole. Instead, each joint owner has a full right to the whole of the asset in question.[7] The "jointness" arises from the fact that there is at least one other person with exactly the same right to the whole asset. From the law's perspective, it is as if there is only one owner.

It is possible for tenancy in common and joint ownership to exist in the same asset. For example, if A, B and C are joint tenants, but C severs his joint tenancy, then A and B are joint tenants of a 2/3 undivided share and C owns the other 1/3.

With these theoretical points explained, it is possible to understand (rather than just be aware of) one of the key practical differences between joint tenancies and tenancies in common – survivorship. Survivorship is the rule that says that when one joint tenant dies, no interest in the property owned as joint tenants passes to the deceased's legatees.

Instead, if, for example there were previously two joint tenants, there will now be one full owner, the survivor. There is no similar rule for tenancies in common.

The explanation for this difference is the nature of the two interests. Joint tenants each own the whole of the property rather than a share in it. When one joint tenant dies, there is simply one fewer owner of the whole of the asset.[8] Once there is only one joint tenant left, the ownership simply becomes ordinary ownership. Tenancy in common, on the other hand, does not achieve this result, because each tenant does own a share of the property, and there is no automatic reason why the surviving tenant should become entitled to a share in the property that he or she was not previously entitled to.

Converting a joint tenancy into a tenancy in common (severance)

Joint tenancy can be converted into tenancy in common by giving notice of severance to the other joint tenant(s). Upon the happening of such an event, the severing joint tenant gains an undivided share in proportion to the number of joint tenants there were. This explains why it is common to think in terms of joint tenants as owning a 50% share, even though that is not technically correct.

Joint tenancy is also severed if one of the joint tenants sells his or her interest. This makes sense – whilst A might be happy to have the survivorship rule apply as between himself and B, he may not be happy to have it applied as between himself and C (especially if C is a company). In technical terms it occurs because the unity of title, which is a prerequisite for the existence of a joint tenancy, is broken – C's title derives from B, rather than the same source as A's title.

Insolvency also severs joint tenancy so that the joint tenant's creditors are protected. Obviously, death does not sever joint tenancy (hence the survivorship rule) but if a joint tenant dies leaving an insolvent estate, it is possible for creditors to apply to the court for an order that the surviving joint tenant must pay an amount to the estate not exceeding the value lost to the estate (Insolvency Act 1986, s.421A).

At law and in equity

The only assets that can be owned as tenants in common at law are chattels. Where land or choses in action are subject to co-ownership, in order for there to be a tenancy in common, there will be a joint tenancy at law (if there is more than one legal owner) and then a tenancy in common in equity. For land, this rule derives from Law of Property Act 1925, s.1(6), and the explanation was the perceived difficulties a purchaser could face in trying to identify and negotiate with tenants in common, whose number could increase on every death if the deceased's interest passed to multiple persons.[9]

For choses in action, the rule derives from common law.[10] The explanation arises from the fact that choses in action are essentially obligations; often to pay money. If there was a tenancy in common at law, the debtor would have to work out who to pay and how much to pay each, which, for the reasons explained above, could be quite complicated. On the other hand, the rule of law that payment to any joint creditor is sufficient to discharge the debt[11] makes a joint tenancy far simpler to operate.

Identifying Jointly owned Property

The basic condition for the existence of a joint tenancy is the satisfaction of the four unities:[12]

- Unity of possession – each joint owner is entitled to use the whole of the jointly owned asset.
- Unity of interest – the joint tenants must have the same right to the asset.
- Unity of title – each joint tenant must derive his or her title from the same immediate source.
- Unity of time – the interests must vest at the same time.

Tenancy in common requires only unity of possession.

Nevertheless, these unities do not help us understand what will actually cause joint ownership to come into existence. Three main ways can be identified:

a. Express declaration;
b. Resulting trust arising from a contribution to the purchase price;
c. Constructive trust (in particular common intention constructive trusts of the family home).

'Proprietary estoppel' should not be ignored, but plays second fiddle to common intention constructive trusts in the context of family homes and is not fully developed in relation to non-land assets (although see *Strover v. Strover*[13]).

(a) Express declaration

The expressed intention of the parties is a fundamental basis for the law's intervention, so its role in relation to jointly owned property is unsurprising. In relation to land, the land transfer form used for conveyancing (TR1) provides an opportunity for the transferees to make a declaration of a trust to determine the beneficial enjoyment of their co-ownership. Such a declaration will also lead to the entry of a "Form A" restriction on the Land Registry:

> *"No disposition by a sole proprietor of the registered estate (except a trust corporation) under which capital money arises is to be registered unless authorised by an order of the court."*

In other words, an individual registered proprietor cannot dispose of title to the land without first appointing a second trustee. This ensures overreaching of the underlying equitable interests in the event of sale.

(b) Resulting trust

Where more than one person contributes to the purchase price of land (or another asset), in money or money's worth, there is a "presumption" that the land is held on trust for the contributors in proportion to their contributions and irrespective of who is the legal owner (*Dyer v. Dyer*[14]). If the contributions are unequal, this will necessarily be a tenancy in common.

In the event that there is an express declaration of beneficial interests in the land this will usually override the resulting trust analysis, but will, obviously not bind a contributor who is not party to the declaration (*City of London BS v. Flegg15*). Nevertheless, this result is, potentially, subject to the common intention constructive trust.

(c) Constructive trusts

As a general guide, one should consider whether there is a constructive trust in any circumstance where it is felt that it would be "unconscionable" or "unfair" for the legal owner to deny some interest to another person. That is of course, only the starting point, and one then needs to find a legal hook to hang the particular case on, but as a mental "trigger", unconscionability is useful (see, for example, *Pennington v. Waine*).[16]

One area which merits a little more extended treatment is the common intention constructive trust of the family home. In relation to family homes,[17] the courts take the legal position (i.e. who the registered proprietors are) as a starting point. Thus, if there is a single legal owner it is presumed that he or she is the sole beneficial owner and if there are two registered owners, equal beneficial entitlement is presumed.

These are, however, only presumptions, and they can be rebutted by any evidence which suggests that the parties' common intention was something different. Such intentions are to be deduced objectively from the parties' conduct and what that would reasonably have conveyed to the other party. If it is not possible to ascertain by direct evidence or inference the parties' actual intention, each is entitled to that share which the court considers fair having regard to the whole course of dealings between the parties (*Jones v. Kernott18*). Financial contributions and promises made between the couple are relevant, but many other factors will be taken into account.

Such beneficial interests are not set when the property is acquired and may change as the parties' relationship and conduct changes (e.g. contributions to the mortgage). Lord Hoffmann referred to this aspect of the trust as making it an "ambulatory constructive trust" (*Stack v. Dowden19*), which reflects the position that, in theory, the trust has always existed and that the entitlements have varied over time. This is as distinct from "remedial" constructive trusts, which exist in the US, and allow the court to impose a constructive trust as from the date of the judgment. The fact that the common intention constructive trust is not a remedial trust is crucial for tax purposes, as will be seen below.

One point that has not been resolved beyond doubt is the question of whether an express declaration by the parties can, effectively, be overruled by the courts imposing a constructive trust. In *Pankhania v. Chandegra*,[20] the Court of Appeal held that an express declaration could not be so varied. However, in the earlier case of *Clarke v. Meadus*,[21] the High Court held that express declarations are not immutable or incapable of being affected by subsequent events. By analogy with the law on pre-nuptial agreements, my view is that such express declarations should be upheld if they are freely entered into by each party with a full appreciation of its implications unless some overriding unfairness has arisen in the meantime (*Radmacher v. Granatino22*).

JOINTLY OWNED PROPERTY AND INCOME TAX

The starting point when one looks at income arising from jointly owned property is generally taken to be that tenants in common are entitled to the income in proportion to their entitlement to the underlying capital and joint tenants are entitled in proportion to the number of joint tenants (i.e. 50:50 if there are two tenants). Most of this part will be spent looking at potential exceptions to that rule, before considering the relationship between jointly owned property and the benefits in kind legislation.

Income shifting between spouses/civil partners

For spouses/civil partners there is a presumption for tax purposes that they are beneficially entitled to income arising from jointly owned property in equal shares (ITA 2007, s.836). Note, however, that certain types of income are excluded from this rule (s.836(3)):

- Income to which neither of the individuals is beneficially entitled;
- Partnership income;
- Income from a property business to the extent that it includes the commercial letting of furnished holiday accommodation;
- Income from shares in a close company;
- Income that is treated as the income of a specific person pursuant to some other rule.

There is another exception to this rule that applies where the spouses/civil partners are:

1. Beneficially entitled to the income in unequal shares; and
2. Their beneficial interests in the income correspond to their beneficial interests in the property from which it arises.

In those circumstances, the spouses may make a joint declaration of their beneficial interests in the income and will thenceforth be taxed in accordance with those interests, provided notice is given to HMRC within 60 days (s.837(3)). Such a declaration should be made on form 17 and is optional for each different asset owned. One further point is that it is wise to draw up a deed to act as evidence of the spouses' entitlements (if one does not already exist) given that the default legal position will likely be a joint tenancy (if there is co-ownership at all). HMRC's current practice is to insist upon evidence of the unequal entitlements.[23]

Sections 836 and 837 are interesting for two reasons. First, they, by necessary implication, permit spouses to engage in asset/tax planning. Obviously the spouses can alter the incidence of tax by altering their beneficial entitlements to the underlying asset. It is also possible, however, for one spouse to own 99% of the property and the other to own 1%, but for the spouses to be taxed on 50% of the income each, if no declaration is made. The reasons why one spouse may wish to keep hold of the bulk of the asset as opposed to giving it to his or her spouse will be for that spouse to explain!

The second interesting point is that s.837 expressly contemplates the possibility of a joint owner's beneficial entitlement to income from an asset being different from that owner's beneficial entitlement to the underlying asset. This is the subject-matter of the next section. In relation to spouses and civil partners, s.837 means that property which the spouses/civil partners own jointly cannot benefit from any such split in capital and income entitlement. However, s.836 only applies where all of the owners of the joint property are spouses or civil partners,[24] so introducing a third party will enable them to move outside of the ss.836 – 837 regime.

Splitting capital entitlement and income entitlement

The fundamental question to be answered in this section is whether the income entitlement of a tenant in common can be made to differ from the tenant's entitlement to the underlying capital. Logically, this ought to be possible – one can create a trust on (largely) any terms one wants, so why not one that effects such entitlements? The view to the contrary is premised on an assumption that there is some necessary and basic connection between entitlement to the capital value of an asset and entitlement to income from that asset. On analysis, however, that assumption turns out to be wrong.

In the first place, it is wrong in terms of the historical path of the law on joint ownership. As a matter of basic law, both tenants in common and joint tenants are each entitled to the whole of the income from the jointly owned asset and neither joint owner is entitled to <u>any</u> income as against the other joint tenant/tenant in common. Overall, therefore, neither tenant has an absolute entitlement to any amount. It was thus previously the case that a tenant in common could collect all of the income and keep it for himself, without any consequence, as long as he did not oust the other tenant in common from the property:

> "There is no doubt as to the law before the statute of 4 Ann. c. 16. If one tenant in common occupied, and took the whole profits, the other had no remedy against him whilst the tenancy in common continued, unless he was put out of possession, when he might have his ejectment, or unless he appointed the other to be his bailiff as to his undivided moiety, and the other accepted that appointment, when an action of account would lie, as against a bailiff of the owner of the entirety of an estate."[25]

The statutory provision Parke B was referring to is section 27 of Statutes 4 and 5 Anne c.16 which was introduced in 1705 and read as follows:[26]

> "Actions of accounts shall and may be brought and maintained…by one joint tenant and tenant in common… against the other, for receiving more than comes to his just share or proportion…"

It should be noted that even after the intervention of Parliament there was still no necessary link between capital entitlement and income entitlement. For example, if the income was the result of effort put in by one tenant in common alone, it would not be unjust from him or her to take all of the income:

> "Again, there are many cases where profits are made, and are actually taken, by one cotenant, and yet it is impossible to say that he has received more than comes to his just share. For instance, one tenant employs his capital and industry in cultivating the whole of a piece of land, the subject of the tenancy, in a mode in which the money and labour expended greatly exceed the value of the rent or compensation for the mere occupation of the land; in raising hops, for example, which is a very hazardous adventure. He takes the whole of the crops: and is he to be accountable for any of the profits in such a case, when it is clear that, if the speculation had been a losing one altogether, he could not have called for a moiety of the losses, as he would have been enabled to do had it been so cultivated by the mutual agreement of the cotenants?"[27]

Nor, it should be noted, does the existence of a trust, at least for land and choses in action, directly affect this position because tenants in common are not fiduciaries vis-à-vis each other.[28]

Second, it is uncontroversial that partners, who generally own partnership property as tenants in common, can agree to entitlements to partnership income that are different from entitlements to partnership income. It would be very difficult to justify a rule that allowed partners to divide up income in any way that they chose, but restricted non-partnership joint owners to mirroring their capital entitlements. The only necessary difference between the two situations is the existence of a "business". Indeed, there may be very good reasons for the parties deciding upon such a disconnect between income and capital, as *Henderson v. Eason* recognised.

Third, such a possibility is expressly contemplated by ITTOIA s.837, as mentioned above, and it is also contemplated by HMRC in their manuals (at PIM1030):

> "Where there is no partnership, the share of any profit or loss arising from jointly owned property will normally be the same as the share owned in the property being let. But joint owners can agree a different division of profits and losses and so occasionally the share of the profits or losses will be different from the share in the property. The share for tax purposes must be the same as the share actually agreed."

Fourth, such a possibility was expressly accepted by the Special Commissioners in *Kings v. King*.[29] The Commissioners accepted both that Mr and Mrs Kings were the joint owners of a property (paragraph 59) and that Mrs Kings had surrendered her entitlement to rent, and therefore could not be taxed on an entitlements basis (paragraph 62). The Revenue's argument was not that this was impossible, but that the evidence did not support such a surrender.

One issue that could arise is whether such a situation amounts to a settlement for the purposes of CGT, income tax or IHT. The question for CGT purposes is whether the two co-owners are absolutely entitled as against the trustees.[30] It appears that such joint owners are still absolutely entitled vis-à-vis the trustees – their capital entitlements are no different to those of standard tenants in common.

For IHT purposes, the question is whether property is held for persons in succession.[31] As long as there is nothing binding the parties to persist with the tenancy in common – and thus the divergent entitlements to income and capital (which could be analysed as an interest in possession trust of an amount equal to the difference between capital entitlement and income entitlement) – the absolute entitlement of the tenants in common ought to mean that the property is not held for persons in succession.

Finally, if taxpayers are intending to implement such a situation, they will have to be careful to ensure that the receipt of income matches entitlement and thus extra income is not received by the joint owner who is claiming he or she should not be taxed on it. The reason for this is that many taxing provisions make the person who is entitled or in receipt of the income liable. For example, interest is taxable on the person receiving or entitled to the interest,[32] and the First Tier Tribunal used this shortcut to taxation in *Halpin v. HMRC*.[33]

Issues Relating to Joint Bank Accounts

The general rules for taxing income arising from joint bank accounts are as stated above, but two traps should be noted that apply particularly to joint bank accounts. The first trap is that the beneficial interests, and thus the basic entitlements to income, may not be what they are expected to be. HMRC have shown a willingness to apply equitable presumptions when deciding what they believe the beneficial entitlements are.

For example, in *Bingham v. HMRC,*[34] HMRC were asking the Tribunal to apply the presumption of advancement on survivorship. Essentially, the father (Mr Bingham) had put money into a bank account which was held jointly with his children. Between strangers such a gift would give rise to a presumption of a resulting trust in favour of Mr Bingham (i.e. the children would hold their interests in the bank account on bare trust for Mr Bingham). Obviously, the children were not strangers, and normally a gift from a father to his children is subject to the presumption of advancement, but where the gift is of an interest in a bank account, there is a presumption of advancement on survivorship. In other words, during the father's lifetime the money standing to the credit of the account is held beneficially for the father, but on his death, the children take it beneficially.[35]

The Tribunal did not record the full complexity of this submission and instead referred simply to the basic presumption of a resulting trust.[36] On the facts, it did not matter because the Tribunal applied the settlements legislation (see immediately below), but it may be that cases will arise where these presumption are more important.

The second trap is that the settlements legislation, as mentioned above, can undermine any purported gift of an interest in a joint bank account if the donor is still beneficially entitled to draw on the account (ITTOIA 2005 s.619 ff.). This was the basis of the decision in *Bingham*, where the Tribunal accepted that there was an informal family settlement excluding the father, but he was not excluded in legal terms, and thus was caught by the settlements legislation.[37] Had the family arrangement been binding, with Mr Bingham simply acting as a trustee, the legislation would not have applied in respect of his adult children.

Jointly Owning a Property with a Company

Ordinarily, if a company purchases an asset, say a car or a house, and permits an employee or director to use that asset, a charge will arise under the benefits in kind tax code.[38] If, however, the individual were to jointly own the asset in question with the company, the question arises as to whether the asset has been "provided"[39] or "made available",[40] or whether the individual's use of the asset can be solely attributed to his or her rights as a joint owner?

