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SOME THOUGHTS ON AVOIDANCE

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We learned at mother's knee, that while tax evasion is bad, tax avoidance is OK. And now, suddenly, we find ourselves in a world where tax avoidance is no longer OK: the perceived tax avoider is reviled in the press and perused by tax authorities. Is there a clear limit to the concept of 'avoidance', beyond which there are possibilities for legitimate tax planning?

The British statutes talk about "tax avoidance" and about obtaining a "tax advantage". I think they are the same concept in different words, and the essential feature of the concept is that it is *comparative*. Take that well-known passage from Lord Wilberforce's speech about *advantage* in *IRC v Parker* 43 TC 396 at 441, HL.

> "…there must be a contrast as regards the receipts between the actual case where these accrue in a non-taxable way with a possible accruer in a taxable way, and unless this contrast exists the existence of the advantage is not established…"

I do not read this as a statement of the law of England, but rather as an explanation of the meaning of the concept. If I am right about that, then what I say here about avoidance and obtaining a tax advantage is going to be either true or not true, whatever system of law we are talking about.

I said we "suddenly" find ourselves in a new world. But actually it has been coming for a long time – in the United Kingdom, at any rate. The first straw in the wind was the decision in *Black Nominees* [1975] STC 372. This involved a well-known film star called Julie Christie (although her name is mentioned only obliquely in the report of the case). She had put herself under contract with the trustees of a newly-created trust at a small salary. She then sold her interest in the trust to – as it happens – clients of mine, for a price which represented 82% of her earnings as an actress, and this was paid to her in instalments, as and when the earnings came in. It seemed to her like a great deal, because her earnings from acting were liable to income tax at 83%, whereas there was no tax on gains from sales of interests in trusts. The Inland Revenue were of course less pleased. And I believe that what really got up their nose was that the purchasing company did not pay tax on the fees either, because they treated what they paid Miss Christie as a trading expense! Everybody was very shocked when the court decided that what appeared to be instalments of the sale price of a trust interest were really her income as an actress and taxable accordingly. The *Black Nominees* case was decided in 1975, and I do not think anyone coming across the decision for the first time today would be in the least bit shocked. If I can write the script for my imaginary newcomer to the case, he might say - taking, he would say, a realistic approach to the situation, "Of course the money Julie Christie got came from acting in movies. Wherever else? And money film stars get from acting in movies is taxable income. I wonder why she bothered to appeal?"

The courts in the United Kingdom have had many opportunities of considering questions of this kind since the days of *Black Nominees*. A list of the leading cases is in Appendix I, and the upshot – and forgive me if I take here a very broad brush – is that this kind of 'realistic' approach has become part of our law, to the point that when the draftsman of Finance Act 2013 wanted a definition of arrangements which could be classed as "abusive" under the General Anti-abuse Rule, he would refer to those which sought to confer a *tax advantage*, and the concept was already a familiar one from the decided cases: if I engage in a transaction for the purpose of obtaining a tax advantage, the law will deny me the advantage. The concept is not unique to the United Kingdom: it was expressly embodied in many of our colonial statutes; I have had American lawyers explain to me the decision in *Aikens Industries* [1971] 56 TC 925, and it seems the Americans have had a similar doctrine for years; it is not essentially different from the concept of *abus de droit* in civil law countries; and it informs much of the thinking behind the OECD initiatives.

How does this affect the advice we can give our clients? I think we can take the expression "tax advantage" as the frontier between what we can advise and what we cannot. On this side of the frontier is legitimate tax planning. On the other side is the scheme which is not going to work, and which – in the United Kingdom – can penalise me for helping the client to do it. I should say straight away that not every series of events which results in the Treasury collecting less tax means that somebody has been engaging in tax avoidance. It is a mistake a lot of people make – journalists especially. Take the case – much in the news a few years ago – of Sir Philip Green. He gave his wife some shares in a UK company, so that after the gift she enjoyed the dividends declared by the company – which sounds altogether harmless, until you know that while Sir Philip resided in England, his wife lived in Monte-Carlo, with the result that the effect of the gift was that no UK tax was paid on the dividends. The Press were up in arms. 'Wicked tax avoider;' they cried. There were other aspects of Sir Philip's behaviour which were criticised, but they are not to my purpose here. The question I want to ask is, 'Did he avoid any tax?'

