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COMPULSORY PURCHASE AND ROLLOVER RELIEF

by Barrie Akin

CGT[1] rollover relief under the convoluted provisions of ss.152 to 159 TCGA 1992[2] does not distinguish between voluntary and involuntary disposals by the taxpayer. So if a taxpayer is forced to dispose of land under a compulsory purchase order ("CPO") and is able to satisfy the requirements of the legislation, rollover is available. However, as is well known, s.152 applies in principle to assets used only for the purposes of a trade throughout the period of ownership, and does not assist property investors, even if they have no choice as to when (and to whom) they dispose of their property. Nor does it assist a trader who reinvests the sale proceeds in land which is held as an investment: see s.152(1). And if the land has been used for the purposes of the taxpayer's trade for only part of the period of ownership, the relief will be restricted under s.152(6) and (7).

The 1982 Finance Act introduced provisions which remedied these apparent shortcomings in s.152 where there is an element of compulsion in the disposal. The relevant provisions are now in ss.247, 247A and 248. Before that time, the only CGT rollover relief specifically targeted at compulsory purchase was the small part disposal provisions, now contained in s.243. Those provisions are not discussed further in this article, except where they are relevant to relief under s.247.

Section 247 relief generally attracts far less attention than s.152 relief, and its full implications are frequently overlooked, probably because the side note to s.247 is misleading. It says: *roll-over relief on compulsory acquisition.* But that does not tell the full story. The relief is available in many cases where the disposal is not the result of a CPO.

The Basics

The basic thrust of s.247 is to permit rollover relief in the same basic manner as relief under s.152, but on disposals of land the proceeds of which are reinvested into further land and where the sale is a result of the exercise of compulsory powers or is to a body which has or may acquire such powers, as to which see below.

The timing criteria for reinvestment are the same as those in s.152(3)[3] and the same theoretical issue arises as to how the disposal consideration can be "applied" by taxpayer up to one year before the disposal: see *Watton v. Tippett.*[4] The provisions concerning partial rollover are essentially the same as those in s.153, and there are also rules dealing with rollovers into wasting assets.

There is also, as with s.152, the right to make provisional claims to relief before reinvestment takes place (see s.247A), a right to rollover where another group company makes the acquisition and a prohibition on "roll around relief" where assets are acquired intra group: see s.247(5A). The remainder of this article deals with the elements of s.247 relief that differ from s.152 relief.

Opening Words

As for the language of the statute, s.247(1) requires that:-

> "(a) land ("the old land") is disposed of by any person ("the landowner") to an authority exercising or having compulsory powers; and
>
> (b) the landowner did not take any steps, by advertising or otherwise, to dispose of the land or to make his willingness to dispose of it known to the authority or others; and
>
> (c) the consideration for the disposal is applied by the landowner in acquiring other land .."

Restriction of the Relief to "Land"

An obvious point which emerges from the section is that the relief relates to disposals and acquisitions of land only. The greater flexibility of s.152, which covers a wide range of assets in respect of which rollover is permitted, is simply absent from s.247. Compulsory purchase powers are generally directed towards the acquisition of land[5], so it is not surprising that the draftsman restricted the relief to disposals and acquisitions of land. No doubt a policy case could be made for extending s.247 so as to permit rollover where the new asset is not land, but an asset which would satisfy s.152.

What is "Land"?

Section 247(8) TCGA says that "land" includes any interest in or right over land, so (subject to wasting asset issues) a freehold disposal can be rolled over into a leasehold acquisition. But this partial definition says nothing about buildings – it merely addresses rights and interests in and over land, but says nothing about its physical nature. Does "land" therefore include buildings? If it does not, then the relief will not operate effectively where the bulk of the value of the asset disposed of related to buildings. The bulk of the value of the disposal would not be attributable to "land" and could not be the subject of a s.247 rollover.

The other partial definition of "land" in the TCGA is to be found in s.288(1) TCGA. The subsection says:-

> "In this Act, unless the context otherwise requires –
>
> … "land" includes messuages, tenements, and hereditaments, houses and buildings of any tenure."

So both of these definitions expand the natural meaning of "land", but in largely different ways – one is concerned entirely with the legal nature of land: the other is largely concerned with its physical nature. Crucially, there is nothing in the context of s.247 that *requires* the definition in s.288(1) to be disapplied. Each can apply to land which is the subject of a s.247 claim, with virtually no overlap and certainly with no direct conflict. In addition, the provisions in s.248 dealing with rollover into wasting assets and dwellinghouses reinforces the view that "land" must here also include buildings.

That also appears to be HMRC's view, as SP 13/93 accepts that s.247 relief can apply to shelter gains on the disposal of buildings and can apply where the rollover is into buildings rather than bare land. It should be remembered however that both HMRC and the Court have taken a different view of the meaning of "land" in other statutory contexts: see *Starke v. IRC* [1995] STC as to whether the definition of "agricultural property" in s.115(2) IHTA 1984 evinced sufficient contrary intention for the definition of "land" in the Interpretation Act 1978 to be disapplied. Consider also the position for s.152 rollovers, where the asset categories set out in s.155 make it tolerably clear that land and buildings are separate classes of assets for the purposes of that relief.

Build Your Own?

A second issue as regards buildings is: given that "land" should include buildings for the purpose of s.247 relief, can expenditure incurred on the *construction* of a new building on land already owned by the taxpayer constitute the application of disposal proceeds "in acquiring other land" for the purposes of s.247?

As a simple matter of language, it is by no means clear that the amounts paid to a builder for the construction of such a building will satisfy this requirement. Can placing brick upon brick amount to the acquisition of a building? In addition, if "land" here includes buildings, expenditure incurred on construction is arguably incurred on the enhancement of the existing asset, namely the existing land, rather than on the acquisition of new "land", as defined. Unlike the position under s.152, where HMRC have made it clear that such expenditure is capable of qualifying for rollover,[6] taxpayers should tread with extreme caution here.

Excluded Land

Understandably, the relief is denied when the land acquired by the taxpayer qualifies for private residence relief or does so within six years of its acquisition: see s.248. Interestingly however, s.247 has no equivalent to s.159. That section prevents non residents such from rolling over gains on the disposal of United Kingdom assets by reinvesting the proceeds into foreign assets used for the purposes of the same trade. Accordingly, a UK-resident but non-domiciled individual who disposes of land in a transaction to which s.247 potentially applies can reinvest the proceeds in new land situated outside the United Kingdom and still be eligible for relief. There is nothing in the legislation to refuse the relief where the land is outside the United Kingdom, but any disposal of the overseas land by a non domiciled but United Kingdom resident individual would of course fall outside the charge to CGT, unless the proceeds are remitted to the United Kingdom: see s.12.

Is a CPO Necessary?

Whatever the side note to s.247 says (see above) the actual text of the section makes no direct mention of

CPOs and does not does at first sight require the disposal to have been made as a result of the exercise of compulsory purchase powers. It merely says that the disposal must be to "an authority exercising or having compulsory powers".

Section 247(8) says that this phrase is to be construed in accordance with s.243(5), which says:-

> "In this section "authority exercising or having compulsory powers" means, in relation to the land transferred, a person or body of persons acquiring it compulsorily or who has or have been, or could be, authorised to acquire it compulsorily for the purposes for which it is acquired, or for whom another person or body of persons has or have been, or could be, authorised so to acquire it."

Long-winded as it undoubtedly is, this definition makes it clear that actual compulsory acquisition via a CPO is only one possible way of satisfying this part of the legislation. Even without the exercise of compulsory powers, the relief can apply if the person making the acquisition has compulsory powers ("*who has ... been or could be authorised to acquire it compulsorily*") *and* the purpose of those powers is also the purpose for which the acquisition is actually made. So if the only power possessed by the person or body is a power to acquire for the purposes of building a railway from A to B, a sale of an office building to that body for its own occupation is most unlikely to be capable of attracting relief – the power of compulsory acquisition is unlikely to permit the acquisition of an office building for occupation by the railway company.

But many compulsory purchase powers are extremely wide. This can in theory extend the relief considerably. Consider the freely negotiated sale of an office building by an investor to a Regional Development Authority, which will occupy the building for its own use. The purposes for which such an authority can compulsorily acquire property are incredibly wide – certainly wide enough to encompass the acquisition of the building for its own use: see the Regional Development Agencies Act 1989, ss.4, 5 and 20. Accordingly, a chargeable gain on such a sale could be the subject of a rollover under s.247, provided of course the other requirements of the section were met. There are practical difficulties in making use of the apparent width of the relief in such circumstances – namely the provisions of s.247(1)(b) – see below.

Who can be an "Authority"?

Many "official" bodies, including central government and public and local authorities, have powers of compulsory purchase for a host of purposes[7]. But the possession of such powers is not confined to "official" bodies – commercial organisations frequently possess compulsory purchase powers. Utility companies and railway companies are obvious examples. Their powers are usually granted by private Acts of Parliament –see, for example, the Channel Tunnel Rail Link Act 1996. HMRC accept that a tenant exercising a right to buy a freehold reversion under the Leasehold Reform

Act 1967 can be an "authority" for the purposes of s.247: see SP 13/93.

Inchoate Compulsory Powers

It is tempting to argue that sale to a person who does not currently possess compulsory powers could nevertheless fall within the ambit of s.247 because s.243(5) refers to "*a person or body of persons ... who has or have been, or could be, authorised to acquire [the land] compulsorily* …" This could, taken literally apply to anybody at all, as it is conceivable that parliament might confer powers of compulsory purchase on anybody. Any such argument is, of course, wholly unrealistic and ignores the messy structure and history of compulsory purchase. The more realistic explanation of the draftsman's use of "could be" is that it is intended to cover bodies whose powers of compulsory purchase are subject to the authorisation or confirmation of a third party, such as a Secretary of State. For example, the Acquisition of Land Act 1981 which follows a two stage procedure under which a body intending to make a compulsory purchase must usually have its CPO confirmed by the Secretary of State. Arguably, such a body only possesses compulsory purchase powers once it has its authorisation for that particular CPO. Until then it only falls within s.247 because it "could be authorised" to acquire the land compulsorily.

Purchasers without Compulsory Powers

The definition in s.243(5) has a further feature: it also treats as "an authority exercising or having compulsory powers" a person or body of persons

> "for whom another person or body of persons has or have been or could be authorised … to acquire … [the land compulsorily for the purpose for which it is acquired]."

