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DELAY AND ALTERNATIVE REMEDIES IN JUDICIAL REVIEW CLAIMS AGAINST HMRC

By Michael Firth

As the saying goes, the early bird gets the worm, but the early worm gets eaten. And so it is with judicial review claims against HMRC. Commence the claim before you have exhausted your appeal rights to the FTT, and HMRC may argue that you have failed to exhaust all alternative remedies. Wait until you have a decision from the FTT, however, and you can expect HMRC to argue that you are hopelessly out of time to bring your claim for judicial review. Taxpayers therefore appear to face a choice between being the early worm (get eaten by alternative remedies) or the late bird (no worm due to delay). HMRC have even been known to argue both points in the same claim at the same time; that is, the taxpayer should be refused permission to proceed with judicial review both because he/she has not yet exhausted alternative remedies and is, in any event, late. The possibility of any tension between effectively arguing that the taxpayer is both too early and too late appears lost on HMRC.

The purpose of this article is to explain why HMRC are generally wrong on both accounts. First, as regards alternative remedies, because the FTT will typically refuse to consider public law issues on a statutory appeal. Second, as regards delay because it is usually difficult to identify any prejudice caused to HMRC by virtue of the delay, not least because the same decision will often be under challenge before the FTT, and, therefore, there is a good reason to extend time.

Alternative remedies

HMRC are always keen to observe that judicial review is a remedy of last resort and that it should not be made available to persons with an alternative remedy. They are particularly keen, these days, to refer taxpayers and the Courts to the case of *R (Glencore Energy UK Ltd.) v HMRC Revenue and Customs* [2017] EWCA Civ 1716 and, in particular, paragraph 57:

> "In my judgment the principle is applicable in the present tax context. The basic object of the tax regime is to ensure that tax is properly collected when it is due and the taxpayer is not otherwise obliged to pay sums to the state. The regime for appeals on the merits in tax cases is directed to securing that basic objective and is more effective than judicial review to do so: it ensures that a taxpayer is only ultimately liable to pay tax if the law says so, not because HMRC consider that it should. To allow judicial review to intrude alongside the appeal regime risks disrupting the smooth collection of tax and the efficient functioning of the appeal procedures in a way which is not warranted by the need to protect the fundamental interests of the taxpayer. Those interests are ordinarily sufficiently and appropriately protected by the appeal regime. Since the basic objective of the tax regime is the proper collection of tax which is due, which is directly served by application of the law to the facts on an appeal once the tax collection process has been initiated, the lawfulness of the approach adopted by HMRC when taking the decision to initiate the process is not of central concern. Moreover, by legislating for a full right of appeal on fact and law, Parliament contemplated that there will be cases where there might have been some error of law by HMRC at the initiation stage but also contemplates that the appropriate way to deal with that sort of problem will be by way of appeal."

The principle they seek to derive from this passage is that where a taxpayer has the right to appeal to the FTT against a HMRC decision, that is an alternative remedy and, therefore, judicial review should be refused.

It is sometimes tempting to High Court Judges with busy lists, containing more "deserving" cases than a taxpayer's attempt to escape liability for tax that 'Parliament has declared due', to seize upon the intuitive proposition that a statutory appeal to the FTT is an alternative remedy and, therefore, the claim can be dismissed in short order. The fallacy in this reasoning is that the FTT appeal would only provide an alternative remedy if the FTT was able to hear and decide the same grounds as are raised in the judicial review. As matters stand, in most situations the FTT will refuse to hear arguments raising public law issues, on the basis that it does not consider that it has jurisdiction to do so (and HMRC will usually object to any attempt to raise such arguments in the FTT by seeking to have them struck out). Accordingly, for true public law challenges to a HMRC decision, the FTT appeal route does not provide an alternative remedy. *Glencore Energy UK Ltd* does not, in fact, say anything different. The reason why Glencore wished to pursue judicial review was not because the issues they raised could not be aired before the FTT (each of them could – see §§59 – 64), but because of the mandatory review period before the challenge could be taken to the FTT (§§65 and 69).

The Court of Appeal explicitly recognised that the alternative remedy principle would not apply to true public law challenges that could not be considered by the FTT:

> "In [*re Preston* [1985] 1 AC 835], the allegation was that the Inland Revenue Commissioners had made a promise not to collect tax in certain circumstances (i.e. had created what would today be called a legitimate expectation not to collect an amount of tax), and although the allegation was not made out, the House of Lords was prepared to accept that such a claim could be made by way of judicial review. In fact, the tax appeal process

> would have been incapable of dealing with such a claim of unlawfulness on the part of the Commissioners, which did not go to the merits of whether the criteria for imposition of tax were or were not met (a subject fit for examination on appeal), but rather to enforcement of fundamental rule of law standards against the Commissioners if they had in fact made a promise not to initiate the tax collection process in the first place."

The same point was also made by Lewis J in *R (oao Manhattan Systems Limited) v. HMRC* [2018] EWHC 1682 (Admin):

> "Where Parliament has created a statutory appellate system to hear appeals against decision, that system, rather than judicial review, is generally appropriate, and permission to apply for judicial review is generally refused, because of the availability of an alternative remedy which is adequate (see. e.g. *R (Glencore Energy UK Ltd.) v HMRC Revenue and Customs* [2017] EWCA Civ 1716). There are cases where the particular grounds of challenge available before a tribunal are narrower than those available in judicial review, in which case judicial review may be appropriate in relation to those other grounds (see, for example, *CC & C v HMRC* [2014] EWCA Civ 1653)."

Indeed, this is consistent with the fact that in *R (oao Davies and another) v. HMRC* [2011] UKSC 47 the Supreme Court specifically indicated that the judicial review claim should have gone before the FTT appeal. This was the course taken by the first appellants but not the second appellant:

> "It is unfortunate that, for whatever reason, the course taken in the case of the first appellants was not taken in the case of the second appellant. Were either of his contentions in the present proceedings to prevail, it would follow that the Commissioners invested a large amount of time – as well as a conspicuous degree of care – in application to the issues of his residence and

> ordinary residence of principles inapplicable to them. In their Decision they expressly noted that their function was to apply the law rather than the guidance in the booklet. But, whereas issues of fact between the Revenue and the first appellants in relation to their circumstances in 2001-02 remain unresolved, the now conclusive resolution by the commissioners of the issues of fact between the Revenue and the second appellant in relation to his circumstances from 1992-93 to 2003-04 at any rate throws the effect of these proceedings into sharp relief. For, although it remains an open question whether, upon application of the ordinary law, the first appellants were resident and ordinarily resident in the UK during the year relevant to them, we know that, upon application of the ordinary law, the second appellant was resident and ordinarily resident in the UK during the years relevant to him. As the appellants rightly stress, a legitimate expectation that the ordinary law will apply to them is a matter of no legal significance in that it adds nothing to the right of every citizen to due application to him of the ordinary law." (§5)

It follows that, generally, the FTT appeal should not be regarded as an alternative remedy.

In terms of other possibilities, one that taxpayers should be aware of is that in cases not raising issues of law or policy, an application to the Adjudicator or Parliamentary Ombudsman may be considered to provide an alternative remedy (*R (oao NCM 2000 Ltd) v. HMRC* [2015] EWHC 1342, §§51 – 59).

Even where there is an alternative remedy, however, it must still be considered whether it is an effective and more suitable remedy:

> "Whether the alternative statutory remedy will resolve the question at issue fully and directly; whether the statutory procedure would be quicker, or slower, than procedure

by way of judicial review; whether the matter depends on some particular or technical knowledge which is more readily available to the alternative appellate body; these are amongst the matters which a court should take into account when deciding whether to grant relief by way of judicial review when an alternative remedy is available." (*ex p. Waldron* [1986] QB 824 at 852, Glidewell LJ).

An example of where the FTT appeal route might not be equally as effective and suitable could be where there is a general challenge to the lawfulness of a statutory regime that is of wide importance:

> "The Sections are on-going legislative provisions. The issue of the legality of the Sections and their consistency with Community law in the public interest must plainly be determined as a matter of urgency and these proceedings are the appropriate vehicle for this purpose. To refuse this application on that ground would be to promote rather than remove uncertainty and would scarcely accord with the duty of the court (if necessary by its own motion) to consider the compatibility of the Sections with Community law and promote legal certainty. I accordingly decline to accede to this objection on behalf of the Defendants." (*R (oao Federation of Technological Industries) v. CCE* [2004] EWHC 254 (Admin), §3).

If there is real doubt as to the existence of an equally effective and suitable alternative remedy, the sensible course is for the Court to stay the judicial review rather than dismiss it.

Delay

The general rule is set out in CPR 54.5:

> "(1) The claim form must be filed –
> (a) promptly; and
> (b) in any event not later than 3 months after the grounds to make the claim first arose."

This time limit may not be extended by agreement between the parties (CPR 54.5(2)).

Alternatively, but to the same effect (*R (oao Clark) v. HMRC* [2017] UKUT 379 (TCC), §54) is r.28 of the Upper Tribunal Rules 2008 (SI 2008/2698):

> "(1) A person seeking permission to bring judicial review proceedings before the Upper Tribunal under section 16 of the [Tribunals, Courts and Enforcement Act 2007] must make a written application to the Upper Tribunal for such permission.
>
> (2) Subject to paragraph (3), an application under paragraph (1) must be made promptly and, unless any other enactment specifies a shorter time limit, must be sent or delivered to the Upper Tribunal so that it is received no later than 3 months after the date of the decision, action or omission to which the application relates."

Given that commencing a judicial review in the Upper Tribunal is a simpler process, with no fee, the latter is more likely to be relevant.

When grounds first arise

The question of when the "grounds to make the claim first arose" can sometimes lead to debate in claims against HMRC. Often the crux of the matter is that HMRC have decided that additional tax is due. This decision may crystallise in stages:

1. After prolonged correspondence, HMRC set out their view that further tax is due and state an intention to raise assessments.
2. HMRC raise the assessments.
3. HMRC carry out an internal review of the assessments (at the taxpayer's request) and uphold the assessments.

Common sense suggests that the grounds should be considered to arise only after the conclusion of stage 3, which represents

HMRC final view on the matter which cannot be displaced by any further internal procedure.

HMRC have been known, however, to argue that the time limit runs from stage (2) and, sometimes even, stage (1). The arguments against such an approach are convincing. First, it is only after stage 3 that HMRC's position is effectively set in stone. Second, if the taxpayer were to seek judicial review after stage (1) he/she would not actually have the decision that crystallises the liability to tax. If the taxpayer were to seek judicial review after stage (2) he/she would have failed to await the outcome of the review process which could (theoretically) lead HMRC to uphold the public law complaint. Third, a common-sense approach is supported by the authorities:

> "I do not think it fair to blame the appellant for not having tried to launch judicial review proceedings earlier. It is not obvious to me that the right approach to difficult problems such as this is to rush off to the administrative court. Most people try to resolve their difficulties over access to public services by negotiation and agreement with the authorities. Very few have the knowledge or the resources to approach the administrative court. If all the people who were trying to persuade public authorities to comply with their legal obligations did so, the court would soon be swamped. Better by far to try and achieve a negotiated solution. Indeed, while negotiations are going on, the court may well refuse leave on the ground that the application is premature." (*A v. Essex County Council* [2010] UKSC 33, §117)

On any sensible view, commencing judicial review whilst HMRC's internal review is underway would be premature. Even if one did take stage 1 (or 2) as the time when grounds first arose, it is difficult to see why there would not be a good reason for extending time:

> "In our judgment, on the facts of this case, where each of the decisions was a step along the path required by statute when a direction under section 38 is being contemplated by a PCC, and where the Chief Constable argues that a flawed approach by the PCC underlies all the decisions made, it is understandable that the Chief Constable should wait until the final decision before launching proceedings. Those circumstances provide a good reason to extend time. We anticipate that PCC would have alleged a challenge was premature if launched before the process was completed." (*R (oao Crompton) v. Police and Crime Commissioner for South Yorkshire)* [2017] EWHC 1349 (Admin), §107, Garnham J).

Promptness

It will be noted that the time limits in the CPR and Upper Tribunal rules both have a short stop and a long stop limb: the claim must be brought promptly and, in any event, within three months. The promptness requirement generally has no application in cases raising EU law issues because it is so vague as to be contrary to EU law (*Sita UK Ltd v. Greater Manchester Waste Disposal Authority* [2011] EWCA Civ 156, §11). In other cases, it is potentially engaged, but its effect depends upon the nature of the decision being challenged: is it the type of decision that ought to be challenged immediately because of the potential effect on good administration?

> "What is "prompt" depends on the nature of the challenge. This was in substance a challenge to a budgetary decision of central government. In my judgment it is self-evident that such a challenge has to be brought very promptly indeed, since it potentially threatens the budgetary arrangements of the Government for an entire year." (*R (oao Liverpool CC) v. Secretary of State for Health* [2017] EWHC 986 (Admin), §45, Garnham J)

> "Prompt action is necessary so that the parties, and the public generally, know whether they are able to proceed on the basis that a decision is valid and can be relied on and so that they can plan and make business decisions accordingly. In the context of a challenge to a decision affecting the sale of a significant, publicly-owned asset, the wider public interest, as well as the interest of the bidders, provide a real need to ensure that any challenge which may affect the sale process is resolved quickly." (*R (oao Sustainable Development Capital LLP) v. Macquarie Corporate Holdings Pty Ltd* [2017] EWHC 771 (Admin), §31, Lewis J)

If the lapse of time causes no prejudice, there is unlikely to be a lack of promptness:

> "Indeed, when considering whether an application is sufficiently prompt, the presence or absence of prejudice or detriment is likely to be the predominant consideration. The obligation to issue proceedings promptly will often take on a concrete meaning in a particular case by reference to the prejudice or detriment that would be likely to be caused by delay." (*Maharaj v. National Energy Corporation of Trinidad and Tobago* [2019] UKPC 5, §37).

It is difficult to see how a challenge to a tax assessment, for example, requires any particular urgency above and beyond the three-month time limit or what prejudice HMRC could suffer as a result of a claim for judicial review not being commenced within the three month long-stop time limit. If HMRC consider that they have suffered any prejudice, it is incumbent upon them to identify it at the outset:

> "Nowadays the pre-action letter of response allows a respondent or interested party to draw attention to the possibility of any prejudice or detriment. Compliance with pre-action protocols and the Civil Procedure Rules should ensure that in most cases issues of prejudice or detriment to good administration are identified at the

> outset." (*Maharaj v. National Energy Corporation of Trinidad and Tobago* [2019] UKPC 5, §41).

Extension of time

Claims brought outside this time limit require the Court or Tribunal to exercise its discretion to extend time. Consideration of the reason for the delay is a relevant factor but the Administrative Courts have not been applying the strict, modern case law on relief from sanctions to extending the time for bringing a claim for judicial review (despite HMRC sometimes attempting to rely on CPR 3.9 and the related case law).