In three cases, the taxpayer has lost this argument. All involved cars that were owned by the individual as a tenant in common with the company. The difference was how the car came to be in co-ownership:

- *Christensen v. Vasili*[41]– The company bought the car and transferred a part share to T.
- *Samson Publishing Ltd v. HMRC*[42]– The company and T bought the car together, as tenants in common.
- *G R Solutions v. HMRC*[43] – T bought the car and transferred a part share to the company.

In *Christensen*, Pumfrey J relied heavily on the fact that the employee obtained his interest in the car from the employer, it was thus 'conferred' on him by the employer.[44] However, he also said that if the car was not "made available" then nor was there any question of the employee being permitted a benefit in the form of the use of the employer's 95% interest.[45] In other words, if the joint ownership was sufficient to avoid the "made available" test, it also avoided the residual benefit test.[46]

In *G R Solutions*, the Tribunal held that one must apply the expression "made available" to the point in time at which the vehicle is used and was persuaded by the argument that:

> "…if both the employer and the employee want to use the car at the same time, it is not possible for part of the car to go to one destination and part of the car to another, and that when the employee uses the car for private purposes, the employer's share of the car is being made available to the employee at that time." [32]

Based on this logic, it appears that the mistake that all of these taxpayers made was to use a tenancy in common rather than a joint tenancy. As was explained above, a joint tenancy involves two persons being viewed from the law's perspective as the sole owner. No question of undivided shares is involved, thus the employer could not be making its share available – it has no such share.

Similar reasoning may apply to jointly owned land/houses if the company and the employee/director are joint tenants, although the trust of land rules add complexity.[47] HMRC's own view of such situations is that they have arguments to support a benefit charge, but that the strength of these arguments will depend on the facts of the case.[48]

JOINTLY OWNED PROPERTY AND INHERITANCE TAX

Jointly Owned Property as Part of the Estate

No particular issue arises in relation to tenancies in common – the undivided share is part of the deceased's estate and passes in accordance with his or her will/the rules of intestacy. Joint tenancies are where matters get a little more complex because, as was explained above, the death of a joint tenant causes them to drop out of the picture – nothing passes to any donee. Nevertheless, this does not avoid a tax charge because IHT looks at a person's estate immediately before death.[49]

Further, the fact that the joint tenant is about to die does not affect the value of the joint share. In this way a joint tenant's rights are different from the rights of a life interest holder. The value of a life interest holder's rights immediately before he or she dies is nil – no one would buy that right (applying reasonable foresight, but not hindsight – *MacArthur v. HMRC*[50]). For a joint tenant, the important difference is that the joint tenancy could be severed in the instant before death, meaning that the deceased's interest's descent into worthlessness is not inevitable.

The value of a share in jointly owned property is less than the equivalent proportion of the value of the asset as a whole. This reflects the difficulty in selling that interest and the right of the other co-owner to use the property. HMRC's starting point is generally a 10% reduction. No reduction is available, however, if the co-owner is a spouse or civil partner. This is because the joint interest is valued with the "related" property in the spouse's estate.[51]

Gift with reservation

One interesting point about the interaction between jointly owned property and the gift with reservation rules should be noted, and this arises in relation to discounted gift trusts. The point of this tax planning is that the settlor gifts away property into a discretionary settlement under which he or she retains a right to annual payments of a certain amount for life. The transfer of value into the settlement is reduced by the value of the retained right, because that is how one calculates the net loss to the settlor's estate.

HMRC accept that this planning avoids the gift with reservation rules and the pre-owned asset tax rules; instead, their interest is normally in the value of the retained right (see, for example, *HMRC v. Bower*[52]). Further, whilst it is normally effected using insurance based products, there is no reason the same reasoning should not apply to ordinary trusts.

The relevance of jointly owned property comes when one wants to carry out the planning with two spouses. There are two benefits to doing this. First, both spouses' nil rate bands can be made use of. Second, the rights to annual payments last for two lives rather than one which gives rise to a joint lives premium when calculating the discount (and thus allows the couple to settle more, even taking account of the two nil rate bands).

Problems would arise if the spouses independently created two separate discounted gift trusts, with each being able to benefit from the trust created by the other spouse because the reciprocal settlements would mean that there was a gift with a reservation.

In order for the spouses to create the trust together, they must settle property that they own as joint tenants. This is because the essence of the planning is that each spouse carves out a right to annual payments from the right that he or she already has. If the spouse was to acquire new rights as part of the settlement process (i.e. in an undivided share settled by the other spouse as a tenant in common), there would be a gift with a reservation. Such an outcome is avoided by settling property owned as joint tenants because both spouses are fully entitled to the whole of the property settled (rather than just an undivided share in it). They can, therefore, both be said to carve out their rights.

Bank accounts and double taxation

Where a bank account is held by persons as joint tenants, each holder may access the whole of the value of the bank account. Each holder, therefore, has power to dispose of the property and thus the value is in each holder's estate (IHTA s.5(2)). When an account holder dies, IHT is due on the value in that person's estate and, subsequently (or, perhaps, at the same time), when another holder dies, IHT appears to be due again on the same value.

This potential double taxation was recognised by the Court of Appeal in *Melville v. IRC*:

> "A clear example [of a provision that produces double taxation]…is one falling within s 5(2) of the 1984 Act, the very common case of a joint bank account which permits any holder to draw on that account. The same property, the moneys in the account, is under s 5(2) taxable on the death of each holder."[53]

Nevertheless, in practice, and apparently by way of concession, HMRC treat each account holder as beneficially entitled only to the proportion of monies in the account which he has contributed (see *Melville* at §36).

IHT and the Constructive Trusts

There may be cases where the parties are unmarried (hence no inter-spouse exemption can apply), but a common intention constructive trust means that the home the partners shared was already held on trust (at least to some extent) for the surviving partner. Potentially, the same or similar reasoning can apply to other assets, such as shares and one should always be on the look out for possible constructive trusts.[54] Such trusts can reduce the surviving partner's estate for IHT purposes, although one has to consider whether the gift with reservation rules or pre-owned asset tax rules may apply.[55]

JOINTLY OWNED PROPERTY AND CAPITAL GAINS TAX

Exchange of interests in jointly owned property

There used to be a concession (D26) that permitted co-owners to separate out their interests in co-owned land without incurring a chargeable gain (i.e. to divide their shares). This has now been enacted in TCGA 1992 s.248A, the key conditions for which are, inter alia, that the consideration for the disposal is or includes an interest in a holding of land held jointly by the co-owners and the disposal results in each of the co-owners solely owning part of the original holding. There have been suggestions (apparently from HMRC) that "land" here does not include a building. This has to be wrong (see s.288 and Interpretation Act s.5 and Schedule 1).

Co-owned shares and entrepreneur's relief

No advantage can be gained in relation to reliefs that require a certain level of shareholding by jointly owning sufficient shares to satisfy that requirement. For example, in relation to entrepreneur's relief, if persons hold shares jointly, the individuals are treated as the sole holder of so many of the shares as is proportionate to the value of the individual's share (TCGA s.169S(3)).

Shared goodwill and disincorporation

Ordinarily, extracting the goodwill from a company will involve the shareholders being taxed under capital gains or dividend principles, and the company paying corporation tax on a chargeable gain. Disincorporation relief has just been introduced, but with a very low cap of £100,000 for goodwill that will make it useless for many taxpayers.[56] Is it possible to achieve a similar effect, at least as regards the goodwill, without the tax consequences, by careful analysis of intellectual property law and tax law?[57]

The starting point has to be the action of passing off which is the way that goodwill is generally protected in the absence of registered trademarks. Five basic elements must be established in order to succeed in an action for passing off:[58]

1. A misrepresentation;
2. Made by a trader in the course of trade;
3. To prospective customers of his or ultimate consumers of goods or services supplied by him;
4. Which is calculated to injure the business or goodwill of another trade; and
5. Which causes actual damage to a business or will probably do so.

As a first step towards achieving the desired result, one can focus on the concept of a "misrepresentation". When dealing with groups of companies, the unregistered trademarks are not normally recognised by the public as referring to any single company within the group; instead, they represent the group as a whole. From this it follows that the group can rearrange its business internally in whatever way it likes, without there being any question of a deception arising. Thus Templeman LJ said in *Revlon Inc v. Cripps & Lee Ltd*:[59]

> "No purchaser knows or cares whether REVLON FLEX is made in Wales by a Venezuelan company or in New York by a Delaware corporation."

Similarly, no issue of misrepresentation arises when a new company is added to the group and takes the group name. For example, in *Dawnay, Day v. Cantor Fitzgerald*,[60] a 50:50 joint venture was set up by the Dawnay Day group on the one hand and Cantor Fitzgerald on the other. Whilst the joint venture continued it traded under the Dawnay, Day brand, but Cantor Fitzgerald later bought the joint venture's business and was found liable in passing off for continuing to use the Dawnay, Day name for the purchased business. The relevant part of the Court of Appeal judgment is the discussion of the legal state of affairs whilst the joint venture persisted:

> "So long as DDSL was carrying on its business as "part of the Dawnay, Day Group", an attempt by any or all of the other Dawnay, Day companies to restrain DDSL

> from trading as Dawnay, Day Securities would, in my opinion, have failed. It would have failed because DDSL could have relied on its implied licence to trade as "Dawnay, Day Securities". It would have failed, also, because DDSL in trading under that style would not have been misrepresenting anything."

Where customers would not care whether a particular individual or group of individuals provided the service or goods through a company which they own or in their own names it ought to logically follow that, even if the goodwill is owned by the company, the company cannot rely on the law of passing off to restrain use of the unregistered trademarks the company uses because there is no deception.[61] This will be particularly true of persons providing services.

Based on this, and depending on the facts, one can say that there is no reason why the shareholder must transfer the goodwill to himself in order to start trading using the same unregistered trademarks used by the company.

Is it possible to go further and establish that valuable goodwill accrues in the sole-trader? Consider what would happen if the company eventually ceased all business, but the sole-trader kept on trading under the same mark. Whilst a person does not lose their goodwill the instant that they stop trading,[62] goodwill is normally regarded as destroyed if the business is abandoned in circumstances where there is no intention to recommence it at a later time.[63] Thus, when the company permanently abandons all business, it will cease to own any goodwill.

At this point, at the very latest, it must be the case that the sole-trader now owns goodwill associated with the mark as otherwise his business will be unprotected and anyone could pass of their goods or services as his. But equally, there cannot have been any transfer of goodwill from the company to the sole-trader because a transfer of goodwill in gross (that is, without also transferring the underlying business), is void (a point that HMRC recently relied upon, successfully, in *Iliffe News v. HMRC*[64]). Instead, the sole-trader has acquired his own goodwill in the mark without any acquisition from the company.[65]

In fact, the correct analysis appears to be that up until that point, the company and the sole-trader "share" goodwill in the relevant trademark. For example, in *City of London Group PLC v. Lothbury Financial Services Limited*, Proudman J held that a company formed using the group name acquired goodwill in that name:[66]

> "In any event, until the administration, LFS did only non-PR consultancy work and it was formed under that name originally with the consent of LF. LFS was accordingly an existing company formed legitimately under a name which included the words "Lothbury Financial". Thus LFS shared the goodwill of that name and any change in the ownership of part of the goodwill owned by LF could not affect the goodwill of LFS. There is no misrepresentation simply by continuing to use a name after any connection between the two companies has ceased."

This idea of "shared" goodwill has sometimes been expressed in terms of joint ownership of the goodwill,[67] but that has usually been without any analysis of how such a conclusion fits within the framework of jointly owned property generally. In particular in cases such as *Lothbury Financial Services*, LFS could not have acquired ownership of part of LF's goodwill because that would be an invalid transfer of goodwill in gross. Difficult questions would also arise as to what the proportions of tenants in common would be, given that neither party has considered the issue, and whether a joint tenancy would even be possible in light of the four unities. The preferable explanation of "shared" goodwill is, therefore, that it is two separate assets of goodwill, that happen to be associated with the same trademark.

In terms of the capital gains analysis of the above, it appears that:

- The company has at no point disposed of its goodwill, it retains it for as long as it is contemplating carrying on business;[68]
- No capital sum has been derived from the goodwill (TCGA s.21);
- No relevant value shifting has occurred (TCGA ss.29, 30).

In terms of the income tax analysis, there may be a question as to whether the company is making an asset (its goodwill) available to the shareholder.[69] This raises similar issues to those which arise in relation to jointly owning cars and houses with a company. Here, however, the position is arguably stronger because the sole-trader acquires and uses his own, separate goodwill which just happens to be associated with the same trademark as the company's goodwill. The trademark itself is not an asset owned by either person.

CONCLUSION

As can be seen jointly owned property gives rise to a number of potential opportunities in relation to the law of taxation, as well as some potential pitfalls. Spotting these opportunities or pitfalls is half the task, properly analysing the surrounding legal framework is the other half. This article has sought to identify and analyse some of the issues, others will have to await another day – for example, what are the tax consequences of dissolving a company that owns property as a joint tenant?

Endnotes

1. Trustees own as joint tenants so that the survivorship rule (see below) avoids complications if one trustee dies.
2. Partners typically own partnership property as tenants in common because the survivorship rule is seen as inimical to such business relationships. A joint tenancy is, however, possible, if it can be shown that that was what was intended - *Bathurst v. Scarborow* [2004] EWCA Civ 411.
3. See *Plural Ownership*, Roger J Smith, OUP 2005 at pp.25 – 26 for an interesting discussion of this point in relation to tenancies in common which are generally said not to require such "unity of interest".
4. See, for example, the Domesday Book ("Day of Judgment Book") 1086, which refers constantly to "Rex tenet" – "the King holds".
5. Obviously the separate legal personality of a company means that the shareholders have no proprietary interest in the assets owned by the company, whereas tenants in common certainly do. The analogy is only intended to illustrate the undivided nature of tenancies in common.
6. Note the example given in *Jacobs v. Seward* LR 5 HL at 474, of a ship that was taken out to sea by one tenant in common without the consent of his co-tenant. "In that case it was held that the property was destroyed by the act of one tenant in common, and therefore trover would lie in respect of the co-tenant's share." It appears that Lord Hatherley was only thinking of cases where the property was actually destroyed such that no future benefit could be provided to the other co-tenant.
7. A point that HMRC acknowledge at TSEM9850.
8. The fact that companies do not "die" previously meant that companies could not be joint tenants. This was changed by the Bodies Corporate (Joint Tenancy) Act 1899. Dissolution of the company is corporate death for these purposes (s.1(2)).
9. Note also, in this regard, the rules that (1) if land is to be conveyed to more than four co-owners, the four who are named first take legal ownership as joint tenants holding on trust for all of them (s.34); and (2) even when the beneficial interest is a joint tenancy between the legal owners, s.36 deems there to be a trust so that the trusts of land regulatory provisions (now in TLATA 1996) can apply.
10. See, for example, *Re McKerrell* [1912] 2 Ch 648
11. *Wallace v. Kelsall* 151 ER 765 "…one of the parties has received satisfaction for a joint demand due to himself and others, which puts an end to such joint demand…"; and *Re EWA (A Debtor)* [1901] 2 KB 642.
12. Satisfaction of the four unities does not, however, automatically mean that there is a joint tenancy.