So a purchaser with no CPO powers of its own can nevertheless be regarded as "an authority exercising or having compulsory powers". What if a property investor (who is clearly never able to benefit from s.152) sells land to a developer and the land lies within the area of a Regional Development Agency, which has extensive CPO powers within its area? The Agencies' areas, taken together, cover the whole of England (see Schedule 1 to the 1989 Regional Development Agencies Act) and an RDA can acquire property compulsorily and dispose of it at an undervalue, if that would further the economic development and regeneration of its area and the Secretary of State consents: see sections 4 and 5 to that Act. So, can the investor sneak within s.247 rollover provisions simply because an RDA *could* be authorised to acquire the land for the developer, even if the developer and the RDA have never spoken? At a less extreme level, what if the RDA says that it would consider going through the CPO process if an investor does not act promptly to develop its own land and, in the event of a CPO being made, it would then consider selling to a developer? Could that assist the investor who then sells to a developer to forestall a CPO?

It seems to me that these arguments (which have, perhaps understandably, been put forward to investors by developers) misunderstand the draftsman's intention, which appears to have been to allow rollover relief for

CPO disposals and for disposals entered into to avoid having to go through the CPO process. So where an acquiring authority had power to acquire on behalf of another, it would be sensible to relieve direct sales to that other person. Compulsory powers of this kind do exist. One can be found in the Military Lands Act 1892 – see s.1(3), where the acquiring authority (a county council) has power to acquire land on behalf of others (certain volunteer organisations, which themselves are capable of holding property in their own name). The existence of such a specific CPO power suggests (albeit not conclusively) that the Court is likely to regard the use of "for whom" in s.243(5) as requiring a narrow interpretation - applying it only to situations in which there is a clear statutory authority under which one body has power to acquire on behalf of another. Since the contrary argument could make s.247 available to virtually all sales of investment land in the United Kingdom, it would be surprising if the Courts did not take a narrow view here.

Marketing

It must be remembered that s.247(1)(b) will prevent rollover if the owner has taken active steps to sell the land. Its requirements are:-

> "the landowner did not take any steps, by advertising or otherwise, to dispose of the old land or to make his willingness to dispose of it known to the authority or others."

This does not mean that the landowner must not intend to sell. That would be illogical, as s.247(1)(a) clearly allows relief where the sale is not under a CPO. It is active marketing and the communication of an intention to sell that creates difficulty here. This does however raise practical difficulties. What can a landowner say when approached by an authority that is minded to exercise its statutory powers? Must he initially put on a show of unwillingness? Must he continue to do so and if so for how long? If, when approached, he says that he is perfectly willing to sell, has he fallen foul of s.247(1)(b)? It seems to me that the answer is in the negative. A response to an approach cannot, in the context of this legislation be the "taking of steps, by advertising or otherwise … to make his willingness to dispose of [the land] known …"

A further issue here is communication to one's own advisers such as solicitors or chartered surveyors. Even if no marketing of the land is undertaken, is the communication to one's own advisers of a willingness to sell sufficient to contravene s.247(1)(b) even when those advisers have not passed the information to third parties? The answer here must be that communication to one's own advisers is not communication to "others" in the context of this legislation.

And what if the landowner has marketed the land previously but then decided not to sell? The paragraph has no time limit, so arguably any earlier marketing of the land causes difficulties. Fortunately, HMRC have a practical solution to this – CG 72202 says that any activity that falls foul of s.247(1)(b) is to be disregarded if it took place more than three years "before the compulsory acquisition in question". Presumably this is also intended to apply to sales to authorities having compulsory powers, rather than just to disposals under a CPO, but it does not say that.

Miscellaneous

It should not be forgotten that the amount received by the landowner may not strictly relate solely to the land. Some may relate to goodwill or trade disturbance or to the reduction in value of land that is not disposed of. Section 245 deals with these issues and potentially reduces the amount on which s.247 relief can be claimed.

Conclusion

This rather obscure corner of the capital gains tax legislation may be coming to life shortly. A host of CPOs have been served on investors in preparation for the development required for the 2012 London Olympics. There is also considerable non-CPO activity in adjacent areas and the author is aware of at least one developer that has suggested that the relief is readily available where the sale to the developer might forestall a CPO by a Recognised Development Agency. It will be interesting to see what resulting disputes emerge.

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[1] Throughout this article, I use "CGT" to denote both capital gains tax and corporation tax on chargeable gains

[2] All statutory references are to TCGA 1992 unless otherwise stated.

[3] See s. 247(5)(b) TCGA 1992; see also s. 246 on the timing of disposals and acquisitions.

[4] [1997] STC 893. The point is, rightly, ignored in practice by HMRC.

[5] That general statement is not completely accurate – there is statutory power to authorise the acquisition of any kind of property in an emergency: Civil Contingencies Act 2004, s. 22(3).

[6] See, for example ESC D25

[7] See for example, the powers of the Secretary of State for Defence under the Military Lands Act 1892 and of Regional Development Agencies under the Regional Development Agencies Act 1989.

BENEFICIAL OWNERSHIP: AFTER *INDOFOOD*

by Philip Baker

What does the term "beneficial owner" mean in a tax treaty? In principle, we ought to know exactly what it means. The term has been used in tax treaties since the 1940s; it is in the OECD and UN and US Models; it is found in virtually every tax treaty which the United Kingdom has entered into. Curiously, we have had very little guidance as to the meaning of the term until a recent Court of Appeal decision in the case of *Indofood International Finance Ltd v. JP Morgan Chase Bank NA*[1].

The term "beneficial owner" is usually found in the dividend, interest and, sometimes, the royalties article of a tax treaty. These articles generally provide for a reduced level of withholding tax on the relevant category of income: however, the reduced tax is only available if the beneficial owner of the dividends, interest or royalties is a resident of the state which is a party to the treaty. Hence, the beneficial ownership limitations – or "BO limitation" to its friends – is a restriction on the availability of the reduced tax rate.

It is pretty clear that the BO limitation was introduced to counter treaty shopping by the channelling of the relevant income through a resident of a state with a suitably attractive treaty provision. The issue for some time has been, however, exactly how broad is the scope of the BO limitation. Put another way, how artificial must the conduit arrangement have been for the benefit of the treaty to be denied?

At one extreme, one can imagine situations where simply by registering shares or loan notes in the name of a nominee who was resident in a treaty state, one might try to claim the benefit of the relevant treaty. At the other end of the spectrum, all companies ultimately distribute the income they receive to shareholders or other stakeholders: if a company were to be denied the benefit of a treaty because the income received might ultimately be paid on to a third party, then when would any company or collective investment vehicle ever be entitled to the benefit of the three central provisions of most tax treaties?

Surprisingly, there has been virtually no case law on the meaning of beneficial ownership until the *Indofood* case. There was a Dutch case a few years ago where a UK company acquired a usufruct to receive the dividends on certain Dutch shares: the Amsterdam Court held that a person who is entitled to a usufruct over the dividends only was not the beneficial owner, but the Hoge Raad correctly reversed this by holding that the mere fact that the company had an entitlement only to the dividends and not to the corpus of the shares themselves did not prevent it from being a beneficial owner. There has been a more recent Swiss case[2] where the treaty benefit was denied on the grounds that the taxpayer had failed to prove that it was the beneficial owner. More tantalising, ten years or so ago a case was being prepared for trial before the UK Special

Commissioners concerning a Luxembourg bank in liquidation: was the bank still the beneficial owner of interest it received from the United Kingdom? Sadly, the case was settled before it went for trial.

There is Commentary from the OECD on the meaning of beneficial ownership. This has developed over the years. The original Commentary to Articles 10 and 11 of the OECD Model referred to the exclusion of agents or nominees who were interposed in an attempt to obtain treaty benefits. Following the Conduit Companies Report[3] the Commentary was extended to include conduits which had such narrow powers over the income they received that they were in the position of mere fiduciaries with regard to that income. This seemed, in fact, to be as far as the OECD could achieve consensus on the meaning of beneficial ownership. And a very sensible point it was too: it meant that the BO limitation excluded very obvious cases of treaty shopping, but went no further. States that wished to go further than this in deterring treaty shopping could – and did – include more elaborate anti-treaty shopping provisions in specific treaties. If one looks, for example, at the anti-conduit provisions of the current UK/US Tax Treaty, they provide strong evidence that the BO limitation is of relatively narrow scope, and that the treaty partners (or at least one of them) wanted a broader anti-treaty shopping provision.

The OECD Commentary, with its emphasis on agents, nominees and conduit companies acting as mere fiduciaries, provided a fairly useful rule of thumb for determining beneficial ownership. If the recipient entity went into liquidation, and it was a mere fiduciary, then any dividends etc., it had received could be claimed by the "real beneficial owner" and would not be available for general creditors in the liquidation. If, however, the dividends etc., really belonged to the entity in liquidation, then the income would be available for its general creditors and it would have been the beneficial owner of that income itself.

As explained, since March 2006 we do have a Court of Appeal case on the meaning of beneficial ownership, though some would doubt whether it has done much to clarify our understanding of the meaning of the term.

For a case which has sought to clarify one of the key expressions used in international taxation, what is surprising is that it was not technically a tax case. It was a civil case brought between the two parties to a loan agreement. The background is relatively complicated, but can be simplified. An Indonesian company wished to raise a loan for business purposes: if it had done so directly, there would have been a 20% withholding tax on the interest it paid. Instead of raising the loan directly, it established a Mauritius subsidiary which then issued the loan, with JP Morgan acting as trustee for the bondholders. Interest paid from Indonesia to Mauritius benefited from the Indonesia-Mauritius Tax Treaty, with a reduced withholding tax of 10%. Interest paid from Mauritius for the benefit of the bondholders was not subject to any withholding tax.

The precise terms of the arrangement with the Mauritius finance subsidiary were important. The identical amount of money was borrowed by the Mauritian company as was then lent on to the Indonesian parent: the rate of interest on the loan to and from Mauritius was identical. The terms of the documentation provided for interest to be paid by the Indonesian parent to the Mauritian subsidiary on day 1, and from the Mauritian subsidiary to the trustee for the bondholders on day 2: in fact, it was found as a fact that the interest was paid directly from the Indonesian parent to the trustee for the bondholders, missing out the Mauritian subsidiary. According to the Court of Appeal, the terms of the loan documentation precluded the Mauritian subsidiary from meeting its interest obligations to the bondholders from any source other than interest paid by its Indonesia parent[4], thus the Court of Appeal seems to have considered that both in practice and according to the documentation, the Mauritian subsidiary was effectively obliged to pay on every dollar received from its Indonesian parent to the bondholders: none of the interest received could be retained by the Mauritian subsidiary.

