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Editor: Milton Grundy

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THE PRINCIPESSA

Milton Grundy

When she was entertaining her British friends, the Principessa was fond of saying – and she did not mean it entirely as a joke – that Italians treated taxes more as suggestions than commands. And now that she was coming to live in England, she was discovering that British taxes were much the same – for the "Non-doms" at least. She would come to England for a maximum of nineteen years, and if she invested only abroad and kept her income and capital abroad, she could forget about income tax and capital gains tax, and about inheritance tax too. She knew that after the first seven years she would have to pay £30,000 a year for the privilege, but that (after the recent decline in the Sterling exchange rate) did not strike her as unreasonable. But it left two problems unsolved – first, what was she going to do for spending money, and second, how could she own a home in the United Kingdom?

She first addressed her mind to the problem of remitting money to the United Kingdom without incurring a tax charge. The money she had before she arrived – the "old money", she could remit without any tax liability, but the income she received and the gains she made afterwards – the "new money", she must keep abroad. If she each year accumulated a 5% return on her investments as new money, and spent 5% of the old money, she could live in England for twenty years without any tax, and still keep her fortune intact. It seemed like a good plan. What she needed was some machinery for keeping the new money abroad while being at liberty to remit the old money.

To solve this first problem, she turned to her brother Giorgio. Giorgio had established a trust for the benefit of his grandchildren, in the Island of Guerjesman. He had started it with €10,000, but had never got round to settling more (or perhaps, she wondered, had never – after recent events in the financial markets – been in a position to do so). The Principessa had a proposition for him: she would deposit her money – most of it anyway – with his Guerjesman Trustee for twenty-one years, on the following terms:-

(i) the deposit would carry a trifling rate of interest, and could be withdrawn (as a whole or in part) at any time;

(ii) at the end of the twenty-one years or (if earlier) when the last withdrawal was made, the Trustee would pay her, by way of further reward for the use of her money, 99% of the benefits it had received – that is, the aggregate of the income and gains the Trustee had accumulated, less any losses and less the interest payments, provided that in no circumstances should the liability of the Trustee exceed the assets in the trust fund.

She appreciated that this was an unusual arrangement, but evidently it was not unheard of: one of her Muslim friends had a Sharia-compliant bank deposit in Dubai, which was not very different, and a little while ago she had met a very clever young man, who used a UK version of such a deposit as a way of turning income into a capital gain. And she explained to Giorgio that this arrangement could – if all went well – be a good deal for his grandchildren. Of course, there was the risk that they would be left with nothing, but if he would appoint her the Protector of the trust, she would use her position to ensure that the Trustee made sensible investments. At the same time she would ensure that the Trustee invested only outside the United Kingdom.

She then turned to her second problem. She had never lived in rented accommodation, and she was not going to start now. She would buy herself a nice house – in Belgravia maybe, or Notting Hill Gate. But such a house would bring with it a potential inheritance tax liability. That must be avoided. But how?

She remembered that her brother Giorgio used to have a collection of Ming vases or – more precisely, he had a Liechtenstein Anstalt which owned the collection of Ming vases. Only last year he sold the Anstalt to a "Non-dom", who wanted to convert unremitted foreign income into a decoration for his London home without incurring a tax charge. That was not her problem – and never would be, but the purchase of the Anstalt gave her an idea. She knew Giorgio was looking for a purchaser for his collection of Tang vases – or, more precisely, for his Guerjesman company which owned them. These vases were quite a recent acquisition and were not worth any more than cost. Giorgio agreed to sell the company to her for the cost price of the vases. What happened next was choreographed by her solicitor (with the advice of Counsel), but the upshot is that:-

(i) most of the company's shares are preference shares, and they are owned by a "thin" Guerjesman trust she created (i.e. on trust for herself for life and subject thereto as she may appoint);

(ii) the company has sold the vases and lent the proceeds to the Guerjesman Trustee on arm's length terms;

(iii) the Principessa has borrowed the proceeds from the Trustee interest-free and used them to buy a house; she has charged the house to the Trustee, which has charged the debt to the company;

(iv) each year, the Trustee waives its right to a preference dividend, in consideration for which the company waives its right to interest.

The Principessa is happy to have the title to the house in her own name, and pleased that she will enjoy principal private residence relief on any sale. The one cloud on her horizon is the UK Government's propensity for changing the rules, sometimes with retrospective effect. She hopes they have learnt their lesson from the loss of taxpayers which followed their last changes, but if not, she can always look at Switzerland or Monte-

Carlo, or at Gibraltar, Barbados or Seychelles, and – come to think of it – she has a cousin who retired to the Algarve with some offshore structure which left him with a very manageable tax liability.

NELSON DANCE: THE HIGH COURT CONFIRMS THAT 100% BPR MAY APPLY WHERE THE VALUE TRANSFERRED IS ATTRIBUTABLE TO TRANSFERS OF ASSETS USED IN A BUSINESS

by Marika Lemos

Business property relief ("BPR") has often been thought of as a relief applicable to transfers of different categories of property. The danger with this approach is that it wrongly focuses attention on identifying the nature of the property transferred and on whether or not it meets the definition of "relevant business property" contained in s. 105 of the Inheritance Tax Act 1984 ("IHTA"). Instead, the correct approach is to identify the transfer of value that has resulted in a reduction in the value of "relevant business property" in the transferor's estate, regardless of whether an actual transfer of the "relevant business property" takes place: so held the High Court, upholding the decision of the Special Commissioners in the case of the *Trustees of the Nelson Dance Family Settlement* v *HMRC* ("*Nelson Dance*").[1]

The significance of the *Nelson Dance* decision is that it upset what was previously thought to be the position regarding 100% relief for assets falling within s.105(1)(a) IHTA ("property consisting of a business or an interest in a business"), namely that BPR did not apply to transfers of individual assets of a business. It was thought that it applied only to a transfer of the whole of a business or an interest in a business.[2] From *Nelson Dance*, it is now clear that assets that previously formed part of the transferor's business qualify for relief. For example, where the property transferred is agricultural property, and agricultural property relief ("APR") is limited to the agricultural value of the land, it is now clear that, provided all the other relevant conditions are satisfied, 100% relief will apply to the development value of the land, i.e. the value in excess of the agricultural value, which was attributable to the transferor's "relevant business property".

Nelson Dance: the facts

The decision in *Nelson Dance* was on a preliminary issue. Consequently, for the purposes of hearing the preliminary issue, facts were agreed as follows:

(1) Nelson Dance ("Mr Dance") made a transfer of value, as defined in s.3 IHTA ("the Transfer of Value") on a date as yet unconfirmed in late 2002 or early 2003 ("the Transfer Date").

(2) Immediately prior to the making of the Transfer of Value, Mr Dance owned and carried on the business of farming as a sole trader ("the Business").

(3) (i) The Business did not consist wholly or mainly of one or more of the following, that is to say dealing in securities, stocks or shares, land or buildings or making or holding investments;

(ii) Mr Dance owned the Business throughout the two years immediately preceding the Transfer of Value;

(iii) The Business was not subject to a binding contract for its sale at the time of the Transfer of Value.

(4) The assets used in the Business included land and buildings ("the Land and Buildings"), namely some 1,735 acres of agricultural land near Andover, Hampshire, consisting of Upper and Middle Wyke, Finkley Manor Farm and East Anton Farm, Icknield Way plus two cottages - Nos 1 and 2 East Anton Farm Cottages.

(5) Prior to the Transfer of Value Mr Dance executed a settlement (the Nelson Dance Family Settlement ("the Settlement")) upon discretionary trusts such that the property which came to be comprised in it was "relevant property" as defined in s.58 IHTA 1984

(6) On the Transfer Date, Mr Dance executed two declarations of trust ("the Declarations of Trust"), by virtue of which East Anton Farm comprising approximately 141 acres and the two cottages Nos 1 and 2 East Anton Farm Cottages and part of Finkley Manor Farm became held upon the trusts of the Settlement.

(7) The Declarations of Trust gave rise to the Transfer of Value.

(8) The land transferred to the Settlement qualified as agricultural property for the purposes of s.116 IHTA, was occupied by Mr Dance for the purposes of agriculture throughout the period of two years ending with the date of the Transfer of Value, and was not subject to a binding contract for sale at the time of the Transfer of Value.

(9) Upon the Transfer of Value, Mr Dance did not transfer a business or an interest in a business to the Trustees.

(10) Mr Dance died on 1st April 2004.

On those facts, HMRC had issued a Notice of Determination to the effect that none of the value transferred was attributable to the value of "relevant business property" so that BPR under s.104 IHTA did not apply. The Trustees appealed to the Special Commissioners against that determination; a preliminary issue was directed to be heard; and the Special Commissioner Dr John Avery-Jones ruled in favour of the Trustees: the appeal was allowed and the determination was quashed. HMRC appealed to the High Court, where the preliminary issue was stated as follows:

> "Whether on the facts agreed or assumed [above], BPR was available on the value transferred by the Transfer of Value (defined [above]) (i.e. the transfer of value associated

> with the creation of the Nelson Dance Family Settlement by the transfer of the relevant property into the hands of the Trustees)."