13. [2005] EWHC 860 (Ch).
14. [1788] EWHC Exch J8
15. [1988] AC 54 – parents contributed to the purchase of a property by a couple and the contribution was not by way of loan
16. [2002] EWCA Civ 227.
17. There is no theoretical reason why the same doctrine cannot apply to other types of property.
18. [2011] UKSC 53 at §51
19. [2007] UKHL 16, §62
20. [2012] EWCA Civ 1438
21. [2010] EWHC 3117 (Ch)
22. [2010] UKSC 427, §75, §169
23. TSEM9851.
24. *Bingham v. HMRC* [2013] UKFTT 110 (TC) §58.
25. *Henderson v. Eason* 117 ER 1451, per Parke B.
26. This statute was repealed by the Law of Property (Amendment) Act 1925, Schedule 10. In relation to land it has been replaced by the trusts of land legislation, see now TLATA 1996, ss.12 and 13 which give the courts the right to regulate the occupation of land held in trust and order payments from one co-owner to another.
27. *Henderson v. Eason* at 720 – 721
28. *re Bliss* [1903] 2 Ch 40 at 57
29. [2004] STC (SCD) 186.
30. TCGA 1992, s.60
31. IHTA 1984, s.43.
32. ITTOIA 2005 s.371
33. [2011] UKFTT 512 (TC). The rent was received solely by Mr Kings in *Kings v. King* (above).
34. [2013] UKFTT 110 (TC)
35. *Re Figgis* [1969] 1 Ch 123
36. §43. The reference to Lewin on Trusts (18th Edition) at chapter 9-85 is, however, confirmation that this is the point that HMRC were making.
37. §58.
38. ITEPA 2003 s.63ff.
39. E.g. living accommodation – s.97.
40. E.g. cars and vans – s.114.
41. [2004] STC 935
42. [2010] UKFTT 489 (TC)
43. [2012] UKFTT 234 (TC)
44. §§11 – 13.
45. §11.
46. Now in ITEPA s.201.
47. TLATA 1996, and see *IRC v. Eversden* in the High Court at [2002] STC 1109.
48. Employment Income Manual, EIM11414.
49. IHTA 1984, s.4. See *Lim & Others v. Walia* [2012] EWHC 4187 (Ch) – where a life insurance policy provides for death benefits and terminal illness benefits, if the joint policy holders decide not to claim the terminal illness benefit and instead the survivor gets the death benefit, there was still a joint tenancy of a valuable right to the terminal illness benefit immediately before the deceased's death. In that case this meant that the Inheritance (provisions for Family and Dependants) Act 1975 could apply, but it also means that IHT can apply.
50. [2008] STC (SCD) 1100 at §61
51. IHTA 1984, s.161.
52. [2009] STC 510
53. [2001] STC 1271, §36. See also *John Matthews v. HMRC* [2012] UKFTT 658 (TC).
54. See *Patmore v. HMRC* [2010] SFTD 1124
55. It is difficult to see how there is a "gift" if it is the law, rather than the parties, that is redistributing the interest. In any event, if the trust existed from the very first point of ownership, as often it will, then no interest has ever been transferred from one partner to the other, subject to the point made above about ambulatory constructive trusts. Tax law does not cope well with disposals taking effect pursuant to constructive trusts.
56. Finance Bill 2013, s.58(4).
57. The analysis below is presented with pre-2002 goodwill in mind.
58. See *Spalding (AG) & Bros v. A W Gamage Ltd* (1915) 32 RPC 273, HL.
59. [1980] FSR 85

60. [1999] EWCA Civ 1667
61. Issues could potentially arise in relation to employee or director's fiduciary duties. These would be matters for the company to raise, whether directly or through a derivative action. The unanimous but informal consent of the shareholders will normally sufficient to ensure that even if the company was later sold, the purchasers could not bring an action (*Re Duomatic Ltd* [1969] 2 Ch 365).
62. In *Ad-Lib Club Ltd v. Granville* [1971] FSR 1, the claimant still had goodwill in the name of a nightclub he had owned and run five years earlier. The unqualified proposition that goodwill can only subsist with a business is, therefore, wrong – see HMRC's different view at CG68050. There is also no reason why the transfer of the assets of a business *must*, contrary to the intention of the original owner, also cause the goodwill to transfer; that would amount to expropriation – see *FCT v. Murry* (1998) 193 CLR 605 and *IN Newman Ltd v. Adlem* [2006] FSR 16.
63. The Law of Passing Off, 4th Edition, Wadlow at 3-220; *Ultraframe v. Fielding* [2005] EWHC 1638 (Ch).
64. [2012] UKFTT 696 (TC).
65. Taking this argument to its logical conclusion would mean, in relation to goodwill outside of the 2002 intangible fixed assets regime, that there is a deemed disposal on the extinction of an asset for zero consideration which could potentially give rise to a loss (see TCGA s.24(1) and CG68070).
66. [2012] EWHC 3148 (Ch), paragraph 82. See also *Habib Bank v. Habib Bank AG Zurich* [1982] RPC 1 but note the opposite view in *Dawnay, Day v. Cantor Fitzgerald* [1999] EWCA Civ 1667. The fact that it was a 50:50 venture between the original owner of goodwill in the name and another company in *Dawnay, Day* may explain the court's position that the joint venture could not accrue goodwill in its own name.
67. For example *Sir Robert McAlpine Ltd v. Alfred McAlpine Plc* [2004] EWHC 630 (Ch), at paragraph 18.
68. In theory, if the Court of Appeal was right to find an "implied licence" in *Dawnay, Day* and that applies in non-joint venture cases, HMRC could argue that this licence is a part disposal of the goodwill under TCGA s.21(2)(b). First, however, licences of goodwill in gross (i.e. without sufficient 'control') are void (The Law of Passing Off, Wadlow, paragraph 3-212). Second, the supposed licensee does not need a licence because even without one, there is no misrepresentation and thus, no passing off. Third, would such a licence have any significant market value? Fourth, any amount actually received for the licence would fall within the intangible fixed assets regime rather than the capital gains regime (CTA 2009, s.896).
69. By virtue of the benefits-in-kind legislation (in particular ITEPA 2003 s.205) applicable to directors or via the close company rules in CTA 2010, s.1064. Note, that s.1064(3) only deems an expense to exist for the purposes of s.1064(2)(a), not s.1064(1) which governs when the section applies.

HOW CLEAR, TRANSPARENT, ACCESSIBLE & FORESEEABLE IS TAX LAW & PRACTICE?[1]

by David Goldberg QC

On Sunday 3 March this year, I conducted an experiment: I read out loud, first, a number of pages from the Inland Revenue Ordinance of Hong Kong which contains the whole of what is the most widely admired, efficient and accepted tax system in the world and, then, the same number of pages from our tax legislation here which, ex hypothesi, does not contain the most widely admired, efficient or accepted tax system in the world.

In each case, I found the average time taken to read a page and multiplied it by the length of the relevant code: there are 267 pages in the Hong Kong Ordinance, each with fewer words than are to be found on each page of UK legislation; and I took there to be 13,316 pages in the UK's direct tax legislation (though its length and different conventions about page numbering make it difficult to be entirely accurate even about how many pages the UK rules take up).

The experiment indicates that it would take 9 hours and 19 minutes to read the whole of the Hong Kong Tax Code.

The equivalent exercise with the UK legislation would take 768 hours, just over 19 working weeks or about four and one half months: to put that in perspective, if I started reading now for 8 unbroken hours on every working day I might just about finish in time for my summer holiday in August.

Anyone listening to an entire reading of the Ordinance would have some idea, not only of the principles which underlie the tax law of Hong Kong, but also of the rules which govern it: perhaps because it needs to be translated from English into Chinese and from Chinese into English, the language is relatively clear and the concepts employed are straightforward.

Here, for example, is the relevant part of the main charging provision in the Hong Kong Ordinance, s.14:

> "... profits tax shall be charged for each year of assessment at the standard rate on every person carrying on a trade in Hong Kong in respect of his assessable profits arising in or derived from Hong Kong."

That tells the reader virtually everything that you need to know about the tax charge: everything else is minor detail.

And here is an example – TIOPA 2010 s.371BA – from the minor charging provisions of the recently simplified CFC legislation:

"**s.371BA Introduction to the CFC charge**

(1) The CFC charge is charged in relation to accounting periods of CFCs in accordance with section 371BC.

(2) Section 371BC applies in relation to a CFC's accounting period if (and only if) –

(a) the CFC has chargeable profits for the accounting period, and

(b) none of the exemptions set out in Chapters 10 to 14 applies for the accounting period.

(3) A CFC's chargeable profits for an accounting period are its assumed taxable profits for the accounting period determined on the basis –

(a) that the CFC's assumed total profits for the accounting period are limited to only so much of those profits as pass through the CFC charge gateway, and

(b) that amounts are to be relieved against the assumed total profits at step 2 in section 4(2) of CTA 2010 only so far as it is just and reasonable for them to be so relieved having regard to paragraph (a).

(4) "The CFC charge gateway" is explained in section 371BB.

(5) Subsection (3) is subject to section 371SB(7) and (8) (which relates to settlement income included in a CFC's chargeable profits)."

That is an example of modern and vigorous drafting, but it does not tell you everything you need to know about the CFC charge: no one listening to the whole of the UK Code being read aloud would have any idea what it meant; length makes it hard to grasp; the language and the structure make it difficult to understand.

The different length and complexity of the two codes is NOT attributable to the need to raise more taxes here than in Hong Kong. A 267 page code is capable of bringing in as much revenue – and, perhaps, even more revenue – than our 13,000 or so pages of legislation.

Nor is it attributable to a greater fairness in our code than in that of Hong Kong: tax is imposed in Hong Kong without the benefit of democratic sanction but, even so, I do not know anyone who thinks it unfair.

The correct explanation is that the difference between the two systems is attributable to a wholly unnecessary complexity of concept here, coupled with high rates which are then ameliorated, not only by multiple (but necessary) reliefs hedged about by many non essential limitations, but also by charging sub codes unnecessarily introduced to meet the demands of special interest groups.

It might, of course, be said that nobody needs to read the whole of our legislation to find the answer to any particular tax question; and there would be truth in that if our tax code had unity and coherence.

It did, once: it enshrined a basic principle; it taxed income profits calculated by reference to some well established commercial principles.

That is what the tax law of Hong Kong still does.

But the rococo, unprincipled and unnecessary elaboration of our code, cluttered, as it is, with many TAARs means that it no longer does that: it is capable of springing surprises: unexpected loss of relief can occur; tax charges, which are not easily foreseeable, may arise.

It is, accordingly, necessary to know something of the whole tax code in order, accurately, to identify the appropriate tax treatment for any given situation: it is necessary to know that the legislation, quite full of shocks, will not deliver one in any particular case; and the only way of achieving that degree of knowledge is to study something which takes 4½ working months to read and longer – much much longer – to understand.

Length alone accordingly contributes considerably to a lack of clarity, transparency, accessibility and foreseeability in our system.

Now most of the complexity enshrined at such length will not affect a worker paid under PAYE who is likely to be unaware that he or she is bearing tax.

But much of it will affect any small business person setting up a business – especially in corporate form – and it must surely be wrong to subject *any* business to this length of code.

And, in addition to the burden of length, there are European, domestic, cultural, cross-cultural, administrative, curial and political factors which all contribute to a loss of clarity and foreseeability.

The European factors which increase uncertainty are not unique to the UK and I shall not detail them.

The domestic and cultural features which contribute to a lack of clarity are, first, an unwillingness to be honest about the true effects of our tax system (so that we continue to maintain that the income tax and NICs systems are separate and that we have a basic rate of 20%, when they are really the same thing, and the true low rate is, for most people, 32%) and, secondly, a deliberate tendency in the draftsman – which I shall illustrate shortly – to be less than wholly clear.

One cross-cultural factor which complicates and obscures our tax code is an increasing tendency to legislate by reference to accounting standards.

On one level, this can be seen as no more than the recognition of the basic principle that the word "profits" is to be given a business sense.

However, accounting standards are in a more or less constant state of flux as the methods of estimating (not determining, but estimating or, as it might better be called, guessing) when profits arise become supposedly more sophisticated; and they embody three further aspects which make them machines for the manufacture of uncertainty and instability.

First, they are avowedly not a means of computing profits, but a method of presenting a picture of the overall financial performance of a company.

Secondly, accounting standards operate by reference to something which accountants call "the substance" which means that you need to determine what has happened on some supposedly realistic basis which departs from every legal convention known to the civilised world: for example a debt owed by a company may be regarded as not owed by it even though, in law, it is.

There is, accordingly, a basic statutory code intended to operate in accordance with legal principle, which has, within it, a device designed not only to erode that fundamental requirement but also to impose substance tests, which have the effect that it is not only possible, but right, to invent what has happened.

Thirdly, changes in accounting standards to reflect changing views about substance can, unexpectedly, change tax treatment; they can make things which a legislative draftsman could reasonably expect to be there, disappear, with consequences that have been mandated by legislation which has not considered the possibility of disappearance at all.

And I might add that however difficult the drafting of our domestic statutes might be, the language of accounting standards, although appearing to be in English, makes our statutes look as if they were written by Enid Blyton.

A particular difficulty in legislating for the use of accounting standards is that accountants and lawyers use the same words but, very often, ascribe different meanings to them: an example is debits and credits, which lawyers use in one sense and accountants use in a reverse sense.

Another cross-cultural factor which causes a loss of clarity is that our taxes are no longer self-contained: that renders it unsafe to rely on instinct to find an answer.

For example, the charge to IHT; a capital tax, is supported by POAT, a charge to tax on deemed income; and the charge to SDLT, another capital tax, but this time an indirect one, is to be supported by the charge to ARPT, a direct annual charge.

Incidentally, the need for residential property owners to consider what to do about ARPT neatly illustrates the complexity of our tax system: what ought to be relatively straightforward requires a consideration of 5 taxes: SDLT; IT; CGT; IHT; POAT.

The administrative issue is that HMRC operate very many practices, not all of which are published, which are sometimes applied in an inconsistent fashion.

The need for consistency in that respect and the problem of ensuring that it exists will both grow with the introduction of the GAAR, of which more shortly.

The curial factor which militates against the desiderata for a good tax system is this.

Over a period of, say, 30 years, Courts have moved from regarding tax as purely a statutory thing, liability to which is to be determined only by reading the statute, to regarding it as something which is as susceptible to the common law method as anything else.

The common law method traditionally involves the raising, by inter partes disputes, of issues to which the Courts provide solutions, historically by a process of evolutionary adjustment as the needs of society change.

The increasing pace of societal change has, rightly or wrongly, led to an increasing rate of judicial response: what used to take 10 years might now take only one or two; the process is no longer evolutionary but revolutionary.

At present we are in the midst of a process of adjustment in relation to what has been called by slovenly minds the problem of tax avoidance; and it is undoubtedly the case that the Courts have not yet found a response to the issues which is, to them, satisfactory.

Thus the original response here was to hold that circular self cancelling schemes and linear preordained transactions did not work, not because of the facts but because of something, unidentified, in the statute.

By a process of several further adjustments, we have reached the present position, which is that all tax questions are resolved by applying the statute, construed purposively, to the facts, viewed realistically, a formulation which involves two elements of uncertainty.

First, purposive construction inevitably involves attributing a meaning to a statute different from that which an ordinary reading of the words gives: unless that is so, there is no need to construe purposively; it is only necessary to construe.

Moreover, the rule that we can now consult material outside the statute adds further to the difficulty of construing statutes.

Secondly, the ability to view the facts realistically raises an issue as to how far it is possible to reconstruct a transaction or to say that nothing at all happened.

At the Court of Appeal level, there is, on the most recent cases, a disagreement as to whether a realistic view of the facts allows things to be ignored or not.

The disagreement is, of course, not expressed: with rare exceptions, Courts always pretend that they are being consistent, but every practitioner in the field knows not only that a process of revolution is in train, but also that not every judge will apply a strict approach to the resolution of tax issues: as the universe tends inevitably to entropy, the smaller common law world now tends inexorably to the mantra that every result must be fair which, no matter what merit it may have generally, is peculiarly inapt in relation to tax.

On top of this there is, worst of all, the political factor.

As a matter of politics, not as a matter of necessity or economic good sense or sensible taxation, we are now to have a GAAR.

There are many examples of GAARs in the world, but our proposed draft is the most objectionable I have seen.

The GAAR will apply only if the statute, construed purposively and applied to the facts, viewed realistically, still gives the taxpayer a tax advantage (a term which is, unnecessarily, inadequately defined in the draft legislation, an example of the draftsman's tendency away from clarity).

In that situation, HMRC may, if they reasonably consider the taxpayer's conduct to be an abuse of the system, change the law for him alone to deny the tax advantage provided for by the purposively construed legislation.

In other words, the GAAR will apply to deny a tax advantage where the purpose of the legislation is to give that advantage.

And the basis for the denial of the intended advantage is the disapproval of the administrator.

There are, supposedly, safeguards but, in the end, the power is to change the law by administrative fiat and a power of that kind is inevitably unsatisfactory for at least three reasons.

First, experience teaches that the decision as to whether something is reasonable in the tax context is always emotional, not rational, so that the safeguards are apparent but not real.

Secondly, no matter what criticism may be made of what the legislation presently provides, there is no ideal method of identifying a taxable subject matter; every way of doing that will be open to some form of objection and any one method is just as good as any other.

Thirdly, the proponents of rules like the GAAR see it as upholding the rule of law.

An approach of that kind is, of course, justifiable if every form of profit belongs to the State and the ability of the citizen or corporation to retain any part of it is a gift from the State.

That is, however, not a situation which accords with a correct analysis of our political or legal philosophy and it is necessary to be clear here: what our GAAR is intended to do is to deny, under the guise of law, the benefit of the words in the statute to some chosen class of alleged miscreants whose only misdemeanour is to ask that the law be applied to them honestly.

Here is a quote from Joseph Schumpeter (*The Economics and Sociology of Capitalism*):

> "The spirit of a people, its cultural level, its social structure, the deeds its policy may prepare – all this and more is written in its fiscal history ... He who knows how to listen to its message here discerns the thunder of world history more clearly than anywhere else."

Our tax system as it stands sends the message that we are a sophisticated, unnecessarily complex but essentially well-intentioned people. If we add to it the GAAR the message changes: we shall show ourselves to be unbalanced, tending to the totalitarian and essentially mean-spirited; it will not be green and pleasant.

Endnotes

1. This article is derived from a talk given by the author at the seminar "Does Our Tax System Meet Rule of Law Standards?" on 21 March 2013. The Bingham Centre will be holding a one-day conference on the topic of "Tax and the Rule of Law" on 20 November 2013.