Some cases pose the question in terms of whether there is a good reason to extend time (e.g. *R (oao Crompton) v. Police and Crime Commissioner for South Yorkshire)* [2017] EWHC 1349 (Admin), §107; *R (oao Long v. Secretary of State for Defence* [2014] EWHC 2391, §111) which involves consideration of, inter alia, the reasons for the delay and any prejudice caused. Other cases ask whether there is a good reason for the delay; indicating that it is essential that the claimant provides a good reason for the delay with the question of prejudice to the public authority only arising once such an explanation has been provided. For example:

> "In general, the courts require strict adherence to the time limit. It is open to the Court to grant an extension of time under CPR3.1(2)(a) in an appropriate case. However, there must be a good reason or adequate explanation for the delay and the Court must be satisfied that extending the time limits will not cause substantial hardship or substantial prejudice or be detrimental to good administration." (*R (oao NCM 2000 Ltd) v. HMRC* [2015] EWHC 1342 (Admin), §40)

This conflict in the authorities has now been resolved by the Privy Council in favour of the former approach: the time limit may be extended even where there is no good reason for the delay and that absence of prejudice to the public authority is a key consideration in favour of extending time.

Absence of prejudice as a key consideration in favour of extending time

It is relevant to start by considering why the time limit for judicial review is relatively short (compared, for example, to the time limit for bringing a contract or tort claim. The one month time limit for appealing a HMRC assessment to the FTT is readily explicable by the fact that such an assessment will nearly always be the culmination of an investigation by HMRC of which the taxpayer is aware, will identify itself as an appealable decision and will indicate when and how that appeal should be lodged). In many areas of public life there are very good reasons why delay in bringing a claim for judicial review may be prejudicial to other persons or would otherwise be detrimental to good administration. This is for the simple reason that often public authorities take decisions that will require the implementation of real-world consequences: constructing a building or closing a public service, for example. It is obvious that a successful challenge to the decision after construction has commenced or the service has been closed will likely cause serious difficulties:

> "[the Board of the Privy Council] is satisfied that where, as here, the proceedings would result in delay to a project of public importance, the courts were right to adopt a strict approach to any application to extend time. It was unnecessary to show specific prejudice or hardship to particular parties." (*Fisherman and Friends of the Sea v. Environmental Management Authority* [2018] UKPC 24, §25 – concerning a challenge to the decision to grant a certificate of environmental clearance to BP Trinidad and Tobago).

There are, however, other cases where although a decision has been taken and although the time limit may have passed, the challenge is retrospective in nature. The Supreme Court has recognised that such cases raise different considerations when it comes to delay and are more akin to tort claims:

> "The judge placed at the forefront of his account of the relevant legal principles that "there is a significant public interest in public law claims against public bodies being brought expeditiously" (para 119). That is of course true in judicial review, when remedies are sought to quash administrative decisions which may affect large numbers of people or upon which other decisions have depended and action been taken. It is normally a prospective remedy, aiming not only to quash the past but also to put right the future. Expedition is less obviously necessary in a claim for a declaration in vindication of the claimant's human rights, upon which nothing else depends, or of a claim for damages. These are retrospective remedies, aimed at marking or compensating what has happened in the past. Public authorities are no longer in any different position from other defendants in the general law of limitation (see limitation Act 1980, s 37(1)). This claim is more akin to a tort claim than to judicial review." (*A v. Essex County Council* [2010] UKSC 33, §116, per Lady Hale).

A judicial review claim seeking to avoid payment of tax HMRC claim is due falls into this latter category. Given that the reason for the short time limit is the potential for prejudice to other persons/good administration, it would be illogical to exclude this factor from consideration in an application to extend time unless and until a good reason for the delay has been shown. The Privy Council has now confirmed that this is the correct approach in the context of a similar debate arising in the case law of Trinidad and Tobago:

> "One school of thought would exclude the presence or absence of prejudice or detriment from an assessment of whether delay has been unreasonable and whether an

> extension of time should be granted. On this approach it is only if there are good grounds to extend time that the court will go on to consider whether an extension of time would result in prejudice or detriment. If prejudice or detriment is shown, leave to apply for judicial review may still be refused. If, however, there are no good grounds for extending time, leave to apply for judicial review will be refused notwithstanding the fact that no likely prejudice or detriment has been established. In this way an applicant is deprived of the opportunity to rely on an absence of prejudice or detriment. Another school of thought considers the presence or absence of prejudice or detriment to be at least a relevant consideration when determining whether there is a good reason to extend time and in Abzal Mohammed the Court of Appeal went so far as to hold that the court may not refuse leave if there is no prejudice or detriment." (*Maharaj v. National Energy Corporation of Trinidad and Tobago* [2019] UKPC 5, §32).

It was held that questions of prejudice or detriment are highly relevant to the grant of an extension of time:

> "In the same way, questions of prejudice or detriment will often be highly relevant when determining whether to grant an extension of time to apply for judicial review. Here it is important to emphasise that the statutory test is not one of good reason for delay but the broader test of good reason for extending time. This will be likely to bring in many considerations beyond those relevant to an objectively good reason for the delay, including the importance of the issues, the prospect of success, the presence or absence of prejudice or detriment to good administration, and the public interest." (§38).

> "For these reasons the Board accepts the submission of Mr Fordham on behalf of the appellant that, far from constituting an insulated residual discretion,

considerations of prejudice and detriment are capable of being of key relevance to the issues of promptitude and extension of time." (§43)

The Privy Council stopped short of endorsing the view that an extension should be granted unless there was *both* undue delay and prejudice or detriment:

"While prejudice or detriment will normally be important considerations in deciding whether to extend time, there will undoubtedly be circumstances in which leave may properly be refused despite their absence. One example might be where a long delay was wholly lacking in excuse and the claim was a very poor and inconsequential one on the merits, such that there was no good reason to grant an extension." (§47).

In light of this, the position would appear to be as stated by Woolf LJ, three decades ago, in *R v Comr for Local Administration, Ex p Croydon* [1989] 1 All ER 1033, namely, that if the claimant has behaved sensibly and has a valid claim, he/she will not be denied a remedy if there is no prejudice:

"While in the public law field, it is essential that the courts should scrutinise with care any delay in making an application and a litigant who does delay in making an application is always at risk, the provisions of RSC Ord 53, r 4 and section 31(6) of the Supreme Court Act 1981 are not intended to be applied in a technical manner. As long as no prejudice is caused, which is my view of the position here, the courts will not rely on those provisions to deprive a litigant who has behaved sensibly and reasonably of relief to which he is otherwise entitled." (at 1046 – cited at §29 of Maharaj in the context of setting out the position in England and Wales).

Such a conclusion is important because HMRC's typical approach is to simply rely on the claimant's delay as a sufficiently good reason of itself to refuse permission, without HMRC advancing any case on prejudice at all. Plainly, in light of Maharaj, that is inadequate.

When HMRC do attempt to make out a case of prejudice, they have been known to rely on their own expectation that the FTT proceedings would determine the question of the validity of the assessment. It is difficult to see how that amounts to prejudice – what would HMRC have done differently if the judicial review had been commenced in time?

> "There is no real prejudice to the Council caused by the delay as its case is not that if the judicial review application had been brought earlier, it would not have incurred the expense which it did because the Council has continued incurring expenses even after the present judicial review claim was brought. I assume that it would have acted in the same way if the judicial review claim had been bought more promptly. So I would not refuse permission on the grounds of delay." (*R (oao Croydon Property Forum Ltd) v. Croydon LBC* [2015] EWHC 2403 (Admin) §35)

As a general rule, if the decision sought to be reviewed is under appeal to the FTT, it is difficult to see how HMRC can have suffered any prejudice by virtue of the fact that the taxpayer seeks to challenge the same decision on additional grounds in a claim for judicial review. Matters might well be different if the decision sought to be reviewed is not under appeal and a significant amount of time has passed during which HMRC were entitled to consider that the matter was closed.

Pursuing an appeal to the FTT as a good reason for delaying judicial review

For the reasons set out above, the presence or absence of prejudice is likely to be a key consideration when considering whether to grant an extension of time, but it is not the only consideration. Claimants, therefore, must still seek to explain why the delay has occurred with a view to showing that they have behaved reasonably/sensibly.

Pursuing an appeal to the FTT may provide a good explanation as to why judicial review was not sought earlier. There is authority in the form of *R (oao Greenwhich Property Ltd) v. CCE* [2001] EWHC Admin 230 where this was accepted:

> "The delay in seeking judicial review of that assessment is because the claimant initially appealed to a Value Added Tax tribunal. But on 20 July 2000 the tribunal decided that there was no right of appeal since the claimant's case depended on an extra-statutory concession and it was "not within the jurisdiction of the tribunal, which is appellate in nature, to review the Commissioners' application of the [concession] any more than it is within our jurisdiction to review the Commissioners' "care and management' powers, such as their conferring and withdrawing the benefits of extra-statutory concessions". On 15 August 2000 this application for judicial review was made. On 18 September 2000 Richards J granted permission to proceed notwithstanding the delay since he was satisfied that there was a good reason for it. Mr. McKay, who appeared before me on behalf of the Commissioners, indicated that he did not propose to take any point based on delay." (§1)

HMRC's typical response to this is that because they (i.e. the Revenue) did not rely on delay, this authority has little weight. Given that extension of time is a matter for the Court and not the parties' agreement (CPR 54.5(2)), and that, further, Richards J expressly did decide that there was a good reason for extending time, this argument appears misplaced.

There is more recent authority in the form of *R (oao Manhattan Systems Limited) v. HMRC* [2018] EWHC 1682 (Admin), where Lewis J considered that seeking expedition of an appeal from the FTT before applying to the Administrative Court for interim relief provided a good explanation for the delay:

> "Initially, I was unimpressed by the period of time taken

> by the claimant to bring this claim for judicial review. However, analysing the chronology, the issue of expedition was, in fact, flagged up by the claimant on 6 June 2017. The grounds attached to the Notice of Appeal expressly referred to expedition. The decision on expedition was not given by the First-tier Tribunal until 5 December 2017. The claimant could, in my judgment, put forward the argument…that it was reasonable to await the outcome of the First-tier Tribunal decision and then to apply for judicial review with a view to seeking interim relief. I accept that argument and that explains the delay between the end of the three months from 18 May decision to a period of 5 December 2017. I also accept [the claimant's] submission that the claimant would need a reasonable period of time thereafter in order to bring the judicial review claim. The decision refusing expedition did not restart any 3-month period." (§13)

On the facts, seven weeks (including Christmas) was at the "outer limits of any acceptable time" for responding to the FTT decision refusing expedition.

Conclusion

The safest advice must always be to commence judicial review as soon as possible and within three months of HMRC setting out the decision that is objected to. Nevertheless, upon proper consideration of the authorities, delay after that time ought not to be a bar to a claim for judicial review if, as is usually the case, HMRC have suffered no prejudice and the taxpayer has been diligently pursuing an alternative challenge to the same decision (e.g. via the FTT).

If HMRC raise the prospect that there is an alternative remedy, typically in the form of an appeal to the FTT, that ought to be unsuccessful unless the grounds raised in the judicial review are the same as would be considered by the

FTT in the statutory appeal. If there is any doubt as to whether there is an equally suitable and effective remedy to judicial review, the correct course is not to dismiss the claim but to stay it and to wait and see if the putative alternative remedy lives up to HMRC's expectations. The right to advance substantive tax law arguments before the FTT is not, however, an alternative remedy to advancing public law arguments in a claim for judicial review.

DISPUTES WITH HMRC: WHY THEY ARISE AND HOW TO RESOLVE THEM

By David Goldberg QC

A few weeks ago, a retired General of the British Army came to see me.

He had fought in the Bosnian War and in The Troubles: he had fought in Iraq and in Afghanistan; he had, as soldiers do, walked in the valley and stood on the mountain top; he had done a lot of soldiering and seen a lot of action; he knew how to defeat an enemy and, to him, Saddam Hussein, ISIS and the Taliban were as nothing.

But, when he came to see me, he was facing an enemy of an altogether different order, an enemy which was proving to be tougher by far than any he had come across before, an enemy he did not know how to defeat.

Who or what, I hear you ask, is this enemy, with the cunning and the strength to daunt an experienced and brave soldier?

The answer is officials of HMRC who had, as it were, trapped the General (or, more accurately, the business for which he worked) in the fiscal equivalent of the Normandy bocage and left him feeling that he was bogged down, that he was getting nowhere, that he did not have any plan to escape from this entanglement and no idea how to formulate a plan.

The experience is, nowadays, not at all uncommon when taxpayers have to deal with HMRC; and the true story of the General is apt partly because it links disputes about tax with the military and partly because any dispute with HMRC is, viewed realistically, a form of warfare.

Although any dispute with HMRC will, more or less inevitably, begin with negotiation, it can, nowadays, easily escalate into litigation which, adapting what von Clausewitz said of diplomacy and war, is or should be seen as negotiation by other means.

But I have made an assumption, which I need to examine, that HMRC are an enemy and I have jumped straight to disputes without discussing either how or why they arise or their mechanics: I should say something about the how and the why before I go much further.

It is, of course, axiomatic that no dispute can arise unless there is a taxpayer who has done something: quite obviously, someone who does nothing, but just lies there like an amoeba, is not going to be in dispute with HMRC.

So, before a dispute can arise, there must, as a minimum, be a person who is adequately connected to the UK tax system (most typically a UK resident) who has done something capable of attracting liability to tax.

Now, broadly speaking, the things a taxpayer might do can be divided into three categories which, in ascending order of risk, can be described as the Routine, the Efficient and the Adventurous which might, these days, be more accurately described as the Stupid.

What I have called the Stupid or the Adventurous is something which is mass marketed as a way for the butcher, the baker, the banker, the candle stick maker and anybody else to avoid or to reduce tax and which very often comes with an apparently reassuring guarantee of free litigation, though it needs to be understood that the guarantee is of litigation, not of freedom from cost.

Schemes of this sort – tax avoidance schemes - are, these days, more or less doomed to failure and there is no point in doing them unless you particularly want a dispute with HMRC so that you can be moved up the risk rankings with a view to changing relations with your CLM.

Whether it is right or wrong that the law and public opinion should have got into a state where adventurous things are doomed to fail and those who have undertaken them are sentenced to public ignominy are, no doubt, matters that can sensibly be debated.

But what cannot be debated is that that is the state things are in: nowadays, if you want to do something purely to save tax, something which has no commercial purpose or economic effect, the sensible advice is “Don’t” and there really cannot be much doubt about that.

What there can be more room for debate about is whether the things I have called Efficient can be, and are, nowadays, regarded as, Adventurous or Stupid and, in order to explore that question, I need to say more about what I mean by Efficient.

Efficient things are those which have a commercial purpose but which can be carried out in a way which will bring with it, as an incident, some form of relief from tax or some freedom from tax.