Then the Indonesia-Mauritius Tax Treaty was terminated.

The termination of the Treaty would have meant that the tax to be withheld on the interest from the Indonesian parent reverted to the normal domestic rate of 20%. However, the loan documentation contained a provision that, if the tax rate on the interest was increased, the payer had to gross up the amount paid so that, net of the higher tax, the bondholders received the same return as previously. Because this put a heavy burden on the borrower, it had the option, *if there were no reasonable steps it could take to revert to the reduced withholding tax*, to repay the loan early.

Now one comes to the final nub of the *Indofood* case: the Indonesian borrower said that there were no reasonable steps it could take to maintain the low withholding tax, so it should be allowed to repay the loan early. By contrast, JP Morgan, acting for the bondholders, said that there was a very reasonable step which could be taken; that the Indonesian borrower should take this step; and there was no reason to repay the loan early. Pretty obviously, the interest rates available had changed so that it was attractive to the borrower to repay early and refinance, while JP Morgan, acting for the bondholders, wanted the loan to remain in place.

The simple solution proposed was to interpose a Dutch entity between the Indonesian borrower and the Mauritius entity and get the benefit of the Indonesia-Netherlands Tax Treaty, which also had a 10% reduced withholding tax (or even the possibility of a zero withholding tax).

Two arguments were raised to show that the proposed Dutch company would simply not work: that it would not be the beneficial owner of the interest; and that it would not be a resident of the Netherlands for treaty purposes. If either of these could be shown to be correct, then the proposed Dutch company would simply not achieve the reduced withholding tax, and a measure which was doomed to failure could not be a reasonable measure to take.

Technically, the question was whether the Dutch company would be entitled to the reduced withholding tax under the Indonesia-Netherlands Tax Treaty. This was essentially a question of how the Indonesian Revenue would respond to the Dutch company – would they regard it as the beneficial owner – and, if they rejected a treaty application, how would the Indonesian Courts respond? Technically, therefore, the issue was one of Indonesian law and practice. The litigation came to London, however, because the loan agreements had a choice of jurisdiction clause which gave jurisdiction to the English High Court.

At first instance, Evan-Lombes J held that, if the Mauritian company had been the beneficial owner of the interest, so would the interposed Dutch company. Of course, there is a very simple answer to this: maybe the Mauritian company should not have been regarded as the beneficial owner in the first place.

The Court of Appeal reversed the first instance judgment. Unanimously, they considered that the proposed Dutch company would not be the beneficial owner of the interest. This meant that, for the first time, an English court had to provide a definition of the term "beneficial owner" in a tax treaty. Unfortunately, the way they did so has provided little clarity to the meaning of the term.

Two important points should be made about the Court of Appeal. First, none of the judges, and none of the counsel involved in the case, was an expert in taxation, let alone in international taxation. It is, in many respects, one of the most bizarre features of this case that a key issue concerning the meaning of a term used in multiple tax treaties was decided without any representation from a revenue authority and without the participation of anyone with any expertise in international tax before the Court of Appeal.

Secondly, as a technical matter, the Court of Appeal had only to decide whether the interposition of the Dutch company was a reasonable measure for the borrower to follow. It might have been sufficient simply to state that the Indonesian Revenue had gone on record that they would not regard such an interposed company as the beneficial owner: litigation in Indonesia was certain to follow if the proposed route was adopted, and one imagines that a route that was certain to lead to difficult litigation could hardly be a reasonable measure. That was not, however, the short cut route which the Court of Appeal adopted. Rather, the Court decided to face squarely the question of the meaning of beneficial ownership.

One of the great fears of international tax lawyers has been for many years that a question concerning beneficial ownership would come before a court in a common law country with little or no expertise in international tax. The fear was that the judges would recognise the term “beneficial ownership” from their knowledge of equity and the law of trusts, and would assume that the term had the meaning under the common law system with which they were familiar: that is, that there was a distinction between legal ownership and beneficial ownership. The meaning of the term would then be muddled up with the distinction between the separate ownership interest of the trustee and his beneficiary under a trust. Not only would the resulting meaning lead to unintended consequences for trustees seeking to claim the benefit of tax treaties, but it would also lead to a meaning of the term "beneficial ownership" which non-common law countries would have difficulty in following.

At the end of the day, the term "beneficial ownership" is used in multiple treaties entered into between countries with common law systems and countries which have continental European civil law systems, or other systems that have totally different historical origins. What the term needed was a "international fiscal meaning" rather than a meaning that depended on the domestic law of the country where the issue arose[5].

If one were to applaud any point in the Court of Appeal's judgment, it is that the Court decided that the term "beneficial owner" should not take a meaning according to the domestic law of the United Kingdom, but that it should have an "international fiscal meaning". This is understood to mean that the Court thought it should have a meaning which would be the same in all countries, and not vary from one country to another.

The question was how to find this international fiscal meaning. Here, there are some good things and bad things about the judgment. The good things are that the Court of Appeal referred to the OECD Commentary and appeared to endorse that Commentary as giving the international fiscal meaning. The bad elements were some unfortunate references to statements from the Director General of Income Tax in Indonesia to the effect that it meant “the full privilege to directly benefit from the income”. That phrase gives little, if any, clarification to the meaning of the term. Also rather less helpful were statements by the Court of Appeal that a technical and legal approach to beneficial ownership should not be adopted, but regard should be had to “the substance of the matter”. Often in cross-border arrangements, great care is taken on the technical and legal aspects – a broad brush, substance approach was bound to lead to uncertainty.

At the end of the day, and on the basis of the facts of the case (and it is very important to recall that this was decided on the facts of the particular case) the proposed Dutch company would not have been the beneficial owner of the interest. On that basis, therefore, the proposed solution would not work, and it was not reasonable to require the borrower to go down a route that would not work.

Where does this all take us to?

If one observed the flurry of activity in the City of London after the judgment came out, one might have concluded that this was some earth-shaking revelation which no-one could have foreseen. If one draws back for a moment, however, and looks at the facts of the case, can one really be surprised at the outcome? Recall: the Mauritian company borrowed the identical amount that it on-lent, at the same interest at which it on-lent, and the Court of Appeal found as a fact that the Mauritian company could do nothing with the interest it received but use it to pay the identical amount of interest that it had to pay on. In this type of egregious circumstance, is there any real surprise that the Dutch company which was proposed to take the place of the Mauritian company would not have been the beneficial owner? If beneficial ownership had any meaning at all, surely it would exclude the type of interposed entity which had no function whatsoever but to receive income and pay on the identical amount of income: in fact, it had so little function that, according to the Court of Appeal, the actual flows of money missed it out completely.

The biggest difficulty with the case is not that it confirms that the proposed Dutch company would not have been the beneficial owner. The real difficulty is how far the judgment extends: what other arrangements would be held to fall foul of the BO limitation?

In principle, therefore, the case itself should have had a relatively limited impact. In practice, nervous advisers have worried that it may have much broader implication, and call in question existing financial structures.

At the time of writing this short note, discussions between City law firms, the Law Society and HM

Revenue & Customs has led to the publication of draft guidance by HMRC on the impact of the *Indofood* case. The guidance seems to have been prompted by a desire to reassure the City that many existing structures would not be subject to any adverse scrutiny as a result of the case. However, it is fair to say that the approach adopted by HMRC to reach this comforting result is not particularly appealing from an intellectual point of view.

Many of the City law firms seem to have tried to bury the *Indofood* case by arguing that it was concerned with a finding of fact as to the possible outcome of a claim for treaty benefit in Indonesia, and had nothing to do with UK tax law. Technically, this may be correct. However, as a practical matter, the decision is clearly of broader import. Once the Court of Appeal accepted that the term "beneficial ownership" should have an international fiscal meaning, there was no reason why that meaning should not equally apply if similar facts arose with regard to the United Kingdom. At the very least, there is strong persuasive authority from the Court of Appeal as to the meaning they would give to this phrase.

HMRC, in its guidance, accepts that the Court of Appeal has provided guidance as to the meaning of the phrase in UK law (and not simply in Indonesia). However, they emphasise that this meaning should be seen in the context of the object and purpose of a treaty: the object and purpose includes combating international tax avoidance through treaty shopping. The guidance suggests, therefore, that the phrase only has its international fiscal meaning when treaty shopping is intended, but does not have its international fiscal meaning when there is no treaty shopping intention. Intellectually, this is a very unattractive position to take, and it is hard to see any legal support for this approach. The approach allows HMRC, however, to identify a number of accepted commercial arrangements which, provided there is no treaty shopping intended, will not be denied treaty benefits on the grounds that the international fiscal meaning of beneficial ownership should be applied.

Whether this draft guidance becomes a final text remains to be seen.

In the meantime, the somewhat unusual circumstances of the *Indofood* case have provided us with the first real discussion of the meaning of beneficial ownership around the world. Whether one is any the wiser after this decision, remains to be seen.

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[1] Court of Appeal, 2nd March 2006, (2006) 8 ITLR 653; [2006] STC 1195.

[2] *Re v. SA* (2001) 4 ITLR 191.

[3] 1986.

[4] In fact, examination of the terms of the loan documentation – not, sadly, quoted in either the High Court or the Court of Appeal, but which have been made available to the author – show that this was probably not correct. Instead, while it was unlikely that the Mauritian subsidiary could have raised money from any other

source, it was in principle capable of doing so and was not precluded.

[5] As would happen if the term was given its domestic law meaning by operation of the equivalent of Article 3(2) of the OECD Model.

THE MUSIC BETWEEN THE NOTES

A review of "*More Essays in International Tax Planning*" by Milton Grundy[1]

By Conrad McDonnell

Legend has it that in 1969, in order to obtain a copy of the first edition of *Tax Havens* by Milton Grundy, you had to make your way to a certain office in a certain side street in Vaduz in Liechtenstein: the book was not available for sale in the United Kingdom and the secrets contained within its pages it were considered far too daring for ordinary consumption. In these enlightened times the latest version of that book, as *Offshore Business Centres: A World Survey* (seventh edition) is of course readily available, in all good bookshops as the saying goes.