The Trustees' case

Statutory scheme: loss to donor

The Trustees' case focused on the statutory scheme of the IHTA and in particular, the 'loss to donor' principle. Under the IHTA, tax is charged on "value transferred" by a "chargeable transfer" (s.1). The Trustees argued that both to establish that a transfer of value has occurred and to quantify the amount of the transfer, the relevant focus is on the reduction in the value of assets in the transferor's hands and not on any increase in the value of assets held in the hands of the transferee (ss.2 and 3 IHTA). This, the Court held, is reflected in s.3(3) IHTA which makes special provision for cases where the transferor acts, or omits to act, in ways that reduce the value of his estate.[3] Counsel for the Trustees drew the Court's attention to that fact that various of the exemption provisions in Part II of the IHTA operate by express reference to what happens to the assets of the transferee in relation to the disposition.[4] He argued that the fact that the intention to focus on what happens to assets in the hands of the transferee is made express in these particular provisions reinforces the impression that the 'loss to donor' principle is the general governing principle.

Section 104 IHTA does not make it relevant to look at the assets in the hands of the transferee. It provides for BPR in the following terms:

> "(1) Where the whole or part of the value transferred by a transfer of value is attributable to the value of any relevant business property, the whole or that part of the value transferred shall be treated as reduced:
>
> (a) in the case of property falling within section 105(1)(a) (b) or (bb) below, by 100 per cent;
>
> (b) in the case of other relevant business property, by 50 per cent;
>
> but subject to the following provisions of this chapter.
>
> (2) for the purposes of this section, the value transferred by a transfer of value shall be calculated as a value on which no charge is chargeable."

In effect, it was argued that, for the purposes of determining the availability of BPR, whether or not the business or part transferred should continue as a business in the hands of the transferee was a red herring.

The concept of a business as a form of 'property' for the purposes of BPR

In the case where a person carries on a business, it is, for the purposes of s.105(1)(a) IHTA, the business (or the interest in the business) which is treated as the "relevant business property", rather than individual assets owned and used within the business. This interpretation is reinforced by s.106 IHTA which provides that "property is not relevant business property unless it was owned by the transferor throughout the two years immediately preceding the transfer": s.106 cannot be referring to individual assets of the business.

Counsel for the Trustees referred also to s.110(b) IHTA. In providing that "the net value of a business is the value of the assets used in the business (including goodwill) reduced by the aggregate amount of any liabilities incurred for the purposes of the business", sub-paragraph (b) indicates that it is necessary to take into account the assets used in the business in valuing business as a form of business property. It was common ground that the land transferred by Mr Dance was used in his farming business up to the point when it was transferred. It was therefore part of the value of that business for the purposes of IHTA.

Attributing the value transferred to relevant business property

The real bone of contention was how the value of the land should be attributed, and in particular whether the transfer of value associated with the transfer of the land was to be regarded as attributable to the value of Mr Dance's farming business (which itself constituted "relevant business property" under s105(1)(a) IHTA) at the time of the transfer.

Counsel for the Trustees submitted that the value transferred might be regarded as attributable both (a) to the value of Mr Dance's farming business as conducted by him immediately before the transfer (i.e. to "relevant business property") and (b) to the value of the land transferred (which would not be "relevant business property"). It did not matter that value could be attributed to both since s.104 IHTA did not require a choice to be made exclusively between one category or another. For example, s.112 (excepted assets) IHTA indicated that the draftsman contemplated that the value of particular assets could be attributable to "relevant business property" (such as a business) and also to assets themselves. The determining point was the fact that the assets, i.e. the land, had been used in the business: the value attributed to it fell, by virtue of s. 110 IHTA, to be attributed to the value of the business.

HMRC's case: attributing the value transferred to the value of the land

Counsel for HMRC argued that, on a proper application of s.104, a choice does have to be made about whether the value transferred by the transfer of value was attributable to the value of Mr Dance's farming business or was attributable to the value of land, and that this was supported by the way in which ss. 199 (liability, disposition by transferor), 216 (delivery of accounts), 227 (payment by instalments – land, shares and businesses) and 237 (imposition of charge) IHTA are drafted and fall to be applied. In the context of the arrangements created by Mr Dance, the operation of those other provisions, which were expressed, Counsel for HMRC argued, in materially similar terms to s.104(1) IHTA, indicated that the draftsman assumed that the choice of characterisation does have to be made and that the proper characterisation was that this was a transfer of value attributable to a transfer of land.

Court's analysis

While acknowledging that if a characterisation was required, it was more natural to characterise the asset transferred by Mr Dance as land, Mr Justice Sales considered the Trustees arguments to be correct[5] for the following reasons:

(1) The Trustees' arguments had the merit of according simplicity and certainty to the statute, by contrast with the approach proposed by HMRC. He considered that the draftsman too had opted for simplicity in using the concept of a 'business' as a form of property distinct from its assets. He considered that the "rather convoluted formula in s.104(1) IHTA (whether the value transferred by a transfer of value 'is attributable to the value of any relevant business property' - rather than simply saying 'is attributable to any relevant business property')" involves, in the case of a business, direct cross-reference to the simple test in s.110 to determine whether the value transferred is attributable to the value of the business".[6] He pointed out that the test in s.110 can readily be applied before and immediately after the disposition, to give a change in the value

attributable to a business, in harmony with s.3(1).

(2) He accepted Counsel for the Trustees' submission that the general scheme of the legislation was the 'loss to donor' principle which directs attention to what happens to the transferor's estate. A charge to tax does not turn on what happens to the property in the hands of the transferee, save where the legislation expressly provides to the contrary. He found that, rather than displace the general scheme of the legislation, the provisions of ss.104(1), 105(1)(a) and 110 IHTA reinforced it. This interpretation met the object of BPR, in that it encouraged the use of assets in a business right up until the time of transfer.[7]

(3) He agreed that s.112(1) tended to indicate that the value of particular assets could be attributable to "relevant business property" (such as a business) and also to assets themselves, and that accordingly, where the value was attributable both to the 'business' and to an 'asset', specific provision was required to remove the value associated with that asset from the operation of BPR.

(4) He accepted the submission for the Trustees that the construction of s.104(1) which provided for an application of BPR in relation to a business was more in harmony

> with the other instances of the application of BPR contemplated by s.105(1), than was the construction proposed by HMRC. He agreed that the emphasis is on the simple issue of whether the transferor's "relevant business property" decreased as a result of the transfer of value not what was the nature of the assets transferred looked at in isolation. Quoting the examples contained in the skeleton argument on behalf of the Trustees, Sales J did not consider that HMRC had any good reply to illustrations of the operation of s.105(1).[8]

As for the detailed arguments put forward by HMRC in relation to the IHTA provisions imposing liability and for administering and collecting the tax, Sales J was not persuaded. In general terms, he considered that such guidance as these provisions might provide could not outweigh the matters set out above as indicators of the true construction and operation of s. 104(1). He accepted that their intended operation and effect did not impinge upon the approach to the application of s.104(1) IHTA outlined above. However, he did comment on the operation of certain of these provisions. Because he held that their intended operation did not impinge upon the approach to the construction of s.104 IHTA, his analysis in relation to those provisions is necessarily *obiter*. In the author's respectful view, Sales J may have taken the analysis too far.

‘Business’ as ‘property’ for all purposes of IHTA?

The author agrees with the analysis and conclusions reached in relation to the construction of s.104 IHTA: in her view, the IHTA does operate by reference to the ‘loss to donor’ principle, and the proposition that ‘business’ is treated as a class of ‘property’ to which value is attributable for the purposes of BPR is supported by the provisions affording that relief. But it is not a necessary corollary of this analysis that a ‘business’ is generally treated as ‘property’ for all purposes of the IHTA, as is suggested by Sales J in para [38] of his Judgment.

Sales J rejected the submission made on behalf of HMRC in relation to s.199 IHTA which (so far as is relevant) provides as follows:

> “(1) The persons liable for the tax on the value transferred by a chargeable transfer made by a disposition … are:
>
> (a) the transferor;
>
> (b) any person the value of whose estate is increased by the transfer;
>
> (c) so far as tax is **attributable to the value of any property**, any person in whom the property is vested (whether beneficially or otherwise) at any time after the transfer, or who at any such time is beneficially entitled to an interest in possession in the property;
>
> (d) …”

In essence, HMRC argued that for the purposes of s.199(1)(c) the reference to tax “attributable to the value of any property” is a reference, in this case, to the value attributable to the land transferred by Mr Dance to the Trustees, and not to the business which Mr Dance carried on (i.e. the property which was held to constitute the “relevant business property”). HMRC argued that the formulation of the words in bold above is similar to the formulation of the words in s.104(1), that the focus here is on the assets transferred, thus ensuring that the Trustees are among the persons liable for tax due in respect of the transfer to them. It was argued that this informed the relevant focus under s.104 (1) IHTA. The judgment records that similar points were made in relation to s.216 IHTA, and were rejected for similar reasons.