Examples of the kind of thing I have in mind are carrying out a disposal of a trading company in a way which allows SSE to be obtained, or acquiring a company partly for debt in the expectation that, subject to the usual limitations, relief will be given for the interest accruing on the debt, or structuring debt in such a way that the effects of the BEPS rules are mitigated.

Not very long ago – certainly 10 years ago and, perhaps, until more recently - we used to take it for granted that efficiency in carrying on a business was not only permitted, but also encouraged, by the tax system.

However, partly because of pressure from ill informed politicians, who have, in turn, been inspired by ignorant left wing activists who have no understanding of what a tax system does or is supposed to do, the revenue have started to get more and more interested in challenging the search for efficiency and this is the area in which most of us here will have experience of an increase in tension between HMRC and taxpayers.

The routine things done in the course of carrying on a business – the things done without any thought about tax at all – ought not to cause any dispute with HMRC, but the complexity of the tax system nowadays and the hunger of some revenue officials to raise challenges is such that even the routine does not always go without challenge.

Once you have a taxpayer who has done something, whether it be routine, efficient, adventurous or stupid, there is an engagement between the taxpayer and the tax system, between the taxpayer and the State.

Now, until comparatively recently we used to think of tax as, in a certain sense, voluntary: of course, we knew that we had to pay it, but there was no real sense of obligation.

However, I suppose things began to get more obligatory in 2004, when the DOTAS regime was introduced and the requirements imposed on a taxpayer have been growing more and more stringent since then.

Quite apart from these developments, a taxpayer who has done something, has always had an obligation to report what he has done to HMRC by a certain time and in a certain way.

An important point about returns is that the way in which they are made can limit the time HMRC has to open a dispute and also reduce the risk of penalties.

It is, of course, well known that HMRC have a period of one year in which to open an enquiry into a return delivered in time (FA 1998 Sch 18 para 24) and, if they don't open an enquiry within that period, they can only then challenge a person's self assessment if they can show that, putting it broadly, they could not have raised the challenge earlier because of an act or omission of the taxpayer, so that it was the taxpayer's fault, rather than theirs, that an enquiry was not opened in time – FA 1998 Sch 18 paras 43 to 45.

Moreover, there are further time limits which preclude HMRC from making challenges outside the enquiry window and after a certain time which are dependent on the taxpayer being honest and not careless – see FA 1998 Sch 18 para 46.

It follows from all this that any large company putting in a tax return will need to think about the following questions:

a. has the senior accounting officer (FA 2009 Schedule 46) complied with his or her obligation to ensure that his company's tax arrangements are fit for purpose?
b. has the return made full disclosure of everything necessary to disclose to make sure that, unless they have opened an enquiry in time, HMRC will not be able to challenge the company's self assessment after the enquiry window has closed?

In relation to this question, taxpayers often wish to strike a balance between the risk that disclosure will invite unnecessary enquiry and the risk than non disclosure leaves things open for longer than necessary.

c. has the return been drawn up carefully and honestly, so that HMRC will not be able to claim penalties for careless or deliberate error under FA 2007 Schedule 24?
d. has the return been accurately drawn up so as to ensure that late payment penalties under FA 2009 Schedule 56 will not be payable?

Consideration of these issues at an early stage will limit the scope for dispute with HMRC, but it does not eliminate it altogether.

If a company has done only routine things it is, perhaps, unlikely that it will get an enquiry though, even then, it is certainly not impossible.

Conversely, if a company has done adventurous or stupid things, an enquiry is more or less inevitable although some people, oddly, manage to get away without one.

It is in the middle ground of the efficient transaction that the most change has been seen: HMRC used not seriously to challenge what I have called efficient transactions but now, very often, they do and, quite often, when they do, they raise the question of penalties early in the debate.

As a general comment, it is quite obvious to me that the question of penalties is usually raised long before HMRC can have any idea at all whether a penalty is in any way appropriate.

In my view, HMRC are, these days, using penalties as a threat and as a negotiating tactic and, accordingly, in a way which is inappropriate and perhaps even improper.

A question which accordingly arises is how to react to the threat of penalties and I shall have more to say about that shortly, when I consider how an enquiry from HMRC is best dealt with.

However, I mention at this stage that I have had some success in countering HMRC's threats of penalties by relying on the Protection from Harassment Act 1997 which prohibits harassment and provides for criminal and civil sanctions for breach of the prohibition.

The Act applies to the Crown and defines harassment to include alarming a person or causing the person distress – and making a premature or unjustified claim to penalties certainly does that.

Another general comment that I might make is that when people come to see me about a dispute, they are self evidently in a dispute with HMRC.

It is possible that this gives me a somewhat unbalanced view of how relationships between HMRC and taxpayers are: just as a cancer surgeon, who sees patients only once they have been diagnosed with cancer, might get the impression that everybody will get cancer, so it is possible that I am given the impression that everybody is in dispute with HMRC.

However, not everybody I see is in dispute with HMRC, so that I do not think that I am suffering from an unbalanced view of things: I believe that there are now many more disputes between HMRC and taxpayers than there used to be.

Because the potential for dispute exists, it is necessary to prepare for it from the earliest possible time.

Now, of course, nobody doing what I have described as a routine thing is at all likely to have taken advice about it from anybody who has anything to do with tax: it will just have happened and, in a sense, the absence of advice about it is a hallmark of its innocence, something which may help to protect it from enquiry, though even innocence does not provide a guaranteed protection from enquiry.

Conversely, anybody thinking of doing something effective or stupid is almost certain to have taken tax advice about it.

As the advice in relation to the Stupid should have been “don’t”, it is unlikely that anybody here will be dealing with enquiries relating to the Stupid and so I shall not cover an enquiry of that type: that means I shall not deal in any detail with Follower Notices or APNs which are means of collecting money before HMRC have made a formal claim to tax; enforcement action of that kind should not be relevant in cases which aren’t in the Stupid Category.

Again, then, the type of enquiry on which to concentrate is that conducted into the effective.

Now, disputes do not arise because there is a requirement imposed on HMRC to have a dispute, nor do they arise by accident.

They arise because HMRC want to have a dispute: in relation to what I am calling efficient transactions, the creation of the dispute will always be a matter of choice on the part of HMRC.

A problem nowadays is that HMRC are looking to have more disputes than used to be the case.

It is this willingness to dispute which may make it right to characterise HMRC as an enemy and it is what makes it essential, when arranging what is to be done, to bear in mind that a need to defend it robustly might arise: indeed nothing effective should be done nowadays unless it is understood that an enquiry into it is likely to be opened and the taxpayer is prepared to face the enquiry.

It needs to be remembered in this context that an enquiry may well lead to an amendment of a self assessment and to an appeal against the amendment.

Because that is so, nobody should do anything of the kind I am describing as effective unless they are willing to fight to uphold its effect.

On the appeal, the burden will generally always be on the taxpayer to show that his self assessment is right (the position is different if HMRC begin their enquiries only after the enquiry window is closed) and it follows that, from the inception of anything which is influenced by tax, the taxpayer should be thinking about how he will show that his self assessment was right.

That means that he will need to show what he did and, very often, why he did it.

It is, accordingly, necessary from day one of the thinking about the efficient thing to be done, to consider how the what and the why will be proved.

One thing that very often happens when the time comes to defend something which has been done is that there is nobody left in the company who can give evidence about something which may have happened years before.

The risk of that happening is, of course, ever present but it can be mitigated if thought is given at the planning stage to who should be involved and who will be able to give evidence later.

So the possibility of enquiry needs to be thought about from inception: thought needs to be given to the paperwork and it needs to be borne in mind that HMRC will almost certainly ask to see it and that it is not a good idea to say “No” even if one can.

The reason why it is not a good idea to say “No” to HMRC’s request for paperwork is twofold.

First, HMRC have enormously wide powers to get information under FA 2008 Schedule 36, so that there is generally little point in refusing production.

Secondly, HMRC will understandably assume that there is something in papers which you refuse to produce which you do not want them to see.

Whether that is true or not, HMRC will be much much more interested in things a taxpayer does not want to produce than they will be in things they are given without argument: refusing to give HMRC things for which they ask will needlessly increase the intensity and heat of the battle leading to a loss of focus and light.

In thinking about the paperwork to produce to reflect the transaction there is a balance to be struck between creating documents sufficient to establish the what and the why of a transaction and the wish not to create documents which might be embarrassing: I would prefer to err on the side of producing documents.

In particular, if there is a tax benefit which, it is hoped, will be obtained from a transaction, it is usually best to recognise its existence and to explain its subsidiary context rather than to pretend that it does not exist: a skilled reader of company documents will generally be able to tell when part of a story is omitted and omissions can be much more significant and harmful than the true story; an omission is nearly always a confession of guilt.

Another point people sometimes stress about is privilege, which protects a much more limited class of document from disclosure than is generally realised and which, in any event, should not be relied on.

The reason why it should not be relied on is that relying on it sends the message that there is something harmful to the taxpayer in the document for which protection is sought, and that message is likely to be far far more damning than anything in the advice.

After the efficient thing has been done, there will be the need to make returns and to think about the issues I outlined earlier.

And, after the returns have been made, the waiting will begin: will HMRC open an enquiry within the enquiry window?

I rather think that with large companies, which tend to conduct quite open relationships with HMRC, it is most likely that the dispute will begin with HMRC opening an in time enquiry into the company's self assessment.

Now, HMRC's conduct of the enquiry is governed not only by the specific (but limited) rules about enquiries in TMA 1970 and FA 1998 Sch 18 but also by the general rules of public law: HMRC must not behave irrationally or oppressively; they must not act with a collateral motive, they may not do anything which they do not have power to do and they must treat all taxpayer's alike.

It is notable that, while HMRC are entitled to more or less full disclosure from the taxpayer, the taxpayer is not given an equivalent right to disclosure from HMRC.

That makes it difficult to know whether you are being treated in the same way as another taxpayer and getting information from other taxpayers or from the revenue to aid in a claim of unequal treatment has proved far from easy.

Indeed, the general public law limitations on HMRC's conduct are unlikely to be useful where HMRC are just carrying on an ordinary enquiry which was begun in time; there may be more scope for relying on public law remedies where an enquiry has been begun after the enquiry window has closed; but where the enquiry was begun in time there are two reasons why the general rules of public law are unlikely to be of use to a taxpayer.

The first reason is that the statutory power to enquire given to HMRC is not circumscribed in any way and, in particular, it is not, circumscribed by rules about the extent to which the enquiry may be taken nor, subject to one rule which I shall explain shortly, circumscribed by time.

Accordingly, the power to enquire is one which it is difficult to control using public law remedies because it is so very wide.

The second reason why the power to enquire is not apt for control by general public law remedies is that the taxpayer is given, by the legislation, two specific ways of dealing with an enquiry; and there is a general limitation on the ability to get a public law remedy which is that, where legislation provides for a specific way of dealing with a matter, the existence of the specific way of responding usually excludes the general law remedies.

The two specific ways of dealing with the enquiry relate to different times in the enquiry process.

An enquiry is brought to an end by the issue of a closure notice and a closure notice must specify either that HMRC accept the self assessment made by the taxpayer or that HMRC have reached certain conclusions affecting the self assessment which require amendments to be made to it and, in that case, the closure notice must amend the self assessment so that it makes a claim for a specified amount of tax – see FA 1998 Sch 18 para 34.

There are also similar provisions which allow for a partial closure notice to be issued.

Now, once HMRC have opened an in time enquiry, the taxpayer's affairs are put in to limbo: HMRC have not accepted the self assessment as right but, equally, they have not asserted that it is wrong and this limbo state lasts until the closure notice has been issued.

Not many people enjoy the limbo state: it is, after all, a form of purgatory; you do not know whether you are in the heaven of an agreed self assessment or the hell of being told you are wrong.

The first specific remedy given to the taxpayer in the context of a continuing enquiry is to ask HMRC to conclude the enquiry by issuing a closure notice and, if they won't do that, the matter can then be referred to the Tribunal which can order the issue of a closure notice.

However, the Tribunal will only order the issue of a closure notice if it is satisfied that HMRC do have enough information to reach a conclusion and so, persuading a tribunal to order a closure notice can be quite difficult if HMRC are saying that they aren't in that position.

The second specific remedy given to taxpayers arises once a closure notice has been issued amending a self assessment: the taxpayer may then appeal against any conclusion expressed in or any amendment made by the closure notice.

I shall talk about what happens on an appeal shortly but let me now return to the stage at which HMRC have just opened an enquiry.

Sooner rather than later, HMRC will explain the point they are interested in and, at this stage, the probability is that everyone on the taxpayer's side will be optimistic that they are going to get this sorted out and a letter will be written explaining why the self assessment submitted was correct and needs no amendment.

Now, once upon a time, not that long ago if we were dealing with an enquiry into something routine or efficient, we could reasonably have expected the letter explaining things to lead to a speedy resolution of the matter, to agreement that the self assessment was correct.

But the level of aggression has risen now and some things which, when they were done, might have been regarded as efficient might now be regarded as adventurous (I have in mind the scheme for mitigating tax using corporate partners in fund management partnerships which seems adventurous now) and, anyway, HMRC now has a greater appetite for disputing efficient things than they once had.

It is likely now that the first letter of explanation will not lead to the hoped for rapid resolution: the overwhelming likelihood nowadays is that HMRC will write back and say something like "Thank you so much. That is very interesting and helpful but we are ever so politely going to ask for a bit more information. For example, could you let us have every single thing which shows exactly why you did this thing into which we are enquiring".

The question is what to do in response to that kind of reply.

Broadly speaking, the response can be softly softly or it can have a bit more steel in it. There is no right or wrong way of responding and the choice must be made according to the taste of the taxpayer in question.

Now most large companies do not want to get too aggressive and anyway there is no point at this stage in getting difficult because, as I have explained, a refusal to disclose is bad psychology and, in any event, pointless.

So the probability is that what at least appears to be a fulsome and willing disclosure will be made and, on the taxpayer's side, the hope will still be that an agreement can be reached and matters be resolved.

And HMRC are likely to reply saying that they are ever so grateful but could they please just have a teeny bit more information and at this stage, they might lightly introduce the idea that there could be penalties if the taxpayer doesn't give in – and this is the danger point.

Everything will, at this stage, seem more or less lovey dovey and there may be a belief that with just one more heave we shall get out of danger into safety.

Make no mistake that is wrong: no matter how smiley HMRC may seem at this stage, you are looking at a crocodile and it is at least sometimes if not always wrong to smile back.

The General had made the mistake of smiling at the crocodile: he had not been eaten at the stage he came to see me, but he had been sucked into the fiscal bocage in which HMRC did nothing to resolve the matter but went on asking for more and more irrelevant information, a process which sucks the energy and life out of people until they have no will to continue.