THE BOND AND THE SHORT OF IT

by Nikhil V. Mehta

The Government proposed to abolish the distinction between short interest and yearly interest in their Consultative Document on changes to the income tax treatment of interest published on 27th March 2012. In the same document, they also proposed to do away with the ability of UK companies to use Quoted Eurobonds for intra-group funding ("IGQBs").

The responses to the consultation were published in October 2012. Due to adverse comments from respondents, the Government decided not to proceed with either proposal. The responses were quite measured, unlike the reaction of the American colonies when the British attempted to impose stamp duties on them in the 18th century. As Alistair Cooke wrote:

> "It was the first internal tax that Britain had ever proposed and its effect was to rouse the colonists to a fury".

The relevant stamp duties disappeared as a direct result of the reaction. Similarly, short interest has remained. There are not many occasions when one gets a chance to celebrate the maintenance of the status quo after a consultation. On this occasion, I think it is worth doing so in an understated way. As someone who has become quite fond of short interest, and has come to live with IGQBs, I am pleased with the outcome, if not a little surprised.

Short Interest

Short interest is a wonderful concept. Many years ago, when I was a young student of taxation, I found its simplicity made short interest easy to grasp. When there are wonderful alliterative case names like *Bebb v Bunny* and *Corinthian v Cato* to memorise, student research really does not get much better!

There was (and, thankfully now remains) a nice fiscal Trivial Pursuit question for tax geeks: when is UK source interest not subject to (as opposed to exempt from) withholding? When it's short!

The expression "short interest" is not a statutory term. It is the opposite face of the coin that has "annual" or "yearly" interest engraved on it. With statutory consolidation and changes to the tax treatment of interest payments, "annual" has gone and "yearly" remains: see the general withholding tax provision in Section 874 of the Income Tax Act 2007. So, short interest is the opposite of yearly interest. East is east and west is west…although finding the border is not always easy, which I will discuss later.

Much of the case-law on the distinction had to do with getting tax relief for interest: see for example *Cairns v McDiarmid* (the Rossminster non-deposit scheme) and *Minsham Properties v Price* (charges on income for a corporate taxpayer). With the introduction of the loan relationships code for companies and progressive restrictions on tax relief for interest for non-corporate borrowers, the distinction between short and yearly interest became irrelevant for deductibility purposes. Its only importance lay in whether deduction of tax at source applied. Yearly interest was subject to withholding in the absence of an exemption. Short interest did not attract withholding: that Trivial Pursuit question again.

No doubt this is what prompted the Government to canvass for abolition of the distinction. Perhaps it had become an anachronism. After all, we have had the deduction of tax machinery in our tax system since 1803, with the distinction between yearly and short interest appearing three years later. Both concepts have been around long enough for the taxpaying community to get used to them, so why should short interest continue to enjoy freedom from withholding?

The answer of course is that "short interest" can arise for any period of less than a year including even a single day. Unlike yearly interest, short interest can arise unexpectedly, for example, if a fiduciary holds funds belonging to someone else for a few days or weeks than had been intended.

To impose withholding obligations in the really short scenarios smacks of taking a hammer to crack a nut. It puts an unnecessary compliance obligation on the payer. If someone fails to withhold inadvertently and then finds himself liable to pay tax and interest on unpaid tax, that creates more difficulties both for the payer and, I suspect, HMRC. By its very nature, short interest will suffer tax in the normal course by direct assessment within a reasonable timeframe after it is paid (or not in the hands of non-residents and exempt institutions). If it is not taxable on assessment e.g. if paid to a non-resident with no other UK connections, then withholding is unnecessary: it would be counterproductive for HMRC to require non-residents to make domestic claims, let alone treaty claims, to avoid withholding or to get refunds of tax withheld.

The responses to the Consultation contained a number of examples of commercial situations where the "gross" treatment of short interest remains important today. It is worth setting these out:

- intra-group cash pooling arrangements and intra-group funding arrangements generally;
- the issue by companies of commercial paper; repo, stock lending and other collateral arrangements;
- short term bridging finance;
- late payments due under property leases;
- payments made under reinsurance agreements;
- payments of certain types of derivative;
- payments made under certain securitisation arrangements.

The examples show that the treatment of short interest is certainly not anachronistic. If anything, the circumstances in which short interest can arise have increased, and are still not complete. Short-term bridging finance is one of the most common examples where short interest can arise, and this can be incurred in a range of situations, including the funding of capital assets and working capital. A recent example was a short-term project finance loan from an offshore bank's overseas office to a UK purchaser of substantial infrastructure equipment which it was going to sell on to an overseas party. An unexpected mismatch between receipts and expenditure made the finance necessary for the UK company. The bank could not have relied on the exemption in Section 879 as the loan was made in its offshore business, and it was also not within the Tax Treaty Passport Scheme for overseas lenders. Making claims would have been unworkable while grossing-up would have been commercially unthinkable, given the inherent costs of bridging finance. Timing was another issue. The treatment of the interest as short was extremely important to the financing for both borrower and lender.

If withholding were extended to short interest, the specific exemptions from withholding on yearly interest paid to banks and other specified classes of lender in ITA 2007, Chapter 15, Part 3, would presumably have to be extended to all interest. But that would not be sufficient to deal with the range of lenders and investors now involved in "short" lending including investment funds and high net worth individuals. Indeed, there is something to be said for extending the "yearly" exemptions: due to the state of the financial markets in recent years, the sources of finance from conventional banking providers have diminished, and new categories of lenders and investors have emerged in areas like syndicated lending which traditionally were the exclusive province of banks. But that is another debate as it relates to yearly interest.

The grey area is the crooked dividing line between short and yearly interest. In what circumstances can short interest become yearly? In the October 2012 document, HMRC said:

> "HMRC will make changes to its guidance in the Savings and Investment Manual (SAIM) to set out more clearly its view of 'short' loans that are repeatedly rolled over."

Recently, HMRC published their proposed changes to the Savings and Investment Manual in draft. At the time of writing, the draft is subject to comments. So far as rollovers are concerned, HMRC have proposed a new opening paragraph in SAIM 9076. It is worth setting out the whole of SAIM 9076 with the new draft opening paragraph, which appears below in bold:

> "Applying case law principles
>
> **This [the previous paragraph in SAIM 9075 discusses Cairns v McDiarmid and the focus given to the intention of the parties] will be the case in particular where a loan has a duration of less than 12 months but is 'rolled over', once or more than once, to a second year. HMRC's view is that in the absence of evidence to the contrary, the intention of the parties will have been for the loan to have lasted more than 12 months.**
>
> It is always a question of fact whether, in any particular case, interest is yearly or short. The intention of the parties will be the most important factor in deciding the question (see SAIM9075).
>
> The question of whether interest is short interest, from which the payer has no obligation to deduct tax, is most likely to arise in the context of payments made by a UK resident to a person whose usual place of abode is outside the UK. If the interest is short, there is no need for the recipient to apply under a relevant Double Taxation Agreement to receive the interest gross (or with tax withheld at a reduced rate). There is guidance at INTM505010 onwards.
>
> A UK resident may make a series of loans, each of less than a year, to a non-resident, and claim that the interest is short. HMRC staff should refer to the guidance at INTM542010 in such cases.

Uncertainty may also arise as to whether there is a duty to deduct tax from interest in circumstances comparable to that in Bebb v Bunny (SAIM9075) – where a sum of money remains outstanding for a period that may, or may not, be longer than a year. For example, a manufacturer might guarantee to refund the purchase price, with interest from the date of claim, if a product proves faulty: such claims may normally be processed speedily but, in disputed cases, may drag on for over a year.

Where the parties intend at the outset that monies due will not be left outstanding longer than 12 months, the interest will be short – even if, in a few cases, there are delays which prolong the period over which interest accrues. If however the parties anticipate at the beginning that the debt will exist for more than a year, or appear to be indifferent as to whether it will or not, the interest is likely to be yearly.

Where the payer of the interest is uncertain about whether it is short or yearly, they may in practice 'play safe' by deducting tax. If the recipient of such interest objects to the tax deduction, HMRC staff should advise him or her to take up the matter with the payer, see SAIM9180.

If, conversely, the payer decides that interest is short and pays it gross, HMRC staff should not challenge that view unless

- the decision appears to be completely unjustified on the facts and in the light of relevant case law, or there is reason to suspect a definite intention of avoiding the payment of withholding tax; and
- material sums of tax are at risk"

I doubt if there will be changes made to this part of the draft guidance as a result of comments from interested parties. HMRC clearly have a difficult task in laying down safe harbour rules under which short interest should not be treated as yearly interest in a rollover situation. In my view, the key words in the new draft paragraph are "in the absence of evidence to the contrary". If the parties intend at the outset that interest should be rolled over, then it is clear that the interest should be yearly interest as in *Cairns v McDiarmid*. But as in that decision itself, any attempt to dress up yearly interest as short is likely to arise in an avoidance context and, if so, is unlikely to succeed given the anti-avoidance arsenal available to HMRC. However, given the many reasons in today's financial world why interest is rolled over, a genuine decision taken by the parties to rollover prior to the short-term maturity of the loan, should result in the interest remaining short. Of course, if this is done on more than one occasion, in practical terms the onus on the interest payer becomes greater to show the interest remains short.

HMRC's view in their draft wording is that, in a rollover situation, there is a rebuttable presumption that the interest is yearly. The key to rebuttal is ensuring there is written evidence to support the intention of borrower and lender. One problem with standard loan documentation provided by the lender is that there is no scope for amending that with nice recitals to show what is happening and why. The borrower usually does not have the negotiating power, no matter how strong the business relationship with the lender, to amend the document in this way. But there is ample scope outside the loan itself to achieve this-for example, unilaterally in the borrower's board minutes and also in exchanges of letters between the parties. It is important to take the trouble to do this and not just sign up to the extension agreement with nothing telling the right story.

There are other techniques available which have the effect of making withholding unnecessary. For example, properly structured, a zero coupon security issued at a discount does not give rise to withholding tax when it matures, as a discount is not subject to withholding tax. The recent decision of the Upper Tier Tribunal in *Pike v Revenue and Customs Commissioners* is a timely reminder that the distinction between interest and premium/discount is not easy, particularly where the security carries no periodic interest. But in a commercial situation where the debt is properly drafted and the parties have a genuine intention that nothing should accrue or be payable until maturity, the discount route remains viable. Of course, if the real driving intention is to avoid withholding, then that is vulnerable.

IGQBs

The Quoted Eurobond exemption was announced in the 1984 Budget in what was called the "Corporate Finance Package". It was a watershed year for changes to the UK's corporate tax system. Apart from Quoted Eurobonds, the Finance Act 1984 introduced deep discount securities, qualifying corporate bonds and controlled foreign companies. The Quoted Eurobond exemption was a direct response to UK companies' grievance that they were unable to tap the Euromarkets directly for finance as withholding tax put them at a financial disadvantage. With the removal of exchange controls in 1979, it was incongruous that there was no straightforward tax-efficient way for UK companies to issue Eurobonds. The technique employed was to use a Dutch finance vehicle to issue the Eurobonds, coupled with an onloan back to the UK parent: the finance vehicle claimed exemption from UK withholding from interest on the onloan under the double tax treaty. The fiscal cost of this was a negotiated taxable turn in the Netherlands. While this route was tried and tested, it did not prevent HMRC looking at treaty-shopping aspects. But the new exemption did away with the use of Dutch finance vehicles and enabled UK companies to issue Eurobonds directly.

But the original version of the exemption had a couple of twists to it. It was not sufficient for the bonds to be "quoted". In addition, the interest had to be paid by an overseas paying agent or the bonds had to be held in a recognised clearing system. These additional requirements were inserted to reflect what HMRC had been told about the workings of the Euromarkets: they were not tax restrictions as such. But they implied that the exemption was intended to apply to public issues of bonds in the Euromarkets in the conventional way and not much else.

IGQBs first came to the fore when the original version of the exemption with the two twists was still in force in the 1980s. The first time I came across an IGQB was an issue of unlisted securities by a Cayman subsidiary, which onlent the proceeds under an IGQB to its UK parent. The interest on the IGQB was paid by an overseas paying agent as it made no sense for the bond to be held in a recognised clearing system, given that there would be no trading in it. As time went on, the two twists disappeared and the definition of "quoted" was confined to simple listing, as is the case today in Section 987 of the Income Tax Act 2007. That made IGQBs much easier to structure. If HMRC did not like the use of IGQBs, they could have tightened up, not relaxed, the "quoted" requirement. The change to straightforward listing was seen as an acceptance of the use of IGQBs.

That being the case, it was strange that the March 2012 Consultative Document raised this issue again and invited comments on proposals to restrict the exemption for IGQBs where there was no substantial or regular trading in the IGQB. Given the nature of the beast, how could an IGQB be allowed to trade by the issuing group?

Not surprisingly, the responses to this proposal were also negative. They included the following:

> "The well-established Eurobond market in the UK could be undermined. This would weaken London's competitive position, reduce inward investment in the UK, and put the UK at a disadvantage compared to competing jurisdictions.

- The change would add to compliance costs, as businesses sought to restructure existing arrangements.
- Clearing and paying agents' systems would need to be re-designed to manage withholding tax arrangements, and an exemption would be required for quoted Eurobonds held on trading account by a holding company
- Redemption of existing quoted Eurobonds could be triggered, and grandfathering rules would be needed to provide certainty and stability to existing arrangements.

On the specific proposal that the restriction would apply where intra-group bonds are listed on stock exchanges where there is no 'regular or substantial trading', a number of respondents said that such instruments are often part of a chain of bonds through which third party finance is raised, and are listed on such exchanges to take advantage of lower regulatory costs. It was argued that a 'regular or substantial trading' test would be difficult to frame, hard to administer, and impose a compliance burden.

Some respondents felt that the concept of an 'intra-group' quoted Eurobond would be difficult to define; many favoured a narrow wording based on an existing statutory definition such as that used capital gains."

The underlying theme of the responses was that the legislation permitted the use of IGQBs and many issues had gone ahead on that basis. If it ain't broke, why fix it?

It will be appreciated that we have come a long way from the original rationale for Quoted Eurobonds back in 1984. But that is not surprising: the financial markets have evolved considerably, so why should tax legislation and practice not follow suit? If there is perceived avoidance, then that can be addressed, but not at the expense of the broader market which has used the generosity of the current exemption for structuring unlisted issues, whether on a private placement basis or otherwise.

The Government announced in the October 2012 paper that they would consider the question of the extent to which withholding tax should be withheld in the cross-border context further. The logical conclusion on IGQBs is the same as that in 1984 for bond issues by offshore finance vehicles: do away with the need for them, but with the substitution of a better alternative. Just as with the Mark 1 exemption for Quoted Eurobonds, what is now required is a broad exemption from withholding tax on interest for finance raising by UK companies, subject to anti-avoidance measures. The IGQB could then be put out to grass, but with an honourable track record!

DATA HOLDER NOTICES UNDER SCH 23 FINANCE ACT 2011

by Aparna Nathan

INTRODUCTION

In my experience, there has been an increased incidence of clients receiving data holder notices under the provisions of paragraph 1 Sch 23 Finance Act 2011 ("FA 2011"). These data-holder notices usually require the recipient to provide information of a specified sort which it is assumed the recipient will hold.

Recipients of data holder notices (known as "relevant data holders") include employers, persons making payments in respect of public lending rights or copyrights, persons making payments of interest. Even broader in conceptual terms than these categories of relevant data holders is the category set out at para 17(1) Sch 23 FA 2011: a relevant data holder is a "person by whom licences or approval are issued or a register is maintained".

It follows that any body that maintains a register is a relevant data holder and may be the recipient of a data holder notice. Consequently, clubs of any sort, unions and other bodies that maintain a register may well need to consider their position if they receive a data holder notice. Should such a body automatically hand over the requested information? In my view, the answer is, "no".

POINTS TO CONSIDER

Data Protection Act

The relevant data-holder has certain obligations (such as non-disclosure) under the Data Protection Act 1998. However, a body may be able, in appropriate circumstances, to rely on the exemption from the non-disclosure provisions which is set out in s.35(1) Data Protection Act and which provides:

> "Personal data are exempt from the non-disclosure provisions where the disclosure is required by or under any enactment, by any rule of law or by the order of a court."

Accordingly, in order to be able to rely on s.35(1) Data Protection Act 1998 and furnish the relevant data to HMRC, it is imperative that the request for data is validly made. If the data-holder notice is invalid but a relevant data holder nevertheless provides the information to HMRC, the relevant data holder could be in breach of its obligations under the Data Protection Act.

Validity of the Notice

The first point to consider is whether the relevant data notice is validly issued: in other words does it comply with the requirements of Sch 23 FA 2011.

The "relevant data" that may be sought from a relevant data holder falling within para 17 Sch 23 DA 2011 in such circumstances are set out in para 15 Data-gathering Powers (Relevant Data) Regulations SI 2012/847 ("the Regulations") which provides:

> "(a) the name and address of anyone …to whom an entry in the register relates or related;
> (b) particulars of the …entry;
> (c) information relating to any application…for entry on that register."