Deriving support for his analysis by what he described as the purpose of the provisions, namely to impose liability for the tax upon a range of persons, Sales J’s answer to HMRC’s argument was that tax may be attributable both (a) to the value of the property which is transferred (i.e. the land) and (b) to the value of property which is retained by the transferor (i.e. the business which the transferor continues to carry on): in effect, that the reference to “any property” in s.199(1)(c) IHTA could include a reference to the property which was “relevant business property” for the purposes of s.104(1) IHTA.

The author respectfully disagrees with this analysis. The reference in s.199(1)(c) to “any property” need not apply to "relevant business property" i.e. to the property of the transferor, in order for the transferor to be among the range of persons caught by s.199: the transferor is made liable by s.199(1)(a) IHTA. S.199 does provide for an extended meaning of "property": it includes references to any property directly or indirectly representing it (s.199(5) IHTA), thereby introducing the concept of statutory tracing into the provisions of Parts VII and VIII IHTA. But unlike ss. 104 and 105 IHTA there is no provision extending the meaning of "property" to "relevant business property", and therefore to a 'business'. While there can be some overlap in the identity of the persons made liable under the different sub-sections of s.199, the desire to make the transferor liable, but as owner of the 'business', cannot be a justification for extending the meaning of "property" in this context in the manner that Sales J's analysis implies. In the author's view, the purpose of 199(1)(c) is to make any person to whom the value of property transferred can be traced liable for the tax. The absence of a reference to "relevant business property" means that this provision does not impact on the interpretation of s.104. But, unlike s.104, s.199(1)(c) IHTA is a provision for which the relevant focus is the identity of the transferee. This is determined by tracing the value of the assets transferred into the hands of the transferee.

HMRC also relied on s.227 (Payment by instalments – land, shares and businesses) to show that the relevant focus is the property in the hands of the transferee. Counsel for the Trustees agreed that the focus was on the property in the hands of the transferee in this section, but explained the reason for this in the context of the purpose of s. 227 IHTA, i.e. to provide relief in allowing payments by instalments in relation to liability to tax in respect of transfers of particular categories of property. This explanation was accepted by Sales J. It is important to note, that in a similar way to ss.104 and 105 IHTA, but in contrast to s.199 IHTA, a special category of property to which s.227 applies is defined, namely "qualifying property." A "business or an interest in a business" is "qualifying property" by virtue of s.227(2)(c) IHTA. In the author's view, this is further evidence that, save for instances where the legislation specifically so provides, a 'business' is not generally treated as "property" in the IHTA.

The precise meaning of "property" is particularly important in the context of s.237 IHTA, as it impacts upon the circumstances when a charge on property in respect of unpaid tax and interest can arise in favour of HMRC. Following on from his analysis in relation to s.199 IHTA, Sales J considers that s.237(1)(a) IHTA, which provides that a charge can be imposed on "any property to the value of which the value transferred is wholly or partly attributable", enables a charge to arise in favour of HMRC in relation to both the property transferred (i.e. in *Nelson Dance*, the land) and the business (i.e. the continuing business retained by Mr Dance). This analysis is justified on the basis that it follows the imposition of liability to pay the tax under s.199(1)(c) on both the transferor and the transferee.

The author disagrees with Sales J's analysis on the imposition of liability under s.199(1)(c). It is not surprising, therefore, that the author also disagrees with Sales J's analysis of s.237 IHTA. It seems that he reached his conclusion in relation to s.237 through backward reasoning, i.e. that because a charge could, as a matter of general law, be imposed in respect of the sales proceeds of a business, there is no reason why a business cannot be 'property' for the purposes of s.237. But there is, in his judgment, no analysis of the internal structure of s.237, nor any discussion of the statutory tracing and following which seem to be inherent in some of the mechanisms for imposing liability and administering and collecting the tax set out in Parts VII and VII of the IHTA. Analysing the provisions of Parts VII and VIII of the IHTA in those terms may have prevented Sales J from reaching the (albeit *obiter*) conclusion that he did.

Conclusion

There is no doubt that *Nelson Dance* is an important decision and one which is valuable to taxpayers.

Nelson Dance has changed the way that BPR has hitherto been understood to apply. The fact that there is no requirement under s.105(1)(a) IHTA that the asset transferred is itself a business means that BPR is unlike other reliefs in the context of VAT (transfer of a business as a going concern) and capital gains tax (roll-over relief) which relate to transfers of businesses transferred as going concerns.

In many cases, tax will have been paid or cumulative totals calculated on the understanding that BPR was not available. However, where tax has been assessed and paid, the inheritance tax prevailing practice provision (s.255 IHTA) is likely to prevent a successful claim for recovery of overpaid tax (under s.241 IHTA) and interest (under s.235 IHTA) from being made. Where tax has not yet been assessed and no amount has yet been paid in satisfaction of a liability (for example because the transfer was a PET or within the transferor's nil-rate band), cumulative totals can be recalculated to take into account the new understanding of the circumstances when BPR may apply.

The *obiter* remarks made in relation to s.237 IHTA are potentially problematic. If (though which it is hoped that they do not) HMRC do decide to rely on Sales J's reasoning as a basis for arguing that a charge under s.237 IHTA arises on the part of the business retained by the transferor, the taxpayer's case will, in the author's view, be the better one.

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[1] [2009] EWHC 71 (Ch)
[2] Textbooks on inheritance tax took the view that individual assets of a business could not fall within s. 105(1)(a) IHTA which affords 100% relief (see para.10 of the Special Commissioner's decision [2008] STC (SCD) 792 for references to the relevant passages in three leading textbooks).
[3] In such a case, there is a 'transfer of value' only if the value of another person's estate or of any settled property (other than property treated by virtue of s. 49(1) as property to which a person is beneficially entitled) is increased and the omission was not deliberate.

[4] See ss.18 (transfers between spouses), 23 (gifts to charities), 24 (gifts to political parties), 25 (gifts for national purposes) and 30 (transfers where exemption depends upon the giving of an undertaking by the transferee as to what will be done with the transferred assets) IHTA.

[5] Paragraph 22 of the Judgment makes clear Sales J's preference for the arguments put forward by Counsel for the Trustees: in a short paragraph, the word 'correct' appears three times.

[6] At para 23.

[7] Note that at first instance HMRC had attempted to introduce passages in Hansard which, it was argued, showed that the purpose of BPR was to enable a transfer of a whole business to successors (see para. 9 of the Special Commissioner's decision). Special Commissioner John Avery-Jones did not see any ambiguity in the legislation and did not therefore consider it necessary to consider Hansard (see para. 17). There is no indication in the judgment of the High Court that there was any disagreement about the purpose of BPR, described at para [26].

[8] The examples are not reproduced in this article, but are a useful illustration of the operation of BPR in different factual circumstances.

CONTEMPLATING *GRACE*: THE IMPACT OF *RCC V GRACE* ON THE TEST FOR DETERMINING INDIVIUDAL RESIDENCE

by Aparna Nathan

It is a well recognised fact that the law for establishing an individual's residence status is far from satisfactory. The statutory rules contained in s829 et seq ITA 2007 do not set out tests for determining whether an individual is resident in the UK: that task has been left to the courts. The limitations of the courts' appellate jurisdiction have not been conducive to the formulation of a clear and practical test for determining an individual's residence status. It is against this background that HMRC Booklet IR20 was welcomed by practitioners with its introduction of a 91-day test, and formed the backbone of most practitioners' advice on the issue of determining an individual's residence. However, HMRC's approach in the *Gaines-Cooper* case has cast doubt on practitioners' ability to rely on HMRC's published practice in IR20. HMRC have been at pains to state (see HMRC Brief 01/07- found as an Appendix to IR20) that they have not resiled from the practice set out in IR20. They state:

> "Where an individual has lived in the UK, the question of whether he has left the UK has to be decided first. Individuals who have left the UK will continue to be regarded as UK-resident if their visits to the UK average 91 days or more per tax year, taken over a maximum of up to 4 tax years...There was no change to HMRC practice about residence and the '91 day test'..."