The right thing to do once you have provided all the information that there is about the transaction – but only once you have done that – is to stand to your tackle and put up a fight.

The right thing at this stage is to say to HMRC "you have had all the information you can reasonably require. Now either issue a closure notice so that I can (as I shall) appeal or shut up".

And, by the way, if penalties have been raised as a possibility, the suggestion needs very rough handling and the sooner the better.

I have no doubt whatever that asking for a closure notice is the right thing to do at this stage: it shows a willingness to fight; it shows confidence; it shows spunk and belief in your case.

Of course, nobody actually wants to go to an appeal hearing.

But I guarantee you that the best way of avoiding a hearing is to say that you want one: I guarantee you that once you demand a closure notice, HMRC will start to say that they are not in a position to give you one.

Of course, HMRC will still try to give you the runaround, but you will have seized the moral high ground.

Until HMRC's settlement and litigation strategy was brought into force, taking the moral high ground and battering HMRC from there was a more or less certain way of achieving a favourable resolution of the matter.

The ludicrous settlement and litigation strategy and the introduction of HMRC's internal governance procedures which involve the use of the TDRB has made reaching a sensible agreement much much more difficult than it used to be, but that only sharpens and reinforces the need to be prepared to fight.

After all, if it is not going to be possible to settle a matter because HMRC say that the settlement and litigation strategy precludes it or the TDRB prohibits it, the choice is between fighting and giving in and, if you are going to give in, what is the point of having started?

It seems obvious to me that, if you have done a transaction you believe in, the rational choice is to say that you are going to fight and then to pursue a course of action which shows that you will do that as soon as complete disclosure has been made.

Although that is the rationally correct thing to do, most taxpayers don't want to do it: they cling to the receding hope of settlement in the belief that, if they beg enough, HMRC will give in and, anyway, who wants to go to war even if the form of war is, apparently civilised litigation?

I understand that approach. I have had clients adopt it. I have never seen it succeed. Never.

Of course, I cannot say that it never succeeds: I can only say that I have never seen it succeed; HMRC do not respond to the importunings of taxpayers any more than women respond to men's tears.

Once the correspondence has reached the stage I have been dealing with, it will continue in one way or another until one side gives in (that is not usually HMRC in cases where the non firm approach is adopted) or the taxpayer lodges and starts to prepare an appeal.

Before I go on to consider what happens on an appeal, I should make three points about discovery assessments – claims to tax made for the first time outside the enquiry period.

First, there may be more scope for challenging what HMRC are doing in making discovery assessments on general public law grounds than there is for challenging HMRC's conduct in relation to enquiries.

Secondly, HMRC generally carry the burden of establishing that they are able to make a discovery assessment – that is, they must establish that there was fault on the taxpayers part which prevented HMRC from making the claim within the enquiry window.

The first two points together mean that there may be scope to challenge the validity of a discovery assessment than there is to challenge what is done as a result of an in time enquiry.

Thirdly, because of the second point about burden, it is worth thinking about who should open the appeal: in tax appeals it is usually the taxpayer who should open but, where HMRC carry the burden, there may be a lot for saying that HMRC should open.

In all cases, whether arising as a result of an in time enquiry or an extended time discovery assessment, there will, by the time an appeal is lodged, be a claim document: it may be a closure notice or a discovery assessment but there will always be a document which makes a claim.

It is always worth examining this document closely: it may contain procedural or substantive defects; it may limit the points HMRC are allowed to raise on appeal.

However, assuming the claim is validly made, the matter will, if a taxpayer has decided to fight, go to appeal and I should say something in conclusion about how an appeal is likely to go.

We tend to think of law as quite a hard wired subject, a bit like arithmetic where, I am led to believe 2+2 always equals 4.

However, those judges who have written about how they decide cases tend to emphasise two points.

The first is that law is very plastic: no sooner have we drawn our lines, said one famous US judge, then we start to rub them out and blur them.

The second point is that "dirty dogs don't win cases", a point expressed in that way by Lord Browne-Wilkinson, which tends to emphasise the epigram of US litigators, which is that, to win a case, you must "capture the merits and stick the capture".

How do these points apply to tax cases?

Here in the UK, until about 40 years ago we read the statute more or less literally and, if it did not impose tax, we did not read it as imposing tax: the statute was applied in a very inflexible way.

However, starting with the 1980s, attempts to avoid capital gains tax met with a hostile response from the Courts: the law became that tax avoidance schemes do not work.

Now, the rule as I have just put it was expressed that way only in one First-tier Tribunal case and you will not find the matter expressed that way in any case of significant authority.

Since 1982, the House of Lords has expressed the position in different ways in different cases but I think the generally accepted form of the rule today is that you “apply the statute, construed purposively, to the facts viewed realistically” – and aphorism originally framed by Ribeiro PJ in *Arrowtown* and since then widely adopted as the true position.

It will be seen that this way of looking at things creates a very flexible position: construing purposively allows the Court to give a statute a meaning it does not naturally have while viewing the facts realistically allows the Court to decide that the real facts are different from the facts as they appear to be and that can, for example, allow the Court to ignore things which have actually happened.

The question which then arises for any taxpayer who has undertaken an efficient transaction is whether the Court is going to apply the law so as to strike down and render ineffective the tax benefit which, it was hoped, would be obtained as a result of the efficient transaction.

Certainly, the law now has in it sufficient flexibility to allow a Court to do that, but that does not mean that the Court will do that.

Here, the second point of judging comes into play: the question is “who is the dirty dog?”

I suggest that, where a transaction has been driven solely by a tax motive, the taxpayer will be seen as the dirty dog and will lose.

But where there is a commercial reason for a transaction (and particularly where a judge could see himself doing the same kind of thing personally) I believe HMRC will be seen as the dirty dogs and will lose a case.

In short then, the outcome is going to depend on being able to show the commercial purpose: if the transaction would have been done if tax had never been invented, it should bring with it any hoped for tax benefit.

I remain steadfast to the belief that tax benefits incidental to inherently commercial transactions should and will be obtained.

However, obtaining them requires toil and sweat: it requires the willingness to fight; if you sit taking the pounding the enemy is giving you without fighting back as the General, with whose story I began, had been doing, you will never escape from the bocage.

But you are not without weapons. There comes a time when you must manoeuvre them into position and start firing back: in that way, you should be able to escape and, indeed, by bringing an appeal, counter attack.

In my experience, the sooner the taxpayer does that, the better.

NEW TRUSTS

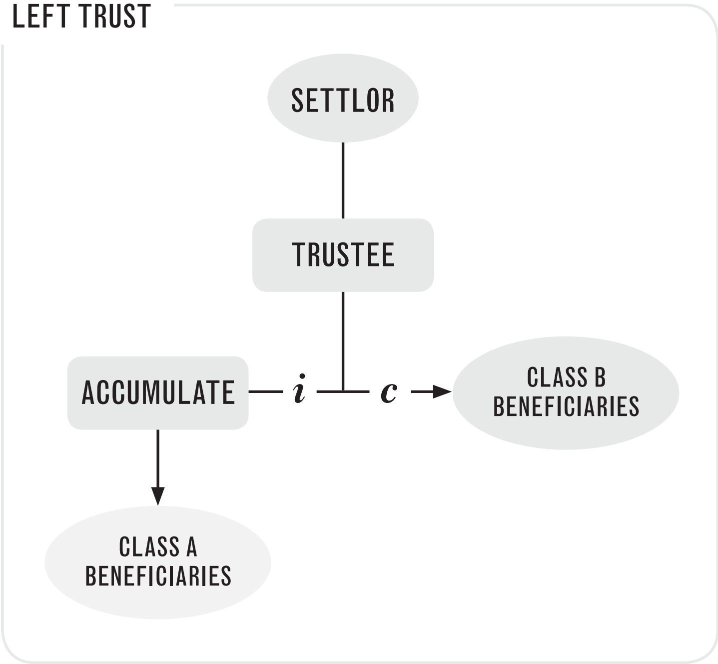
By Milton Grundy

The trusts I am going to discuss are "New" in the sense that they are trusts which I have devised fairly recently. They were designed to solve specific client problems. These have been mainly UK tax problems, but those of my readers who do not concern themselves with UK tax problems do not have to stop reading here: I am not going to dig into the nooks and crannies of the UK tax system; I shall stay with general concepts – assets and values, income and capital, commercial and non-commercial, and I hope that at any rate some of what I have to say will be relevant to each of you, whichever side of the Cliffs of Dover you come from.

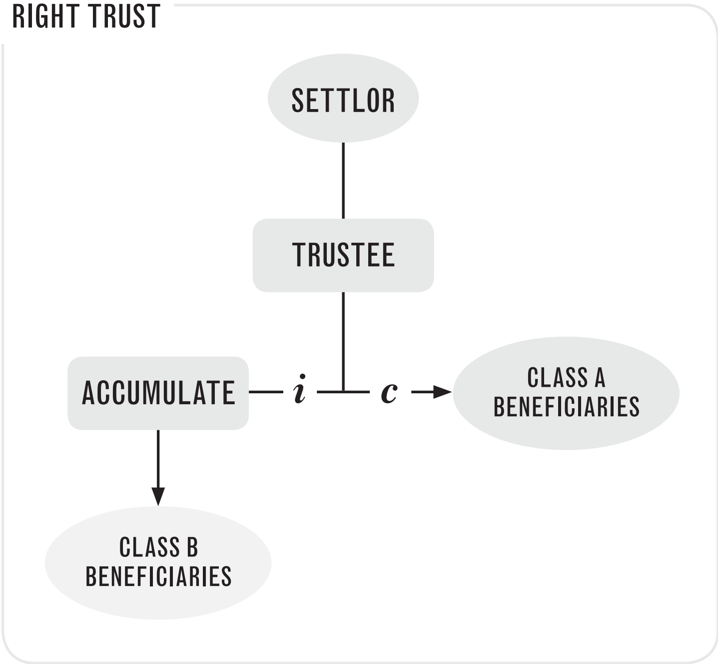
My first New Trust I call the Twin Trust. It is the least new of the four. The Twin Trust is a structure which is useful where the beneficiaries reside in countries which distinguish between income distributions to beneficiaries and capital distributions to beneficiaries. The United Kingdom is one such country, and our courts have spent many years explaining the difference – not altogether satisfactorily, but I think it is plain that a payment made to a beneficiary out of the income of the trust fund is going to be treated as income in the hands of the beneficiary and taxable as such, while a payment to a beneficiary made out of the capital of the trust fund will be treated as capital – at any rate so long as it is not part of a series of regular amounts and not expressly made for meeting living expenses. The Twin Trust is a mechanism for ensuring that payments to beneficiaries have a capital source. And the mechanism is just as effective for offshore trusts as it is for domestic trusts, and I should mention here too that UK beneficiaries have a defence against the tax imposed by those provisions we commonly call “section 720” – and, I guess, the corresponding provisions in Ireland – on the basis that, during the currency of the trust, the accumulated income cannot be “used directly or indirectly for providing a benefit” to an individual.

The diagram (opposite) shows two offshore trusts, each in the same form and with the same settlor. I have divided the beneficiaries into two more or less equal groups, which I show as *Class A* and *Class B*. In the Left Trust, the income is accumulated for the benefit of the Class A beneficiaries. The benefits the Class B beneficiaries get come out of capital which is untainted by any income. The same is true of the Right Trust, but the other way round. There the income is accumulated for the benefit of the Class B beneficiaries, and the benefits to the Class A beneficiaries come out of untainted capital. Of course, this cannot go on for ever. But it can go on for quite a long time. If – to take “toy” figures – the trust investments yield 4% a year, made up of 3% income (after withholding tax) and 1% capital gain, and the trustees in each case make distributions each year to beneficiaries, amounting altogether to 4% of the original capital, then at the end of 33 years the trust fund will in each case still have the same value, but the investments will all be in the accumulation fund. What to do then, I am happy to leave to my successor. The beneficiaries can hardly complain if I have given them a 33 year tax holiday. Who could ask for more? But if I may give my successor a tip, he – or she – might look at the possibility that the trust come onshore, so that each class of beneficiaries together can sell their interests to an offshore purchaser for a capital sum.

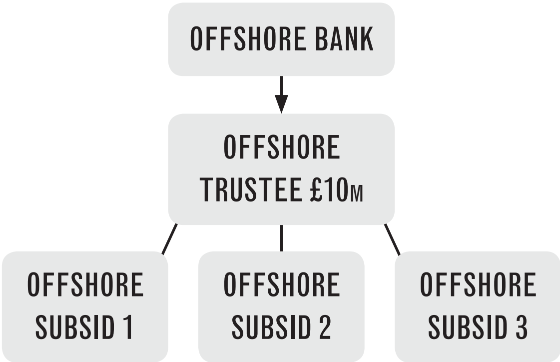
LEFT TRUST



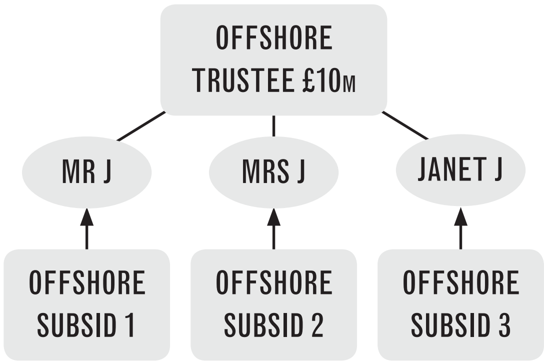
RIGHT TRUST



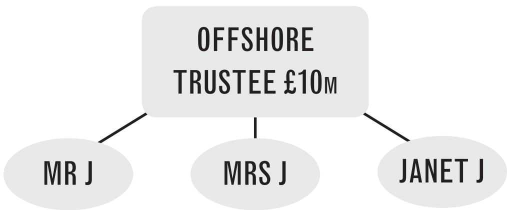
So to the next New Trust, which I have called the "Fortress Trust". The Fortress Trust is like a play in three acts. Act One takes place wholly offshore. There are many variants, but typically what happens is this.



An offshore bank settles – say - £10m on trust for its three offshore subsidiaries. The trustee is also offshore. It is to hold the trust fund on trust to accumulate the income throughout the accumulation period, and subject thereto for the three subsidiaries in such proportions as they may unanimously decide, with discretion in default. It is a feature of this trust that the interest of each one of the subsidiaries is freely assignable. By itself, a beneficiary's interest is not worth very much. An assignee, like the original beneficiary, is not entitled to anything until the end of the accumulation period – which can be 125 years nowadays, under English law. And what he gets then depends on what he can agree with his fellow-beneficiaries, and, if there is no agreement, it will depend on how the trustee will exercise his discretion. On the other hand, the value of the three interests, taken together, will always be the same as the value of the trust fund, and if the beneficiaries, acting together, decide they do not want to wait 125 years, but want the trust fund distributed to them immediately, the well-known rule in *Saunders v Vautier* tells us that they can require the trustee to distribute the trust fund to them immediately. It is also a feature of this trust that it confers extensive powers on the beneficiaries – powers to change the trustee, power to amend the trust deed and so on, but these can also be exercised only by unanimous decision of the beneficiaries. The bank now looks for customers – people who would like to buy these trust interests. You may be wondering why anyone should want to buy them, but that is something I shall come to in a moment.