As I say, *Avoidance* and *Advantage* are comparative concepts. An "advantage" cannot exist on its own: there has to be something less advantageous you can compare it with. So also with "avoidance". Consider the sentence, "You can take the autoroute* to Nice airport and avoid the traffic in the Promenade des Anglais." That tells us that there *is* another route, which goes along the Promenade des Anglais. It may be the shorter route. And were it not for the heavy traffic at the height of the season, you might well take it. But you can go a longer way round and so avoid the traffic. To put it in general terms: if there is a Route A which avoids, there has to be a Route B (which may be the shorter route) to the same destination but does not avoid. If you took the wrong turning on the autoroute and went instead to Ventimiglia, you would not say, “I found a way to get to Ventimiglia, avoiding the Promenade des Anglais”, because there is no route from here to Ventimiglia which includes the Promenade des Anglais. The same is true of avoiding tax. If I engage in a transaction by which I avoid tax, that is my Route A, and it posits the existence of a Route B, which may be the obvious way to go but would involve a higher tax liability. Let us go back to the case of Sir Philip Green. He gave shares to his wife and paid no tax on the dividends. That was his Route A. If the transaction were to constitute tax avoidance, there would have to be a Route B, which would lead him to the same destination, but involve a tax liability. It seems to me that Sir Philip had no Route B. There is no way under our law for a man to make an outright gift of shares to his wife and remain liable for tax on future dividends. You might say that Sir Philip’s gift to his wife was not like going to Nice airport, where you have the choice of going along the Promenade des Anglais or not. It was more like going to Ventimiglia, where there is no Promenade des Anglais to avoid. And I am comforted in the correctness of my view, by the fact that Her Majesty’s Revenue and Customs evidently are of the same opinion, for no proceedings appear to have been taken against Sir Philip in respect of this transaction.

I should now like to look at a few transactions which have benign tax consequences, and try to see whether they are Nice Airport transactions, avoiding the Promenade des Anglais, or Ventimiglia transactions, with no Promenade des Anglais to avoid. Let me start with the dilemma faced by a UK resident individual who has an asset which has appreciated in value and plans to go and live in the United States. He does not want to sell the asset before he leaves, because that way he will pay UK tax on the gain, which does not seem fair, because he will be contributing to the cost of UK government services he is not going to be in the United Kingdom to enjoy. But if on the other hand he sells the asset when he is a resident of the United States, he will have to pay US tax on the gain, which does not seem very right to him either, since the gain will have accrued before he becomes resident in the United States. What he does is this. While he is still UK resident, he transfers the asset to a partnership in which he and his wife are partners. That occasions no charge to tax. Once he has become US-resident, the partnership sells the asset. That gives rise to no gain, because the Americans treat the base cost to the partnership as the market value of the asset when the partnership acquires it from the partner. Does he avoid tax? Of course, neither the US Treasury nor the UK Treasury collect any tax, but that, as I have said, is not the answer to the question: we have to look at what he has done and whether he could have done it in a way which would have cost him more tax. What he did in the United Kingdom was to transfer his asset to a partnership and then become non-resident. This was his Route A, and there was no tax cost. But there was no Route B: there was no way he could have incurred a tax charge by giving his wife a share in the asset. So – no avoidance. Similarly, from a US perspective, there is no way the partnership could have disposed of the asset and triggered a tax liability. This example may, I think, serve as a model of the kind of planning that is still open to us.

Let me turn now to a case which has an offshore element. As I have said, this always tends to make people assume that some kind of avoidance is going on. But let us see. I have of course changed the names to protect the innocent, but otherwise the facts are these. Mr X is a UK resident and has three cousins resident in other places. His cousins are planning to create a fund for the benefit of the family as a whole. A Cayman bank owns all the units in an offshore accumulating discretionary unit trust. The proposal is that the four cousins buy all the units from the bank, keeping some units for themselves and giving others to younger members of the family. Non-UK readers should know that if Mr X transfers assets to an offshore entity and has what the statute calls "power to enjoy" the income of those assets, the statutory provisions have the effect of attributing the income of the offshore entity to him. But in this case he transfers nothing to the unit trust. He purchases the units from the bank and pays the price to the bank. This does not bring him within the statutory wording: these require the taxpayer to have "power to enjoy" the income from the assets he transfers or assets derived from them, and Mr X does not in any sense have power to enjoy any income arising from the assets transferred. What he has power to enjoy is the income of the assets which the trustee of the unit trust owned before he came on the scene. In the past, my view would have been that Mr X does not come within these provisions at all. But now? Now I think we have to ask ourselves whether Mr X could have achieved his objective in a more tax-prone way. By purchasing the units, he gets to share in a fund which can accumulate income tax-free and to which family members can call upon for help if needed, but the units have no value to a creditor or a disaffected spouse or indeed anyone outside the family. The transaction may have the "feel" of avoidance, but what tax exactly does Mr X avoid, and how could he have achieved he same ends and incur a tax liability? I think Mr X can truly say that he has no Route B.