There are currently on-going judicial review proceedings in relation to the perceived failure of HMRC to apply their guidance in IR20. It is understood that in two such cases permission to bring judicial review proceedings has been refused and that these refusals are being appealed. Whatever the outcome of such judicial review proceedings, the fact remains that IR 20 cannot currently safely be relied upon by practitioners. As a result, practitioners are once more forced to revert to, and rely on, the case law in this area. The most recent High Court decision on individual residence is *RCC v. Grace*[1]. The facts in that case were, briefly, as follow. The taxpayer was an airline pilot, in the employ of British Airways, whose work required him to make long-haul flights between the UK, South Africa and elsewhere. He had a house in Cape Town, and he had a house in the UK near Gatwick Airport. The UK house (which was fully furnished) was the taxpayer's principal residence between 1990 and 1997. In 1997, he set up home in Cape Town – initially in a rented apartment and later in a house which he purchased. The taxpayer was on the electoral roll in the UK as a resident, post was sent to him at his UK address, he had a bank account in the UK into which his employment income was paid, he had a dentist and doctor in the UK, but he did not belong to any club or society in the UK other than the professional body of the British Airline Pilots Association, and he had no relatives in the UK apart from his ex-wife (whom he met twice in 30 years) and their daughters (whom he never met in 30 years). The taxpayer was assessed to income tax on his employment income for the years 1997/1998 to 2002/2003 on the basis that he was UK resident and ordinarily resident. The Special Commissioner held that the taxpayer was non-resident and not ordinarily resident, stating at para 40:

> "...I find that after 1997 the Appellant did not dwell permanently in the United Kingdom as his permanent residence was in South Africa. Also, the United Kingdom was not where he had his settled or usual abode as that was in South Africa. During the years of assessment the subject of the appeal the Appellant left Cape Town for business purposes only. Although he retained a house in the United Kingdom that house was not in the nature of a home but was rather a substitute for hotels."

And then at para 42:

> "...I find that although the Appellant was resident in the United Kingdom before 1997 in that year there was a distinct break and since then his settled mode of life has been in South Africa...since 1997 he has returned to the United Kingdom but only for the purpose of his employment."

On section 334 ICTA 1988, which concerned whether the taxpayer had left the UK for the purpose of only occasional residence abroad, the Special Commissioner stated at para 55:

> "However, in my view his presence abroad after that date was not for the purpose only of occasional residence abroad but for the purposes of continuous and settled residence in his house in Cape Town punctuated only by the need to

> visit the United Kingdom for the purposes of his work."

Finally, on s336 ICTA 1988, which concerned whether, on the assumption that the taxpayer had left the UK and had ceased to be resident, the taxpayer's visits to the UK were for temporary purposes only, the Special Commissioner stated at para 59:

> "In my view, leaving aside the availability of living accommodation, all the factors mentioned above point to the conclusion that after September 1997 the Appellant was in the United Kingdom for temporary and occasional purposes only. He was here in order to do his work and for no other reason. He has no intention of establishing his residence here and his intention was to establish his residence in South Africa. Thus in my view section 336 applies to the Appellant so that he is not to be treated as resident in the United Kingdom."

In the High Court, Lewison J overturned the decision of the Special Commissioner, holding:

1. that the taxpayer's life did not indicate that there had been a "distinct break" in the pattern of his life: the setting up of a home in Cape Town only meant that he went from having only one home in the UK to having two homes, one in the UK and one in Cape Town;

2. that, in relation to s336 ICTA 1988, presence in the UK for the purposes of

work, under a permanent or at least an indefinite contract of employment, was not a temporary purpose – it was not casual or transitory;

3. that s336 ICTA 1988 applied where the taxpayer was not resident, and residence had to be established on common law grounds or because the taxpayer fell within s334 ICTA 1988;

4. that s334 ICTA 1988 applied only where the taxpayer had "left" the UK, and if he had "left" the UK the taxpayer must have left for the purpose of occasional residence abroad. The concept of "distinct break" was relevant when determining whether the taxpayer had "left" the UK and also when considering the purpose for which he had left the UK i.e. whether it is for occasional residence abroad. It was conceded by HMRC that if the taxpayer had left the UK by reason of having set up home in Cape Town, he had left for more than occasional residence abroad.

Does *Grace* provide clear guidance on how to determine an individual's residence status?

The *Grace* principle (so termed for convenience) is simple enough to state: in order for a UK resident and ordinarily resident individual to be treated as non-resident and not ordinarily resident, that individual must really have "left" the UK. However, this begs the question, "When is an individual regarded as having *left*"? In answering this question, regard must be had to the manner in which the taxpayer orders his life before and after his purported departure from the UK. If, before his departure, there are clear links with the UK, and such links are absent or minimal after his departure, this would tend to show that the taxpayer has "left" the UK: in other words one needs to look for a "distinct break". What amounts to a "distinct break" will vary from individual to individual and no single, universally applicable, rule can be formulated. It is clear from the foregoing that *Grace* provides no greater certainty when seeking to determine an individual's residence status than the cases that preceded it. It does not, therefore, give the practical certainty provided by IR20 prior to *Gaines-Cooper*. That said, however, the High Court judgment in *Grace* is more consistent with the view of the facts adopted in that case and the principles enunciated in the cases preceding it than was the decision of the Special Commissioner.

Lewison J's judgment clarifies the interaction of the statutory provisions on residence with the common law rules on residence. It also shows that an individual's presence in the UK for the purposes of work is not to be regarded as involuntary or to be placed in some special category to which less weight can be attached than is attached to other factors. Further, Lewison J warns against focusing unduly on the term "distinct break" and seeking to define its parameters when determining an individual's residence status. One surmises from this warning that the question of whether there has been a "distinct break" is something that should be reasonably clear from the facts in each case. The author's real concern with Lewison J's judgment, however, follows from the finding that the taxpayer had not ceased to be UK resident and ordinarily resident simply because he had set up home in Cape Town. Lewison J was quick to hold that from having only one home in the UK the taxpayer had become a person with two homes – one in the UK and one in Cape Town. In the author's view, this seems to make it more difficult for an individual leaving the UK to show that he is no longer resident in the UK. It is not possible simply to point to the existence of a fully-furnished and functioning home in another country. Such a move, while helpful, must, in the author's view, go hand in hand with a significant reduction in links with the UK (or, ideally, a termination of links with the UK) in order for non-UK residence to be established. Lewison J's judgment on this point will also make it much easier, in the author's view, for non-UK residents to become UK resident because a non-UK resident could be regarded as UK resident even if he continues to have a home abroad.

Establishing non-UK residence and non-ordinary residence following *Grace*

In *Barrett v RCC*[2], the Special Commissioners considered certain factors to be relevant when determining whether there had been a "distinct break". The factors were:

1. the taxpayer was employed under the same contract of employment both before and after his purported departure from the UK;

2. the taxpayer's duties and place of performance of those duties did not change;

3. the taxpayer did not establish a permanent residence abroad;

4. the taxpayer's partner and family continued to live in the UK in the same family home both before and after his purported departure from the UK;

5. the taxpayer did not make special financial arrangements for his time abroad e.g. bank accounts, credit cards, medical insurance. He maintained and used his UK bank accounts and credit cards;

6. no special arrangements were made in relation to his car, driving licence, residence permits, foreign identity card;

7. there was uncertainty about the date of departure from the UK, which seemed surprising given that this was meant to be a major event. In particular, the taxpayer did not have his ticket, boarding pass stub or similar evidence of date of departure;

8. the taxpayer's diary did not evidence a "distinct break".

To this list one can add the following factors:

9. whether the taxpayer has items in storage in the UK;

10. whether the taxpayer has club or other memberships in the UK;

11. whether the taxpayer is on the electoral roll in the UK;

12. whether the taxpayer maintains a property in the UK and, if so,

    a. whether it is let out ;

    b. whether it is fully furnished;

    c. whether it is fully staffed;

    d. whether all the utilities are connected.

These factors are not in themselves determinative and must be viewed in the light of all the circumstances.

Conclusion

Grace, in the author's view, suggests that the steps that a putative emigrant must take in order to become non-UK resident have become aligned with those that he must take in order to abandon a UK domicile of origin. This seems to set a rather high threshold for breaking UK residence. The counsel of perfection has to be that a putative emigrant must not retain any links with the UK, and not visit the UK during the first year after his departure from the UK, in order to demonstrate clearly that there has been a "distinct break" in the pattern of his life. Such advice is unlikely to be willingly received, and, more importantly, applied in practice. There are, it is understood, currently moves afoot to introduce a statutory test for establishing residence based purely on day counts. In the light of the current uncertainty in this area, the certainty introduced by a properly drafted statutory test must be a cause for celebration.

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[1] [2009] STC 213
[2] [2007] UKSPC SPC00639 at para 48

AVOIDING THE ORDER OF REMITTANCE RULES BY HAVING A "GOLDEN" BANK ACCOUNT

by Patrick Soares

In order to use the remittance basis, an adult who is domiciled outside the UK but who has been resident in the UK for at least 7 out of the prior 9 years *must* nominate overseas income or gains which are to be taxed on an arising basis (ITA 2007 s.809C). There are tax trap provisions in ITA 2007 s.809I and s.809J, which apply if the taxpayer remits to the UK some or all of his nominated income or gains and leaves overseas other income or gains of his which are taxable on a remittance basis. The problem can be overcome by having a separate "golden" bank account.