The word "address" found in para 15(1) Sch 23 FA 2011 is defined by para 47 Sch 23 FA 2011 as "including an electronic address". If the data holder notice requests details of the private address of the persons on the register, it would be appropriate to ask HMRC why they are seeking the private address given that a business address would be less sensitive and could arguably achieve a similar end.

Second, consider carefully whether the items of information listed under in the data holder notice are consistent with the items of information that the HMRC is permitted to request.

Third, check to see whether the data-holder notice specifies the reason why the relevant data is being sought. It is not appropriate for HMRC to request data without indicating clearly why they are seeking that data. Support for this view is at para 2(1) and para 3(2) Sch 23 FA 2011. Para 2(1) provides that:

> "The power in paragraph 1(1) is exercisable **to assist with the efficient and effective discharge of HMRC's tax functions –**
> (a) Whether a particular function or more generally, and
> (b) Whether involving a particular taxpayer or taxpayers generally." (emphasis added)

Assuming that there is some statement in the data holder notice of the intended use to which the information sought will be put, it is necessary to assess whether that statement of intended use is too broad or unspecific to meet the requirement in para 2(1) Sch 23 FA 2011.

If, on such an assessment, it appears that the statement of intended use of the data sought is too broad and unspecific, it is entirely appropriate to ask HMRC to clarify their reasons for seeking this data.

Fourth, under para 3(2) Sch 23 FA 2011, HMRC are not permitted to specify relevant data in a data-holder notice:

> "unless an officer of Revenue and Customs has reason to believe that the data could have a bearing on chargeable or other periods ending on or after the applicable day[1]".

It is entirely reasonable therefore to establish whether the data holder notice gives sufficient details about why HMRC are seeking the data sought and what bearing that data has on chargeable periods falling within the four years preceding the date of the data holder notice.

It must be remembered that HMRC have a duty to exercise their powers in a reasonable and proportionate manner. As a consequence, it is appropriate to consider whether the information sought achieves a balance between the interests of (1) the relevant data holder, (2) the individuals whose details are sought on the one hand and (3) the ends sought to be achieved by HMRC on the other hand.

In appropriate cases, the European Convention on Human Rights may also be in point and should be considered.

CONCLUSION

What is clear is that it is by no means true to say that the recipient of a data holder notice under Sch 23 FA 2011 must automatically hand over the data sought. It is imperative to consider the recipient's obligations under the Data Protection Act 1998 and to establish whether the data holder notice is validly made. Any necessary clarification should be sought from HMRC in appropriate cases and should, if properly presented, result in a mutually satisfactory outcome.

Endnotes

1. "Applicable day" is the first day of the period of 4 years ending with the day on which the notice is issued (para 3(3) Sch 23 FA 2011).

CAPITAL VS. REVENUE: SOME POINTS TO BEAR IN MIND IN DISPUTES WITH HMRC

by Laurent Sykes

1. This note sets out some of the points to bear in mind in disputes with HMRC over what is revenue and what is capital in the context of repairs and improvements.

SCHEME OF WORKS

2. HMRC are known to challenge the revenue nature of expenditure incurred as part of a wider project on the basis that the expenditure is incurred as a part of a "scheme of works" which viewed as a whole is of a capital nature. The statutory basis on which a deduction is resisted is s.74(1)(f) and (g) ICTA 1988 (now s.53 CTA 2009).
3. HMRC's approach makes it determinative whether or not expenditure was, as a matter of fact, incurred as part of the same "works". It is clearly wrong however to say that a repair is any less of a repair simply because it was undertaken at the same time as an improvement and as part of the same project. Such an argument was deployed by HMRC in the case of *Christopher Wills* (TC00479) where the argument was rejected (HMRC had submitted that the work undertaken and claimed as repairs was part of a wider capital scheme to convert the outbuilding into additional living space).
4. HMRC sometimes rely to support their case on a Tribunal case known as *Moonlight Textiles* (TC00755). The reliance is misplaced. Here the taxpayer had not provided any breakdown which would permit a closer categorisation and this was why the taxpayer lost. The FTT said: "As HMRC

had pointed out however, the Appellant had provided a list of items of expenditure which might have distinguished between repairs and improvement in any detail." The Appellant had therefore not discharged the burden on it. It is clear from that decision that the work involved improving the premises and therefore in the absence of a breakdown the FTT took the only decision which it was able to.

5. Taking the "works" as a starting point is the wrong starting point and an irrelevant one because it depends on subjective questions as to whether an expense was incurred as part of the same project. The correct starting point is to identify the relevant asset or entirety. In *O'Grady v Bullcroft Main Collieries* 17 TC 93, Rowlatt J approved *Lurcott v Wakely* [1911] 1 KB 905, a non-tax case. He said:

   > "But the critical matter is - as was pointed out in the passage read from Lord Justice Buckley's judgment, in the case which has been referred to - what is the entirety? The slate is not the entirety in the roof. You are repairing the roof by putting in new slates. What is the entirety? If you replace in entirety, it is having a new one and it is not repairing an old one."

6. Vinelott J described the approach in *Brown v Burnley* [1980] STC 524 as follows:

   > "However, two general observations can be made. First, in the often-cited words of Buckley L.J. in *Lurcott v Wakely & Wheeler* [1911] 1 KB 905, at page 924: "Repair is restoration by renewal or replacement of subsidiary parts of a whole. Renewal, as distinguished from repair, is reconstruction of the entirety, meaning by the entirety not necessarily the whole but substantially the whole subject-matter under discussion." The second and related observation is that the question, "Is this a work or repair?" prompts the further question, "A repair of what?"; or, as Buckley L.J. expressed it, "What is 'the whole subject-matter under discussion'?" In the case of a covenant in a lease it may be possible to identify the whole as the whole of the demised premises. In the context of s 130(d) there is no such guide."

7. Identifying the entirety is important because a replacement of part of the entirety can be a repair, whereas a replacement of the whole (or substantially the whole) of an entirety cannot be. For instance, if I replace the sole of my shoe with a new sole, that is a repair. If I replace my entire shoe, that is not a repair. As Lord Nicholls said in the *Auckland Gas* case [2000] STC 527:

   > "To take a homely instance, replacement of a worn washer on a household tap is normally regarded as a repair of the tap even though one of its parts has been wholly replaced. The tap has been repaired by the replacement of one of its component parts."

8. The point is also important because the mere relocation of a part of an entirety (even if it involves a replacement of that part, to be located somewhere else) does not of itself necessarily give rise to capital expenditure. In *Samuel Jones & Co (Devonvale), Ltd v Commissioners of Inland Revenue* 32 TC 513, the facts were set out by the Lord President as follows:

   > "The old chimney had been in existence for some 80 to 90 years and had been subjected to the usual overhaul, repointing and relining to which such appliances have to be periodically subjected; but, as a result of increasing age and subsidence of its foundations, it came to be in a dangerous state and on the advice of their experts the Company had to replace it. With the object of keeping the factory in operation they did so by erecting a substitute chimney close by the existing chimney and then taking down the old chimney whenever the new chimney was in a position to take over the functions previously dis-

> charged by the old chimney. It is found as a fact that the new chimney is not an appreciable improvement over the old chimney. So far as function is concerned its suitability for boiler draught is exactly the same as that of the old chimney. No additional steam-raising plant has been installed."

9. This reflects the facts as found in that case: "The new chimney was sited close to the old in the middle of the factory in a block of buildings which also contains furnaces and boilers. The new chimney is about the same height as the old one (approximately 100 feet), and projects through an aperture (rather larger than in the case of the old chimney) in the roof." It was held that the expenditure was revenue.
10. This to be contrasted with the new chimney in *Bullcroft v O'Grady Main Collieries* 17 TC 93 where the chimney was also moved. The reason for the decision in that case was that the chimney was the entirety - see per Rowlatt J: "I think the chimney is the entirety here" (doubt was in any event cast on this conclusion in the *Samuel Jones* case by all three judges in the Court of Session[1]). In the *Samuel Jones* case by contrast, it was not and the cost of the newly positioned chimney was allowed.
11. The entirety might be vast. In the case of a pipeline, road, rail or cable network, the relevant entirety could be the whole pipe, road, rail or cable network. (See *Transco plc v Dyall* [2002] STC (SCD) 199, *Highland Railway Co v Balderston* (1889) 2 TC 485 and the *Auckland Gas* case.)

CHANGE OF MATERIALS

12. There is no requirement in order for works to be a repair and to give rise to revenue expenditure that the materials used are exactly the same as the originals.
13. Thus in *Conn (H M Inspector of Taxes) v Robins Bros Ltd* 43 TC 266 the repairs were still revenue even though different materials were used: the slate roof was replaced with one of corrugated asbestos; oak flooring was replaced with concrete in the main shop; certain timbers were replaced with steel joists encased in oak. Overall, the result was in substance to repair what was there before and not to improve it, and the expenditure was revenue.
14. In the *Transco* case, polyethylene was inserted into existing pipe network. It was held by the Special Commissioners:

> "… there has been no overall improvement in sections of the network, as polyethylene has only been inserted in pipes which required repair or which were at risk of fracture. What was done was a mere replacement of parts of the pipeline that were defective and the renewal of those parts. All that has been done was necessary to renew and relay the network as it was; only those parts of the pipes which were defective, or which were at a high risk of failure, have been renewed. The character and nature of the property possessed by Transco has not been changed nor indeed has it been materially improved. The material used (polyethylene) is cheaper than cast iron. To adapt the words of the Lord President, what was done was a mere insertion of polyethylene pipes into the old pipes, which were worn out or partially worn out, and renewing them in whole or in part along the whole network. That did not alter the character of the network."

15. However substantial changes which alter the character of the entirety by upgrading it are unlikely to give rise to revenue expenditure (see the *Auckland Gas* case).
16. It should be noted that changes in modern methods may mean that there are differences, and indeed improvements, between, say, the materials or components used to effect the repairs and the original materials or components.

There are examples of this in *Conn v Robin Bros* and the *Christoper Wills* case. That does not mean the expenditure is not revenue. The point is also made in the *Auckland Gas* case where Lord Nicholls said: "It often happens that, with improvements in technology, a replacement part is better than the original and will last longer or function better. That does not, of itself, change the character of the larger object or, hence, the appropriate description of the work."

APPORTIONMENT VS. NOTIONAL REPAIRS

17. It is not possible to obtain a deduction for so-called "notional repairs". If one replaces an asset in need of repair with a different one which is superior then one cannot look at the expenditure which one *would* have incurred in replacing the asset with one of the same character.
18. However one should not view this as precluding, as HMRC sometimes seek to argue, the ability to apportion expenditure between that which is revenue and that which is capital. For instance, if I use concrete to repair a road and I also use concrete to extend the road, it is possible to apportion the cost of the concrete between the revenue and capital elements. This has nothing to do with notional repairs.

PATCHWORK REPAIRS

19. HMRC sometimes argue that a repair which avoids the need for more regular patching up repairs is capital. This is not so. Expenditure can be revenue if it is on repairs which are undertaken so that patchwork repairs which would otherwise be necessary are avoided. It is true of course that expenditure is not revenue just because it is incurred so that patchwork repairs are avoided. But similarly the argument that expenditure is not revenue simply because it prevents the need for patchwork repairs is a nonsensical one. If I choose to replace the sole of my shoe rather than to patch up the holes in it periodically, that is still a repair.
20. Thus in *Conn v Robins Bros Ltd* the facts found by the Commissioners were that quite substantial works were carried out and yet these were held to be repairs. The head note summarises this as: replacing the slate roof with one of corrugated asbestos; inserting steel joists at first floor level and building new walls above; replacing oak flooring with concrete in the main shop; replacing the shop front, eliminating a bow window; and replacing certain timbers with steel joists encased in oak. On appeal by the Revenue, Buckley J, dismissing the appeal, said:

    > "It was, I think, expenditure which the Company incurred because, unless something had been done, the state of the property would have become so decrepit that it would have been impossible for the Company to continue to carry on its business there."

21. Put another way, if the expenditure is not on a new entirety or an improvement to the entirety which alters its nature, it is still likely to be revenue.
22. In the Irish case of *Hodgins v Plundr & Pollak* [1957] I.R. 59 (which is referred to in the *Auckland Gas* case by Lord Nicholls), a weigh-house was substantially rebuilt, the relevant entirety having been found to be the entire factory premises and not the weigh-house. The Irish Supreme Court held this was revenue. Kingsmill Moore J, giving the leading speech with which the other members of the Supreme Court agreed, said:

    > "This building though small was large enough to enable part of it to be used as a store and a workshop. It was heavily damaged and the walls were cracked as the result of a storm so that substantial repairs became necessary, and the company decided that

> the most effective way of meeting the damage was not to attempt a patchwork repair but to pull down and rebuild the old structure. This was done and a new weigh-house was constructed using the old foundations and some of the original materials."

23. He went on:

> "The Company now have a weigh-house which is in good repair instead of a weigh-house which was in danger of becoming ruinous, but there is no suggestion that it is more convenient, more effective or of greater capital value, than the old weigh-house would have been if it was in thorough repair. I am unable to see that any new capital asset has been created."

24. Logically, all of this makes sense. It would be nonsensical if the tax system gave relief for patching up but not for repairs which for a good number of years obviate the need for patching up. Provided what is being incurred is in fact on a repair or in substance maintenance, and the character of the entirety has not been altered, then it is entirely logical that the law treats those in the same way.

REPAIR OF SOMETHING NOT YET DAMAGED

25. Expenditure can be revenue expenditure if it is incurred on replacing something which has not yet been damaged. In *Transco* part of the repairs were precautionary repairs as the Special Commissioners noted:

> "Also, there has been no overall improvement in sections of the network, as polyethylene has only been inserted in pipes which required repair or which were at risk of fracture. What was done was a mere replacement of parts of the pipeline that were defective and the renewal of those parts. All that has been done was necessary to renew and relay the network as it was; only those parts of the pipes which were defective, or which were at a high risk of failure, have been renewed. The character and nature of the property possessed by Transco has not been changed nor indeed has it been materially improved. The material used (polyethylene) is cheaper than cast iron. To adapt the words of the Lord President, what was done was a mere insertion of polyethylene pipes into the old pipes, which were worn out or partially worn out, and renewing them in whole or in part along the whole network. That did not alter the character of the network. Although some old cast iron pipes have had polyethylene pipes inserted into them, that has been done only where necessary for the purposes of repair, or precautionary repair, and has not been done to the whole network. Those considerations would point to the conclusion that the expenditure is properly chargeable as revenue expenditure."

MATTERS OF FACT AND DEGREE

26. In dealing with a revenue vs. capital dispute, matters of fact and degree arise. One is required to view the changes in light of the overall effect on the relevant entirety. Lord Nicholls said in *Auckland Gas*:

> "The nature of some objects and their component elements is such that replacement of one or more components will not necessarily be regarded simply as a repair of the larger object. This is particularly so if the replaced element differs from the damaged original in such a way as to change the character of the whole. A house is a simple example of this. Demolition and rebuilding of a dangerous flank wall

of a house would normally be regarded as repairing the house. The answer might not be so obvious if an entire derelict wing of a large house were demolished and rebuilt, especially if the new construction were substantially different from the original. Questions of degree may arise in such cases."

CONCLUSION

27. It will be worth bearing the above points in mind in a capital vs. revenue dispute with HMRC.

Endnotes

1. Lord Carmont for instance said of the earlier High Court case: "Rowlatt, J., it is true, found that he could regard the chimney in the O'Grady case as being the unit or the entirety as he called it. In the present case I am clearly of opinion that the unit to be considered is the factory and the chimney cannot be taken in isolation. There was no improvement in the factory, on the findings of the Case, by the erection of the new chimney in place of the old. It is an entirely subsidiary matter in the factory."

FIRST PRACTICAL IMPACTS OF THE GAAR

by Michael Thomas

As of mid July 2013, the UK will, of course, have a statutory general anti-abuse rule ("the GAAR"). The purpose of the GAAR is supposed to be to stop aggressive tax schemes. When the GAAR was announced, my view was that its practical impact would be extremely limited. My essential reason was that the UK's voluminous and ever-growing tax code, a large proportion of which now comprises targeted anti-avoidance rules, is sufficient to stop the vast majority of schemes. The most significant development of the last ten years in relation to tax planning schemes has been the "DOTAS" disclosure rules, contained primarily in Finance Act 2004. DOTAS, of course, requires schemes to be disclosed to HMRC at an early stage and these are typically then swiftly blocked by legislation. All of the aggressive tax avoidance schemes which have succeeded before the courts in recent years have almost invariably been blocked by legislation long before the courts reached a final decision.

Accordingly, my understanding was that the GAAR was meant to act as a sweep-up provision which catches those very few aggressive tax avoidance schemes which would otherwise slip through HMRC's net, and even then only for a short time. Such a GAAR would follow the pattern of similar rules which have been enacted in other jurisdictions. The impact of the GAAR would then be limited to killing-off a relatively small number of aggressive tax avoidance schemes, many of which would have failed before the courts in any event and all of which would have had a short life-span.