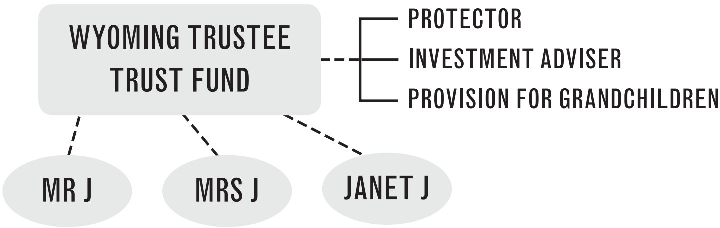


Customers have now been found, and the curtain rises on Act Two. Enter three onshore investors – Mr Jones, Mrs Jones and their adult daughter Janet. Each of them buys an interest in the trust from one of the subsidiaries and takes an assignment of that interest. The price may not be the same in each case, but the total is going to be £10m plus a premium – the premium being effectively the bank's profit. The bank and its subsidiaries retire from the scene, and what we are left with is this.



Before we look at the possible tax advantages of this investment, it is worth spending a moment on its asset protection consequence for the investors. Suppose Mr Jones becomes bankrupt, and his trustee in bankruptcy takes possession of Mr Jones's interest in the trust. It is not an asset of significant value: it is no more than the right to sit out the remainder of the 125 years and hope the Trustee exercises its discretion in his favour. I cannot see that the trustee has any cause of action against Subsidiary One, which sold Mr Jones what he wanted as a commercial bargain. And the trustee in bankruptcy has no shadow of a claim against the £10m, other than the hope of a distribution after 125 years – which means, in practice, that he will do a deal with Mrs Jones and Janet on more or less any terms they offer. The asset protection aspect of the Fortress Trust is to my mind a signal advantage of this structure – an advantage which, as we shall see, it can confer on an insurance policy. It serves to remind us too, when we are thinking of its tax consequences, that it is a commercial transaction and not (at any rate for UK tax) a "settlement".

Which brings me to Act III of this drama. Looking at the transaction from the point of view of the Joneses, they have bought interests in a trust not made for them but made for sale. It is rather like buying an off-the-peg suit: it is basically what you want, but still needs some adjustments here and there. The Joneses may want to have their own investment advisers. They may want to make provision for children and grandchildren, or appoint a protector, or have provisions permitting donations to charities or disenfranchising divorced spouses or creditors, or – in today's atmosphere – cleanse the structure from everything offshore by replacing the trustee chosen by the bank with a trustee established in New Zealand or Wyoming, thus.



What the Joneses have essentially bought is freedom from creditors and a machine for holding all those things wealthy people want to control – a significant interest in a public company, yachts, art, Caribbean Islands and so on, with no significant exposure to creditors or – which is an important feature – to tax on gifts, emigration or death, and the ability to accumulate income and capital gains without any exposure to tax, other than withholding tax. If the clients are resident for tax purposes in the United Kingdom, then once more, the spectre of s.720 comes to haunt the UK practitioner. The reason why I do not regard s.720 as a problem is summarised in the Appendix below. The UK system also has the feature – and I think it is shared by the tax systems of many other countries – that benefits to beneficiaries not in the form of money, or of something that can be turned into money, are not taxable. I am thinking here of beneficiaries for example sailing in a boat owned by the trust; that is, in effect, a way of meeting the expenses of running a boat out of untaxed income. Whether or not purchasers of interests in Fortress Trusts are liable to tax by reference to income or gains of the Trust or by reference to any benefits they receive is primarily of questions of law – the law of the tax regime to which they are subject. But the exposure of each of them to capital taxes – on death, gifts, emigration – is going to turn primarily on the question of the value of the interest in the trust – which, as I have indicated, has at most a nuisance value, and if that is right, it is right as a fact, and it is as so whether we are talking about UK inheritance tax or US or Canadian exit tax or any form of tax on death. There is a feature about the acquisition of an interest in a Fortress Trust which troubles some people, and that is that it effects an immediate diminution in the value of the purchaser's estate: yesterday he has X million pounds; now he has an asset of only nuisance value. Why does that not trigger a tax charge? It seems to me that the answer, in the United Kingdom at least, is because it is, as I have said, a commercial transaction between the bank's subsidiary and the purchaser: commercial transactions have been expressly exempted ever since inheritance tax came into existence.

The language of the Fortress Trust looks at first sight a bit like that of the usual kind of discretionary settlement – a beneficiary may get something in the distant future, but he does not really know what. But the power structure is very different: in a discretionary settlement, the settlor is paying the money, and he confers on the trustee whatever power he chooses. But here, the beneficiaries are paying the money, and they are going to want the power to appoint and dismiss the trustee and make changes to the provisions of the trust deed. The Fortress Trust is in a way more like a company than a trust – the trustee playing the role of the directors, controlling and managing the investment portfolio, and the beneficiaries playing the role of the shareholders, with the power to hire and fire members of the board and to make changes to the memorandum and articles. You could say that the settlement is more an aristocratic vehicle: the one at the top graciously bestowing gifts gratefully received by the underlings. Whereas the Fortress Trust is an essentially bourgeois vehicle: the power and the benefit are in the same hands. I venture to think that this is more or in keeping with our times. By way of example, let me indulge myself with a little reminiscence. In this story, the late and lamented husband had left a considerable fortune on discretionary trusts for his widow and children. The trustee, who shall remain anonymous, but I shall call NatWest for easy reference, had a discretion how much to distribute and how much to accumulate, and was entitled to an annual fee equal to – I think it was – ½ % of the value of the trust fund. The discerning manager saw that the less he distributed and the more he accumulated, the larger the annual fee would be, and the larger his bonus would be. And when I came on the scene, the widow was selling pictures off the walls to pay for the groceries! This is of course an extreme case, but I think there are many cases where beneficiaries of trusts drafted decades ago wish they had power to update the provisions of the trust deed, as they could have done, of course if the trust had been in the form of the Fortress Trust.

My third New Trust is the Managed Investment Platform. The Fortress Trust is for investors interested in security and accumulation of income and gains. It may, as I said, accommodate non-cash benefits to family members, but it is not a machine for providing beneficiaries with spending money. The Management Investment Platform *is*: it is for investors who are happy to accumulate income and gains but also want to be able from time to time to draw out some tax-free spending money. Here it is in diagram form.

BANK

£10m + X LTD

SUBSID SETTLOR

£10m

TRUSTEE

ACCUMULATE INCOME FOR 25 YEARS

INCOME TO X LTD FOR SIX MONTHS

REVERSION TO SETTLOR

As before, the first steps take place offshore. The bank has lent its subsidiary £10m. The subsidiary has settled £10m plus the shares in X Ltd on trust to accumulate the income for 25 years, and subject thereto to pay the income to X Ltd for six months and subject thereto for itself absolutely. If the subsidiary does not wish to wait 25 ½ years for the reversion to fall in, it can from time to time sell a fraction of its entitlement to the reversion to a local purchaser, who can surrender it to the trustee for a price equal to the same fraction of the £10m.

Enter now the onshore investor, Mr Smith, who buys the reversion from the subsidiary. Mr Smith is now the holder of the reversion, and the trust looks like this.

TRUSTEE
£10M + X LTD

ACCUMULATE INCOME FOR 25 YEARS

INCOME TO X LTD FOR SIX MONTHS

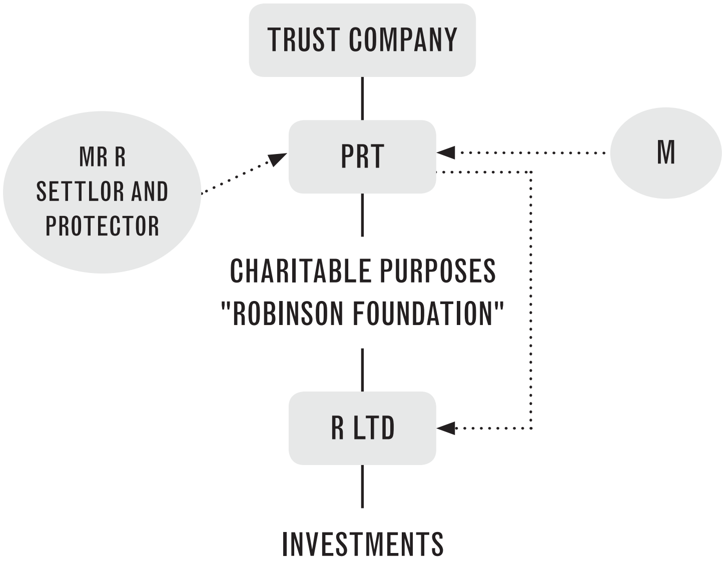
REVERSION TO MR SMITH

Like the Fortress Trust, the Managed Investment Platform is another off-the-peg suit, which will need some further tailoring to fit Mr Smith – the appointment of a new investment adviser, a protector maybe, and so on. If he does nothing further, the fund will accumulate its income and retain its capital gains for 25 years free of any tax except withholding tax, and then the trust fund, after paying its income to X Ltd for a further six months, will become the property of Mr Smith. In the United Kingdom, the vesting of the assets in Mr Smith will be treated as a disposal by him of his interest in reversion in exchange for possession of the trust assets, and he will pay capital gains tax on his gain. I guess much the same is true in other countries. The tax Mr Smith pays at the end of the 25-year period is in effect the tax he did not pay on the income and gains accumulated year by year, but there is of course no credit for withholding taxes. He has had the benefit of 25 years' tax postponement – and, more importantly, the trustee has been able during that period to sell successful investments and re-invest the whole of the sale proceeds without making provision for capital gains tax, a feature which adds quite considerably to the growth potential of an investment portfolio. If at any time during the 25½ years he needs spending money, he can sell to the bank a percentage of the reversion for a price equal to the same percentage of the £10m and the bank can surrender that percentage to the trustee for the same sum. Suppose he paid a 5% premium – paying £10.5m for the reversion to a fund of £10m, then 10% of the reversion will have a base cost of £1.05. He now sells this 10% of the reversion to the bank. The bank will pay him £1m on the sale. It can then surrender the 10% to the trustee for £1m. No doubt the bank will make a small charge for this facility, but Mr Smith will have no capital gain, and therefore no capital gains tax liability. On the contrary, he will have a loss reflecting the premium he paid on the purchase of the reversion.

If Mr Smith limits the percentage of the reversion sold to the value of the income accumulated and capital gains made, he will continue to have a fund of £10m. Suppose the trust fund is invested to yield a net 4% a year, and Mr Smith makes no surrender for three years. He may then sell to the bank his right to surrender 12% of the reversion. The bank pays him £1.2 million and receives £1.2 million on the surrender. In that case, the £1.2m which has come into the trust fund from the investments will be balanced by the £1.2m going out of the trust fund to the bank. If this pattern is repeated, the trust fund will remain stable at £10m. But the base cost of the remaining percentages of the reversions will go lower, giving rise to a potential capital gains tax charge – on these figures – from year 21 onwards, by which time anything can happen – there may no longer be a capital gains tax or Mr Smith may no longer be living in the United Kingdom, or at all. I betray in my last sentence the truth behind the Managed Investment Platform – that I thought of it from the beginning in terms of a purchaser who is subject to UK tax. Staying with the UK aspect just for the moment, I think the reversion is an item of a capital nature, and, as I have said, no tax arises on the disposal of parts of it. There is no "settlement" in a tax sense. And, as with the Joneses, no s.720 liability. Whether the tax result of investment in a managed investment platform is favourable to investors resident in other countries, leave for my readers to decide.

Which brings me to my last trust, the "Sky-hook" trust. This is my rather demotic term for an offshore trust which makes money for its beneficiaries by doing business with onshore customers. These will generally be customers with some kind of family tie to the trust, but who are not beneficiaries. The "sky-hook" trust can take many forms, but the example I am going to take is the offshore foundation which issues offshore bonds - just to family members. It makes money for charity, but it uses its offshore zero-tax status to benefit onshore bondholders. The offshore bond is not, of course, a "bond" at all: it is the name given to a single-premium endowment policy. It is essentially a savings vehicle with a small amount of life cover. The tax treatment of the bondholder is often very lenient, and nowhere is this more true that in the United Kingdom. Indeed, its promise of zero-tax accumulation and 20 years' non-taxable drawdown, with the blessing of the Her Majesty's Revenue and no hint of social disapproval, is – when you come to think about it – fairly amazing. But there are practical drawbacks. As with all insurance contracts, you only get your money if the insurance company is honest and solvent. Which means that you will probably want to do business only with the Big Brands. Big Brands are conservative investors: understandably, they are not going to put money into any investment they cannot liquidate. And Big Brands charge big fees – and need to because they have big expenses – not least in the form of commissions they pay to salesmen. So why not have one's own private offshore insurance company, issuing bonds only to family and friends? Most people think you need a large issued capital for an insurance company, and a staff of actuaries and others to administer the business. But that is not true. An offshore bond or other endowment policy is essentially a managed portfolio coupled with life insurance. You can buy–in portfolio management, and you can go into the market and buy–in some life cover, and Hey Presto you are in the life insurance business.

But not quite. In any offshore centre you would want to use, a licence is required to do life insurance business. And I am afraid the government official whose job it is to give or withhold a licence is going to take the same view as the view I attribute to "most people" – that you need a big issued capital and skilled staff. So, is the private offshore insurance company strictly for multi-millionaires only, or is there a solution to this problem? This is where the "Sky-hook" trust comes into the picture. I start with the basic proposition that if I issue policies – or do anything else – without any intention of making a profit, and in the event actually make no profit, I am not carrying on a business. And I do not think it matters if someone else benefits, so long as I do not benefit myself. Picture then, the "Sky-hook" trust which issues the policies and makes no profit, but has a wholly-owned subsidiary which re-insures the liabilities arising under the policy and makes a profit doing so.



Mr Robinson, on the left, creates a charitable trust with a private trust company ("PRT"), which belongs to a major trust company in an offshore jurisdiction. In the self-effacing way so many benefactors have, he calls it the "Robinson Foundation". It has a subsidiary, which I have labelled "R Ltd". His daughter Mary, whom I show on the right, takes out the policy with PRT acting in its capacity as trustee of the Robinson Foundation and pays the premium to PRT, which in turn pays the premium money to R Ltd in return for an undertaking by R Ltd to meet all liabilities arising under the policy. R Ltd buys in the necessary investment expertise and life cover. It is probably located in the same offshore jurisdiction as the private trust company, but it may be located in a treaty jurisdiction if the nature of the investments makes that desirable. The taxable profits of R Ltd will be only a small fraction of the income from the investments, and if the company is going to be located in a jurisdiction with a serious tax rate, it will of course be important to negotiate ahead of time a deal with the local tax authorities that the growth of R Ltd's liability to the PRT will be deductible in computing its profits.