The question we need to ask ourselves each time is, "Is there a Route B with a tax charge along the way?" Sometimes there is no Route B because the tax authorities, by legislation or practice, do not provide one. Suppose I, as a UK resident, buy an offshore "bond", which is essentially a wrapper for a portfolio of investments, plus a tiny amount of life assurance. I draw down 5% of the premium each year, and pay no tax until the policy matures, in 20 years' time. Even assuming we have income tax in 20 years' time, it is still quite a *coup* to postpone payment of tax for, on average, 10 years! But there is no Route B, with a tax charge, because the legislation expressly provides that there should not be. Sometimes there is no Route B, because the tax has never been enacted. There is, for example, no tax on unrealised capital gains. So I do not have to look for a Route B if I buy leases at peppercorn rents, or shares that declare no dividend, and wait for them to increase in value. The legislation does not require me to pay tax while I wait. This is a proposition which people find easy to accept when the assets in question are blocks of flats in Mayfair, but more difficult to accept where the investments purchased are units in a unit trust in the Cayman Islands. But the location of the assets is immaterial: I cannot obtain a tax advantage by buying assets which yield no income, wherever they are located. Of course, I may run up against anti-avoidance provisions which attribute to me income which is not really mine; but in that case I pay tax because the legislation says so, not because of any general anti-avoidance rule. Just as there is no Route B for the investor in non-income-producing assets, so there is similarly no Route B for the non-UK domiciled individual who goes to live in the United Kingdom or for the non-Italian who goes to live in Italy, or for the non-UK resident who stays in the United Kingdom for no more than 89 days each year.

There are some transactions which strike one as a bit too good to be true, which suggests that they may be struck down as avoidance. I recall the case of the US citizen living in

London, who wanted to make charitable donations. He was of course liable for both UK and US tax. If he gave to a UK charity he got no US tax relief, and if he gave to an American charity, he would – as the law stood then – get no UK tax relief. His solution was to establish a US charity with a UK charitable company as a subsidiary and give to the UK company. That satisfied the requirements for tax relief in both countries. And if we are going to apply the "Is there a Route B with a tax charge?" test, we can start by applying it to the UK tax result. And the answer is that he made a gift to a UK charity, and obtained UK tax relief for doing so, and there just is not a way he could have made that gift and not obtained a UK tax benefit by doing so. I understand that the US charity would make an election under s.7701 of the Internal Revenue Code, with similar consequences in the United States. I believe that the transaction was in fact blessed by HMRC and the IRS, which is a comforting piece of information.

It is sometimes said that conduct is avoidance if it reduces your liability to tax in a way that conflicts with the policy objectives of the relevant legislation, and that is why giving up smoking is not tax avoidance. Well, you can argue about the policy objectives of tobacco duty. How much is it about reducing smoking and how much about raising revenue? But – to pursue my analysis – the reason giving up smoking is not avoidance is because there is no Route B: there is only one route to becoming a non-smoker, and that involves saving on tobacco duty; there is not another route whereby you can become a non-smoker and still pay tobacco duty!

But there are cases where policy objectives seem more relevant. The United Kingdom, like many other countries, taxes lifetime gifts. But it offers an exception for taxpayers who make gifts and survive seven years. A typical problem here is the father who would like to give assets to his son, but fears they will be dissipated in Ferraris and blondes before the son reaches an age of discretion. Up to a decade or so ago, father would often solve this problem by settling the assets for the benefit of the son, but the tax costs of the settlement route now makes this unattractive. Life insurance offers a solution: father's gift is an insurance policy which gives the policyholder limited access to funds for an initial period. This seems an ingenious solution to the problem created by the effective demise of the family settlement, but actually, it is plain vanilla inheritance tax planning, and there is no Route B, where the parties could achieve the same result and incur a tax charge. The discounted gift policy is a variant of this. Father takes out a policy which confers on the policy holder two rights – the right to a sum on maturity and the right to draw down 5% of the premium each year for 20 years or until he dies. He gives the first right to his son, and he retains the second. The gift is taxable, if father fails to survive seven years, but the value of the gift may be much lower than what the donee ultimately receives. Here again, there does not appear to be any more taxable way of achieving the same result.