To an extent, where *Offshore Business Centres* leaves off, *More Essays in International Tax Planning* commences. The former provides a pragmatic review of general business conditions and the companies and other legal vehicles available in each jurisdiction, as well as a brief summary of key treaty elements, but essentially leaves it as an exercise for the reader what to do with all of this information. As *Essays* did before it, now *More Essays in International Tax Planning* takes these ingredients and refines and blends them so that we see what delights may emerge. *More Essays* is not a didactic textbook, nor a work of reference: it is assumed that the reader already has a good working knowledge of the

United Kingdom tax system and the international tax arena. On the contrary, the purpose of *More Essays* is to present inspirational ideas, to show the reader what may be possible, and to provoke discussion. The essays take a conceptual approach rather than setting out the detailed implementation of any of the schemes discussed. In that way, it is like a book which is about food, rather than an actual recipe book. That is perhaps an important point: unlike most professional works, this is a book which is designed to be read from beginning to end in the conventional manner and enjoyed in that way.

It should be said that *More Essays* does not of course present a solution for every situation, instead it presents a variety of approaches based on common themes. To continue the food analogy, it is a book organised around selected ingredients, rather than a presentation of a complete repertoire. Some of the approaches have doubtless been implemented many times on behalf of selected clients, and the author speaks from much experience of refining these schemes over the years — other approaches are frankly acknowledged to be untested for want of a client who is in precisely the right position to implement them.

Chapter 1 (London as an Offshore Centre) examines the use, by overseas residents, of the United Kingdom as a low tax jurisdiction. These are familiar concepts, but it is useful to the reader to have them collected together in this way. Limited partnerships and limited liability partnerships are discussed, before a more detailed treatment of the UK settlement established by a non-resident and non-domiciled settlor, the use of a UK company as an agent, and the use of a UK company as a holding company. A particular focus (and a recurring theme throughout *More Essays*) is the extent to which these vehicles may benefit from the international double taxation treaty network.

The Finance Act 2006 changes for UK trustees of non-resident trusts are mentioned, but the brief and efficient way in which that is done reveals much about the overall approach of this work. The Finance Act 2006 is just another development in a long line of legislative tinkering, and it is a detail which should not distract us from the broad concepts at play. Where other books might keep their feet on the ground and plough through the legislative changes, this work instead chooses to soar above all of that in order to reveal the elements which are really of interest. As the title page says, the music is not in the notes, but in the space between the notes (a quotation attributed to Debussy).

Another theme which is repeated throughout *More Essays* is the tax efficient treatment of royalties. Royalties are of particular interest to the international tax planner since of course in practice an asset which generates royalties is likely to be simultaneously exploited in many different high-tax jurisdictions. In this context, Chapter 1 examines the use of the UK company as a stepping-stone for royalties in relation to several different source jurisdictions, as well as the use of UK trusts. An Appendix sets out a worked example in relation to a Hong Kong pop singer: worked examples are otherwise not used in *More Essays*.

As is appropriate in these days of globalisation, there is significant focus on cross-border issues for companies, in particular the apparently simple (but common in practice) problem of how to derive dividends or business profits from activities in another jurisdiction while minimising local tax costs. But where other works or professional conferences may set out to address all of the complexities involved, in some cases adding layers of mystique which are perhaps uncalled for, the approach here is beguilingly simple. Issues such as transfer pricing are essentially disregarded as mere details of implementation: what is of interest here is the overall structure and the broad concepts in play.

Chapter 2 (The Uncertainty Principle) is a short but extremely thought-provoking essay analysing the implications of *Franklin v CIR* (1930) 15 TC 464. The case is a mere footnote in most textbooks and not very well known. The premise here is that a receipt which is unascertainable in amount is not a taxable receipt until such time as the amount of it can be ascertained. The consequences of this are explored, and in particular a scheme is presented for the almost indefinite deferral of tax on royalty income from a copyright work.

Chapter 3 (The Zero-Tax Trust) leaves the shores of the UK to explore the benefits which might flow from the use of a trust in a tax haven jurisdiction, rather than the more standard offshore company. As many readers will be aware, “tax haven” jurisdiction in relation to a trust can include, among others, Australia, New Zealand, Israel, South Africa, and the United Kingdom, since all have a tax system such that a resident trustee of a trust established by a non-resident is not taxable on trust income arising outside the jurisdiction. The main point of interest is the extent to which such a trustee can benefit from various tax treaties.

The second half of this chapter includes a longer treatment of the use of the two types of international trust which are available in Barbados. These are of particular interest in relation to income sourced in the United Kingdom, Canada and the USA, since Barbados has relevant treaties with all three jurisdictions. There is a detailed analysis here of certain provisions of the treaties and the related Barbadian legislation: this type of analysis is otherwise rare in *More Essays* but it is certainly useful here. For example, we learn of the use of a "shield trust" in order to preserve treaty benefits.

Chapter 3 culminates with a specific discussion of the use of Cyprus trusts and Cyprus low tax companies, and in particular the extent to which they may enjoy the benefits of Cyprus' extensive treaty network with other European countries. The discussion is topical and up to date (including, for example, a general discussion of the recent treaty amendments and the current status of Cyprus' double taxation treaties with the former Soviet Union and with the former Yugoslavia). This is the type of information and analysis which it must surely be difficult to find elsewhere.

Chapter 4 (The Offshore World and the UK Taxpayer) should cause the reader to stop and re-assess the current prevailing view that there is now no advantage available to a UK resident and domiciled individual through using an offshore company or trust to hold certain assets. The real issue here is how to circumvent s.739 ICTA 1988 and/or s.13 TCGA 1992 (in conjunction with s.77 TCGA 1992, in the case of trusts). Those sections of course have the effect of attributing respectively the income and the gains of any offshore vehicle to the UK resident individual who established the structure. But perhaps it is possible to sidestep them?

One way to get around s.13 TCGA 1992 is to establish a company such that each individual investor in question has less than a 10% stake in the company. (In essence the purpose of this legislation is not to penalise genuine equity investments in overseas companies, but only to tax the holders of "personal" or "family" companies, although the 10% test is something of a blunt tool to achieve that objective.) The use of a stake below the threshold is a well known approach which is often discussed but rarely implemented in practice. *More Essays* examines some of the practical implications of this type of structure, since it could potentially be used as a collective investment vehicle which is worthy of considerably more interest from offshore financial institutions.

A more advanced way to avoid s.13 is through the use of a Thin Trust combined with an offshore company, in the reverse sense from how that might usually be done. This is an extremely interesting idea but I will say nothing more about it here: full details are in Chapter 4 of *More Essays*.

In relation to income tax, two alternative mechanisms are proposed to allow a UK resident and domiciled investor to invest in an offshore portfolio of investments, without triggering a charge to tax under s.739 ICTA 1988. *More Essays* frankly accepts that these mechanisms may be difficult to implement in practice. Like several of the schemes which are presented here for consideration by individuals, these mechanisms do depend on locating an existing offshore investor who is willing to sell an existing substantial offshore structure, for a suitable price. Of course in practice such persons do exist, in particular if the price is right, but locating them and bringing the parties together to a satisfactory conclusion calls for an intimate knowledge of the offshore world which few possess. As the author says, "I have only seen a few examples of these kinds of structures over the last forty years, and if they had ever become really popular, they would surely have been stopped already."

All of this is merely leading up to the pièce de résistance, a vehicle which, if the various practical obstacles can be overcome, has the potential to avoid (or defer indefinitely) both UK income tax and UK capital gains tax, and also to escape source country taxation (if there happens to be an appropriate double taxation treaty: Spain is the example discussed) — and all of this, even though the ultimate beneficial owner remains UK resident and domiciled.

Offshore limited partnerships (for example under the Jersey Limited Partnerships Act) are discussed, for example as a means to change the source of business income where the business is conducted by a UK-resident non-domiciliary. To extend these same benefits potentially to UK domiciled individuals, the contingency principle from Chapter 2 is reintroduced, here in relation to a UK-offshore partnership, and a novel vehicle termed the “offshore discretionary company”.

Finally in Chapter 4, there is a discussion of the UK capital gains tax “market value” rule (s.17 TCGA 1992) and how this may, in certain circumstances, result in either a chargeable gain which is significantly less that the actual profit arising on disposal, or a base cost which is close to current market value. The reduction in the disposal consideration requires a combination of circumstances which would not unusually arise naturally (although it sometimes may), and the suggestion is that to create those circumstances artificially would amount to *Ramsay*-type avoidance. The method leading to an uplift in base cost has no such drawbacks, other than that it needs to be implemented before the investment is first made, that is to say probably many years before disposal. One is reminded of the question: “When is the best time to plant a forest?”, the answer of course being “20 years ago.”

Chapter 5 (International Tax Planning through Life Assurance) concerns the use of life assurance bonds as a "wrapper" for investments. This is a well-established concept in tax planning, for example there is a well-known structure called a "personal portfolio bond" (Milton Grundy reminds us that it was he who invented that structure, and indeed that name for it, in the 1970s). There are of course two key elements to any use of life assurance as a wrapper. First, the policyholder does not own the investments directly, nor does he have any beneficial interest in them: instead he has the insurance company's contractual obligation to him which is designed to be of equal value (so long as the insurance company remains solvent, which insurance companies tend to do with certain spectacular exceptions). Second, the person who is beneficially entitled to the investments is an insurance company which may benefit from tax-free investment income and gains.

It is the second benefit which is explored in Chapter 5, in an international tax planning context. In particular the chapter concerns the use of an insurance company which is tax resident in a "high-tax" jurisdiction like the United Kingdom (there is also discussion of Ireland and Luxembourg), issuing a policy to a resident of a different jurisdiction. Such an insurance company may be in a position to claim treaty relief from source country taxation: in particular there is a detailed discussion of the US-UK treaty, since that 2001 treaty has "anti-treaty shopping" provisions which are normally notoriously effective.