An individual may have an offshore bank account A with the nominated income of (say) £75,000 therein. He may have bank account B with income of £1m and bank account C with capital gains of £2m. If he only brings to the United Kingdom the monies in bank account C (which means he pays capital gains tax at 18%), these provisions are wholly irrelevant. Also if he only brings to the United Kingdom the monies in accounts B and C, these provisions are wholly irrelevant. If he brings any part of the monies in the nominated account A to the UK without bringing also the whole of the overseas income and gains of his to the United Kingdom, then these provisions will be relevant. Once these provisions apply section 809I(2) states that the liabilities to income tax and capital gains tax shall be determined as if the overseas income and gains had been remitted to the United Kingdom in the order set out in s.809J(2) and *one must ignore totally the actual sources from which the remitted monies came.*

One can see that this can be particularly serious if a taxpayer remits capital gains to the United Kingdom thinking he will only be liable for an 18% tax charge: it will be seen that the result of the re-ordering is his overseas foreign income will be deemed to have come to the United Kingdom first. The reordering rules are in s.809(J). One must first (step 1) find the total amount of the individual's nominated income and gains and also the individual's "remittance basis income and gains" (remittance basis income and gains are the foreign income and gains of the individual taxable on a remittance basis *for all the tax years up to and including "the relevant tax year"*) ignoring of course the nominated income and gains. The relevant tax year is the year in which the remittance to the United Kingdom takes place.

Step 2 requires one to find the amount of the foreign income and gains of the individual for *the relevant tax year* (ignoring once again the nominated income and gains): one then puts those gains and income into each of the relevant paragraphs (a) to (h) in s.809J(2). *The nominated income and gains is not attributed to any of the paragraphs.*

Step 3 requires one to find the *earliest* paragraph where the amount determined under step 2 is *not* nil. If the amount in the first such paragraph does not exceed the *"relevant amount", ie, the amount remitted to the United Kingdom*, then the taxpayer is treated as having remitted the income and gains within that paragraph and for that tax year. If the amount within the paragraph is more than the relevant amount then the amount remitted is treated as the relevant proportion of each kind (category) of income or gain within *the paragraph* for that tax year. (There may for example be more than one type (category) of income falling within s.809J(2) paragraph (c).) The relevant amount, i.e. the amount which is remitted to the United Kingdom and which is taxed accordingly as above, is (as one would expect) reduced to the extent that it is brought into charge to income tax or capital gains tax applying the above (<u>step 4</u>). However, if it has not been reduced to nil then <u>step 5</u> operates and it states that one must go further down the list of paragraphs in s.809J(2): this may mean, for example, going down from s.809J(2)(c) (being the relevant foreign income paragraph) to s.809J(2)(d) (being the foreign chargeable gains paragraph). Finally if having gone through all the paragraphs with regard to income and gains *which arose in the year of remittance*, the relevant amount has still not been reduced to nil then one goes to <u>step 6</u>. One then has to look at any income and gains which arose to the individual *in tax years prior to the year of remittance*: one goes down the list in s.809J(2) to see what income or gains have arisen in what the legislation calls "the appropriate tax year": the appropriate tax year is the latest tax year which is before the tax year when the monies were remitted to the United Kingdom, being a year when the taxpayer was on the remittance basis.

The list of paragraphs in s.809J(2) is as follows:-

(a) relevant foreign earnings (other than those subject to foreign tax);

(b) foreign specific employment income (other than income subject to foreign tax);

(c) relevant foreign income (other than income subject to foreign tax);

(d) foreign chargeable gains (other than gains subject to foreign tax);

(e) relevant foreign earnings subject to foreign tax;

(f) foreign specific employment income subject to a foreign tax;

(g) relevant foreign income subject to a foreign tax;

(h) foreign chargeable gains subject to foreign tax.

Example

The taxpayer in 2008/09 has a bank account with £3m of investment income which has not borne any foreign tax. (It thus falls within s.809J(2)(c).) He also, in that year, has a bank account which has £1m of foreign chargeable gains which have not been subject to foreign tax. (Section 809J(2)(d) is the relevant head.) In year 2009/10 he has a third account which has investment income which accrued in 2009/10 of £0.5m. Finally he has a fourth account in 2009/10 which has a capital gain of £416,666 which was realised in 2009/10. He nominates gains in the sum of £166,666 (which produces the tax bill required of £30,000, the £166,666 being taxed at 18%) in his fourth account to be his nominated gains (£0.25m being thus left un-nominated in this account). In the year 2009/10 he remits £1m to the United Kingdom.

The rules in s.809I and s.809J apply because the taxpayer remits to the United Kingdom the nominated gains. Although he has remitted all his income and gains for the year 2009/10 to the United Kingdom he has not remitted all the earlier income and gains which arose or were realised in 2008/9. The situation therefore satisfies the conditions of ITA 2007 s.809I(1) and one must read on.

2008/09		2009/10	
Income/Gains	Actual Remittances	Income/Gains	Actual Remittances
£3m investment income (para c)	Nil	£0.5m Investment income (para c)	£1m ("the relevant amount")
£1m chargeable gains (para d)		£0.25m chargeable gains (para d) and £166,666 chargeable gains (nominated amount)	

The first thing to do (step 1) is to find "the relevant amount": the relevant amount is £1m (s.809J(1)).

Step 2 requires one to determine how much income or gains (*other than the nominated gains of £166,666*) fall within the particular paragraphs in s.809J(2), and it will be seen that for the year 2009/10, the s.807J(2)(c) relevant foreign income is £0.5m and s.807J(2)(d) relevant chargeable gains is £0.25m.

Looking at step 3 the *earliest* paragraph where the amount in the paragraph is not nil is paragraph (c) (ITA 2007 s.809J(2)(c)), namely relevant foreign income: this is the sum of £0.5m. £0.5m does not exceed the £1m (being the relevant amount) so the taxpayer is treated as having remitted the £0.5m by virtue of step 3 and potentially 40% tax is payable thereon. The relevant amount has now been reduced from £1m to £0.5m – that is step 4.

Step 5 states that if the relevant amount is not nil (and it is not nil: it is £0.5m), one must then go to the next paragraph in the list, and if the amount in that paragraph is less than what remains of the relevant amount (and it *is* less because it is £0.25m worth of gain compared to £0.5m worth of relevant amount left to be attributed to any income or gains), then one treats the £0.25m as having been remitted to the United Kingdom and the taxpayer pays potentially 18% tax thereon.

£0.25m remains unattributed so it is necessary to go to step 6.

This requires one to go back to the immediately prior year which for these purposes is the appropriate tax year, and one matches the £0.25m (so carried back) with, first, the relevant foreign income, and if there is any leftover unmatched amount, then with the foreign chargeable gains. As the relevant foreign income for the year 2008/9 is £1m the whole of the 0.25m is matched with the same so the taxpayer is treated as having remitted £0.75m worth of income to the United Kingdom and £0.25m worth of gains in 2009/10.

Note that if the taxpayer in 2009/10 had remitted only £0.25m to the United Kingdom and this was out of his nominated gain these "order of remittance rules" would still apply, and the taxpayer would be treated as having remitted £0.25m worth of income and be chargeable to tax thereon at potentially 40%. This is because in the order of paragraphs relevant foreign income in s.809J(2)(c) comes before foreign chargeable gains in s.809J(2)(d).

The critical points to note are as follows.

(1) The remittance basis income and gains comprising all the offshore income and gains accruing over the years is clearly reduced by the relevant amount so there should be no double charge to tax. There is nothing, however, in the legislation which states that the remittance basis income and gains are reduced because monies have been spent offshore or given away. The aim behind these provisions is to prevent the

taxpayer nominating particular income and then bringing that to the United Kingdom tax free (claiming the same is tax free because the same has already been taxed on an arising basis).

(2) For these provisions to apply some nominated income or gains must be remitted to the United Kingdom: thus one may accidentally fall within these provisions if £1 is remitted to the United Kingdom from nominated income or gains.

(3) There is nothing in the legislation to indicate that if the nominated income is less than the amount which gives rise to a tax charge of £30,000, so that there is an increase in the income under ITA 2007 s.809H(4) that notional increase can be looked upon as being nominated income. It is difficult to see how any notional figure can be remitted to the United Kingdom. Thus if a taxpayer has an overseas account with £1,000 in it and interest of £100 arises therefrom (this is the "golden" bank account) and he nominates that income and he brings no part of those monies to the United Kingdom then these *order of remittance rules in s.809I and J are wholly irrelevant*. Thus the need for a golden bank account.

MAKING SENSE OF SECTION 809L

by Laurent Sykes

Section 809L ITA 2007 contains the guts of the new remittance rules introduced by FA 2008. Those who find the section confusing on first reading may take comfort from the fact that the draftsman also, in places, appears confused.[1] The highly compressed language needs to be unpacked before it can be fully comprehended, and is an example of why, sometimes, more actually *is* more. The aim of this brief note is to do some of this unpacking.

The first step is to recognise that s809L caters for nine different kinds of remittance. This reflects the fact that there are three categories of remittance which are catered for (conditions A and B which operate as one, condition C and condition D - I refer to these below as “category 1”, “category 2” and “category 3”). Further, each of category 1, 2 and 3 applies slightly differently, depending on whether remittance is being tested by reference to property, services or debts. (To summarise the last point crudely, I can remit income or gains if I bring the money, or anything derived from it, into the UK (property), use it outside the UK to pay for a service received here (services) or to pay off a debt outside the UK incurred in relation to either (debts).)