If I am going to be guilty of avoidance, do I have to do something myself, or is it sufficient that trustees of a settlement of which I am a beneficiary, or directors of a company in which I am a shareholder, take some steps to shield me from a tax liability? We generally think of an avoidance transaction as one in which the taxpayer participates – he borrows some money, say, or joins a partnership, and then receives a benefit which he hopes will not be taxable. But that is not necessarily the pattern. Let me take an example. Readers from outside the United Kingdom should know that we have a provision which attributes the capital gains of non-resident companies to resident shareholders, or to resident beneficiaries of settlements whose trustees are shareholders. This cannot be circumvented by the company having a subsidiary, because the capital gains of the subsidiary are attributed to the parent, and thence to the trust and thence to the beneficiary. But suppose the offshore company substitutes for its subsidiary a Thin Trust.

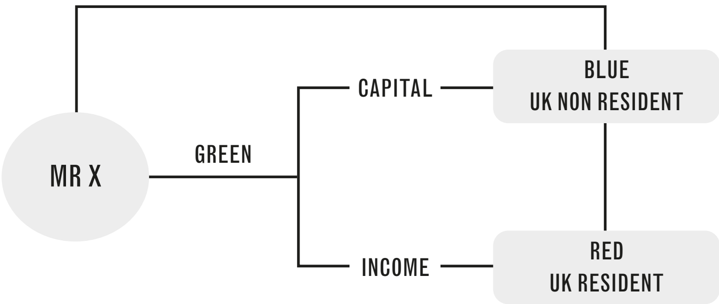
"Thin Trust" is my shorthand for a trust which has effectively only one beneficiary but is not a nomineeship. In this structure, the gain is made by the Thin Trust, of which the offshore company is the beneficiary, and while there is machinery for attributing gains of companies to trusts, there is no machinery for attributing the gains of trusts to companies. So, since the gains of this Thin Trust cannot be attributed to the offshore company, there is nothing to attribute to the offshore trust, and in turn nothing to attribute to the resident beneficiary. Is the concept of avoidance broad enough to cut through the Thin Trust and visit the capital gains tax liability upon the beneficiary? The offshore company, it may be said, took the route of establishing the Thin Trust, to make the investment which yielded the gain (Route A), when it had the perfectly good alternative of making the investment itself (Route B), and did so in order to obtain a tax advantage for the resident beneficiary.

Is that avoidance? That is a difficult question, and I have not been able to find anything in the UK cases which throws any light on it. If I had to form a view, I should say that it depends on the part the Beneficiary played in the transaction: if the trustees acted at his behest, I should say he avoided, and if not, not. I am strengthened in this view by the wording of our General Anti-Abuse Rule. The Rule talks about the taxpayer who *obtains* a tax advantage. That indicates some *act* on the part of the taxpayer. You cannot *obtain* anything unless you do something to get it. So, if I am the beneficiary of an offshore trust, and the trustees – quite without my knowledge – do something which gives me a tax advantage, I do not think I "obtain" that advantage.

Let me consider the rather complicated structure I have in the past called the "Double British". This is a structure designed to take advantage of the tax treaties to which the

United Kingdom is a party, in order to reduce the withholding tax levied by other countries on dividends arising in those countries. Most countries levy withholding tax on outgoing dividends, but tax treaties generally provide that tax is either not charged or is charged at a reduced rate on payments to a UK company. A UK company, however, pays no tax on incoming dividends and charges no tax on outgoing dividends. It follows that the investor living in – say – Monaco can receive dividends from a UK investment company which represent non-UK dividends taxed only at the tax treaty rate. The fly in the ointment is that UK companies pay tax in their capital gains. So what the "Double British" structure does is use two UK companies – one beneficially entitled to the dividends and the other holding the capital as co-trustee of a trust of which the non-resident is the settlor.

The structure looks like this.