However, closer inspection of the details of the legislation, together with HMRC's "GAAR Guidance", as approved by the GAAR Advisory Panel, has caused me to reconsider that view.

From a practical perspective, the examples in HMRC's GAAR Guidance are illuminating. The first point which is striking about the examples is that they are voluminous. By themselves they run to 136 pages. The next thing that is striking about the examples is that they are very much more wide-ranging than I would have expected and involve the discussion of planning which does not involve the most aggressive and contrived kinds of arrangements. Although many of the examples illustrate what the GAAR will not catch, it is worrying that these kinds of scenario are even in contemplation in this context.

It is clear that HMRC potentially see the GAAR as extremely wide-ranging. From an intellectual perspective this is disappointing. Pragmatically, this author can see where HMRC is coming from. Why should it bother spending large amounts of technical resources working out whether or not an arrangement that it does not like would otherwise succeed when it can simply play the trump card of the GAAR?

To understand the importance of the GAAR as a deterrent it is necessary to appreciate the significance of two rules. The first, Clause 209 Finance (No 2) Bill 2013 provides that the GAAR will apply in priority to all other tax rules. HMRC says in Section C of its Guidance that the reason for this is obvious. However, it is not obvious to this author. I would have preferred the GAAR to operate as a fall-back position so that it is only brought into play where all other arguments that which are available to HMRC would fail. However, it is clear that this is not the case, although it will be interesting to see whether judges will be receptive to the GAAR being deployed as HMRC's first argument, especially where the arrangement which is sought to be attacked is not a contrived scheme. This is an issue for the future.

The second critical rule in understanding significance of the GAAR as a deterrent is Clause 208 of the Finance Bill (No 2) 2013. This provides that the Guidance that is issued by HMRC and approved by the GAAR Advisory Panel must be taken into account by the courts. The key point here is that whether or not the GAAR applies is a subjective exercise. The test of "double unreasonableness" in reality adds nothing to the fact that the GAAR being brought into play depends upon a finding that an arrangement is abusive. What is abusive is a subjective concept. There are only two kinds of music: your kind of music and my kind of music. The same applies in relation to the question of what is abusive tax planning. As the debates in the media have recently shown, not everyone has the same view as to what is acceptable tax planning. Part of the rationale for having the Advisory Panel is clearly to enable the decision as to what is abusive to literally be made by the committee. It will be a brave judge who then reaches a different conclusion. The practical importance of this is not to be underestimated. If HMRC can persuade the Advisory Panel to approve its guidance that a particular arrangement is abusive then the result is a massive deterrent effect. Understandably, HMRC loves nothing better than its actions having a deterrent effect because it is then not required to do anything further in order to obtain the result which it seeks. In contrast, challenging taxpayers through litigation is a difficult and time consuming exercise and uses up HMRC's stretched resources.

As indicated above, the GAAR Advisory Panel has already issued its first Guidance with effect from 15 April 2013. The second half of this article is concerned with an immediate and very significant practical effect of that Guidance.

Currently, an important issue for a minority of taxpayers is the question of what to do about high value UK residential property which is held in companies. Very broadly, and as readers will be aware, from 1 April 2013 such property is now subject to the annual tax on enveloped dwellings ("ATED") where that property has a value in excess of £2m and is not used for commercial purposes. The purpose of this article is not to introduce ATED. Suffice to say that the minimum chargeable amount is £15,000 and this rises to £140,000 for properties worth more than £20m. In addition, the capital gains tax protection of using a non- resident company is lost with effect for gains accruing after 6 April 2013. A significant number of high value residential properties are currently held through such companies in order to save inheritance tax. The question then arises as to what to do? Much restructuring has already taken place in recent months as clients decide what to do about ATED.

The key point which needs to be understood is that as a result of the introduction of the GAAR with effect from mid July 2013, or more precisely Royal Assent of the Finance Act 2013, some of the potential options will become very much more difficult. Accordingly, for those clients who have not yet made up their minds as to what they wish to do, they might be well-advised to do so now in order that any restructuring can be undertaken before the GAAR takes effect.

Perhaps the most important point to note is that the HMRC's GAAR Guidance, as approved by the Advisory Panel, states that so-called "double trust" structures will be caught by the GAAR. Essentially, these structures involve the residential property becoming owned by a trust. This trust is within the charge to inheritance tax under the relevant property regime so that tax will be due at the maximum rate of 6% every ten years. However, crucially, the value of the property in this trust is reduced by the value of a debt which has been incurred in order to acquire it. This debt is typically owed to a second trust which has been funded by the occupiers of the property. Readers should please note that this is a very over-simplified explanation of the arrangement but it will suffice for present purposes. If the arrangement works then the property will not suffer ATED and remain outside the scope of UK capital gains tax but any inheritance tax charges will be little or nothing. See further the GAAR Guidance at Section D31.

In order to understand the significance of the GAAR Guidance stating that double trust structures will be caught it is necessary to appreciate two points. One is the relevance of the Advisory Panel's Guidance and the attendant difficulties of trying to undertake arrangements in the face of that. This has been explained above. The second factor which needs to be appreciated is the relatively small number of options which are available to taxpayers who are faced with a charge to ATED.

This author does not claim any monopoly of wisdom when it comes to suggesting potential courses of action. More able minds than my own will doubtless have devised more ingenious ideas to deal with their own clients' problems. What I can say is that the options in relation to ATED include the following.

First, the clients might simply choose to leave the existing structure in place and pay the ATED. This has obvious downsides. It should also be noted that structures involving companies have become increasingly unattractive to hold residential property even before the introduction of the new series of tax charges, including because they are inefficient for capital gains tax and risk an employment income tax charge where there is a "shadow director".

Secondly, the company might either sell the property or let it to an unconnected third party. From a tax perspective this might be a very sensible course of action, provided that any capital gains tax disposal does not give rise to immediate charges. However, for many clients this is not commercially acceptable.

A third solution is to extract the properties from the company and have it held directly by one or more individuals. This avoids the ATED charges. The difficulty with this strategy from an inheritance tax perspective is that should the individual die then a charge at 40% will potentially arise. Such a charge might be mitigated by the use of life assurance, although my understanding is that this could be difficult to obtain not only where the client is of a certain age but also where he or she lacks a sufficient connection to the UK. Another way to mitigate the charge is to have a number of individuals own the property so that only a fraction of its value would be exposed to a 40% charge in the event of a death of that individual. If the property is owned by an individual who is married then a death charge would only arise if both the individual and his spouse die within seven years of one another.

If none of the above options is workable for a client then what to do becomes very much more difficult. In particular, there is tension between not paying ATED and saving inheritance tax. A solution which has been popular is the use of double trust structures. It needs to be emphasised that these structures are not straightforward and involve a large amount of complicated analysis. This is inevitable given that both all of the inheritance tax rules relating to avoiding liabilities in relation to the family home together with the many rules which are aimed at offshore structures are in point together with the new rules in relation to high value residential property. A structure which involves complex analysis and which HMRC has commented upon negatively is never an ideal solution. Nevertheless, for clients who are unable or do not wish to adopt any of the more straightforward solutions suggested above then a double trust structure may in practice be the best way forward.

The crucial practical point which then arises is that any such clients who wish to use a double trust arrangement but who have not yet implemented one need to arrive at that decision very quickly indeed because any structure will need to be put into effect before Royal Assent of the Finance Act 2013, which is expected around mid-July, in order to avoid HMRC being able to deploy the GAAR against it as a very significant additional obstacle.

Finally, it should be noted that if high value residential property is extracted from a company then potentially immediate charges to capital gains tax and SDLT are also in point. These charges are in point irrespective of the end result which the client seeks to achieve. Suffice to say that the capital gains tax position is very much more difficult if the property has been or will in the future be occupied by a person who is resident for tax purposes in the UK. The SDLT position is very much more complicated if debt is secured on the property and cannot be removed using the client's own funds prior to any other steps taking place. It is important to note that the GAAR also has an impact in relation to the dismantling of existing structures because planning which is used to "wash out" gains has also been identified by the Advisory Panel as being subject to the GAAR. See the GAAR Guidance as Section D20 and D21. The GAAR could also be potentially deployed in relation to SDLT where debt is refinanced.

To summarise, the clear message which arises from the GAAR Guidance for clients who own residential property which will be subject to ATED unless steps are taken is that those who are not prepared to either pay ATED in the long-term or plan to either sell or let the property in the foreseeable future would be well-advised to undertake anything but the most straightforward restructuring as soon as possible so that it is completed by early July at the very latest.

The views expressed in this article are for academic discussion purposes only. They must not be relied upon in any way whatsoever, including as a basis from taking or refraining from any kind of action. This article may contain errors or omissions. Any client or professional who requires assistance with the issues raised above must seek appropriate professional advice.

THE RULE OF LAW, TAX AVOIDANCE AND THE GAAR

by Patrick Way QC

INTRODUCTION

On the 20th November 2013 the Bingham Centre for the Rule of Law is holding a one-day public conference on the subject of "Do Our Tax Systems Meet Rule of Law Standards?". The title is something of a hot topic, and the purpose of the article is to consider why this might be and why tax practitioners and others are concerned that, currently, what might reasonably be called, the "rule of public opinion" as voiced by the Press and MPs has to some extent usurped the "rule of law". That this is the case can be seen by reference to the outcry against companies such as Google, Amazon and Starbucks, none of which has broken the law, and yet each of which has faced widespread criticism from MPs, journalists and the Press. Indeed, Starbucks announced on 6th December 2012 that it would make a voluntary payment of £20m. to HMRC in reaction to the apparent public mood against its tax stance. As it happens, Starbucks' most recent accounts reveal a world-wide rate of tax of 31%, which seems relatively high. Further, Goldman Sachs felt the weight of public opinion upon its shoulders to such an extent that it abandoned plans to defer bonus payments to the 6th April 2013 (when the top rate of tax was reduced to 45p) and paid the bonuses before that date, employees suffering the top rate of income tax at 50p instead. The effect of that was to incur a total marginal rate of income tax and national insurance on the bonuses of 57.8%, rather than the still considerable 53.4%. As some commentators have observed, adjusting the time of bonus payments is just the sort of routine advice which many small accountants give to their small company clients. Nevertheless, Sir Mervyn King, the departing Governor of the Bank of England, was amongst those critical of Goldman Sachs, and he said:-

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

OBSERVATION

The writer should say that the comments in this article are his own and are, for example, entirely independent of the Bingham Centre's views.

THE RULE OF LAW AS AGAINST THE RULE OF PUBLIC OPINION

What is the rule of law?

As will be seen from sources such as the website for the Constitution Society, the concept of the "rule of law" is an ancient principle but nevertheless somewhat elusive. As the Society says, the phrase is universally used but not comprehensively defined. They also say that it is commonly understood to mean that "every member of society is bound by and entitled to the benefit of laws which are publicly made and publicly administered and which do not have retrospective effect". The Society goes on to say, as one of its general rules, that "The judiciary are often regarded as the guardians of the rule of law, as it falls to an independent and fair judiciary to enforce that rule of law, especially when invoked by citizens to protect themselves from the excesses of the state or the executive."

Equally relevant in the writer's opinion is the following definition of "tax" taken from Black's Law Dictionary:-

> "A tax is a "pecuniary burden made upon individuals or property owners to support the government ... a payment exacted by legislative authority." It "is not a voluntary payment or donation, but an enforced contribution, exacted pursuant to legislative authority." And it is "any contribution imposed by government ... whether under the name of toll ... custom, excise ... or other name" (Black's Law Dictionary page 1307, 5th edition 1979)

The following is the writer's attempt to provide a definition of the "rule of law":-

> "The rule of law requires that the government of the day exercise its powers, including its powers to collect tax, by reference exclusively to its rules, regulations and legal practices as laid down in statute and built up through case law. The law is sacrosanct, and an individual is entitled to govern his or her affairs exclusively by reference to the law in force, particularly so far as is concerned the citizen's obligation to pay tax."

The Bill of Rights of 1688 established that "the levying of money to or for the use of the Crown without grant of Parliament was illegal". Put it another way (as the writer would put it), "tax may be raised only pursuant to the rule of law and not otherwise."

As we all know, the authority for imposition and collection of tax is by reference to enactments of Parliament, and, of course, Parliament is responsible for approving new legislation. Indeed, before legislation becomes enacted, both the House of Commons and the House of Lords must debate and vote on the proposals. As a result of this we have a fundamental principle of statutory construction, which is that, in seeking to give meaning to legislation, the requirement is to find "the intendment of Parliament" which underscores the legislation in question. Accordingly, when one looks at one of the leading textbooks on statutory construction, *Statutory Interpretation* by Francis Bennion, published by Butterworths, 4th edition, one finds, in his introduction at pages 9 and 10, the following:-

> "Statute law is the will of the legislature; and the object of all judicial interpretation of it is to determine what intention is either expressly or by implication conveyed by the language used, so far as necessary for the purposes of determining whether a particular case or state of facts which is presented to the interpreter falls within it."

So the rule of law overrides any "moral" aspect relating to construction of legislation and in particular concerning the construction of tax statutes and, it follows from that, that the rule of law reigns sovereign over public opinion.

That there is no morality in relation to tax law, and certainly no morality in construing tax law, has until recently been relatively well-accepted. After all, as most readers will know, in respect to morality and tax legislation, we have the well-known judgment of Rowlatt J. in *Cape Brandy Syndicate v. The Commissioners of Inland Revenue* (12 TC 358):-

> "Now of course it is said and urged by Sir William Finlay that in a taxing Act clear words are necessary to tax the subject. But it is often endeavoured to give to that maxim a wide and fanciful construction. It does not mean that words are to be unduly restricted against the Crown or that there is to be any discrimination against the Crown in such Acts. It means this, I think; it means that in taxation you have to look simply at what is clearly said. **There is no room for any intendment; there is no equity about a tax: there is no presumption as to a tax; you read nothing in; you imply nothing, but you look fairly at what is said and at what is said clearly and that is the tax.**" [emphasis added]

That is not to say, of course, that in the modern world commercial enterprises may take no account of public opinion. Indeed, it is critical that they are aware that they cannot, from the point of view of promoting and retaining their image, simply rely upon having adopted a strictly legalistic approach, especially in relation to the management of their tax affairs. If the public deems them to have acted outside the perceived morality of the day then the business will suffer, particularly if their brand is one of utmost integrity.

In this article, the writer considers how public opinion in relation to tax matters has changed dramatically and also queries the role of Parliament – including, in particular, that of the Parliamentary Accounts Committee in relation to its attack (so it would seem) on businesses which have done nothing more than adopt and comply with the rule of law. In a nutshell, in the writer's view it is not for the Public Accounts Committee to chastise companies that save tax within the law. On the contrary, if Parliament finds such an approach objectionable, then it should change the law. Parliament, after all, is the law-maker in the first place.

After all, as Lord Hoffmann has said, in "Tax Avoidance" [2005] BTR 197:-

> "... tax avoidance in the sense of transactions successfully structured to avoid a tax which Parliament intended to impose should be a contradiction in terms. The only way in which Parliament can express an intention to impose a tax is by statute that means such a tax is to be imposed. If that is what Parliament means, the courts should be trusted to give effect to its intentions. Any other approach will lead us into dangerous and unpredictable territory."

So, this illustrates one of the difficulties when trying to pin down what avoidance is, since on *one* analysis any scheme that works is by definition not avoidance: it complies with the intention of Parliament as expressed within the statutory language.

See, for example, the paper entitled "Interpreting Tax Statues: Tax Avoidance and the Intention of Parliament" by

Professor Judith Freedman, Law Quarterly Review, January 2007 for a commentary on this area of law. In that paper Professor Freedman cites the following view which was expressed in the Institute of Fiscal Studies Green Budget in 2006:-

> "There will have been no avoidance if the judges decide that Parliament misfired, so that arrangements fall within the letter of the law – however much it may appear that Parliament may not have intended its language to cover the particular arrangements entered into by the taxpayer. As a matter of law, that is what Parliament has prescribed and a taxpayer does not avoid tax by limiting his or her liability to what the law prescribes." (S Bond, M Gammie and J Whiting, Institute for Fiscal Studies Green Budget (2006), at page 174)

So, pausing here, the writer repeats that it seems to him that it is not for Parliamentarians to chastise persons who act within the law to reduce their tax from what those Members of Parliament might have wished for. On the contrary, as already mentioned, it is his view that those Parliamentarians, if they object, should change the law, and it is certainly within their power, of course, to do so.

The rule of law in practice

Applying the rule of law, surprising as it may seem at first glance to some commentators, can produce both benefits and disadvatages for taxpayers: morality does not come into it.

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

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

Or to put it another way: "The rule of law holds sway in this case whether I like it or not (*and I probably don't like it*)".