I propose to focus on the three categories as they apply to property. For those wishing to see what the legislation looks like once a pen has been taken to those words of s809L which do not relate to property, please see the Appendix. The section looks a lot simpler once this has been done.

Turning then to the three categories of remittance in s809L (conditions A and B, condition C and condition D) as they apply to property, what do all three categories have in common? They each have three conditions built into them (a) a "derivation" condition i.e. the property must either be, or derive from, the income or gains, (b) a "use or enjoyment" condition – which in all cases involves a "relevant person" (as defined in s809M), and (c) an "ownership" condition. Each condition must be satisfied in order for there to be a remittance. I propose to consider each briefly below in reverse order.

(1) The ownership condition

The ownership condition is best illustrated by way of example.

> Example: Non-Dom gives property representing income taxed on a remittance basis to X who makes a gift of it to Y. Y then brings the property into the UK and allows the Non-Dom or another relevant person to use it there at no cost (but without transferring ownership of the property to the Non-Dom). Is this a remittance?
>
> Assume the two gifts are respected as such. Assume also that neither X nor Y is a "relevant person" in relation to the Non-Dom; for example X could be a trust from which the Non-Dom is excluded from benefit, and Y could be an adult

child of Non-Dom. Also assume that Non-Dom is UK resident throughout and that the transitional rules/permanent exemptions do not apply.

Turning to category 1 (i.e. conditions A and B, in s809L(2) and s809L(3)), what distinguishes it from category 2 and category 3 is that it is capable of applying only where the property brought to, received or used in, the UK is property which belongs to a relevant person at that time[2]. For categories 2 and 3 to apply, by contrast, the opposite in true: the property must belong to someone who is not a relevant person.[3] In the example therefore, there is no category 1 remittance since Y is not a relevant person in relation to the Non-Dom.

Category 2 (i.e. condition C, in s809L(4)) applies to property which belongs to a person who is not a relevant person and to whom *the individual* (see s809N(2)), i.e. the Non-Dom, has made a gift of money or other property which is or derives from the income or gains. It follows that the second category is only applicable where the person owning the property which is brought to, received or used in the UK received that property (or property from which it derives[4]) from the Non-Dom himself i.e. the individual whose income or gains are in question. Thus, returning to the example, Y has not received any property from Non-Dom so there cannot be a category 2 remittance.

Category 3 (i.e. condition D, in s809L(5)) applies to property brought to, received or used in the UK which belongs to a person who is neither a relevant person nor a gift recipient and where, simplifying slightly, that owner received it as a result of a disposition made by a relevant person to or for the benefit of that owner. Thus, in this respect, category 3 is wider than category 2 – the person whose property is brought to, received or used in, the UK need not have received it from the Non-Dom himself. However the person must still have received it from a relevant person[5].

Thus, to return to the example, if the Non-Dom gives property to X who makes a gift of it to Y, who then brings the property into the UK and allows the Non-Dom or another relevant person to enjoy the property in the UK, a category 3 remittance is avoided given X and Y are not relevant persons (assuming the two gifts are respected i.e. that the gift by Non-Dom is not viewed as being to or for the benefit of Y). So too are categories 1 and 2 for the reasons set out above.

Note by the way that, in relation to pre-6 April income or gains, the transitional rules limit the definition of relevant person to the Non-Dom himself, so one may well be pushed out of category 1 into category 2 or 3 (if not, outside the rules altogether).

(2) The "use or enjoyment" condition

The "use or enjoyment" condition must also be satisfied in order for a remittance to arise.

It appears easier to fail this condition, thereby avoiding a remittance, where one is dealing with a category 2 or a category 3 remittance. These require "enjoyment" by a relevant person (whereas a category 1 remittance does not) and enjoyment does not count if full consideration is given for it. (Enjoyment also does not count if it is virtually to the entire exclusion of all relevant persons, or if enjoyment by relevant persons is in the same way, and on the same terms as the property may be enjoyed by the general public or by a section of the general public.[6])

The ability, when dealing with a category 2 or a category 3 remittance, to avoid a remittance by the relevant person giving full consideration for the enjoyment allows the harshness of the remittance rules to be mitigated to some degree. As an illustration of this point consider the following: absent this let-out, property representing (say) £100 of income would, if used in the UK, be remitted even if the value of the use in the UK was only, say, £1. The ability to avoid a remittance by paying market value consideration for the use is therefore helpful in these circumstances; pay £1 and avoid a remittance of £100. This, on the face of it, only applies to category 2 and category 3 remittances however.

(3) The "derivation" condition

The derivation condition is the final condition. The property must either be, or derive from, the income or gains. Section 809T tells us that where foreign chargeable gains accrue to an individual on the disposal of an asset, and the individual does not receive consideration for the disposal of an amount equal to the market value of the asset, one is to continue to treat the asset as deriving from the chargeable gains (as well as the undervalue proceeds presumably). Suppose the individual does receive market value: the implication is that one must follow the proceeds of sale rather than the asset itself.

However that is about all the guidance that is given. It is not clear here whether the old remittance cases are going to be relevant.

These authorities might be taken to suggest that an amount received can be said to "derive" from an amount of income or gains where: (a) there is some form of "monetary or financial equivalence" between the receipt in the UK and the income or gains whose remittance is in question (*Grimm v Newman*), and what is received in the UK is "derived from the application of the income to achieving the necessary transfer" (*Thomson v Moyse*). The machinery which is used to effect this can be complex and can involve third parties (*Moyse* and *Harmel v Wright*). In order for a sum received in the UK to be derived from income or gains it is not enough (*Timbrell v Lord Aldenham's Executors*, a useful limiting authority – see below) or even a prerequisite (*Moyse*) that both are represented by the same cash. Nevertheless the mechanism employed may well involve the same cash going in and coming out at the other end (*Harmel v Wright*).

The concept of derivation is therefore a wide one. That is on the whole bad news – although it may be useful in arguing that the generous transitional rules apply; for example paragraph 86 Schedule 7 applies where property consisting or deriving from pre-6 April

2008 relevant foreign income has already been brought to, received or used in the UK by or for the benefit of a relevant person (even if this did not count as a taxable remittance at the time).

But the concept of derivation must have limits. Suppose I fund an offshore company in relation to which s13 TCGA 1992 applies through debt. The company invests the funds and eventually realises a capital gain. The problem with capital gains is that the gain and the clean capital cannot be separated by the use of different accounts. But suppose I demand repayment of my loan and remit the proceeds of repayment? Arguably the repayment proceeds cannot plausibly be said to derive from the gain, but rather only from the loan made at the outset – *Timbrell* is helpful here by analogy.[7] If, before the debt is repaid, I assign the benefit of the debt to a third party and the debt is repaid by the company outside the UK, it is perhaps clearer still that there has been no remittance of property deriving from the gain by virtue of my receipt in the UK of the proceeds of assignment.[8]

Other consequences of falling within a particular category

Which category applies, assuming one does apply, has consequences. The difference between category 1 remittances, on the one hand, and category 2 and category 3 remittances, on the other hand, when it comes to the "use or enjoyment" condition has already been discussed. Note also that the mixed fund rules only apply for the purposes of working out whether there has been a category 1 remittance (see s809Q(2)).

Services and debts

The three categories of remittance contained in s809L also apply in similar form to services and debts. There are some slight variations. For instance in relation to services, s809W provides an exemption for services which relate wholly or mainly to property situated outside the UK and where payment is offshore. For some reason this too only applies to category 1 remittances.

A final word

It may not of course be necessary to avoid a remittance within s809L. A tax charge on remittance can be avoided if the remittance takes place when the Non-Dom is non-UK resident (subject to the temporary non-residence rules and assuming we are not dealing with employment income) or if the permanent exemptions or the very generous transitional rules apply. These points (particularly the last of these) can easily be overlooked.

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[1] Take for instance s809L(7). Why does s809L(7)(e) refer to qualifying property when that is not a concept which is relevant to Condition D? What does s809L(7)(f) add to s809L(7)(d)?

[2] Because it must either be property which is the income or gains of the individual (s809L(1) and s809L(3)(a)) or else derive from such income or gains and be the property of the individual (s809L(3)(b)(ii)). Strictly, the ownership condition need not be satisfied where the property "is" the income or gains of the individual – the cash representing the income or gains could be owned by someone other than the Non-Dom in a case where the income or gain has been attributed to the Non-Dom for tax purposes under e.g. s720 ITA 2007 or s13 TCGA 1992.

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[3] Strictly, in the case of a gift recipient within category 2, at the time of the gift or, in the case of a qualifying disponee within category 3, at the time when it is dealt with as mentioned in s809L(5). It is assumed throughout that no-one who is not a relevant person at the relevant time becomes one later.

[4] See also s809N(7)(c).