But I stray from my main theme, which is that an offshore trust can serve as a "hook" to hang other assets, with beneficial results. Practitioners from the United Kingdom may notice that this policy is not a Personal Portfolio Bond: Mary cannot influence the choice of investments backing the policy. But her father is protector of the foundation, and in practice a trustee is always going to do what the protector wants, which means that the investments backing Mary's policy can include unquoted shares, jewellery, property and so on, which an insurance policy could not contemplate. And it is certainly a good deal cheaper than the offshore bond available in the market. There will in most countries be a charge to tax when the policy matures. The UK investor may take out the policy as the trustee of a "Thin Trust" – ie., a trust primarily for his own benefit, so that what he has to sell at the end of the day is an interest under a trust.

So these are my four New Trusts. It seems to me that the tax effect of each of them is wholly benign. But can it be said that any of them constitutes "tax avoidance", in the sense that the application of some general anti-avoidance rule could alter the tax result? I am, of course, really only qualified to answer this question as far as they affect UK taxpayers, but a few general observations may be useful. Let me go back to the Twin Trust. On the face of it, everything the beneficiaries get is of a capital nature. But is there some way an anti-avoidance rule could be invoked, to say that what they get is really income and should be taxed as such? I do not see any scope for that. The appearance is the reality: the sums they get are actually capital, and in the United Kingdom at least would not be subject to tax.

Let us now look again at the Fortress Trust.

This has more of an avoidance "feel". The estates of all three Joneses have been reduced in value, because the interests they have bought have – taken separately – very little value, even though all of them – taken together – are worth £10 m. Reducing the value of your estate is generally the occasion for a charge to inheritance tax, but here it is just a by-product of a commercial transaction in each case, and – in the United Kingdom at least – commercial transactions are expressly taken out of the class of chargeable dispositions by statute. So now the question becomes, 'Can a general anti-avoidance rule override the statutory rule and impose a charge to inheritance tax?' It might be argued that the Joneses could create a structure like this on their own, and save money by not paying a premium to the bank. Let me call that the Economy Route. Many countries have rules which penalise taxpayers who create foreign trusts, and if the Joneses were domiciled and resident in the United Kingdom, they would run into a thicket of tax liabilities. So, it could be argued, they are avoiding those taxes by doing a commercial deal with a bank instead. I'll call that the Bank Route. The argument would be that the Economy Route and the Bank Route lead to the same destination, and if the Joneses choose the Bank Route because it costs less tax, what they are doing is indeed tax avoidance. The trouble with that argument in this case is that the Economy Route and the Bank Route do not lead to the same destination, and the difference lies in the asset protection, which the Bank Route provides and Economy Route does not. Many countries have laws whose effect is that a gift can, in circumstances which vary widely from one jurisdiction to another be undone, but a commercial transaction cannot. If the Mr, Mrs or Miss Jones who took the Economy Route becomes bankrupt, their trustee in bankruptcy may have access to the trust fund to recover the settlor's contribution. But if the Jones purchaser in the Bank Route becomes insolvent, the trustee in bankruptcy will have no access to the trust fund. He may take possession of the trust interest the bankrupt bought, but will soon discover that it has no value except nuisance value and will be responsive to more or less any offer from other members of the family to buy it back from him.

Now to the Managed Investment Platform, which also has an avoidance 'feel'. Mr Smith can get spending money every year, and yet he will say that he is not receiving income. Well, actually, that is true: he is not receiving income; he is getting back the capital he spent. So can a general anti-avoidance rule treat the money he gets as income? UK taxpayers are undoubtedly helped here by the provisions which treat draw-downs from what are called "offshore bonds" as returns of capital. But I think the real question we have to ask, "Is the money Mr Smith gets from periodical sales of part of his interest in reversion *really* capital, or is it income in disguise?" If it is income in disguise, then an anti-avoidance rule will operate to treat it as income. But it seems to me plainly capital: what Mr Smith does is assign a future right to capital in exchange for cash now. How can the consideration he receives be anything other than capital?

And lastly, in this context, let me go back to the Sky-Hook Policy. Mary Robinson doesn't really get any tax advantage not available to any other policy holder. What she essentially gets is a wider range of investments supporting her policy than the commercial insurer would allow. I have mentioned yachts and Caribbean islands in this context, but perhaps the most interesting use of such a policy is for investment in the unquoted company destined to come to the market in due course. But Mary also enjoys an advantage not enjoyed by beneficiaries of trusts, and that is in the field of registration. The Robinson Foundation may require to be registered and its existence known to the public. But there are no public registers of beneficial owners of insurance policies – which is in a way rather odd, because an insurance policy is just as much a container of wealth as a company or a trust. The insurance industry, however, is a powerful lobby, and I would expect any proposal to create a register of policy-holders to meet very stiff oppositions. The irony of the Sky-hook policy structure, from a disclosure point of view, is that the unimportant part is disclosable and the important part is not.

Appendix

The technical point is that the "transfer of assets" made by the Joneses – the payment of the purchase price of the interest, made to the Subsidiary in each case – does not cause any identifiable income to be paid to anybody. If it is argued that the relevant transfer was from the bank to the subsidiaries, then the answer is that no UK taxpayers were involved or in contemplation. (The purchasers might come from anywhere.) In any event, the Joneses are not "transferors" in relation to that transfer. But the substantial point is the one made in the text: no tax is avoided.

TAX CONSIDERATIONS IN MATRIMONIAL FINANCE CASES

By Laura K. Inglis

The tax issues capable of arising in matrimonial finance cases are myriad. This article endeavors, with no claim whatsoever to exhaustivity, to address several of the most salient. The tax consequences of dividing the parties' assets should be at the forefront of advisers' thinking from a very early stage. Such an awareness not only undergirds a sound negotiating strategy, but is vital for the proper implementation of any financial settlement. For example, if particular assets are likely to be transferred between the parties or sold, it important to identify whether any tax will be payable. Additionally, if there will be tax to pay, it is necessary to consider not only the amount of tax in question, but which party will be liable to account for it, and whether any part of that liability should be redistributed as between the parties. The tax position of the parties apart from the matrimonial proceedings may also need to be taken into account. There may be potential liabilities that are capable of dramatically altering the apparent resources of the parties. Involvement in tax avoidance schemes, in particular, can generate liabilities far in excess of the intended savings many years after the fact.

Capital Gains Tax

This is arguably the type of tax liability most likely to arise in matrimonial proceedings. In order to work out if a potential financial settlement gives rise to a CGT charge, there are three primary questions to consider:

1. Will the potential settlement involve a disposal of assets?

2. If it does involve a disposal, will a chargeable gain accrue?
3. If a chargeable gain accrues, is there tax to be charged in accordance with TCGA 1992, in light of various exemptions and reliefs?

Is there a disposal of assets?

In addressing this first question, it is worth bearing in mind the breadth of the definition of "asset" in s.21 TCGA 1992 – it encompasses all property, whether situated in the UK or abroad, with the exception of cash in sterling (although some assets, e.g. certain wasting assets, are exempt). Debts, foreign currency, and intangible property (including choses in action) are all assets. There is a disposal of assets by their owner whenever a capital sum is derived from them (s.22(1) TCGA 1992). In considering whether a potential settlement would involve a disposal of assets, it is important to ascertain who owns the assets to begin with. For example, where a beneficiary is absolutely entitled as against a trustee, it is the beneficiary who is regarded as the owner of the assets for CGT purposes (see s.60 TCGA 1992). This means that if a property is legally held in joint names, but beneficially owned by one of the parties, only the beneficial owner will face the CGT consequences of any disposal (transfer of the legal interest alone being a non-event for CGT purposes). Alternatively, a property may be legally held by one party to matrimonial proceedings, but be beneficially owned by the other party or both together. Again, it is the beneficial owner(s) who will face the CGT consequences of a disposal.

Will a chargeable gain accrue?

Although, of course, the general rule is that a chargeable again accrues where the consideration received on disposal of an asset exceeds the acquisition cost and other allowable deductions (e.g. sale costs and the costs of certain improvements to the asset), we have to bear in mind that, where the disposal is otherwise than by way of a bargain at arm's length or for consideration that cannot be valued, s.17 TCGA 1992 deems the consideration given and received to be equal to the market value of the asset. Unless another exemption applies, s.17 will apply to a transfer made pursuant to a court order, since a court order (even a consent order) does not constitute a bargain. Additionally, spouses and civil partners are regarded as connected persons (see s.286(2) TCGA 1992), and where the person disposing of an asset and the person acquiring it are connected, they are treated as parties to a transaction otherwise than by way of a bargain at arm's length (see s.18(2) TCGA 1992). Accordingly, unless the parties are living together (such that s.58 applies – see below), any disposal between spouses or civil partners is treated as made for market value consideration. Former spouses or civil partners cease to be connected persons upon decree absolute or final dissolution.

There are special rules for disposals of assets between spouses or civil partners who are living together. Subject to certain limited exceptions, if an individual is living together with his or her spouse or civil partner in any year of assessment and one of them disposes of an asset to the other, both are treated as if the asset were transferred for such consideration as would secure neither a gain nor a loss for the one making the disposal (see s.58 TCGA 1992). For these purposes, spouses or civil partners are treated as "living together" unless they are (i) separated under a court order; (ii) separated by a deed of separation; or (iii) in fact separated in circumstances where the separation is likely to be permanent (see s.288(3) TCGA 1992 and s.1011 ITA 2007). The key question is whether the marriage or civil partnership has broken down. HMRC note that spouses may continue to live at the same address but not be "living together", provided that the marriage has broken down. Alternatively, if the marriage has not broken down, the parties are still treated as "living together", even if they do not reside at the same address (see CG22070). There is no requirement that the parties continue living together throughout the year of assessment for s.58 to apply. Provided they have lived together at some time during a tax year, any transfers they make between themselves for the rest of the tax year will continue to be treated as made on a no gain/no loss basis, even if they permanently separate. It is worth considering the future tax implications of this for the recipient spouse who will be treated, on any subsequent disposal, as having acquired the asset for its original acquisition cost.

Section 58 applies even where the recipient spouse/partner is non-UK resident, and therefore potentially outside the scope of UK CGT, allowing the possibility that UK CGT might be avoided entirely. However, a charge can still arise on a subsequent disposal by the non-resident spouse in certain circumstances (see s.1A(3) TCGA 1992):

(i) where the asset consists of a non-excluded interest in UK land[1];
(ii) broadly, where the asset consists of right or interest in a UK-property-rich company and at any time in the 2 years prior to disposal, the non-resident has held a 25% investment in the company[2]; or
(iii) at the time of the disposal, the non-resident carries on a trade, profession or vocation in the United Kingdom through a branch or agency and the asset is situated in the UK and was acquired, used, or held for the purposes of that branch or agency.[3]

Is there tax to be charged under TCGA 1992?

The preceding rules assist in determining whether a chargeable gain accrues in response to a disposal. Where a chargeable gain does accrue, the next step is to determine whether any tax is chargeable, in light of various exemptions and reliefs. There are many such, but those considered below are perhaps most likely to be relevant in matrimonial finance cases:

Main Residence Relief

There is extensive relief available for an individual on the disposal of (or the disposal of an interest in) a dwelling house, in so far as, for any period of his ownership, it has been his only or main residence. For these purposes, however, spouses or civil partners living together can only have one main residence between them (see s.222(6) TCGA 1992). This relief always applies for the final 18 months of ownership, even if the house is no longer the individual's only or main residence (see s.223 TCGA 1992).[4] Thus, if the house has been a person's only/main residence throughout their period of ownership, but not for the final 18 months, any capital gain is exempt in full. Otherwise, a fraction of the gain is exempt, corresponding to the fraction of the ownership period for which the house was his only/main residence (always including the final 18 months). This means that, although the family home immediately ceases to be the main residence of the spouse or civil partner who leaves it following separation, that person can dispose of their interest in the house to the other spouse/ partner (or indeed anyone else) within 18 months of moving out and still benefit from the relief.

There are additional rules governing main residence relief for UK residents disposing of overseas residences and for non-UK residents disposing of UK residences (see ss.222A-222C TCGA 1992). It is also worth noting that large properties encompassing land and/or additional buildings may not benefit completely from the relief (see s.222(1)-(4) TCGA 1992). There is also a special provision for the disposal of residences in connection with divorce, etc., which can apply more than 18 months after the departing spouse or partner moves out. In particular, the spouse or partner who leaves can claim main residence relief on transferring the former family home to the remaining spouse or partner, provided that three conditions are met (see s.225B TCGA 1992):

(i) the transfer takes place pursuant to an agreement between the individual and his/her spouse/civil partner made "in contemplation of or otherwise in connection with" the dissolution or annulment of the marriage/civil partnership or their permanent separation, or pursuant to an appropriate court order;

(ii) in the period between the departing spouse/partner leaving and the disposal, the house has continued to be the only or main residence of the remaining spouse/partner; and

(iii) the departing spouse/partner has not given notice that another house is to be treated as his/her main residence for any part of that period.

It should be noted that no relief is available under s.225B in circumstances where the house is sold and the proceeds split between the couple.

Gift Hold-Over Relief

Where business assets (or certain shares) are transferred pursuant to a court order in matrimonial proceedings, gift hold-over relief may be available (see s.165 TCGA 1992). In such a case, the chargeable gain is not taxed when it arises (i.e. on immediate disposal of the asset), but instead is held over until disposal of the asset by the new owner. (The previously accrued gain is effectively frozen until a subsequent disposal.) However, if there is any actual consideration given (as opposed to deemed consideration under the market-value rule), the actually realized gain is taxable when it arises, and only the unrealized part of the gain is held over (see s.165(7) TCGA 1992). The deferral of tax is achieved by the transferee being deemed to acquire the asset at market value less the held-over gain.