Similarly, in the case of *Mayes v. Revenue & Customs Commissioners* [2011] EWCA Civ 407, [2011] STC 1269; *affg* [2009] EWHC 2443 (Ch), [2010] STC 1 we find a tax avoidance scheme involving surrenders of insurance policies producing a loss by reference to a prescriptive interpretation of the statute (*application of the rule of law*), in circumstances where the taxpayer in question suffered no similar economic loss. As will be seen in the analysis below of the *Lobler* case, the courts held, in effect, in *Mayes*, using the writer's own language rather than the court's, that the rule of law had to be observed, however unsavoury that might appear to the judge applying the law. Consequently, the taxpayer's avoidance scheme had to be found to be successful since it fell fairly and squarely within the legislation which directed, in effect, that a significant tax benefit accrued. One might even say, based upon some of the comments mentioned above, that it was therefore not avoidance at all; but the writer does not adhere to that principle. Rather, in his view, the taxpayer's attempt to pay less tax than might otherwise have been the case (certainly less than the amount which Parliament would have considered to be the case had it addressed the point and covered it properly) was successful after all. The avoidance fell within the prescriptive rules on the statute, however odd the result which those prescriptive rules produced.

But the rule of law cuts both ways and can produce outcomes which are very much to the detriment of the taxpayer. In the case of *Orsman v. HMRC* ([2012] UKFTT 227 (TC), a case involving stamp duty land tax (SDLT), Miss Orsman bought a house for a total consideration of £250,000. The SDLT on that amount would have been £2,500 only, since the consideration fell within the 1% threshold. Unfortunately, Miss Orsman also acquired some other items including some fixed units in the garage which had a value of £800. These fitted units counted as *fixed chattels* as if they were part of the house itself, and as a result their value increased the total consideration for the house, chargeable to SDLT, from £250,000 to £250,800. This resulted in the whole of the increased consideration moving from the 1% band into the 3% band for SDLT purposes. This is because SDLT operates on a "slab" basis, meaning that as you cross from one threshold to another (here from 1% to 3%) you "take with you" the *whole* of the consideration and not just the extra amount (here £800) which pushed you into the higher band in the first place. This meant that Miss Orsman had to pay a total of £7,524 SDLT for the house (an extra £5,524) and this additional amount of £5,524 arose exclusively because of the effect of Miss Orsman's buying the cupboards for £800. In other words, it would have been cheaper for Miss Orsman to have asked the vendors to remove the cupboards completely, and she could then have bought new cupboards with the tax saving, as well as a small car to put in the garage.

Now, you may ask, did HMRC apply the rule of law here, or did they seek to recover only what public opinion so freely talks about: Miss Orsman's "fair share of tax"? Of course, HMRC applied the rule of law and helped themselves to additional tax worth nearly ten times the value of the cupboards.

Or, how about the case of *Joost Lobler v. HMRC* ([2013] UKFTT 141 (TC)? This involved, like *Mayes*, partial surrenders of life policies involving taxable income arising under ITTOIA 2005 Chapter 9 Part 4, only this time the legislation applied to the great disadvantage of the taxpayer. Indeed, in the opening paragraph of the judgment, Judge Charles Hellier acknowledged, so it would seem, with some remorse and frustration, that this was a case which produced a remarkably unfair result as a consequence of the application of prescriptive legislation (*the writer would say as a result of the application of the rule of law*), together with, unfortunately – so continued Judge Hellier – Mr. Lobler's ill-advised actions: i.e. Mr. Lobler had not checked the legal position before he took various steps. The facts involved Mr. Lobler moving to England and putting all his life savings into a life insurance policy with Zurich Life and topping that up with a loan from HSBC, such that the insurance policy at one time had a value of over $1.4m. Having put the money into the policy, he then began to withdraw sums from the policy, once in the United Kingdom, taking out sufficient first to repay the HSBC loan and then the balance, more or less, was taken out to enable him to buy a house and to engage in works of renovation in the United Kingdom. So it might be said that all that Mr. Lobler had done was to put money into the policy and then take it out again, and he assumed that there would be no tax to pay, and certainly not on virtually the *whole* amount of the money which went in and out of the policy.

Broadly speaking, however, because of the way the legislation worked, *all* of the amounts that came out were fully taxable. And by applying the rule of law in this way (to the disadvantage of the taxpayer), the judge here was simply adopting a similar analysis as was adopted in *Mayes v. HMRC*. There, as already mentioned, the judge (Proudman J) had held in the Chancery Division that a *planning* scheme that utilised this legislation to the advantage of the taxpayer, was successful because of the prescriptive way in which the legislation worked in each case.

As Proudman J had said in *Mayes*, in *favour* of the taxpayer, and as was repeated in *Lobler, against* the taxpayer, the relevant legislation "is legislation which does not seek to tax real or commercial gains. Thus it makes no sense to say that the legislation must be construed to transactions by reference to their commercial substance … [the legislation] adopts a formulaic and prescriptive approach. No overriding principle can be extracted from the legislation …".

So you can see that the writer is not saying that the rule of law is perfect and produces fair results. What he is saying is that at least you know where you are with the rule of law, particularly if the courts apply a literal and prescriptive meaning to it, adopting the rule set out by Rowlatt J in the *Cape Brandy* case.

Public opinion and Starbucks, Amazon and Google

So now we come to the impact of public opinion. As we all know, the Public Accounts Committee and much of the Press have whipped up a furore in relation to anybody who does not pay what they see as their "fair share of tax". The problem with using the expression "fair share of tax" is that it is thoroughly subjective. You may be different, but the writer has come across very few people who say, "Do you know what? I personally should be paying more tax." What he has come across is people saying others should pay more tax. Anyway, the point is that we have seen that as *a legal matter* there is no equity in a tax statute, and therefore it seems to the writer to be inappropriate to try and identify fairness in tax: the law can be unfair, but – as already said – at least you should know where you are with it if you stick with the rule of law. And Parliament can always change it.

Anyway, if you want an example of how the law is not fair then look at *Orsman* above. Or, look at the rates of tax in 1979 when the government was charging a top rate of earned income of 83% and was taxing unearned income at the rate of 98%. Can you believe that? You earned £100, kept £2 for yourself and gave £98 to the government. But in the writer's view fairness of tax is not something for the Public Accounts Committee. As his colleague in chambers, David Goldberg QC has said, "It is beyond the competence of the Committee to determine whether a particular taxpayer has paid the "right" amount of tax; the proper job of the Committee is to examine against the standards of good administration, whether HMRC is doing its job." Further, as David Goldberg QC said, "A company which pays tax on its profits, computed by deducting from its receipts the expenses incurred to earn them, cannot be said to have avoided tax." A stand needs to be made for "principle" not "demotics" in the view of David Goldberg QC. The writer agrees with him.

More particularly, if Parliament does not like the tax results that are achieved by a taxpayer within the law, then the simple remedy is for Parliament to change the law. They should stop "grandstanding" about tax avoidance; rather they should change the law and remember that they introduced the law in the first place.

Films

The Public Accounts Committee grilled two members of the film industry on 6th December 2012. It is to be recalled that in 1997 the government of the day dramatically changed the benefits to individuals of investing in films. Cutting a long story short, if an investor put money into a film, typically via a partnership, then the new rules produced quite extraordinary benefits. In the first place, the legislation provided that payments for a film would be treated as trading expenditure and not capital expenditure. Also, the entirety of the payment was treated as falling within one year, even if it was paid on, say, the 5th April. Finally, to the extent that a loss arose as a result of the acquisition of the film (as would be bound to be the case in the first year, because of course the expenditure from the film inevitably exceeds the income on a film which has not yet been released), then the whole of that loss could be offset against the investor's general income. Now, in the spirit of this debate, that amounts – in the writer's view – to "government-sponsored tax avoidance". You are converting capital to income; you are ignoring accountancy practice – which would otherwise spread the payments over some years (the lifetime of the film as it were), and you are then allowing that loss to be offset against all your other income: all thanks to the relevant statute. In other words, the government was asking for trouble in my view. Of course, the aim was that as and when the films produced royalties then these would be taxed at that stage. So the government at that time saw no real mischief: just a deferral until tax fell in. And that, after all, is the whole point of the 1997 legislation. So people could hardly be criticised for following along the path set for them by the government which introduced that legislation. In a nutshell, it was to encourage film investment by accepting that there would be large up-front costs but giving those large up-front costs helpful tax treatment (one might say tax avoidance) on the basis that in due course when the film produced profits (if it did) those would be fully taxable.

The two representatives of the film industry who appeared before the Committee on the 6th December tried to make this point but the Committee were having none of it.

Nevertheless, one does not want to be too naive. One of the problems with films and tax avoidance is that *some*, maybe *many*, have utilised these government-sponsored reliefs in a way that was simply not intended and was frankly not allowable – as a matter of *law*. For example, the payments made by way of investment in the first place were "ramped up" in favour of the investors by loans and in some cases the chance of those loans ever falling to be repaid were slim to say the least. Now that *is* abusive, and that is the area which HMRC are focusing on and, in the writer's view, are being successful. But these are two separate aspects, which the Committee should have addressed differently. There is, if you like, benign avoidance on the one hand, which is, as the writer calls it, government-sponsored avoidance (i.e. following the rules as set down by the 1997 legislation). And then there is aggressive avoidance, which would probably fall within the GAAR anyway, as we will see shortly. That involves the artificial increase of investment sums in circumstances where the investor would be unlikely ever to "incur" that expenditure in any real sense of the meaning of that word. Even absent the introduction of the GAAR that approach would fail; with the GAAR it is unlikely even to get "to the starting blocks".

Starbucks, Amazon and Google

Perhaps at this stage we should just briefly look at what the so-called mischiefs are which were adopted by Starbucks, Amazon and Google. Sadly, very few facts have emerged in the Press, but, by and large, the cases have arisen because modern business practices, particularly in the digital age – where transactions take place "in the ether" rather than on paper in an office – have accelerated beyond legislation that was formulated to a very large extent in the late 19th Century and early 20th Century. That ("old") legislation is simply not equipped to deal with modern business methods. In particular, the legislation and case law that remains with us is rooted in the days when a transatlantic crossing might take a week or so; whereas nowadays a transatlantic transaction, of course, can take place in less than a second. Further, the rules that govern modern business practice are not equipped to deal with current global business structures, under which many companies operate with subsidiary companies located all over the globe – including locations such as Guernsey, Switzerland or wherever else they might be, which have their own tax laws, more benign than those of the United Kingdom.

More particularly, there are two aspects of modern life that we need to look at. The first is the *place of contract*, and in relation thereto we should also look at the *place of a permanent establishment*, in both situations where transactions take place cross-border.

And the second situation is by reference to the transfer pricing rules, particularly as they apply in relation to payments for intellectual property – such as for the use of a brand, or for the purchase of a product in respect of which the organisation involved may be one of the world's leading buyers (here, the writer is thinking of Starbucks and coffee).

What Google and many others seem to have done, entirely legitimately, is to arrange for contracts which might otherwise be treated as taking place in the United Kingdom to be executed elsewhere, typically in Ireland, where the rate of corporation tax is much lower than the UK and US rates of tax. The mechanism for achieving this would be based on long established law, being the "*law of offer and acceptance*" by reference to a case such as *Erichsen v. Last* (CA 1881, 1 TC 351). That case involved a Danish telegraph company operating in the 19^{th} Century, which had an agency and office in the United Kingdom dealing with calls received in the United Kingdom using its wires. The relevant contracts were made in the United Kingdom (where acceptance took place) not in Denmark (where the offer took place). From this you can determine the place of business: where *acceptance* of a contract occurs. Similarly, most of us will know the champagne case of *Grainger and Son v. Gough* (HL 1896, 3 TC 462). This involved one Monsieur Louis Roederer, the well-known champagne merchant, whose chief place of business was at Rheims in France. He appointed an English firm as his representative in the United Kingdom for the sale of champagne, and those English agents obtained orders in the United Kingdom, but they were transmitted back to France, and it was in France not in the United Kingdom that the French wine merchant exercised his discretion as to whether to execute the orders or not. Once that had been done, the champagne was then forwarded from Rheims direct to the purchasers at the expense and risk of the latter. It was held by the courts that in that situation the contract for the purchase of the champagne was not made in the United Kingdom: it was made in France, where it was *accepted*. And essentially that is what is happening in modern transactions: care is taken to ensure that the contracts are made by acceptance in the country (say Ireland) where the rate of tax is less than elsewhere (say in the United Kingdom or the United States).

In turn this means that great care must be taken by multi-national groups in relation to the application of the relevant double tax treaty, such as the UK:Irish double tax treaty (SI 1976 No.2151). In particular, care would have to be taken in relation to the definition of *permanent establishment* found in Article 5 of that treaty, to make sure that the Irish company did not have a permanent establishment in the United Kingdom through the use of any agents acting on its behalf in the United Kingdom. This involves taking notice of the provisions of Article 5(4) which reads as follows:

> "(4) A person acting in a Contracting State on behalf of an enterprise of the other Contracting State ... should be deemed to be a permanent establishment in the first-mentioned State if he has, and habitually exercises in that State, an authority to conclude contracts in the name of the enterprise, unless his activities are limited to the purchase of goods or merchandise for the enterprise."

Accordingly, the relevant Irish company could have individuals operating in the United Kingdom "on its behalf", as long as those individuals had no authority to conclude contracts on behalf of the Irish enterprise and did not do so. This is just the same as we have seen as the circumstances within the *Grainger v. Gough* case.

The second area upon which multi-national companies have been relying involves transfer pricing, and it can be said in relation to the companies in question mostly to be in respect of intellectual property rights or the purchase of specific goods such as coffee in the case of Starbucks.

The reality is that these companies do have very valuable intellectual property rights, and this can be demonstrated on the basis that if they were to allow a third party to use their own name (looking at intellectual property), they would charge such third parties (as franchisees) a full market rate. So, under the current principles of transfer pricing the company that owns the intellectual property rights, of course, is entitled to charge all the other companies within the group a full market rate for using the brand name in question. Under transfer pricing rules, missing much out, the price paid within the group has nevertheless to be acceptable on a comparative basis. If therefore, as the writer understands it, the companies in question do indeed have separate franchisees to whom they do in fact charge an arm's length fee for the use of the company's name – as is frequently the case – then there seems nothing to prevent the company in question charging precisely the same fee to its own group members, which the paying company can then deduct the consideration in the computation of its profits. By definition, the fee charged will be acceptable as a matter of law if it is the same as the amount charged to arm's length third parties anyway. The difficulty with this approach (paying fees cross-border for intellectual property rights and other rights) is that what this usually does, (perhaps, *inevitably* does) of course, is to "suck out" large amounts of money from a high-tax jurisdiction into a low-tax jurisdiction where, of course, the rights are based.

The same can be said in relation to the purchase of coffee, for example. Starbucks must be one of the biggest coffee purchasers in the world. It, presumably, buys its coffee in one or more jurisdictions where the rates of tax are low and then charges other entities within the group where the rates of tax are high a market rate for that coffee.

In each of these cases the companies are within the rule of law but, of course, are not within what the current mood of the majority of the public deems to be morally acceptable. I deal with a solution to this problem subsequently.

Finally, there is one point to add in relation to steps involving US companies. Unlike our own code, the United States has a relatively benign controlled foreign company regime. This means that the monies in question which are earned in Ireland, for example, can be left there at low rates of tax with no incentive or requirement for them to be remitted, or treated as remitted, to the United States, where higher rates of tax are paid. So the answer here (and this is not a UK issue) is for the United States to introduce more stringent controlled foreign company rules, that would tax, say, the monies sitting in an Irish group company as if they had been received back in the United States.

A VIEW FROM 1994

The Labour Party's solution to avoidance

Let us now look at the position concerning how the Labour Party thought, back in 1994, they might deal with the question of avoidance. In relation thereto the writer considers a booklet which the Labour Party published in 1994, entitled "Tackling Tax Abuses – Tackling Unemployment". In the booklet are included a number of quite interesting comments, some of which are repeated here. Indeed, the points which are now listed below are ones which the Labour Party identified as being problems in the area of tax avoidance as long ago as 1994:-

"• offshore loopholes: taxation of non-residents, non-domiciles and those with offshore accounts should be overhauled in line with the recommendations of the Inland Revenue. It is not fair that a wealthy few should be allowed to work or live in the UK without making a fair contribution through taxation;
• trusts: the taxation system must be reformed to prevent the abuse of trusts for tax avoidance;

- inheritance tax: this must be made effective and less easy to avoid particularly for those who come to regard it as a voluntary tax;
- offshore tax avoidance – the abuse of offshore trusts and companies continues. The head of foreign claims at the Inland Revenue has stated he does not know how much tax is lost through money going offshore but "there could be substantial sums involved" (BBC 6 O'Clock News, 27/7/94);
- loopholes using trusts – the use of trusts to avoid tax is widely publicised by the tax avoidance industry. In a recent publication, one financial adviser stated under the heading "Why are trusts used?";
  - to avoid and/or reduce inheritance tax;
  - to avoid and/or reduce income tax;
  - to avoid and/or reduce capital gains tax."

"David M Aaron Partnership, The Small Investor's Guide to the Use of Trusts"

What is clear is that billions of pounds are held in trust principally for tax avoidance purposes.