Assuming that the underlying investment needing a tax shelter consists of, not a standard portfolio of quoted securities, but shares in a private company or a more exotic (from the perspective of an insurance company) investment such as a copyright, there are of course obstacles to setting up an insurance company which will be able to hold that investment. The UK and many other jurisdictions have strong regulations for the insurance industry which govern, in particular, the type of assets in which insurance companies may invest so as to secure their liabilities. It is suggested that Ireland and Luxembourg may have a less restricted approach, so long as the liability precisely matches the value of the asset in question: that would be similar to the approach of a traditional offshore insure. Even so, it is probably difficult finding an insurance company in Ireland or Luxembourg which is open to this type of business: some names are suggested in Chapter 5. An alternative structure, making use of a company which is tax resident in the UK but doing no insurance business in the UK, is also proposed.

As can be seen, much of the scope of Chapter 5 is not really tax planning, it is more planning one's way around insurance regulations. Other than the treaty aspects, the tax planning itself is fairly straightforward and follows automatically if the appropriate insurance structure can be set up. Planning around insurance regulations is a newer field of endeavour than tax planning, and consequently less mature; there are also fewer individuals with any experience of it although in a slightly different context my own brother (currently at Royal & Sun Alliance) happens to be one of them, as a consequence of which I am aware that while developments in this area are fast-paced, there are opportunities which arise from time to time.

The final chapter, Chapter 6 (A Place in the Sun) is all about retirement, and in particular retirement to a different jurisdiction accompanied by an effective change of domicile for inheritance tax purposes. This is an idea familiar to any UK tax practitioner, and we have all said to the client with an inheritance tax problem, "Of course, you could just emigrate". Most clients demur: they expect any decent tax adviser to find a way to reduce the inheritance tax bill while they continue to live at home in the UK. Chapter 6 will provide the answers if your client instead happens to say, "Well yes, that is an attractive idea and it would certainly be sunnier too, but where exactly do you suggest we emigrate to?". The chapter covers France, Italy, Spain, Portugal, Greece, Cyprus, Malta, Gibraltar, Guernsey, Monaco, Switzerland and also (less known for their sunny climate, but at least they are close to home) Ireland and the Isle of Man.

The facts set out in Chapter 6 have been verified by members of the International Tax Planning Association (ITPA) practising in the relevant jurisdiction, which of course makes it a hugely valuable resource. Given that, a surprising aspect is that for at least two of the jurisdictions discussed, it is reported that there is a culture of systematic under-declaration of investment income by retirees, to which the authorities may even turn a blind eye: this seems thoroughly alien to any UK tax practitioner.

Would I recommend this book? I certainly would recommend it to anyone offering tax planning advice to private individuals, both because it is inherently an interesting read, and because some of the ideas in it may thus find application. It is also surely required reading for anyone seeking to design innovative offshore products or services for high net worth individuals. I was reminded of Pirandello's play "Six Characters in Search of an Author". There are at least six good tax-planning ideas here in search of a client and they deserve to be more widely known.

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[1] Published in January by Key Haven Publications.

CYGANIK V. AGULIAN: DETERMINING DOMICILE OF CHOICE

by Aparna Nathan

Introduction

Domicile is a concept of private international law rather than a concept of tax law. However, it is used in determining the ability of the United Kingdom to charge certain individuals to tax. An individual who is not domiciled in any part of the United Kingdom but who is resident and ordinarily resident here enjoys significant tax advantages. It is, therefore, a matter of some importance to individuals to ensure that they retain or, as the case may be, establish their domicile in a territory outside the United Kingdom.

The Court of Appeal has recently discussed the question of domicile in the case of *Cyganik v. Agulian* [2006] EWCA Civ 129. The case concerned the acquisition of a domicile of choice by an individual with a Cypriot domicile of origin.

Domicile of Origin

A domicile of origin is acquired when an individual is born (*Henderson v. Henderson* [1967] P 77). Where the individual is legitimate, this is generally the father's domicile at the date of birth. Otherwise, the individual takes its mother's domicile. The domicile of origin continues until the individual acquires either a domicile of dependency or a domicile of choice. When the individual acquires either a domicile of dependency or a domicile of choice, the new domicile continues until such time as it is abandoned. At that time, the domicile of origin revives (*Udny v. Udny* (1961) LR 1 SC and Div.441).

A domicile of origin is said to have a "adhesive" quality because, first, the burden is on whoever alleges that he has acquired a domicile of choice to prove it (*Winans v. IRC* [1904] AC 287 and *Re: Fuld No.3* [1968] P 675) and, second, the acquisition of a domicile is regarded as a serious matter which is not lightly to be inferred from slight indications or casual words (*Re: Fuld (No3)* at p.684, *Winans v. AG* at p.291, *Buswell v. IRC* [1974] STC 266).

Domicile of Choice

A domicile of choice is acquired where a person voluntarily fixes his sole or chief residence in a new territory and intends to remain there for the rest of his days, unless and until something occurs to make him change his mind. The intention to acquire a domicile of choice and to abandon the domicile of origin has to be "clearly and unequivocally proved" (*Moorhouse v. Lord* (1863) 10 HLC 272 at p.286). In *Moorhouse v. Lord* it was considered difficult to prove the acquisition of a domicile of choice in a territory where the individual concerned "must forever be a foreigner" (at p.287). This factor was relevant in the case of *F v. IRC* [2000] STC (SCD) 1, which concerned an Iranian individual who had lived in the United Kingdom for a considerable period but had never fully fitted into British society. The Iranian individual was held not to have acquired an English domicile of choice.

Two requirements must be met before an individual may acquire a domicile of choice in a territory: there must, first, be residence in the territory; and, second, there must be an intention to reside in that territory permanently or indefinitely.

As to the first limb, residence is thought to mean physical presence. A long period of physical presence is not determinative. For instance, a period of residence of thirty-two years in the case of *Udny v. Udny* (1869) LR 1 Sc& Div 441, HL was not conclusive on the question of the acquisition of a domicile of choice. Further, the residence must be the individual's sole or chief residence in order to be taken into account (*Plummer v. IRC* [1987] STC 698; *The Duchess of Portland v IRC* [1982] STC 149).

In relation to the second limb, the individual's intention must be firm and settled (*Re: Clore (No.2)* [1984] STC 609). Where an individual intends to return to his country of origin on the occurrence of a likely contingency, the individual lacks the requisite intention to remain permanently or indefinitely in the territory in which he is residing. Likely contingencies are considered to include retirement, attainment of a specified age, inheritance of a title or the earlier death of a spouse. However, if an individual merely intends to return to his country of origin on the occurrence of an uncertain and unlikely contingency, e.g. winning the lottery, that is not sufficient to prevent an individual having the requisite intention to remain in the territory in which he resides.

Statements made by a person as to his intention are useful evidence but by are no means conclusive (*Wahl v. AG* (1930) 2417 LT 382, House of Lords).

The acquisition of a passport in a particular territory has been held not to be, of itself, conclusive evidence that the individual intends to reside in that territory permanently or indefinitely. The individual's reasons for acquiring the passport are important. For instance, in *Bheekhun v. Williams* [1992] 2 FLR 229, the evidence was that a Mauritian individual had come to the United Kingdom in 1960 and had chosen to retain a British passport when Mauritius became independent in 1968 because he regarded the United Kingdom as his home (at p.239). The trial judge and the Court of Appeal, therefore, held that such a person had acquired a UK domicile of choice. However, in *F v. IRC* [2000] STC (SCD) 1, an Iranian exile, although he had acquired a UK passport, was held not to have acquired a UK domicile of choice by virtue of that fact: his prime motivation for the acquisition of a UK passport was for ease of travel for the purposes of his business.

The question of whether a domicile of choice has been acquired is one of fact to be determined in the light of all the circumstances (*Re Fuld (No.3)* at p.684/685 per Scarman J).

Cyganik v. Agulian [2006] EWCA Civ 129

The case concerned a preliminary question in respect of a claim under s.2 of the Inheritance (Provision of Family and Dependants) Act 1975. The issue was whether the deceased, who was born in Cyprus on 6 October1939, had lost his Cypriot domicile of origin and acquired a domicile of choice in England, where he had lived and worked for a total of forty-three years. If he had acquired a domicile of choice in England, an English Court had jurisdiction to entertain the proceedings under the Inheritance (Provision of Family and Dependants) Act 1975.

The leading judgment was given by Mummery LJ. He relied principally on the judgment of Scarman J in *Re: Fuld (No. 3)* [1968] P 675 which set out the well-established principles (discussed above) applicable when determining whether an individual with a non-UK domicile of origin had acquired a domicile of choice in England. Mummery LJ then set out the salient facts. He compared the deceased's connecting factors with Cyprus and the deceased's connecting factors with the UK.

Connecting Factors With Cyprus

The deceased was born in 1939 into the Greek community in a village in Northern Cyprus (under Turkish control since 1974). The deceased's parents and grandparents were also born in Cyprus. Following the break-off, in unfortunate circumstances, of an arranged marriage with a girl from Limassol, the deceased fled to the United Kingdom. During the time that he lived in

London, which period lasted fourteen years, he wrote to his family in Cyprus regularly and sent them money and presents. In 1967, he returned to Cyprus for two or three months. Later in the year, he travelled overland to deliver a car there. He bought three pieces of land in Cyprus.

The deceased took his young daughter, Helena, to Cyprus with the intention that his parents would look after her. In 1972 the deceased returned to his home village intending to live there permanently with his parents and Helena. However, in 1974, Turkey invaded Cyprus and the deceased returned to the United Kingdom where his daughter and his sister-in-law joined him.

In March 1975, his daughter was sent back to Cyprus, again to be looked after by his parents. The deceased sent money to Cyprus regularly. He wished his daughter to learn the language in order that she would be prepared when the family returned to live in Cyprus. He enrolled his daughter in a Cypriot school. He also made regular trips to see his daughter and his parents in Cyprus. In 1980, when the deceased's mother died, his daughter came to live with him in England.

The deceased continued to make frequent trips to Cyprus and, in 1987, he wished to buy a hotel and to live in Cyprus. However, he did not carry out his wish because the prices were too high. In 1991, the deceased returned to Cyprus and lived there for seven or eight months. From 1996 onwards, the deceased told his bank manager in Cyprus of his intention to retire to Cyprus and asked for his assistance in finding a property. He even went so far as to negotiate prices on some flats.

While living in England, the deceased continued to live the life of a Greek Cypriot: he spoke Greek and watched Cypriot television. He was very much in touch with Cyprus during his time in London. Although he held a British passport, his residence in London was marked by the fact that the regarded himself as Cypriot rather than British. He kept a Cypriot identity card which was, and was seen by him as being, significant for the purposes of exercising his Cypriot rights as a citizen of Cyprus.