Usually, when business assets are transferred by agreement in matrimonial cases, the transfer is completed in exchange for a surrender by the transferee of his or her rights to obtain alternative financial provision. HMRC take the view that the value of the surrendered rights represents actual consideration of such an amount as would reduce the gain eligible for hold-over relief to nil (see CG67192). Exceptionally, the parties may be able to demonstrate that the value transferred substantially exceeded what the transferee could reasonably have expected to receive as the result of a contested court hearing. In such a case, hold-over relief might still be available in respect of a transfer by agreement. However, where the transfer occurs pursuant to a court order in matrimonial proceedings (even a consent order), HMRC accept that the transferee does *not* give actual consideration for the transfer in the form of surrendered rights. This is because a court order reflects the court's exercise of its independent statutory jurisdiction and is not the consequence of any party to the proceedings agreeing to surrender his or her rights in return for assets (see CG67192). Coleridge J stated in *G v G* [2002] EWHC 1339 at [43]:

> "*In an ancillary relief hearing neither party has any 'rights' as such at all: all the powers are vested in the court which may or may not exercise them. The parties may make suggestions as to how those powers are to be exercised. That is all. So when I order a transfer of shares in favour of the wife on a clean break basis she is not 'giving up' her claim for maintenance as a quid pro quo. I am simply exercising my statutory powers in the way I consider to be fair. This would be equally the case where the court was making a consent order, for although the parties may have made their agreement it is for the court independently to adjudge its fairness.*"

<u>Entrepreneurs' Relief / Investors' Relief</u>

Entrepreneurs' relief or investors' relief may serve to reduce capital gains tax where a contemplated disposal is not covered by s.58. Entrepreneurs' relief, in particular, may also combine with other reliefs (e.g. to reduce the tax payable on the subsequent disposal of an asset that initially benefited from gift hold-over relief). Entrepreneurs' relief provides for a 10% rate of CGT on gains from qualifying business disposals, up to a lifetime limit of £10 million (see Chapter 3 of Part 5 TCGA 1992). Broadly, qualifying business disposals include:

(i) the disposal of all or part of a business which has been owned by the individual making the disposal throughout the two years prior to the disposal;

(ii) certain disposals of business assets following cessation of a business that was owned by the individual making the disposal throughout the two years prior to the date of cessation;

(iii) disposals of shares if, throughout the two years prior to the disposal, the company has been a trading company or the holding company of a trading group, the individual disposing of the shares has been an officer or employee of the company (or a company in the same group), and that individual has held at least 5% of the ordinary share capital of the company and been entitled to exercise, by virtue of that holding, at least 5% of the voting rights in the company and either or both of the following conditions have been met: (i) by virtue of that holding, the individual has been entitled to at least 5% of distributable profits and 5% of the company assets available to equity holders on a winding up; or (ii) the individual has been beneficially entitled to at least 5% of the proceeds on a disposal of the whole of the company's ordinary share capital.[5]

Investors' relief extends the 10% CGT rate to certain other types of shareholders, allowing them to benefit from the reduced rate on their first £10 million of gains from qualifying shares (this is also a lifetime limit, but distinct from that for entrepreneurs' relief) (see Chapter 5 of Part 5 TCGA 1992). Broadly, and in so far as relevant for present purposes, this relief is available where:

(i) The shares are fully paid ordinary shares issued to an individual ("the investor") for cash on or after 17 March 2016;

(ii) At the time the shares were issued, none of the shares in the company were listed on a recognized stock exchange;

(iii) At all times from when the shares were issued until the disposal, the company was a trading company or the holding company of a trading group;

(iv) The investor has held the shares continuously from the date of issue and for at least three years from 6 April 2016;

(v) The investor subscribed for the shares for commercial reasons by way of a bargain at arm's length and not as part of a scheme or arrangement the main purpose, or one of the main purposes, of which was the avoidance of tax;

(vi) Neither the investor, nor any person connected with the investor, has at any time since the shares were issued, been a "relevant employee" of the company (broadly, most officers or employees of the company).

Unlike entrepreneurs' relief, there is no minimum shareholding requirement for investors' relief. Moreover, like gift-holdover relief, both entrepreneurs' relief and investors' relief must be claimed by the individual making the disposal.

The Family Home

In many matrimonial cases, the family home comprises the couple's most significant asset. Very often, particularly in cases where a "clean break" is sought, the house is sold and the proceeds split between the couple, or one spouse transfers his interest in the house to the other. Provided such a disposal takes place within 18 months of the transferor(s) moving out, main residence relief should be available. (Section 225B TCGA 1992 can extend this period in the case of a transfer to the other spouse.) However, there may be situations, particularly in cases involving children, where it is desirable for one spouse or civil partner to remain in the family home, and that person lacks the resources to buy the other out. In such cases, the court might take one of the following approaches:

Deferred Charge

The court might transfer the house to the remaining spouse, but give the departing spouse a deferred charge against it. The charge might be for a fixed sum or for a specified proportion of the net sale proceeds. In either case, the interest of the departing spouse is transferred to the remaining spouse, triggering a CGT disposal for which main residence relief might be available (under the 18-month rule or s.225B). The departing spouse acquires a new asset in the form of the deferred charge. Since there is a disposal of an asset whenever a capital sum is derived from it, there will be a disposal of that new asset when the house is eventually sold. Where the charge is for a fixed sum, this constitutes a debt and there will be no CGT to pay, since no chargeable gain accrues to the original creditor on repayment of a debt (see s.251 TCGA 1992). (However, if the loan carries interest or is index-linked, that will give rise to an income tax liability.) On the other hand, where the charge is for a specified proportion of the net sale proceeds, the departing spouse has a contingent right to obtain an unascertainable sum of money in the future. This is not a debt, but rather a chose in action, so the exemption in s.251 TCGA 1992 cannot apply (see *Marren v Ingles* [1980] 1 W.L.R. 983 (HL)). Accordingly, when the house is sold, the departing spouse will face a CGT charge, subject to the availability of any other relief.

Mesher Order

Another possibility is that the former family home is ordered to be held on trust by the parties, with one of them entitled to live in it rent-free and responsible for all outgoings. When the order terminates (e.g. when the youngest child of the marriage turns 18 or leaves full-time education), the house is sold and the proceeds divided between the parties according to the terms of the order. Such an order creates a lifetime settlement for CGT purposes. There is a deemed disposal (at market value) by the parties to themselves as trustees. Provided this disposal takes place within 18 months of the departing spouse having moved out, main residence relief should be available to both parties. When the order terminates, the trust comes to an end, and the parties are deemed to dispose of the property at market value to themselves as beneficiaries in the shares specified by the order (see s.71 TCGA 1992). The trustees are entitled to main residence relief on the entire gain provided that, throughout the trustees' period of ownership, the house has been the only or main residence of the occupying spouse (see s.225 TCGA 1992). If the property is later sold, only the occupying spouse can benefit from main residence relief, but if this occurs soon after the termination of the settlement, significant additional gain is unlikely to have accrued.

Inheritance Tax

Most transfers between spouses or civil partners in the context of divorce/dissolution proceedings are not chargeable to inheritance tax – either because they are not transfers of value in the first place, or else because they are exempt. Because inheritance tax is charged on the value transferred by a chargeable transfer (defined as a transfer of value made by an individual which is not an exempt transfer – see s.2 IHTA 1984), an IHT charge can only arise where there is a transfer of value. "Transfer of value" is defined in s.3 IHTA 1984 to mean "a disposition made by a person (the transferor) as a result of which the value of his estate immediately after the disposition is less than it would be but for the disposition". Some dispositions are excluded from being transfers of value under s.10 IHTA 1984. Section 10 provides that a disposition is not a transfer of value if it is not intended to confer any gratuitous benefit and was made in a transaction at arm's length between unconnected persons (or if the transfer is between connected persons, it is such as might be expected to be made in a transaction at arm's length between unconnected persons). Broadly, this means that IHT does not apply to dispositions made for consideration or pursuant to an obligation. HMRC take the view that dispositions made on divorce for the benefit of the other spouse "normally" fall within s.10 and so are not transfers of value (see IHTM04165).

Additionally, some dispositions are excluded from being transfers of value under s.11 IHTA 1986. Section 11 provides that a disposition is not a transfer of value if it is made by one party to a marriage or civil partnership in favour of the other party or a child of either party for the maintenance of the other party or the maintenance/training/education of the child until he attains the age of 18 or (if later) ceases to undergo full-time education or training. Section 11(6) extends this rule to dispositions made on the occasion of the dissolution of a marriage or civil partnership, or to the subsequent variation of such a disposition. This provision can be particularly useful where the parties wish to vary a maintenance arrangement after their divorce/dissolution, in circumstances where the disposition would otherwise be a potentially exempt transfer and therefore subject to charge if the transferor dies within 7 years (e.g. if ongoing maintenance payments are to be capitalized into a lump sum). It should be noted, however, that the disposition must be "for the maintenance" of the other party or the child. Transfers that significantly exceed reasonable maintenance may not benefit from full relief.

Transfers made pursuant to a court order in matrimonial proceedings (including a consent order), are not transfers of value in the first place because they do not involve any loss to the transferor's estate. There is accordingly no need to rely on either s.10 or s.11 to prevent a transfer of value arising. Leading practitioners' texts justify this on the basis that transfers pursuant to a court order are not dispositions – the liability is imposed by the court exercising its independent statutory jurisdiction.[6] This echoes the reasoning of Coleridge J in *G v G* (see above). HMRC reach the same conclusion relying on *Haines v Hill* [2007] EWCA Civ 1284, where the Court of Appeal affirmed at [35] that an applicant spouse's right to apply for a property adjustment order constitutes consideration equal in value to the money or property that is the subject of the order (see IHTM11032). Either way, it is accepted that a transfer pursuant to a court order in matrimonial proceedings does not bring about any diminution of the transferor's estate, because the value of that estate already reflects the transferor's obligation to the other party (see s.5 IHTA 1984).

The value of not having to rely on s.10 to exclude from the IHT net a transfer made pursuant to a court order becomes apparent in the context of interests in possession, such as are not uncommonly ordered in matrimonial proceedings. A probably unintended consequence of the changes introduced by FA 2010 is that, were s.10 to be relied upon in creating an interest in possession in matrimonial proceedings, the trust property would both form part of the beneficiary's estate and also fall within the relevant property regime. This would mean an IHT charge of 20% if the interest in possession terminated during the beneficiary's lifetime (or 40% on the beneficiary's death), together with 10-year charges and exit charges on the trust. In short, ensuring that an interest in possession created for the benefit of either party as part of a matrimonial settlement is created pursuant to a court order is the safest way of ensuring that s.10 will not be in point.

Where a disposition constitutes a transfer of value, it may be capable of benefitting from various exemptions, the most relevant of which, for present purposes, is the spousal exemption. Section 18 IHTA 1984 provides that transfers between UK-domiciled spouses are exempt from IHT, and transfers from a UK-domiciled spouse to a non-UK-domiciled spouse are exempt up to the level of the nil-rate band (currently £325,000). A non-domiciled transferee spouse may be able to make a domicile election for IHT purposes in order to benefit from the full spousal exemption (see ss.267ZA-267ZB IHTA 1984), but this has the effect of bringing the transferee's entire estate into the IHT net (at least temporarily), so care is needed. The spousal exemption (unlike the CGT provision for transfers between spouses in s.58 TCGA 1992) applies as long as the parties are still married or in a civil partnership, regardless of whether or not they are living together. This offers significant scope for dividing assets free from IHT before decree absolute or final dissolution. (A transfer of value after that date may qualify as a potentially exempt transfer and so escape charge, but only if the transferor survives the gift by seven years.)

A transfer into trust for the benefit of a spouse in matrimonial proceedings (e.g. a trust created pursuant to a *Mesher* order) should be protected from the entry charge by not being a transfer of value – either by virtue of s.10 IHTA 1984 or because it is made pursuant to a court order and therefore involves no loss to the transferor's estate). The trust will, however, be subject to 10-year and exit charges. (Transfers into relevant property trusts are not capable of benefiting from the spousal exemption, since the estate of the beneficiary is not thereby enriched). Further, subject to limited exceptions, there should be no IHT to pay on the death of a spouse who benefits from an interest in possession, since the trust property does not form part of his or her estate (see s.49(1A) IHTA 1984).

Income Tax

There are relatively few income tax issues likely to arise in divorce/dissolution cases, since spouses or civil partners are taxed separately in any event. However, it is worth noting that maintenance payments to or for the benefit of a former spouse or children are income tax free (see ss.727 and 730 ITTOIA 2005). The payer does receive any tax relief (save for limited maintenance payments relief, which is restricted to legally enforceable payments where either the payer or the recipient was born before 6 April 1935 – see ss.453-454 ITA 2007). Additionally, income arising from jointly-held property of spouses or civil partners who are living together is treated as beneficially arising to both parties in equal shares, unless an exception applies (see s.836 ITA 2007). This provision, known as “the 50/50 rule”, applies only for income tax purposes. HMRC have clarified that where property is jointly held before the marriage or formation of the civil partnership, the 50/50 rule only applies from the date of marriage (see TSEM9832). Moreover, the rule ceases to apply immediately when the couple separate permanently (see TSEM9836). The 50/50 rule can be displaced if the parties complete a joint declaration (via Form 17) that they are beneficially entitled to the income in unequal shares (see s.837 ITA 2007). Failure to complete Form 17 can create unexpected income tax liabilities for a spouse who might not might not realize that he is considered still to possess a beneficial entitlement to the income (e.g. a husband who transferred his entire beneficial interest in a jointly-held investment property to his wife many years before their separation). These unexpected liabilities may come to light in the course of subsequent matrimonial proceedings.

Stamp Duty Land Tax

Paragraph 3 of Schedule 3 to FA 2003 exempts from SDLT land transactions made between one party to a marriage or civil partnership and the other, where the transaction is made in connection with the parties’ divorce, dissolution or judicial separation. This exemption applies whether the transfer is by agreement or pursuant to a court order in matrimonial proceedings, but does not extend to transfers to third parties.

Conclusion

The tax implications of potential financial settlements should be considered from an early stage and throughout the proceedings in order to mitigate the parties' tax exposure during what is often already a stressful and difficult time.

Endnotes

1. See also s.1C TCGA 1992 (with effect from 6 April 2019).
2. See also s.1D and Schedule 1A TCGA 1992 (with effect from 6 April 2019).
3. See also s.1B TCGA 1992.
4. It was announced in the Budget 2018 that with effect from April 2020, the final period exemption would reduce from 18 months to 9 months.
5. The qualifying period for all of these qualifying business disposals increased from one year to two years with effect from 6 April 2019. However, for disposals of business assets following cessation, the increased qualifying period only applies for businesses that ceased to operate on or after 29 October 2018. (See paragraph 4 of Schedule 16 to FA 2019.) The new requirement that the individual be entitled to at least 5% of distributable profits and 5% of assets on a winding up and/or be beneficially entitled to at least 5% of the proceeds of a disposal of the whole of the company's ordinary share capital applies to disposals on or after 29 October 2018. (See paragraph 4(4) of Schedule 16 to FA 2019 and s.169S(3) TCGA 1992 as amended.)
6. See, for example, *McCutcheon on Inheritance Tax*, 7th edition at 2-43.

A TALE OF TWO DOMICILES

By Nikhil V. Mehta

There was once a Martian pupil who was a keen student of comparative fiscal jurisprudence. While on a sponsored sabbatical from Mars, he asked his supervisor a number of questions relating to the India/UK Estate Taxes Double Tax Avoidance Treaty 1956 ("the Treaty").

Question 1:

"If neither the United Kingdom nor India have estate duty any more, what's the point of a double tax avoidance convention between the two countries relating to estate duties?"