[5] Or, to be more exact, in circumstances where there was a disposition of property deriving from the income or gains by a relevant person to or for the benefit of the owner i.e. a qualifying disposition. To be more exact still, the legislation does not require a qualifying disposition itself but rather an operation which is effected with reference to a qualifying disposition or with a view to enabling or facilitating a qualifying disposition (a "connected operation"). However, presented in the manner above, it is easier to see the difference with the second category.

[6] S809N(9) and s809O(6).

[7] The case concerned the assignment, by a London firm, of its share of the partnership profits owed to it by an Australian firm. These would have been taxable on remittance. The profits were assigned to a Chilean firm with which the London firm was also involved. The London firm was, in relation to the Chilean firm, both debtor and creditor, on capital and trading account respectively. The debt due from the Australian firm, assigned to the Chilean firm, was set against the amounts owed on capital account by the London firm to the Chilean firm and was then applied by the Chilean firm in satisfying its debt on current account owed to the London firm. In cash terms however there was only one payment, by the Australian firm to the London firm. In the Court of Appeal Lord Greene MR, with whom Morton LJ and Somervell LJ agreed, considered that: "In the course of its journey from Australia back to London [the character of the money] had been entirely changed. It had been changed because it had passed into the ownership of Chile and become an asset belonging to Chile, and, when it came out from the ownership of Chile, it came out for the purpose, not of effecting a transfer from Australia to London of London's share in the Australian profits, but for the purpose of discharging a debt due from Chile to London, a purpose for which it was perfectly open for Chile to use it." Morton LJ and Somervell LJ agreed. Morton LJ

emphasised that the Commissioners had found there to be a "real transaction, with a real business effect, by their finding that 'the sums in question were remitted by Chile in part payment of the debt' ".

[8] One also needs to be sure that the loan is not a "relevant debt" so as to avoid a remittance under category 1 as it applies to debts (as opposed to property). However, whilst just about arguable, it seems unlikely that the debt could be so viewed. If the debt was not a relevant debt at the outset (because the money loaned went outside the UK, not to the UK), it seems unlikely that an assignment of the debt for money received in the UK could turn it into one.

APPENDIX

809L Meaning of "remitted to the United Kingdom"

(1) An individual's income is, or chargeable gains are, "remitted to the United Kingdom" if—

(a) conditions A and B are met,

(b) condition C is met, or

(c) condition D is met.

(2) Condition A is that—

(a) money or other property is brought to, or received or used in, the United Kingdom by or for the benefit of a relevant person …

(3) Condition B is that—

(a) the property… is (wholly or in part) the income or chargeable gains,

(b) the property…—

(i) derives (wholly or in part, and directly or indirectly) from the income or chargeable gains, and

(ii) ….is property of … a relevant person,

(4) Condition C is that qualifying property of a gift recipient—

(a) is brought to, or received or used in, the United Kingdom, and is enjoyed by a relevant person…

(5) Condition D is that property of a person other than a relevant person (apart from qualifying property of a gift recipient)—

(a) is brought to, or received or used in, the United Kingdom, and is enjoyed by a relevant person,….

in circumstances where there is a connected operation.

(6) In a case where subsection (4)(a) … or (5)(a) … applies to the importation or use of property, the income or chargeable gains are taken to be remitted at the time

the property … is first enjoyed by a relevant person by virtue of that importation or use.

…..

(10) This section is subject to sections 809V to 809Z6 (property treated as not remitted to the United Kingdom).

REAL ESTATE TAX IN A TOUGH CLIMATE

by Michael Thomas

In difficult times people focus on saving costs and may be prepared to be more flexible in order to get deals done. The question which then typically arises is whether there is a tax saving which can be achieved by implementing the commercial deal in a particular way. This corresponds with the trend away from ‘one size fits all’ tax schemes, the availability of which has been much reduced by the recent wave of anti-avoidance legislation. In addition, a situation where land often no longer stands at a gain and, for example, the shares in land-rich but debt-laden companies may be significantly reduced in value, makes now an ideal time to embark on restructuring of all kinds.

In the market where developers were racing to acquire new sites vendors were typically able to demand cash for the freehold, and the developers suffered SDLT at 4%. But there are ways in which a development can proceed without such a charge being incurred. The one which tends to work best is for the parties to undertake a joint venture into which the landowner contributes the land and the developer works. The proceeds of sale are then divided between them. No SDLT arises in this situation except to the extent that the developer pays cash up-front. However, even the SDLT charge on any cash might potentially be avoided by the developer making a loan to the landowner. An alternative route for a developer to save SDLT is to have it paid as a builder and marketing agent so that it acquires no interest in land. The problem in practice with this arrangement is that the developer inevitably wants the right to direct conveyances of units, which falls foul of s.44A FA 2003. There are ways around this difficulty, but they tend to add complications and increase the chances of an attack from HMRC. So, where appropriate, the joint venture model is preferable. One point to be aware of if either of these structures is followed is that the landowner will have some income profits.

For investors and those acquiring land for their own use, the question which I am typically asked, albeit less frequently nowadays, is whether this can be achieved without incurring a charge to SDLT. The short answer is that it should be possible to save SDLT provided that both parties are prepared to be sufficiently flexible. However, I am not aware of any planning for residential property which is to be occupied as the purchaser’s home which is sufficiently robust that I would recommend it. It should be emphasised that SDLT planning is difficult, as it is necessary to overcome the general anti-avoidance rule in s.75A FA 2003. Such planning will typically involve risk and needs to be approached with caution.

Two generic ideas to save SDLT for investors are worth a specific mention. One is to use a partnership as an acquisition vehicle. This kind of planning requires the involvement of the vendor but it should not be necessary for it to do anything too onerous. There are several variations on the partnership theme. Some of these ideas are more robust than others, and all involve additional complication. Nevertheless, in a deal of sufficiently high value where there is scope for flexibility then one of them might provide an appropriate solution.

The other suggestion is for the parties to enter into a sale and leaseback with a right to repurchase, and take advantage of the Islamic finance reliefs. Again, there are significant obstacles in the way of using this kind of arrangement as a general planning tool. First, the purchaser must be a financial institution: this definition extends to companies with suitable credit licences but it is not permissible to go out and buy such a company. Secondly, both the leaseback and the right to repurchase must have some commercial substance so that they cannot be disregarded. So, taking advantage of the Islamic finance relief certainly merits consideration if the basic transaction is a sale and leaseback. This idea may also be imported into other transactions, but care needs to be taken to ensure that the conditions for relief are truly met.

Restructuring may be driven by direct tax considerations. For example, now is a good time for an individual to consider making gifts of assets which stand at little or no gain, so as to improve his IHT position. Another idea which is currently in vogue is to remove investment properties from companies so that they are held directly by the shareholders and future gains are taxed on the individual at the favourable 18% rate rather than incurring an effective double charge. There are typically two potential difficulties with this idea. One is that such gain as there is on current market values will be taxed in the company; but often this will not be sufficiently high to prevent the planning, the aim of which is to shield future gains. The other is that SDLT will be payable if the property is sold out of the company to the individuals. However, it is possible to very easily avoid this SDLT charge by selling the property to the individuals in partnership. This is one example of where the SDLT partnerships regime produces favourable results for transactions taking place between connected parties. Others include the incorporation of a partnership business and, more generally, any sale of assets between connected persons.

Where restructuring is driven by commercial necessity then tax remains of paramount importance. Being able to put a low value on land enables tax charges to be minimised where no relief is available. However, care must be taken to ensure that the tax risks are properly managed, because any valuation is open to challenge from HMRC. So, it is important that any valuation which is relied on is sufficiently robust; if there are doubts as to the correctness of a valuation then an additional disclosure might be made against HMRC to guard against a discovery assessment being made after the normal enquiry window has closed.

Taxpayers should also beware the consequences of making guarantee payments. Such a payment is unlikely to qualify to be deductible in computing either income, because there is no concept of a group trade, or capital profits, because the payment is not reflected in the state or nature of any shareholding. In addition, the guarantor is unlikely to be able to recover any VAT as input tax because no supply is made to him. Where possible commercially then a better course is for the guarantor to subscribe for additional share capital in the primary debtor and then to have the payment made directly by the primary debtor.

More generally on the VAT front, there is less scope for more aggressive kinds of planning following the ECJ's decision in the *Halifax* case and the decisions which have followed in its wake. HMRC is also spending more time in the country and is known to be upping its level of scrutiny into shoots: claims that the shoot is not a business are strictly scrutinised and the possibility of a shoot becoming exempt as a sports club is an alternative worth considering. On a more positive note, HMRC has confirmed in RC Brief 54/08 that it accepts that unsold development stock can be moved between connected companies so that a short-term letting does not give rise to an input tax clawback. "Golden Brick" arrangements on sales to housing associations, where a partially completed building is supplied by the developer to the housing association together with a further supply of works to reach practical completion, should also remain safe. Another positive development is that the VAT Tribunal has been taking a broad view as to what is a transfer of a business as a going concern following the ECJ's decision in *Zita Modes Sàrl v Administration de l'enregistrement et des domains*[1]. This position is yet to be reflected in HMRC's published guidance but there is considerable opportunity for taxpayers to self-assess boldly in this area.