Most of his friends were part of the Greek Cypriot community, and, after he met the Polish lady, Renata, who later became his fiancée, they included people from the Polish community. It was found as a fact that he had "a strong emotional attachment to the land of his birth, both the island of Cyprus as a whole and in particular to the area of his birth". It was held that he retained "a very strong sense of Greek Cypriot identity".

Connecting Factors With England

Mummery LJ observed that the deceased had come to England on a British passport at the age of eighteen in 1958 following the broken engagement. He lived with relatives in North London and worked as a mechanic when he first arrived. In 1968, his brother joined him in London for two months. At that time, he was living in a house and letting out rooms so that he could make money to go back to Cyprus.

In 1969 he began a relationship with the mother of his daughter.

In 1969/1970 he bought another property in Shepherd's Bush Road which he let out in bedsits. After his return from Cyprus following the Turkish invasion, he sought to convert the bedsits into a hotel. The deceased lived in the hotel and helped service it until his death. He bought several other properties in and around West London.

He started a relationship in 1977 with a Polish lady. That lasted about fifteen years. In 1992, he separated from the Polish lady.

In 1993, he met another Polish lady, Renata, who was later to become his fiancée. They lived together as man and wife for the rest of his life. In 1999 the deceased and Renata got engaged.

The deceased bought another property the upper floors of which were used as a hotel and the basement of which was refurbished, in 2002, as a flat. It was claimed by Renata that she and the deceased intended to get married in April 2003 and that the flat was intended to be their matrimonial home. The deceased died unexpectedly in February 2003.

The judge at first instance held that although the deceased had maintained his Cypriot domicile of origin until 1995, between 1995 and 1999 at some unspecified date he had acquired an English domicile of choice. His principal reason for saying this was that the deceased had become engaged to Renata in England. He surmised from this that the deceased intended to live in England with Renata permanently or indefinitely.

Mummery LJ held that the judge had erred. If, as was agreed, the deceased had not acquired a domicile of choice in England between 1958 and 1995 because he did not intend to live in England permanently or indefinitely, it could not reasonably be inferred from what happened after 1995 that he had formed a different intention about his permanent home before he died.

Mummery LJ held that the judge had underestimated the enduring strength of the deceased's Cypriot domicile of origin.

Further, the emphasis of the judgment was wrong. The judge had observed that if the deceased had continued with a string of short-term girlfriends, "he might eventually have decided to sell up and go and live permanently in Cyprus."

Mummery LJ held that the question was not so much whether the deceased intended eventually to return permanently to live in Cyprus but whether it had been shown that by the date of his death he had formed the intention to live permanently in England. The crucial point was that the deceased retained his domicile of origin in Cyprus until it was proved that he intended to reside permanently or indefinitely in England.

Mummery LJ also disagreed with the emphasis that the judge had placed on the deceased's engagement to

Renata and on the judge’s inference that his engagement necessarily meant that the deceased intended to live in England. Renata was Polish and her presence in the United Kingdom was precarious given that her continued presence here was illegal.

Mummery LJ held that there was no clear evidence that the deceased had ever intended to reside permanently or indefinitely in England. On that basis, the deceased had not acquired a domicile of choice in England

Mr. Justice Lewison and Lord Justice Longmore both agreed with Mummery LJ.

Longmore LJ noted, at paragraph 56, that Counsel for Renata had submitted that the deceased had acquired a domicile of choice on or after his engagement to Renata, placing reliance, inter alia, on *Forbes v. Forbes* (1954) Kay 341. In *Forbes v. Forbes*, General Forbes had acquired an English domicile by living with his wife and son in London after serving thirty-five years in India. However, his domicile in India was itself a domicile of choice (his domicile of origin being in Scotland). Longmore LJ observed that, “it is easier to show a change from one domicile of choice to another domicile of choice than it is to show a change to a domicile of choice from a domicile of origin.”

This statement merits some consideration: is it a correct statement of law? It might be argued that the same factors must be proved in both situations. In order to show that a first domicile of choice has been acquired or, in fact, a second domicile of choice has been acquired, it is necessary to show both residence and the intention to reside permanently or indefinitely in the alleged new domicile of choice. In the writer's view, therefore, this is an incorrect statement of the law.

Further, in the writer's view, it is not likely that a person will live in the first domicile of choice (which means that he must intend to live there permanently or indefinitely) and then immediately replace that domicile of choice with a second domicile of choice (because he has decided to live permanently and indefinitely there). It is much more likely, in the writer's view, that there will be a period of time between the individual abandoning his first domicile of choice and acquiring another domicile of choice. In the intervening period, the domicile of origin revives. A *Forbes v. Forbes* situation is, in the writer's view, quite rare in reality.

Example

An individual with an English domicile of origin lives and works and marries, say, in Singapore, and acquires a domicile of choice in Singapore. He then decides that he no longer wishes to live in Singapore but wishes to go to France when he retires. If this decision to leave Singapore when he retires occurs at the time when he is still living in Singapore, his English domicile of origin will revive. If he moves to France on retirement "to give it a go" and decides

> to remain there permanently, then he will acquire a domicile of choice in France, having abandoned his domicile of choice in Singapore and, in fact, having superseded his domicile of origin in England.

Longmore LJ may, however, have made the statement in these terms as shorthand for the fact that if an individual has already broken the link with his domicile of origin by acquiring a domicile of choice elsewhere, the domicile of origin may perhaps have a less "adhesive" quality when that individual seeks to show that he has abandoned his first domicile of choice in favour of a second domicile of choice.

Apart from this observation by Longmore LJ, the case of *Cyganik v. Agulian* is a straightforward application of well-established principles: an individual who wishes to acquire a domicile of choice in a jurisdiction must reside there and must voluntarily fix his intention to reside there permanently or indefinitely. This is a question of fact. In *Cyganik v. Agulian*, the individual had maintained strong ties with Cyprus so that, despite his extended period of residence in England, he had not acquired an English domicile of choice.

Establishing Domicile in Practice

For an individual with a foreign domicile of origin, it is ideal to maintain close links with the home country. In other words, the individual in question should ideally do the following: make regular and extended trips to the home country; retain bank accounts in the home country; make or retain investments in the home country; execute a will which is governed by the law of the home country; be involved in business interests in the home country; and include statements in the will to the effect that the individual wishes to be buried or cremated in the home country.

An individual with a UK domicile of origin who wishes to acquire a foreign domicile of choice must minimise his links with the United Kingdom while at the same time extending his links with the jurisdiction which is the proposed domicile of choice. He must, therefore, have extensive ties outside the United Kingdom. He must leave the United Kingdom with sufficient finality. He should, ideally, not keep a residence in the United Kingdom but, if he does retain a residential property in the UK, there must be sound reasons for doing so, e.g. keeping the property as an investment. The individual must not have an intention of returning to the United Kingdom on the occurrence of events that are likely to happen, e.g. retirement, the death of a spouse, attaining a particular age. It would be ideal if the individual tries to assimilate himself within the new territory, e.g. by joining social clubs and other social organisations, acquiring and then exercising a right to vote in local elections, becoming a naturalised citizen of the new territory or acquiring a right of permanent residence. The acquisition of a home there is also helpful.

If the individual moves away from the first territory of choice, he must keep a record of the reasons why he has chosen to move away from there.

Conclusion

Cyganik v Agulian is a useful case because it is a clear application of established principles which apply when determining domicile. One question that is raised by this decision is whether it is, in fact, easier to show a change of domicile of choice from one territory to another territory than it is to show the acquisition of the first domicile of choice. In the writer's view, this is not so.

LITIGATE OR DIE

by Patrick Way

Introduction

"Litigate or die", so some Revenue officials would have us believe, is the new mantra of HMRC. It means, in effect, that it is much more difficult to negotiate out of court settlements with HMRC and that if matters do proceed to court the taxpayer can now expect a much rougher ride, in the form of a more antagonistic cross-examination, than might have been expected previously. Worse still, the reality is that HMRC are now minded, or so they say, to take *all* cases involving tax avoidance to the Commissioners[1]. The expression itself comes from a meeting attended by some instructing accountants of mine. They had promoted a scheme which had subsequently been stopped by a change in the legislation (usually a strong indication that the planning worked) and in relation to which the Revenue authorities had, at first, conceded that no tax was due. Subsequently, before matters had been "signed off", as it were, the Revenue contacted the accountants for a meeting. They said that their new approach was "litigate or die", and consequently they would withdraw their concession and would litigate all the way to the House of Lords, if necessary, no matter how weak their chances of success.

Farthings Steak House

In this article I describe how and why HMRC have moved to this position, and how it manifests itself in general dealings with HMRC and – more particularly – in court proceedings. I also suggest ways of accommodating the approach of HMRC, particularly in relation to hearings before the Commissioners, where the new hostile approach manifests itself to a large extent. The starting point is the case of *Scott & Another (trading as Farthings Steak House) v. McDonald (Inspector of Taxes)* [1996] STC (SCD) 381 (SpC 91). It is an important case because it was the first case in which costs were awarded against the Revenue, in relation to a Special Commissioners' hearing. It is, of course, virtually unheard of to win costs at this level.

The background is that the Revenue considered that the owners of Farthings Steak House, Mr. and Mrs. Scott, had produced incomplete records, and accordingly their tax returns understated the profit in question. On this basis, the Revenue argued that they were entitled to make additional assessments of the further amounts which they thought should be charged. At the hearing, the Special Commissioner referred to the case of *R v. Bloomsbury Income Tax Commissioners* [1915] 3 KB 768 at 783, 7 TC 59 at 64, where Lord Reading CJ had relied upon the judgment of Parke B in *Allen v. Sharp* (1848) 2 Exch. 352 at 364: an assessment could be made in these circumstances only if the authorities:

> "… honestly and bona fide, after due care and diligence, believe[d] [additional tax] to be chargeable."

In *Farthings Steak House* the Commissioner decided that none of the inspectors of taxes involved could possibly have held the necessary honest and bona fide belief, and, accordingly the appeal of the taxpayer was upheld. The Commissioner then had to consider the question of costs since in very unusual circumstances costs of a Special Commissioners' hearing may be obtained by the winner. The Special Commissioner found that the Revenue had "acted wholly unreasonably in connection with the hearing, having shown bad faith", and accordingly the Special Commissioner took the punitive and most unusual step of awarding costs against the Revenue.