"Ah," said the supervisor with a twinkle in his eye. "A very good question, which baffles many. And in the answer hangs a tale. Pull up a chair and let me tell you."

The supervisor began by saying that India had done away with estate duty in 1985 and not replaced it with any other form of tax on death. In the UK, he explained the devolution of death taxes from estate duty to capital transfer tax and then to inheritance tax. He then referred his pupil to Section 158 of the Inheritance Tax Act 1984 and took him through how the UK had extended the application of the Treaty to inheritance tax ("IHT"). India had done nothing comparable as there was nothing in tax terms to which the Treaty could be extended. But the Treaty was not terminated.

"Does that mean that the Treaty, which deals with double taxation between the two countries, applies even though there is only single taxation?"

"Er, yes, but if India brings back estate duty, it would double up again".

The pupil was a little nonplussed by this reply, but went on to ask about domicile.

Question 2:

"I see that the Treaty divides taxing rights between the two countries by reference to an individual's domicile at death and that the country of domicile is determined by the law in force in that country relating to duty. What happens if an individual is deemed domiciled in the UK but his actual domicile is in India?"

"Another very good question", said the supervisor. "The answer is that deemed domicile, which is a post-Treaty unilateral definition created by the UK, cannot trump the definition of domicile under the Treaty. That is made clear by Section 267(2) of the Inheritance Tax Act 1984."

Question 3:

"You mean that someone who dies deemed domiciled in the UK but is domiciled in India under the Treaty will not suffer IHT on his offshore assets?"

"Absolutely, but subject to one catch. This only applies if the foreign assets pass under a foreign will and not under a will made here. So, it is important for such an individual to have appropriate wills made both in the UK and India – and perhaps even in other countries depending on where the assets are."

The Martian looked at his supervisor slightly agog, but had all the information he needed, so thanked his supervisor and got up while browsing through his hard copy of the Treaty.

He had an afterthought:

Question 4:

"Just one more question, if I may. If India no longer has estate duty, how do you determine whether someone had Indian domicile at death? Which Indian law determines this since there is no law which relates to estate duty?"

The supervisor smiled and said: "I think you had better sit down again. This question has created a lot of confusion and generated some misleading answers.

The confusion arises in part because Article 3 of the Treaty talks about someone being domiciled "in some part of" India and "in some part of" Great Britain. It's easy to see that for Great Britain, the word "part" makes sense because an individual can have, for example, an English domicile or a Scottish domicile. The word as it applies to India is misleading because it suggests that an individual could have a domicile in one state as opposed to another and not a single domicile for the whole of India. But the Indian Courts have generally rejected this federal approach to domicile in favour of a national concept based on private international law. The word "part" does not make sense as a federal concept under the Treaty. There are situations where "domicile" has been used in a state context-for example, for student university admissions where priority is given to students domiciled in a particular state. But the Supreme Court, in the leading case of *Dr Pradeep Jain v Union of India [1984] (3) 942* said:

> "The concept of domicile has no relevance to the applicability of municipal laws, whether made by the Union of India or by the States. It would not, therefore, in our opinion be right to say that a citizen of India is domiciled in one state or another forming part of the Union of India. The domicile which he has is only one domicile, namely, domicile in the territory of India. When a person who is permanently resident in one State goes to another State with the intention to reside there permanently or indefinitely, his domicile does not undergo any change: he does not acquire a new domicile of choice. His domicile remains the same, namely Indian domicile."

"Part", therefore, in the Treaty, should not be given any undue significance insofar as it applies to India. One's suspicion is that the draftsman was simply trying to achieve parity when describing India and Great Britain.

But given that "domicile" is used in different areas of law, which meaning applies to the Treaty? The logical starting point is the Estate Duty Act 1953. Even though that has been repealed, it gives some strong pointers. Section 3 of that Act said that a domicile of an individual should be determined as if the Indian Succession Act 1925 applied to him.

The good news is that the 1925 Act is still in force, so it forms a more than persuasive basis for determining domicile under the Treaty.

Section 7 of that Act says:

> "The domicile of origin of every person of legitimate birth is in the country in which at the time of his birth, his father was domiciled; or, if he is a posthumous child, in the country in which his father was domiciled at the time of the father's death."

The Martian pupil interjected: "This is very similar to the English law concept of domicile!".

"Not only that", said the supervisor, "but the Indian courts have consistently followed English cases in looking at domicile even though the cases only have persuasive value. So, the exercise of determining domicile under Indian law has many similarities with English law. Hardly surprising, really, given the common law origins of both legal systems. But let's just go on with the Indian Succession Act. Incidentally, that was of course drafted by the British. The Act acknowledges that a domicile of origin can change, and become a domicile of choice. So, another similarity! And the beauty of the Indian position is that all of this is enacted, so the law is clear-although of course its correct application to any given set of facts remains the province of lawyers and the courts. One cannot, incidentally, assume that the courts will blindly follow English case-law, although they will give it great importance. They will also do the same with leading publications like Dicey & Morris.

There is one peculiar provision which I should mention, which is Section 11. That states:

> **"11. Special mode of acquiring domicile in India.**

> Any person may acquire a domicile in India by making and depositing in some office in India, appointed in this behalf by the State Government, a declaration in writing under his hand of his desire to acquire such domicile; provided that he has been resident in India for one year immediately preceding the time of his making such declaration."

Read literally, anyone could acquire an Indian domicile under this provision by being resident in India for at least a year and depositing the written declaration with the specified office of the Indian Government. But before one gets too carried away with the planning potential of this, I must tell you that it is toothless for the simple reason that the Indian Government do not have such offices. The provision is linked to the British Domicile Act 1861, which was repealed many years ago. Section 1 of that Act provided that a British subject dying in a foreign country did not acquire a foreign domicile unless he had properly made and filed the written declaration in the designated office in that country. For all practical purposes, this procedure is dead and can be ignored.

One last point: where an individual who is deemed domiciled here dies and has a domicile of origin in India, that domicile still has to be substantiated with HMRC. I gather that sometimes this has been attempted by providing so-called certificates of domicile from Indian state authorities. But these do not address the question of domicile under the Indian Succession Act, which is the only relevant test of domicile. And, as I have said, a state domicile is insufficient anyway and involves an incorrect use of the legal expression "domicile". The best way of substantiating domicile in India is a legal opinion from a suitably qualified lawyer based on evidence. HMRC will rightly question whether someone who lived most of his life in England had in fact acquired a domicile of choice in England. Viewed from the Indian side, the fewer connections someone like that had in India, the harder it will be in practice to show that the domicile of origin subsisted-no matter how theoretically adhesive its character."

The supervisor thought they had finished their conversation, but he could see that his young pupil was looking troubled. "Come on, tell me, what's on your mind?"

Question 5:

"Well", said the pupil, "I started wondering about something slightly different. Do people with English domiciles ever go to India to live and if they do, how easy is it to get an Indian domicile and fall outside inheritance tax for offshore assets?"

"How long is a piece of string?!" Exclaimed the supervisor. But he immediately regretted saying that as he saw the baffled look on his pupil's face. Either he was not familiar with the expression, or, more likely, he was about to answer the question based on his knowledge of the average length of all the string in the world at that point in time. "Let me think", the supervisor hurried on. "We need to split people who might do this into two realistic categories. The first category is the Indian origin individual. This could be someone who was born into a family the head of which came to settle in the UK from India a couple of generations ago. Our individual, a grandson in the family – let's call him Sachin-acquired an Indian domicile of origin by virtue of being born legitimately to a father who had a domicile of origin in India at Sachin's birth. It's interesting that the location of a domicile of origin is adhesive both in relation to an individual but also in the way in which it is passed down the generations. For example, a fourth-generation Indian origin family member who was born in the UK could still have a domicile of origin in India by virtue of his father's domicile at the individual's birth. And the father could have inherited his Indian domicile in the same way from his father and so on up the family tree. Now, Sachin could have kept that domicile and then moved to India-in which case it would be relatively straightforward to show that Sachin's domicile of origin never changed-subject of course to having good evidence to support that. But we are not talking about that scenario as you want to know what happens to an English domiciliary. So, we must assume that Sachin managed to give up his domicile of origin in India and to acquire a domicile of choice in England. But strong – indeed magnetic – factors drew him to India where he has lived on a permanent basis.

The second category is the Englishman with a domicile of origin in England and with absolutely no Indian connections in the early years of his life. Let's call him Alastair. Alastair met and fell in love with an Indian girl and moved to Mumbai. He now lives there with his wife and 3-year old son, who was born there. Let's consider both of these.

The first point is which country's domicile law do you look at to determine the question? The deemed domicile IHT classification was irrelevant to Sachin and Alastair before they moved to India because they were already actually domiciled in the UK. If the Treaty did not exist, the question of a change in their domicile and their domicile at death for IHT purposes would be governed by English law. But because the Treaty does exist, we need to look at that and determine the question under Indian law. Of course, the issue only becomes relevant on the death of either of them as the Treaty looks at domicile at death. But where there has been a change in domicile during the life of the individual and the result of that change prevails at death, inevitably both the situation at death and the previous history involving the change must be looked at under the same law.

We are so far only talking about death. Note that the Treaty does not apply to lifetime chargeable transfers for IHT purposes. If Sachin or Alastair were to make any lifetime transfers in relation to non-UK assets after they moved to India, those transfers could be transfers of excluded property if they were not domiciled in England at the time. In that scenario, the question of domicile would be governed by English law. We would also need to consider the deemed domicile tests in Section 267(1) as they would remain relevant for lifetime transfers. For example, if Sachin made a transfer within three years of losing his English domicile, he would still be deemed domiciled here and the Treaty would not help even if his Indian domicile of origin had revived.

So, we need to be clear about which law is relevant and to what. I am only concerned with the situation at death at present as we are discussing the Treaty.

Sachin

Sachin's family has a huge multinational business. He has relatives stationed in different parts of the world who run different parts of the business. Sachin originally helped his father run the London arm, and indeed, had never been to India until he was in his late twenties. He is now 45, and moved to Bangalore (or Bengaluru) seven years ago. He was asked by his father to move there to set up a new tech business, which he did and which is really going places. His wife and two children have now also moved there although he still keeps a flat in London. HMRC took the view that Sachin had acquired a domicile of choice in the UK in his early thirties, and Sachin never challenged that as it seemed to make sense. After all, he had very little interest in India and had no Indian assets. But now he is well-settled in India and has very little reason to go back to the UK. Sachin needs to consider what his ultimate intentions are. If these include making India his permanent home, he may want to take steps to sever his ties with the UK so as to abandon his domicile of choice. As a matter of law, if the domicile of choice is abandoned, then the domicile of origin automatically revives. But it would be prudent for Sachin to ensure that his Indian ties are strong so as to reinforce this proposition, particularly given that he had no ties with India himself before he acquired his English domicile of choice. There is no hard and fast rule as to how long someone like Sachin has to be in India so as to revive his domicile of origin. But undoubtedly Sachin can accelerate the timetable by breaking off significant links with the UK and shoring up his Indian profile. In pure theory, if Sachin had left the UK with a view to emigrating to India and staying there irrespective of the success of the new business, he could get his domicile of origin back in the year of arrival in India. Practically speaking however, there is likely to be a period after leaving the UK where Sachin keeps his options open-and until the options have been closed, it would be difficult to say that the domicile of choice had been abandoned.

Alastair

In Alastair's case, it would be quite natural for him to keep his options open for a long time. No doubt he wants to make a go of things, but India is not the easiest place in the world to move to, and it takes time to adjust. There is a world of difference between visiting on holidays and living there. Further, he has strong ties with the UK and he would really need to consider if he is prepared to give these up. There is nothing inconsistent between living in India for a long period of time and retaining an English domicile of origin. It is sometimes said that a domicile of origin is harder to shake off than a domicile of choice. For one thing, a domicile of origin, as I said earlier, automatically revives when a domicile of choice is abandoned whereas a former domicile of choice does not revive when a subsequent one is surrendered.

Section 9 of the Indian Succession Act states:

> "A man acquires a new domicile by taking up his fixed habitation in a country which is not that of his domicile of origin."

This is essentially the same as acquiring a domicile of choice. A fixed habitation connotes taking up residence in a country with the intention of living there permanently. Alastair may well develop that intention once he is comfortable with his new life in India. But until that intention develops and is backed up by steps to loosen his links with England and to strengthen his Indian ties, Alastair will retain his English domicile of origin. For him, the move to India involves a greater upheaval than for Sachin, and Alastair's position is the opposite of Sachin's: Alastair stands to lose a domicile of origin to gain a domicile of choice whereas Sachin gives up a domicile of choice to regain what he had viz. his Indian domicile of origin.

It would be too simplistic to say that it will take longer for Alastair to switch domiciles than for Sachin, but I think we can say that there are more things for Alastair to do (both in England and in India) than Sachin in order to achieve the change.

<u>Question 6:</u>

"If Sachin or Alastair were to die within three years of losing their English domicile, would their deemed domiciled status under Section 267(1) of the 1984 Act have any impact?

"You really have been looking into this deeply, if I may say so", said the supervisor. "As this is another deemed domicile test created by UK tax legislation, again it cannot override an individual's domicile at death under the Treaty. This would mean that he would be regarded as domiciled in India. As I said earlier, the deemed domicile status remains relevant to lifetime transfers."

<u>Question 7:</u>

"And presumably there would be a similar result for Alastair if he became a formerly domiciled resident here and then died?"

"Let's see. Suppose Alastair has lived in India for ten years, having acquired a domicile of choice there five years earlier. He is then posted to the UK for five years. He will become a formerly domiciled resident in year two of his posting, assuming that he is UK resident in that year and in the previous year. If he were to die as a resident in year 3 without losing his actual domicile of choice in India, he would still be treated as Indian domiciled under the Treaty. As you say, the result is the same because the formerly domiciled resident is also a category of deemed domicile which cannot override the Treaty. But it is relevant for lifetime transfers."

A tax lawyer gets a bit too used to seeing domicile as a bad thing if the upshot is a potential tax liability. The categories of deemed domicile simply reinforce that viewpoint. We should not lose sight of the fact that real domicile is both a right and a privilege. It is harder to get than citizenship in some countries. The Indians would certainly not grant domicile to a foreigner unless the person has taken serious steps to commit to living in India and staying there to the exclusion of other countries. So, domicile-switching is not easy. It is certainly not as easy as residence-switching by limiting days spent in a country and so forth. Of course, if India brings back estate duty, both Sachin and Alastair may get an Indian domicile more easily than I have suggested!"

"Thank you", said the pupil. "Perhaps I should investigate what the chances are of India bringing in estate duty or something similar."

"If you find the answer", chuckled the supervisor, "Let me know. There is a small matter of a General Election to get out of the way this year but after that, who knows? And you better not use time travel to answer that!"

9th January 2019