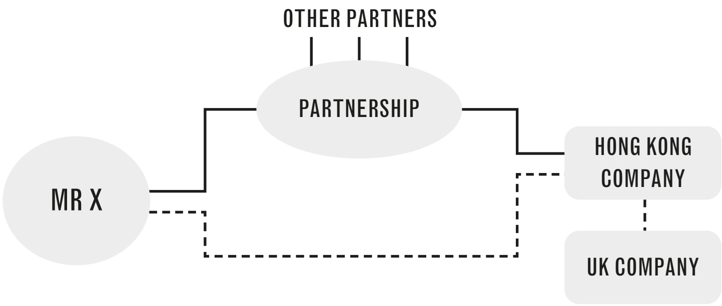
The circle on the left of the diagram is our Mr X – this time an individual resident in Monaco. He owns an offshore company, represented here by the rectangle marked BLUE, which in turn owns a UK resident company – the rectangle marked RED. Mr X has made a "Thin Trust" – which I show marked GREEN, settling the sum to be invested on the Blue

Company and the Red Company as trustees, on trust to pay the income to the Red Company for its own benefit and subject thereto for the Blue Company. The two companies agree that trust investments will be made by the Red Company as joint trustee. Dividends flowing from UK companies and companies in treaty countries are beneficially owned by the Red Company and not subject to tax in the United Kingdom. But the Red Company is a "resident of the United Kingdom" for treaty purpose and is entitled to receive dividends from treaty countries with no withholding tax or a lower rate of withholding tax, as prescribed by the relevant treaties. The Red Company makes an onward declaration of dividend to the Blue Company – there being no tax liability on the way. When a capital gain is realised, this accrues to the Red Company as joint trustee, which can, it seems to me, if necessary take advantage of the capital gains article in the relevant treaty. The Red Company is acting in two capacities. It receives as beneficial owner the dividends arising from the trust investments, and enjoys the UK's benign corporation tax regime for companies receiving and paying dividends. It receives the capital gains from the sale of trust investments as trustee of a settlement made by a non-resident settlor and enjoys the UK's equally benign capital gains tax regime for gains arising from the sale of the trust investments. And the Red Company has treaty protection in both capacities. It declares dividends (representing the trust income) to the Blue Company, which declares dividends (representing the capital gains and the dividends from the Red Company) in favour of Mr X.

Is this structure vulnerable to attack as "avoidance"? Suppose the Red Company is entitled to a dividend from a US corporation. Can the IRS argue that the Red Company is not entitled to the lower rate of withholding tax provided by the UK/US Tax Treaty, because the individual in Monaco always had a possible Route B: he could perfectly well have made the investment in the US corporation in his own name, and only used the UK company to obtain a treaty advantage? The argument is tempting, but I think wrong. This alternative is not a route to the same destination – there is all the difference in the world between running a business oneself – even an investment business, and being a shareholder in a company running a business. Once again it seems to me that each of the parties is paying the tax it should, and one cannot actually point to an avoider.

I am thinking of this structure primarily in terms of portfolio investment. But it is applicable to direct investment, and one additional advantage the use of the UK company provides is the benefit of the Investment Protection Treaties to which the United Kingdom is party. They are not very well known to tax specialists, but they can be very valuable where investment is made in a politically unstable place, and can offer a very good non-tax reason for taking a Route A as opposed to a Route B.

In the next example, the taxpayer is planning to start a new business which he expects to sell after a few years at a substantial gain. He can see a way for the business to have a high base cost, so that he would have no capital gains tax to pay when he sold out. He has had a long history of doing business with a company in Hong Kong, and they were both partners in a partnership which carried on a separate business in Hong Kong.



Mr X is a UK resident. He is in partnership with (among others) the Hong Kong Company. The Hong Kong Company forms a UK company and makes a contract with Mr X, shown as a dotted line, under which Mr X can buy the UK company in ten years' time, subject to some condition – perhaps that Mr X has not in the meanwhile resigned from the partnership. The price Mr X agrees to pay will of course allow the Hong Kong Company to make a profit, but – all being well – the price will be a mere fraction of the value of the company at that time. Nevertheless, the acquisition cost of the shares to Mr X, for capital gains tax purposes, will be their market value at that time, which means that the growth in value of the shares over the ten year period will effectively escape tax. The key to this effect is that Mr X and the Hong Kong Company are "connected persons", and they are connected because they are in partnership together – even though the partnership business has nothing to do with the share purchase. In Appendix II is a note of the relevant UK statutory provisions. But I believe many jurisdictions treat transactions between connected persons as taking place on arm's length terms, whatever may be the actual terms agreed between the parties. In most cases, the effect of this is to increase the amount of tax payable. But here it has the opposite effect: Mr X has a base cost for his shares in the UK company equal to market value, even though he has acquired them for a trifling sum.