Inheritance tax: the voluntary tax – it is unacceptable that inheritance tax can be operated by tax planners as a "voluntary tax". If society is to have inheritance tax, it must be operated fairly. At present, whilst the very wealthy avoid the tax, many others are being drawn into it.

It is not the very wealthy who pay most of the inheritance tax; they are very effective at exploiting loopholes to avoid it.

Among the loopholes now used are ... deeds of variation"

So, it is fair to say that any structure that involves any element of offshore activity, trusts and inheritance tax avoidance must be at the top of the list of the things that the Labour Party regarded as unacceptable avoidance, as must the use of deeds of variation and inheritance tax planning.

The Labour Party and the GAAR

Perhaps more interesting still, however, is the view of the Labour Party in 1994 in relation to the introduction of a general anti-avoidance rule. The writer should say before we look at this that they were considering a GAAR when it meant a general anti-*avoidance* rule; whereas the rule to be enacted very shortly is a general anti-*abuse* rule. Nevertheless, on page 4 of their booklet in 1994, this is what the Labour Party said:-

> "We have rejected a general anti-avoidance provision for two reasons. Firstly, experience elsewhere reveals that it has severe limitations in its success. Secondly, as a matter of principle we believe that the citizen is entitled to know where he or she stands before the tax law. A catch-all provision that came into play when all else fails is unacceptable in a fair tax system."

This seems to the writer to be absolutely right. A general anti-abuse provision seems to him to be unacceptable in a fair tax system for all the reasons that are mentioned in the booklet and in this article. More particularly, it seems to him that a GAAR breaches the rule of law because it is so uncertain that no-one can know where they are with it.

THE GAAR

Rationale for the GAAR

Paradoxically, the proponents of a GAAR considered that it would restore the rule of law. They felt this, it seems, because they had identified that the courts, in their desire to do down distasteful ("egregious") schemes, were at best "bending" the rule of law to find against a tax avoider, and at worst ignoring the rule of law entirely. So the aim seems to have been to introduce a GAAR (within the rule of law, therefore), to allow judges better to dispense the rule of law rather than ignore it because of their moral repugnance of the avoidance involved.

As will be seen, the writer considers it unlikely that the GAAR will achieve this result (of bringing cases involving avoidance back within the rule of law), because the GAAR is too vague and unclear and leaves too much open to debate and uncertainty. In other words, the judges will not be able to follow a *clear* statement of the law in respect of the GAAR but will be left to their own subjective devices. This leaves the citizen unclear as to what the law will be from time to time.

The GAAR's wording

If we now look at the wording of clause 204 in the current Finance (No.2) Bill, we will see why, in the writer's view, the Labour Party was right to be against a GAAR, even when their objection was "just" in respect of avoidance, rather than abusive avoidance:-

"**204. Meaning of "tax arrangements" and "abuse"**

(1) Arrangements are "tax arrangements" if, having regard to all the circumstances, it would be reasonable to conclude that the obtaining of a tax advantage was the main purpose, or one of the main purposes, of the arrangements.

(2) Tax arrangements are "abusive" if they are arrangements the entering into or carrying out of which cannot **reasonably be regarded as a reasonable course of action in relation to the relevant tax provisions**, having regard to all the circumstances including –

(a) whether the substantive results of the arrangements are consistent with any principles on which those provisions are based (whether express or implied) and the policy objectives of those provisions,

(b) whether the means of achieving those results involves one or more contrived or abnormal steps, and

(c) whether the arrangements are intended to exploit any shortcomings in those provisions."

(emphasis added)

So, pausing here, what an earth does the above wording mean? In particular, what does the wording which the writer has put in bold mean? In answering this he looks at the words in bold in two parts.

Dealing with the first part, many commentators have questioned the so-called "double reasonable test". It seems to be included so that one cannot simply say, "Well *I* thought it was reasonable to avoid tax, so *you* can't stop me." On the contrary, you have to ask yourself whether a third party would think that you were being reasonable in thinking that your avoidance was not abusive. But the writer personally still does not really know how this would operate in practice. More precisely, who is to say, in a court, precisely what that means? Different judges have different views, and long may it continue. But how does this help the citizen to know where he or she stands and how does this help the citizen's adviser to advise?

The writer understands that those driving the GAAR consider that the purpose of the double reasonable test is to find out, if you like, what the "reasonable man" considers is abusive. In other words, you are looking to see, so it might be said, what the man on the Clapham Omnibus would think. The difficulty with that is that this moves us away from the pejorative expression, "abusive" to some extent, to the more benign word "reasonable". These are two different concepts and should not be muddled together. The key behind the word "abusive" is, of course, that the legislation is *abused*: this is a strong word and it means that the taxpayer uses the legislation (abuses the legislation) in a way that simply cannot have been intended. Reasonableness does not come into it.

Then let us look at the second part of the wording which the writer has put in bold, where it talks about "in relation to the relevant tax provisions". What does that mean? Does that simply mean that you are caught, *in relation to a particular statutory provision*, if you say, "Ah, right, there's a flaw in *that* wording. Let me exploit that." An example where, it seems to me, that the GAAR would definitely apply (and of course this case is mentioned in the GAAR paraphernalia anyway) would be the *Mayes* case, where the extraordinary rules relating to insurance policies were utilised to the advantage of the taxpayer. It seems to the writer obvious that if one were looking at the GAAR now in relation to *Mayes*, one would say that it cannot be the case, in relation to the relevant tax provisions which produce the mismatch, that they are consistent with any policy objective, but involves some contrived or abnormal step.

But would the GAAR stop Starbucks, Google, Amazon and film schemes?

It may come as a surprise to some politicians (and maybe the writer is wrong) but he does not think for one minute that the GAAR would stop the arrangements involving Starbucks, Google and Amazon. This is borne out by HMRC's GAAR guidance of 15th April 2013 where they say, at para.B5.2 as follows:-

> "... many of the cases of the sort which has generated a great deal of media and Parliamentary debate in the months leading up to the enactment of the GAAR cannot be dealt with by the GAAR."

After all, so far as the planning involving Starbucks, Google and Amazon is concerned, none of those arrangements may be said, in relation to particular tax provisions, to be inconsistent with the intended result of those provisions, nor do they involve any particular abnormal or contrived step, nor any shortcomings in the provisions. On the contrary, they fall full square within the particular provisions. Further, it is "normal" for a multi-national company, for example, to choose to acquire its goods in one central location and also to have its intellectual property similarly located in one jurisdiction; otherwise the exercise of spreading these activities across many companies would be extremely expensive. By putting them in one single location, it makes perfect commercial sense. Accordingly, it can hardly be said to exploit the provisions (i.e. to find a loophole in the provisions) if one uses the statutory provisions to reduce tax because one jurisdiction has a lower rate of tax than another.

What about films?

The position in relation to films is more difficult. If a taxpayer has simply utilised the legislation without any abuse (of course), then it is hard to see how the GAAR could apply. The difficulty arises, as already mentioned in this article, in that some film promoters have exploited the legislation by artificially increasing the amounts invested into films, in such a way that the legislation is unlikely to have been intended to apply to it; or those promoters have introduced extraordinarily high rates of interest or extraordinary amounts of debt and then exploiting legislation as it applies to that. So there must be some areas where the GAAR would apply in relation to films.

Examples produced by the GAAR Advisory Panel

The Interim GAAR Advisory Panel produced, with effect from 15th April 2013, various examples of situations which might or might not fall within the GAAR. This was done pursuant to the provisions of the Finance (No.2) Bill 2013 Clause 208 and the examples do repay very close reading. It seems that these examples will be taken into account in due course by courts in ascertaining whether a particular set of circumstances falls within the ambit of the new GAAR and it is to be observed, therefore, that this is a somewhat dramatic extension of the *rule of law*. After all, it means that Parliament has afforded to third parties being the members of the Advisory Panel (rather than to Parliament itself), the opportunity, in effect, to determine what the rule of law underlying the GAAR may in fact be. In the writer's view this is too great a departure from the rule of law: these powers are best reserved exclusively to Parliament, not to third parties.

Incidentally, the Panel, in their examples, endorse the actions taken by Barclays Mercantile Business Finance Limited, as reported in the case of *BMBF v. Mawson* (76 TC 446). On the one hand it is understandable, given the judgment of both the Court of Appeal and the House of Lords in the case. On the other hand, however, it is to be observed that in the High Court (which judgment was of course overturned) it was held that "The transaction was really about creating a complex and sophisticated structure which enabled [an entity] every year to receive payments representing its share of tax savings ... from the capital allowances [involved]." So this might seem to be abusive on one level, further highlighting the problems which the GAAR may produce: its wording is *not* clear enough.

Equally, the Panel held that use of the main residence election (by which you can choose of two residences is your main one for capital gains tax purposes) was not abusive. This might be a relief to those politicians who claim that the same property is both their *second* residence for the purposes of claiming allowances from Parliament but also their *main* residence so far as claiming capital gains tax relief is involved. If it were not for the view given by the Panel, then the writer's view would have been that claiming a property was *both* a second and a main residence was abusive. We can now rest assured that that is not the case.

POTENTIAL SOLUTIONS

The writer now deals with the solutions that have been put forward in respect of the problem which in this article, perhaps unfairly, we are describing as the problem relating to Starbucks, Google and Amazon. In other words, how do we get the rule of law to match the undoubted moral indignation?

These answers are, first, a *unitary* solution, i.e. one which relates to the particular country that suffers a shortfall in tax, and the other is a *global* solution which requires the assistance of a large number of nations pursuant to suggestions put forward by the OECD. The writer deals with each of these in turn.

Unitary solution

The following has been suggested to the writer, and no doubt to many others, as being a way in which one might address the situation from the point of view of United Kingdom based solution. What we are looking for here is to find a way of bringing back into the UK nets profits which have "properly" arisen in the United Kingdom. In essence, what would happen under the suggested unitary solution, would be that the UK legislation would produce some sort of a formula by reference to which the "UK part" of the world-wide business of a group, could be attributed to the United Kingdom on a fair and reasonable basis. Accordingly, the formula would probably involve, as a numerator, the assets, employees and the sales which took place solely in the United Kingdom, and the denominator, of course, would have the same features, but would be in relation to the world-wide group. This would then enable a percentage of the world-wide business, so far as it might be said to relate to the United Kingdom, to be computed, and that amount would then be taxed at the UK's corporate rate of tax. This therefore would ignore any of the deductions which have caused the problems including, therefore, deductions for payment for royalty rights and payments for materials.

There are objections to this, of course, and it may be that it would be counter-productive to "UK Plc" particularly in relation to large UK-based multi-nationals where significant overseas sales are generated. The effect would be to suck profits out of the United Kingdom rather than bringing them back into the United Kingdom. Also a unitary solution would work to the disadvantage of the United Kingdom if other "competitor countries" did not adopt a similar solution and it would be a brave Chancellor of the Exchequer who would introduce it independently of other jurisdictions.

Global solution

The global solution is one that looks more likely to succeed, although it will take some time, and this is one that is recommended by the OECD. Indeed, on the 19th April 2013 the OECD's Secretary General, Angel Gurria, presented a report to G20 finance ministers and central bank governors which was intended to ensure that all taxpayers pay their "fair share of tax". The report included a reference to:-

- a progress report about a global forum on transparency and exchange of information for tax purposes, including the up and coming ratings of jurisdictions' compliance with the global forum's standards on exchange of information on request;
- efforts by OECD to strengthen automatic exchange of information;
- latest developments to address tax base erosion and profit-shifting;
- a practice that can give multi-national corporations an unfair advantage over domestic companies and citizens.

In relation to this, there were proposals to develop:-

a. instruments to put an end to or neutralise the effects of hybrid mismatch arrangements and arbitrage;
b. improvements or clarifications to transfer pricing rules to address specific areas where the current rules produce undesirable results from a policy perspective. The current work on intangibles, which is a particular area of concern, would be included in a broader reflection on transfer pricing rules;
c. updated solutions to the issues related to jurisdiction to tax, in particular in the areas of digital goods and services. These solutions may include a revision of treaty provisions;
d. more effective anti-avoidance rules, as a complement to the previous items. Anti-avoidance measures can be included in domestic law as included in international instruments. Examples of these measures include general anti-avoidance rules (GAARs), controlled foreign companies (CFC) rules, limitations on benefits (LOB) rules and other anti-treaty abuse provisions;
e. rules on the treatment of intra-group financial transactions, such as those related to the deductibility of payments and the application of withholding taxes;
f. solutions to counter harmful regimes more effectively, taking into account factors such as transparent substance.

Perceived disadvantages of this global approach have been highlighted by some commentators. One objection is that by having a single over-arching international body such as the OECD leading the change and making the fairly dramatic amendments which need to be made, you remove competition from within jurisdictions. There have been fairly dramatic articles about how Ireland has suffered as a result of being at the centre, so it would seem, of tax avoidance, but this is not to say that if all of the Irish offices involved in managing royalty rights and so on were to disappear, as they would do, presumably, pursuant to the OECD recommendations, that the Irish economy would improve. Indeed, the United Kingdom at the moment is going through an exercise of reducing its corporation tax rate, in order to encourage international companies to set up their headquarters in the United Kingdom, and this seems to be successful. So, tax competition, which exists in the current regime, produces some benefits as well as some disadvantages.

CAN AN ADVISOR IGNORE AVOIDANCE?

Hossein Mehjoo v. Harben Barker & Another

The above case is relevant to the debate as to whether the rule of law, on the one hand, or some sort of morality, on the other, holds sway. Broadly speaking, the case involved a negligence case where a non-domiciled individual, missing much out, contended that he should have been advised to enter into a tax avoidance scheme involving offshore bearer warrants. The judge in that case held, broadly speaking, that the advisers were negligent in not advising the non-domiciliary to use such a scheme and held that any reasonably competent accountant holding himself out as having expertise in advising non-UK domiciles should have recommended the planning.

The Times of 6th June 2013 has run a story on this article, starting with the somewhat sensational comment that "The accountancy profession was "*thrown into turmoil*" yesterday after a High Court judge appeared to rule that practitioners had a duty to advise wealthy clients to avoid tax." In the writer's view, journalists should not mix up fact and comment (*Comment is free but facts are sacred* – CP Scott). After all, it is not a *fact* that the accountancy profession was in turmoil on the evening of the 5th June when the article would have been written, given that only a handful of accountants would have known about the judgment at that time.

Nevertheless, the case does illustrate the difficulty which advisers face. Would, for example, the advisers to multi-national companies have been *negligent* (in the light of *Mehjoo*) had they *not* recommended the possibility of locating valuable rights in low-tax jurisdictions? The Public Accounts Committee would say, presumably, that they should have ignored any such obligation to give tax avoidance advice. But a judge might find them to be negligent. So the position is difficult to say the least.

The short answer is that this case demonstrates again that, in the writer's view, the important point is to have regard to the *rule of law* and to the extent that the rule of law is perceived by Parliament and the public to be unacceptable and/or immoral then Parliament should change the law. The legislation affording the benefits in relation to the bearer warrant scheme, after all, was amended after the time that Mr. Mehjoo could have utilised it. So, Parliament did stop a scheme in this situation that was perceived to be wrong. Consequently, we all know where we are in relation to overseas bearer warrants and non-domiciliaries but otherwise, in the writer's view, the most acceptable course is to allow the judges to construe the law as it is absent, any morality, and for Parliament to change the law if the weight of opinion is that a particular law is unacceptable, perhaps because of its immorality.

Equally an adviser must put before a client all the *legal* options as a matter of good practice including proposals for reducing (avoiding) tax. A good adviser will also alert a client to the fact that that avoidance is very much frowned upon, of course, by the public, by the Press, by HMRC and by the courts themselves. The client should then factor all of this information, received from the adviser, into his own decision-making process together with any moral repugnance which he may reasonably feel for tax avoidance. In this way, it is most unlikely that any adviser could be sued for negligence: he would have discharged his obligations to "put the client in the picture fully", and by so doing would allow the client all the information that he needed to make an educated decision.

CONCLUSION

By way of conclusion, it seems as if at the end of all this, there will be significant changes in the law relating to global businesses.

There may well be some form of unitary tax as described, and more likely, in due course, the OECD will produce global policies which presumably will be adopted by members of the OECD and will operate across the globe. The end result will be therefore a new rule of law in this area and it is to be hoped that in these circumstances the new rule of law will be sensible and certain and will be upheld by governments in the future so that citizens and businesses know where they are.

So far as a GAAR is concerned, the writer rather doubts its necessity, given, for the reasons already mentioned, that he doubts it would have any effect on world-wide business practices (because it is aimed at abusive exploitation of statutory provisions, and there seems to him to be no such activity), and in his view it has the significant disadvantage of introducing just the sort of uncertainty which the Labour Party predicted would be the case back in 1994, albeit in relation to a general anti-avoidance rule rather than a general anti-abuse rule.

In a nutshell, Parliament should trust the rule of law given that it is Parliament which has the power to change it wherever it perceives abuses. That is to be preferred, in the writer's view, to responding to moods of public opinion particularly where so little specific information is in the public domain at any time.