The Appeals Unit

The awarding of costs caused such a stir that, as I understand it, the Revenue introduced specialist appeals units in various parts of the country. The remit of each of these appeals units was to consider the merits of cases which the Revenue were proposing to bring before the Commissioners, with a view to ensuring that the mistakes in *Farthings Steak House* would not be repeated. It seems that, over time, these units developed an approach by which they would sanction Revenue appeals to the Commissioners only if they considered that there was at least a 50% chance of the Revenue succeeding (what I call the "gentlemanly" approach). Otherwise, the case would be conceded. So, for the last few years taxpayers and their advisers have worked on this basis, and if it was felt that a tax avoidance scheme had a better than 50% chance of success that was usually sufficient to give it the green light.

The Sea Change

And yet, as mentioned at the beginning of this article, we now have a situation where apparently even if HMRC consider that there is *no* chance of success, they will still bring tax cases before the Commissioners. So, what has precipitated this "sea change"?

The 2005 Latimer Conference

One of the first indications that the old somewhat "gentlemanly" approach ("*50% chance of success or concede*") might be about to be replaced by a more aggressive approach ("*litigate or die*") came at the Latimer Conference (for members of the Chartered Institute of Taxation and officials of HMRC), which took place on 30th September and 1st October 2005. Rather tellingly perhaps, its title in 2005 was "New Beginnings". At that conference, Dave Hartnett, who is the HMRC Director General responsible for compliance, strategy, and anti-avoidance (amongst other things), spoke about countering avoidance and negotiating tax settlements. (As an aside my old friend, Edward[2] Troup, the director of Business and Indirect Tax at the Treasury, also spoke on a similar subject.) Mr. Hartnett described his aim as being, by 2008, to know about all schemes, and to be proactive where necessary to stop schemes, stating that he would always litigate if he felt this was appropriate. He wanted to make sure that avoiders were no better off than what he called *compliant* taxpayers, and he wanted people entering into avoidance to recognise that government was bearing down on them. Most relevantly, his feeling was that the Revenue should litigate all “unacceptable tax planning”, because he was concerned that – increasingly – people were entering into avoidance arrangements with a pre-planned object of settling out of court, in due course, at an amount which would still make the avoidance scheme worthwhile. Consequently, his feeling was that the Revenue should litigate “in full”, and would certainly litigate – to use his terminology – if it was considered that the scheme in question “undermined the integrity of tax legislation” *no matter how slim the chances of success were*. In addition, his view was that national insurance avoidance was “off limits”, and – whatever the merits of the case – he would always want to recover 100 pence in the pound in relation to national insurance planning and not a penny less.

Other signs of impending change

Dave Hartnett’s talk should also be put in the context of other steps which were happening at much the same time and have happened since. I now set out those which I have identified but in no particular order.

Disclosure

The disclosure rules set out in Finance Act 2004 Part 7 came into force on the 1st August 2004. Initially, these were to counter employment-related schemes and – broadly speaking – schemes involving financial products, but such has been their success, from HMRC’s viewpoint, that they have been widened significantly by the introduction of the Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations

2006 (SI 2006/1543). Apparently, at the time the original regulations were introduced there were approximately 1,300 contentious matters involving EBTs alone, which – it can readily be seen – involved a significant amount of the Revenue's management time quite, and moreover, by the time the Revenue got to hear of these schemes much of the "damage" (at least in the Revenue's eyes) had been inflicted. Disclosure was intended (a) to bring employment-related and finance-related schemes to an end as soon as they were disclosed and (b) through the reference system, which would apply to all schemes emanating from the same promoter, to allow otherwise disparate cases to be marshalled into one manageable entity. By and large these aims seem to have been achieved.

Meetings with senior members of the profession

Then there was the occasion when senior members of the accountancy and legal professions were summoned to 11 Downing Street to meet the Chancellor of the Exchequer, in order for him to explain his irritation and annoyance with the tax avoidance industry and Dave Hartnett met, separately, with most of the senior partners of the accountancy firms to ask them to pull out of the tax avoidance industry. In addition, there were threats that if firms of accountants continued to involve themselves in the promotion of tax avoidance schemes they could not expect to be invited to carry out remunerative government-related work.

Employment avoidance

A further clue to the germination of this hard-nosed approach can be gleaned by reading the transcript of another of Dave Hartnett's addresses, this time to the Chartered Institute of Taxation as part of its seventy-fifth anniversary celebrations in 2005. In that address, he described the particular sorts of steps which taxpayers had taken to avoid being within the PAYE net and to avoid paying NIC. Most readers will be familiar with these techniques: they involved, among other things, no doubt, employees receiving – rather than cash - (a) trust interests (b) gold bars (c) carpets (d) platinum sponges (e) vintage wines and even (f) hay and (g) animal skins. Over time, various measures had been introduced by governments of different persuasions to try to stop this sort of tax avoidance, but – so Mr. Hartnett said – the Revenue were generally on the back foot, because the absence of disclosure and other matters meant that they found out about schemes well after they had been completed.

Schedule 22

From my own point of view, however, it was the introduction of Finance Act 2003 Schedule 22, (which very quickly became consolidated as Part 7 of the Income Tax (Earnings and Pensions) Act 2003), that quite unwittingly encouraged the utilisation of a plethora of schemes – which were almost certainly the last straw so far as HMRC were concerned. (This legislation is still referred to as "Schedule 22" by way of shorthand.) Schedule 22 dealt with employment income and income and exemptions relating to securities, and it introduced provisions which allowed employers to transfer securities in a particular way to employees tax-free and then to take various steps to reduce the value of the asset or to pass its value out in a much more beneficial fashion, so that the overall the result to the employees was a significant reduction in income tax and an entire avoidance of NICs. (The 25% scheme referred to at Endnote 1 is a classic example.)

Press Release of 2nd December 2004

The Revenue's reaction was to issue the now famous press release of the 2nd December 2004, in which the Paymaster General (Dawn Primarolo), after some fairly emotive language denouncing the wholly unpalatable avoidance industry, introduced anti-avoidance provisions into the legislation and, most significantly, said that the Revenue regarded themselves as being entitled to bring in *retrospective* legislation to counter Schedule 22 avoidance dating back to the 2nd December 2004 if they thought it fit, in order – in effect – to preserve the integrity of the legislation.

Merger of the Revenue and Customs & Excise

Some readers would say that, in seeking to identify the driving force behind "litigate or die", I am missing the main point, which is that in 2005 the Revenue and Customs & Excise merged. Indeed, various commentators have pinpointed this as being the principal catalyst for the new-style approach of HMRC, based on the fact, of course, that Customs traditionally were much more in the mould of "shoot first and ask questions later" than the somewhat more reasoned and analytical personnel of the Revenue, and Customs' approach has been adopted by the merged HMRC.

City booms

Additionally, as Dave Hartnett acknowledged in his address to the Institute of Taxation, the City has enjoyed an enormous boom in recent years, with the result that some quite extraordinarily huge bonuses have been paid to staff, and some similarly extravagant schemes have been utilised to avoid paying tax. No doubt to the chagrin of HMRC, when one such scheme – involving a relevant discounted security – was taken to the Special Commissioners by HMRC, it was not rejected but endorsed by that tribunal, and the case was not taken further by HMRC (*Campbell v. IRC* ([2004] STC (SCD) 396 (SpC 421).

Need to raise more tax

Finally, it needs to be pointed out that the Government considers that it loses significant amounts of tax from avoidance and wants to "rectify the situation".

Where are we now?

The new approach (crystallised in the expression "litigate or die", but extending to all means of making life uncomfortable for the tax avoidance industry) seems to have been successful. Many of the large firms of accountants have withdrawn from the promotion of "retail" tax avoidance schemes and now limit themselves to one-off bespoke schemes for special clients and special events. The disclosure regime does seem to have flushed out very quickly a large number of tax avoidance schemes, enabling the Revenue to put an end to them. A salient example is the recent introduction of Finance Act 2003 s.75A which stops virtually all the SDLT avoidance schemes that were prevalent beforehand, and produces a situation to be contrasted with the pre-disclosure regime, where, particularly in relation to stamp duty, avoidance schemes carried on for years with impunity.

The new approach to litigation

The United Kingdom has, of course, the adversarial system rather than the continental inquisitorial procedure in court hearings. This means that the evidence is tested through the means of examination and cross-examination, and each party is obliged to put its arguments as forcefully as it can. By contrast, the inquisitorial system involves much more of an overview of the position, with the facts being gleaned by the court and tested from time to time. Counsel is the client's mouthpiece (*adversarial*) rather than a relatively dispassionate presenter of legal opinion (*inquisitional*) for the judges' consideration. The adversarial system has stood the country well, but from time to time it does produce a very lop-sided effect, and increasingly – following the Revenue's new approach to litigation and their "litigate or die" rallying cry – it can leave the taxpayer who is cross-examined in court feeling that he has been very badly treated.

Counsel for the taxpayer may in some cases speak for no more than half a day in a five-day hearing, whilst counsel for the Revenue may speak for four and a half days, four days of which is spent in brutal cross-examination of the client. The taxpayer feels it is unfair and feels that there is a lack of kilter in the process, and may complain that nothing is done to stop this unfair process and nothing is done to even things out. It may be that the Revenue have changed their approach in the last two or three years and have moved from fairly anodyne cross-examination to hostile cross-examination; that is the perception in any event. Whilst the Revenue would deny that this new approach is because of their "love of bloodsports", nevertheless increasingly the feedback is that the taxpayer is left feeling very disadvantaged at the disproportionate time in which his case is attacked, together with the unpleasantness of the attack, and the process – frankly – can be an uncomfortable one to observe.

What can you do?

So how can you even things out and how can you protect your client prior to what may be a very brutal cross-examination before the Commissioners? The first thing to do is to warn the client that cross-examination is almost invariably unpleasant but that it is a necessary way of flushing out the evidence. On the basis that the client has been advised (presumably) that he has a meritorious case he should remain control and not lose his temper or calm demeanour. He should answer the questions without emotion and, of course, honestly. He should not involve himself in speculation and if he does not now the answer or cannot remember he should say so. A matter of fact, "I don't know" is perfectly acceptable and can be disarming.