Does this still work? A few years ago, I would have given it a clean bill of health – from a UK point of view – without a second thought. Now, one needs to look at it more carefully. Could not Mr X simply take the route along the Promenade des Anglais, instead of going via the motorway? Is there any point in involving the Hong Kong Company at all? I think this last question gives us the clue to the answer. If there is some commercial reason for involving the Hong Kong Company – if the Hong Kong

Company provides finance or marketing or has some other non-tax function, then I think the structure still works.

Lastly, I should like to apply the *avoidance* test to a transaction I mentioned briefly in chapter 4 of my *More Essays* (Key Haven Publications PLC 2007). It related to UK capital gains tax arising from the sale of a Canadian oil field, but I have come to realise that it had much wider application, notably in relation to the sale or flotation of a company which the owner has built up from nothing, but I have given it the name "Vancouver Manoeuvre" in memory of its beginnings, I discuss the Manoeuvre here in terms of its UK outcome, but in other countries with legislation similar to s.18 of our Taxation of Chargeable Gains Act 1992, it may be similarly effective.

The entrepreneur in this case – Mr E – owns all the shares in a company ("UK Co"). Their cost is £C, and the gain he foresees is £G. He plans to flote the company on the Vancouver Stock Exchange, and he forms a Canadian Company ("CanCo") to manage the flote. He borrows £C + 2G from a bank and subscribes for all the shares in CanCo. When the flote is ready to go ahead, he sells his shares in UK Co to CanCo for £C + 2G. The UK Co shares fetch only £C + G, and before the tax year is over, or, if earlier, if the share price shows signs of rising above £C + G, he liquidates CanCo and the proceeds of sale together with any remaining UK Co shares are distributed to him. He has made a gain of £G on his UK Co shares, but a loss of the same amount in his CanCo shares. Mr E has certainly made a tax saving, compared with the tax cost of a simple sale, but if he can show that the Canadian company had a commercial purpose – in facilitating the flotation – he should be in the clear.

**This essay is adapted from a talk given at an Itpa meeting in Monte-Carlo.*

Appendix I

UK Decisions 1975 - 1997

Black Nominees v Nicols [1975] STC 372

Floor v. Davies [1978] STC 436

IRC v. Plummer [1979] STC 793

IRC v. Burmah Oil [1982] STC 30

Furniss v. Dawson [1984] STC 153

IRC v. Challenge Corporation [1987] AC 155

Craven v. White [1988] STC 476

Ensign Tankers v. Stokes [1992] STC 226

IRC v. McGuckian [1997] STC 908

Appendix II

His acquisition occurs when contract becomes unconditional.

Taxation of Chargeable Gains Act 1992 ("TCGA") s.28(2).

> If the contract is conditional (and in particular if it is conditional on the exercise of an option) the time at which the disposal and acquisition is made is the time when the condition is satisfied.

Mr X "connected" with Hong Kong Co.

TCGA s.286(4).

> Except in relation to acquisitions or disposals of partnership assets pursuant to bona fide commercial arrangements, a person is connected with any person with whom he is in partnership…

Mr X's acquisition cost of shares is market value.

TCGA s.17(1).

> Subject to the provisions of this Act, a person's acquisition or disposal of an asset shall for the purposes of this Act be deemed to be for a consideration equal to the market value of the asset –
>
> (a) where he acquires or, as the case may be, disposes of the asset otherwise than by way of a bargain made at arm's length…

TCGA s.18(1) and (2)

> (1) This section shall apply where a person acquires an asset and the person making the disposal is connected with him.
>
> (2) Without prejudice to the generality of section 17(1) the person

> acquiring the asset and the person making the disposal shall be treated as parties to a transaction otherwise than by way of a bargain made at arm's length.

Something of a newcomer to the scene is what has been called the *Family Bond.* This is a unit-linked offshore bond, which is like any other unit-linked offshore bond, except that the unit to which it is linked is a unit in a discretionary unit trust. No attempt is made in practice to tax the holder of a unit-linked bond on the income or gains of the unit trust fund, under s. 720 of the Income Tax Act or otherwise, and there seems no reason why the Family Bond holder should be treated differently from other offshore bond holders. In this respect the Family Bond holder enjoys no "tax advantage" over the holder of any other offshore bond. But an important difference lies in the value of the bond: the investment value of the Family Bond - unlike that of regular unit-linked bonds - is not related to the value of the underlying investments of the units to which it is linked, but reflects only the value of the discretionary unit held by the bond issuer, and that unit (like any interest in any other discretionary trust) has no ascertainable value. This opens the door to tax planning, both for capital gains tax and inheritance tax. The issue of the Family Bond, however, is a commercial transaction and confers no benefit on any third party, and subsequent "transfers" or "disposals" generate no tax liability. And there do not appear to be any alternative hypothetical transactions in comparison with which they could be "avoidance".