To summarise, in bad times as in good it is important to scrutinise the tax consequences of any deal to ensure that all potential savings are obtained and pitfalls avoided.

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[1] (Case C-497/01) reported in [2005] STC 1059, [2003] ECR I-14393.

THE 2009 REFORMS OF THE TAX APPEAL TRIBUNALS

by John Walters

The tribunal reform which takes effect UK-wide on 1 April 2009, and which was legislated for by the Tribunals, Courts and Enforcement Act 2007, will see the disappearance of all tax tribunals and tax appeal Commissioners, which have been so familiar a feature of the tax landscape for so long. They will be replaced by a two-tier tribunal arrangement, the Tax Chamber of the First-tier Tribunal and the Finance and Tax Chamber of the Upper Tribunal. The Finance and Tax Chamber of the Upper Tribunal is intended to function principally as an appeal tribunal, taking appeals from the First-tier tribunal. Appeals from the Upper Tribunal will lie to the Court of Appeal, and so, in a sense, the Upper Tribunal is taking the place of the Chancery Division of the High Court in the existing system.

The existing tribunal judiciary and tax appeal Commissioners (with the exception of the General Commissioners, who have been abolished) will function as transferred-in judges of the First-tier Tribunal (allocated to the Tax Chamber) and judges or deputy judges of the Upper Tribunal. In addition new judges of the First-tier Tribunal have been appointed and will be allocated to the Tax Chamber, principally to deal with much of the work hitherto done by General Commissioners. High Court judges, and others, are automatically judges of the Upper Tribunal (and the First-tier Tribunal) and apparently the Chancery judges are keen to sit on the Upper Tribunal, and, in that way, they will not lose all their current tax work.

The reform is not, of course, confined to tax tribunals. It is part of a wide-reaching reform of most existing tribunals in the UK. It is to an extent a “rolling” programme. The new tribunal structure first began to operate on 3 November 2008 dealing with social security appeals. The accession of tax appeals to the structure with effect from 1 April 2009 will be part of the second wave.

There has been a tension between the policy of providing an overall tribunal structure with the same (or very similar) rules, and the need, in the tax area, to take account of the unusually wide scope of complexity of appeals which have to be dealt with. They, of course, range from the very simple to the extremely complicated, and there are arrangements in the Tax Chamber of the First-tier Tribunal to deal with “streaming” cases according to their complexity. There is also a procedural possibility of starting an appeal in the Upper Tribunal, but the indications are that this will be allowed in only a handful of cases each year, according to criteria which have yet to be announced. Starting an appeal in the Upper Tribunal will mean that the Upper Tribunal costs regime will apply from the start (see below).

Procedural rules have been published for both the Upper Tribunal (as a whole) and the Tax Chamber of the First-tier Tribunal. These rules will also operate as from 1 April 2009.

The receipt at the new Tribunals Service Centre in Birmingham of a notice of appeal or other initiating notice to the First-tier Tribunal will start the appeals process off. The first stage will be the allocation of a case to one or more of the following categories: “Default Paper”, “Basic”, “Standard” or Complex”.

The “Default Paper” category will be cases which can usually be dealt with on paper, although a party can require an oral hearing. They will be matters such as applications by HMRC for directions for daily penalties under s.93(3) TMA for the non-delivery of a return.

“Basic” cases will be those where there is no requirement for HMRC to serve a Statement of Case, for example VAT default surcharge appeals. They will proceed directly to a hearing.

“Standard” will be the default category for other cases, which do require a Statement of Case but are not judged to require any or much judicial case management.

“Complex” is the category for those cases which will require substantial case management, in the form of one or more pre-trial reviews. These will obviously be the heavier cases, involving complex or important issues of law, or with complex facts and a large amount of evidence, or involving large amounts of money. A different costs regime (see below) applies to cases in the “Complex” category.

It is only “Complex” cases that the First-tier Tribunal may transfer to the Upper Tribunal. The procedure will be that a transfer will require the consent of both parties, the agreement of the (First-tier) Tribunal seized of the case, and the agreement of both the President of the Tax Chamber of the First-tier Tribunal (Sir Stephen Oliver) and the President of the Finance and Tax Chamber of the Upper Tribunal (Warren J).

There is a new procedure allowing a Tribunal to correct, set aside or review a decision which it has made. This is primarily intended to apply in particular where there has been some procedural defect in the hearing: for example some evidence emerges late.

Appeals will lie from the First-tier Tribunal to the Upper Tribunal only with permission (which must be applied for in writing), which can be given by the First-tier Tribunal or the Upper Tribunal. Where an application for permission to appeal is made to it, the First-tier Tribunal must always consider whether to review its decision. An application for permission to appeal to the Upper Tribunal can only be made if the First-tier Tribunal has refused or not admitted an application for permission to appeal. This is, of course, a change of substance, in that at present appeals to the High Court in tax cases are as of right.

The power to award costs in the Tax Chamber of the First-tier Tribunal is limited, except in "Complex" cases, to the power to make a wasted costs order and a power to award costs if the Tribunal considers that a party or its representative has acted unreasonably in bringing, defending or conducting the proceedings. This is a more confined costs jurisdiction than that currently in the VAT and Duties Tribunal, but it is a wider jurisdiction than that currently in the Special Commissioners – which requires the party against whom costs are ordered to have acted "wholly unreasonably". The present practice of HMRC not to ask for costs in the VAT and Duties Tribunal in most cases where they are successful is to be discontinued.

In "Complex" cases it is the default position that the normal (High Court) costs regime will apply – i.e. costs will usually follow the event, *except* where a taxpayer has not made a written request to the Tribunal, within 28 days of receiving notice that the case had been allocated as a "Complex" case, that the proceedings be excluded from the default costs regime. There is therefore an "opt out" of the default costs regime in the First-tier Tribunal in "Complex" cases, but only the taxpayer can "opt out". If a taxpayer "opts out" he will not, of course, recover costs against HMRC if he wins.

In the Upper Tribunal the normal (High Court) costs regime will apply (without any possibility of "opting out"). However it is understood that a practice may develop of not awarding costs in the Upper Tribunal to an unsuccessful taxpayer who has been appealed unwillingly to the Upper Tribunal (perhaps because HMRC regard his case as a test case or otherwise raising a point of principle which they regard as important).

There is provision in the Tribunals, Courts and Enforcement Act 2007 for the Upper Tribunal to have a "judicial review" (JR) jurisdiction – the inverted commas appear in the rubric to section 15 of the Act. The jurisdiction is in principle a full jurisdiction including power to make a declaration or a quashing order and power to award damages or restitution. The High Court has, in the negotiations and consultations involved in the introduction of the reforms, been very jealous of its historic role in supervising administrative action, and so the JR jurisdiction of the Upper Tribunal is much more confined and procedurally confusing than many practitioners hoped it might be. The existing procedure in the High Court requiring permission to apply for JR is replicated in the arrangements to apply in the Upper Tribunal. An application for JR can only be initiated in and dealt with by the Upper Tribunal if (*inter alia*) the application falls within a class of applications specified for the purpose in a direction given under the Constitutional Reform Act 2005. It is understood that as yet no such direction has been given in relation to applications in the tax field. Also, an application for JR initiated in the Upper Tribunal can only be dealt with there if the judge presiding at the application is a High Court judge or other judge approved specially for the purpose. That procedure cannot (yet) be used in the tax field. The alternative procedure, which must for the time being be followed in all cases, is for an application for permission to apply for JR to be made to the High Court (Admin. Court). The High Court has power to transfer the application to the Upper Tribunal "if it appears to the High Court to be just and convenient to do so" (new s.31A(3) Supreme Court Act 1981, inserted by s.19 Tribunals. Courts and Enforcement Act 2007).

Hearings in “Basic” cases are expected to be at local hearing centres convenient to the parties throughout the UK. “Standard” cases and “Complex” cases will be heard by the Tax Chamber of the First-tier Tribunal (as now) at a limited number of centres organised through the London, Manchester and Edinburgh tribunal centres. The Upper Tier is to be based in the Bedford Square premises where hitherto the Special Commissioners have sat.

This is an outline of how the reformed tribunals are expected to operate. Much detail has been omitted, principally for reasons of space. There is great uncertainty as to how the reforms will work out in practice, but for most tax litigation of the type undertaken by Grays Inn Tax Chambers the expectation is that the procedure may change but that in practice appeals will run (at any rate in the Tax Chamber of the First-tier Tribunal) on very familiar lines. Probably not much will change on the ground – at any rate initially. It will be some time before the Upper Tribunal gets into its stride and the expectations of how it will operate in practice (clearly differently in style, if not in substance, from the High Court) are much more vague.

There have been aspirations to reform the tax appeal procedures for many years. It has been hoped, particularly, that at appellate levels more specialist judges could be involved in hearing tax cases. There is scope for these aspirations to be met by the new system. Only time will tell if they can be realised.

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