Also he should bear in mind that no matter how dissatisfied and uncomfortable he finds the process (and this article is focussing on the client's experience and sensitivities) the Commissioners have seen it all before and will factor into their overview their knowledge that people under cross-examination are frequently nervous and unsure. In other words, no matter how badly a client may feel he has performed in the witness box if he has given his answers honestly and helpfully, there is nothing more to be done. And just because he has had a rough ride under cross-examination, this will not (whatever the client may think) result, by virtue of that fact alone, in his losing an otherwise winnable case ("*snatching defeat from the jaws of victory*").

Notwithstanding this, you should consider how you can legitimately prepare your clients for this process. The relevant codes of professional practice are entirely candid on this, and you must remain within the clear parameters which they set out. Accordingly, a barrister categorically must not rehearse, practise or coach a witness in relation to his witness statement (Code of Conduct of Work by Practising Barristers Rule 705), and a solicitor must not, of course, tamper with the evidence of a witness and must have regard to paragraph 6.5 of the advocacy code for solicitors, which includes very similar wording to Rule 705 of the Barristers' Code.

So, if you cannot rehearse, practise or coach, what can you do beforehand? As a starting point, when formulating the case or settling the witness statement the solicitors or barrister should "test the evidence". This means that they must, on a step-by-step basis, ask the witness as they go along whether each of the relevant points is correct. This, quite legitimately, will highlight *en passant* the sort of questions that are likely to be asked in the cross-examination, but great care needs to be taken, because there is a very narrow dividing line between acceptable preparation of a witness and entirely unacceptable rehearsing or coaching. So, as a consequence, it may be advisable to consider enrolling a client on a specialist course of familiarisation, but, given the limits that attach to these courses (they must relate to entirely hypothetical facts and to circumstances entirely distinct from the actual case) their benefits are reduced to giving a *general* understanding of how the process works and no more.

In addition, great care must be taken in connection with all witness familiarisation courses, because there are dire consequences if a witness, rather than being "familiarised" is "coached": this is borne out by the case of *R v. Momodou* [2005] EWCA Crim.177, which was considered in the civil case *Ultraframe (UK) Limited v. Fielding & Others* [2005] EWHC 1638 (Ch). Following *Momodou*, the Bar Council introduced a guidance on witness preparation in October 2005, to assist barristers in relation to the difficult issues that arise, in the light of the case, in respect of prohibited witness coaching. It is to be emphasised that the main rule mentioned above (paragraph 705) still takes precedence (*absolute prohibition on coaching and rehearsing*). So, the guidance confirms that, whilst witness coaching is prohibited, a process of witness familiarisation is permissible in order to prevent witnesses from being disadvantaged by ignorance of the process or being taken by surprise at the way in which it works.

The following is taken from the guidance:

> "12. The following guidance should be observed in relation to any witness familiarisation process for the purpose of civil proceedings:
>
> (1) Any witness familiarisation process should normally be supervised or conducted by a solicitor or barrister.
>
> (2) In any discussions with witnesses regarding the process of giving evidence, great care must be taken not to do or say anything which could be interpreted as suggesting what the witness should say, or how he or she should express himself or herself in the witness box – that would be coaching.
>
> (3) If a witness familiarisation course is conducted by an outside agency:
>
> (a) It should, if possible, be an organisation accredited for the

purpose by the Bar Council and Law Society;

(b) Records should be maintained of all those present and the identity of those responsible for the programme, whenever it takes place.

(c) The programme should be retained, together with all the written material (or appropriate copies) used during the sessions.

(d) None of the material used should bear any similarity whatever to the issues in the current or forthcoming civil proceedings in which the participants are or are likely to be witnesses.

(e) If discussion of the civil proceedings in question begins, it should be stopped.

(4) Barristers should only approve or take part in a mock examination-in-chief, cross-examination or re-examination of witnesses who are to give oral evidence in the proceedings in question if, and only if:

(a) its purpose is simply to give a witness greater familiarity with and confidence in the process of giving oral evidence; and

(b) there is no risk that it might enable a witness to add a specious quality to his or her evidence; and

(c) the barrister who is asked to approve or participate in a mock examination-in-chief, cross-examination or re-examination has taken all necessary steps to satisfy himself or herself that the exercise is not based on facts which are the same as or similar to those of any current or impending trial, hearing or proceedings at which a participant is or is likely to be a witness; and

(d) In conducting any such mock exercises, the barrister does not rehearse, practise or coach a witness in relation to his/her evidence: see para.705(a) of the Code. Where there is any reason to suspect that a mock examination-in-chief, cross-examination or re-examination would or might involve a breach of the Code, a barrister should not approve or take part in it."

In addition, the guidance has the following to say about witness statements:-

"**Witness Statements**

13. Barristers in civil proceedings are typically involved in settling witness statements. However, the courts have emphasised that a

witness statement must, so far as possible, be in the witness's own words: see eg. *Aquarius Financial Enterprises Inc. v. Certain Underwriters at Lloyd's* [2001] 2 Ll.Rep. 542 at 547; Chancery Guide, Appendix 4, para.1; Commercial Court Guide para.H1.1(i) and H1.2 and Technology and Construction Court Guide para.6.10. When settling witness statements, great care must be taken to avoid any suggestion:

(1) that the evidence in the witness statement has been manufactured by the legal representatives; or

(2) that the witness had been influenced to alter the evidence which he or she would otherwise have given.

14. Furthermore, the evidence in a witness statement must not be partial; it must contain the truth, the whole truth and nothing but the truth in respect of the matters on which the witness proposes to give evidence: see Chancery Guide, Appendix 4, para.6 and Queen's Bench Guide, para.7.10.4(1). A barrister may be under an obligation to check, where practicable, the truth of facts stated in a witness statement if he or she is put on enquiry as to their truth: see Chancery Guide, Appendix 4, para.6. Moreover, if a party discovers that a witness statement which has been served is incorrect, it must inform the other parties immediately: see Chancery Guide, Appendix 4, para.6 and Queen's Bench Guide, para.7.10.4(6). Barristers therefore have a duty to ensure that such notice is given if they become aware that a witness statement contains material which is incorrect."

Other preparation

The client should be encouraged to set aside plenty of time before the hearing to read through again the witness statement and all the relevant papers so that he can be fully prepared for the cross-examination. He should think carefully for himself what questions he is likely to be asked and should practise his answers – in front of a mirror if necessary! In fact, in my experience, such preparation can turn a case back in favour of the taxpayer[3].

What can be done in the hearing itself?

In a typical case, however, as noted above, the taxpayer's evidence will initially be in the form of a written witness statement. Usually, the taxpayer will not be asked to read out the witness statement: this puts him at something of a disadvantage, because he then moves very quickly into the heated atmosphere of cross-examination without time "to draw breath"; whereas it would be desirable if he could answer "friendly" questions to give him confidence and calm his nerves before the cross-examination starts. Accordingly, it is appropriate for Counsel to ask the Commissioners that the taxpayer does read out the witness statement (this request is often denied as it would be in a fully blown trial). Reading a familiar witness statement slowly, however, gives time for the witness to "get into his stride". Thought should then be given to asking the taxpayer some questions in relation to the witness statement although, frankly, the witness statement should have set everything out as fully as possible. The purpose, however, of any such questions is, again, to put the witness at ease. Consideration should also be given to formulating these questions in such a way that the difficult points which the Revenue's barrister is going to raise are anticipated, so giving the taxpayer the opportunity of stating the position in the first place by reference to "sympathetic" questions rather than hostile ones. This in turn *may* mean that it is possible for the barrister acting for the taxpayer to object to further questions being asked on these difficult areas, in the subsequent, cross-examination, on the basis that the information has already been given – but this is probably a vain hope in most cases. Further possibilities to help the taxpayer who has to give evidence are to see whether the cross-examination by the Revenue counsel can be interrupted legitimately, on the basis that a question is not relevant or is a repetition of an earlier question, or, frankly, that it is plainly hostile and nothing else. Usually this is done without much success.

Once the cross-examination has been completed, the barrister for the taxpayer is then given the opportunity to ask further questions. It is a judgment call whether further questions should be asked. If the witness statement is clear and the taxpayer has had a difficult experience in cross-examination, the risk always is that the taxpayer may simply end up contradicting the witness statement (because he is just not thinking straight) and it may be best simply to leave matters as they are and rely on the written statement itself as best presenting his evidence. It should be said, of course, that even though the whole process may leave the taxpayer drained and miserable, he should resist the temptation of giving up[4]. Despite all the foregoing, as already mentioned, the Commissioners are seasoned adjudicators, and – whatever the taxpayer may think about the apparent unfairness – the Commissioners are entirely capable of applying the right balance to the proceedings when weighing up the evidence and producing their decision.

Conclusion

So for the future, taxpayers need to be aware of the position. They certainly need to be made aware that notwithstanding the merits of their case (and bear in mind they may have at least a 50% chance of success or perhaps significantly more – otherwise they would not have brought the appeal in the first place) the courtroom experience is likely to be unpleasant and to require careful preparation. So the taxpayer should be forewarned. It may be appropriate to take the client on a witness familiarisation course, as I mentioned, and in the drafting of the witness statement care can be taken to test the evidence, so that the taxpayer can at least be given, in a wholly legitimate way, an understanding of the sort of things he must be able to deal with. It should also be borne in mind that although cross-examination is part of a fact-finding exercise, which is most important – not to say critical, nevertheless ultimately the case will in the end be decided on its legal merits, and that is where the tax barristers worth their salt should come into their own, no matter how draining and unpleasant the courtroom experience for the client may prove to be.

[1] However, there was a blanket settlement of the "25% scheme" (involving restricted shares and a dividend) and this suggests that notwithstanding the somewhat virile claim that all cases will go to the courts, this is not necessarily the practice so far.

[2] I was forgetting! Because the Treasury is a "Right-on" department, Edward's crossing of the Rubicon from law firm to Treasury has required him to change his name to the much more "*au courant*" 'Ed'!

[3] Richard and Judy's evidence in *Madeley and Finnigan v. HMRC* [2006] STC (SCD) 573 (SpC 547) was a particularly salient example of how witnesses who have prepared can give powerful and ultimately winning answers from the witness box.

[4] This article has its roots in a number of cases where members of the Tax Bar have been involved, including one involving a husband and wife in which one spouse conceded rather than face a similar grilling to that just suffered by the other spouse, and others where taxpayers have come away with the impression that the system is unfair and makes them appear criminal (even though the Commissioners ultimately find in their favour).