This Article is adapted from the author's *International Tax Planning in a Changing World* (Keyhaven 2021)

A SPEECH TO MARK THE PUBLICATION OF "TAXATION OF PARTNERSHIPS AND LLPS" BY DAMIEN CROSSLEY AND MARK BALDWIN

David Goldberg QC

Mark and Damien have asked me to say a few words on the publication of their new book "Taxation of Partnerships and LLPs.

The precise instructions that I have are to "say a few words on the difficulties/ pleasures of partnership taxation and to welcome the publication of the new book in a very English restrained way, nothing too OTT." and that is what I shall try to do.

What, then, is the pleasure of partnership taxation?

I doubt if it lies in paying the tax found to be due from the partners when all the computations so well described in the book have been done.

No! We must look elsewhere for the pleasure.

For me at least, some of the pleasure of thinking about and advising on partnership taxation lies in the difficulty.

That difficulty is, in large measure, created by the somewhat schizophrenic character of a partnership which is perceptively explained in this book.

The point is that partnerships have an internal and an external aspect: the internal aspect relates to the relationship between the partners which is governed by the contract between them; the external aspect governs the relationship with third parties which is generally to be determined without any reference to the partnership agreement.

But, that is not always the case: sometimes, the partnership agreement does have an impact on third parties.

For example, the partnership profit sharing arrangements are essential in determining the share of profits on which a partner is to be taxed and, in that respect, as against HMRC, definitely a third party, though, in some senses, they may consider themselves to be partners, the partnership contract is paramount.

Although, nowadays, there are many cases which may be regarded as standard form, the importance and flexibility of the partnership contract allow a multiplicity of unusual and different structures: difference tends to complexity and complexity gives us the pleasure of making analysis wittily, in the tangle of our minds.

Where partnerships are concerned, the inherent complexity and the use to which it has been put to reduce or(more often) in failed attempts to reduce tax liabilities have called forth legislative responses, many of which have been politically rather than economically inspired.

As a result, there are many many cases in which economic common sense is no longer a sure guide to the way in which a partnership profit or loss will be determined and taxed or relieved.

But, if economic common sense is no longer a guide, this book is: it will lead you through the basic principles and the special legislation and the jungle of relevant acronyms such as DIMF and IBCI and the MOU.

But this book will do more than that.

Any old half way adequate text book will tell you what the law is: only a good law book will tell you why the law is as it is; and this book does that.

And it is better than just a good book: it is readable while comprehensive; it displays a depth of knowledge both of theory and of practice and it explains the what and the why of the law.

On top of that - I hope this is not OTT - it is scattered with odd facts which have nothing to do with the law - the gestation period of the African bush elephant for a start, that the father of Britain's latest saint was a partner for another - which leave me in awe of the authors' general knowledge and make the whole book fun.

For me, now that this book has been written, one of the pleasures of partnership taxation will be - indeed, for me, as I had an early copy, has been -using it.

Inside the books published or distributed under the imprint of the Everyman's Library there used to be - perhaps there still is - a quotation.

For those who have to know how partnerships and their partners are taxed, in other words, for the Everyman involved in partnership taxation, the quotation is apt and this book is worthy of it.

"Everyman, I will go with thee and be thy guide, in thy most need to go by thy side".

Buy one: you won't regret it!

A FEW POINTS OF INTEREST

Laurent Sykes QC

Zero rating evidence

The recent case of *Junjie Liu and Zhe Li v HMRC* [2022] UKFTT 44 (TC), concerned the Appellants' entitlement to zero rate exports of goods. The case illustrates the point that evidence can be "clear" (as the legislative scheme requires for zero rating to be possible) even where there are inconsistencies and contradictions within it. HMRC argued that they were not entitled to zero-rate the exports, not because the exports had not occurred, but simply because the Appellants had not provided sufficient evidence under VAT Notice 703. In particular' HMRC placed great weight on what they claimed were mistakes and inconsistencies in the documentation – mistakes which they claimed prevented zero rating.

The Tribunal, however, rejected HMRC's somewhat arbitrary view. The Tribunal accepted that, relying on *HMRC v Arkeley Limited (in liquidation)* [2013] UKUT 393, the evidence under VAT Notice 703 could be a patchwork of different sources of official, commercial and supplementary evidence. In particular, there was no requirement for every piece of evidence to be correct, as long as the exports were clearly identified from the evidence *taken as a whole*. The Tribunal took a pragmatic view in discounting incorrect details on postage forms and further in holding that there was no need for invoices to be VAT invoices for them to be valid supplementary evidence. The case is contrasted with a number of other decisions going the other way. As with the case below, this case demonstrates the critical importance of properly prepared and clearly laid out evidence.

When is expenditure subsidised

In *Quinn (London) Limited v The Commissioners for Her Majesty's Revenue and Customs* [2021] UKFTT 0437 (TC), the FTT considered when expenditure (in this case R&D expenditure) is "subsidised". The definition which applies treats expenditure as "subsidised" when it is "met directly or indirectly by another person". The concept of expenditure being "met directly or indirectly" by another person also appears in various other provisions of the tax code – in s50 TCGA 1992, in s532 CAA 2001, and in s172 and s603 ITTOA 2005, as well as paragraph 8 Schedule 3 Oil Taxation Act 1975.

HMRC argued that because the expenditure was being incurred by the Appellant in the course of carrying out a contract (of construction) under which it was being paid for the construction works, the expenditure on the R&D which Quinn incurred while performing the contrast (in finding innovative solutions to construction problems) was being "met" by the customer.

If HMRC were correct, it would mean that expenditure incurred before a contract was entered into would not be subsidised but expenditure incurred during the course of a contract would be – unless the contract was loss-making, in which case there would be no subsidy. It is worth noting that Quinn was engaged to build buildings, not undertake R&D.

The Tribunal accepted that the expenditure in question was not subsidised on the facts. The fact that the expenditure being "met" by a third party was one limb of a statutory provision, with other limbs referring to expenditure being met by state aid or by a grant, as well as the heading and defined terms ("subsidised expenditure") informed the proper construction of the relevant provision (s1138 CTA 2009). The words also had to be read in the context of the SME scheme as a whole and should not be read in such a way that the scheme is rendered unworkable. This was sufficient for the tribunal to conclude that expenditure being “met” by a third party, even “indirectly”, still required a clear link between the price paid by the third party and the expenditure borne in respect of R&D. The Tribunal accepted that, as a matter of statutory construction, where Parliament uses the same words in different places in the tax legislation, it should be assumed to have intended the words to mean the same thing unless there is a clear reason to the contrary. Before Quinn, there had been no substantial judicial treatment of s1138(1)(c), but the Tribunal was able to draw on cases which dealt with the same words in the Capital Allowances Acts as “helpful and informative”. By the same token, the case will have relevance in considering the similarly drafted statutory provisions mentioned above.

The decision demonstrates the importance of being able to present all relevant evidence to HMRC when making claims under the SME scheme. The burden of proof is on the company to establish that their expenditure qualifies under the scheme, and, if they are not able to provide the relevant contracts, they may not be able to rebut arguments from HMRC that the expenditure was subsidised (or alternatively that the R&D was subcontracted – another argument HMRC have been raising), such that the relief should be denied. *Quinn* can be contrasted with another appeal that concerned the SME scheme, *Hadee Engineering Co Ltd v The Commissioners for Her Majesty's Revenue and Customs* [2020] UKFTT 0497 (TC), in which the appellants were unable to provide the evidence to demonstrate that certain expenditure was not subsidised or subcontracted. Taxpayers, and especially those claiming under the SME scheme, must be sure to always retain the appropriate records in case of a challenge by HMRC further down the line.

Another set aside decision

In *Abadir v. Credit Suisse Trust Ltd* (case number PT-2021-000157), the Claimant sought to set aside a transfer into a trust of $16.8 million (then worth approximately £8.85 million). This transfer had been based on incorrect tax advice given by Credit Suisse the consequences of which were that a supposedly tax efficient structure had left the Claimant with a tax bill of over £4.6 million. The Supreme Court had restated the circumstances in which a transfer could be set aside for mistake in *Pitt v Holt* [2013] UKSC 26 and the applicable principles were then considered in *Kennedy v Kennedy* [2014] EWHC 4129 (Ch) and in *Bainbridge & Anor v Bainbridge* [2016] EWHC 898 (Ch).

Bainbridge was considered in GTIC Review Volume XIV Number 1 at 59. Here the Court confirmed that when a transfer is set aside for mistake, it is treated, as a matter of general law, as if it had never happened at all. (It is *void ab initio.*) The court also noted that, absent any special legislation to the contrary, there is no reason that this analysis should not also apply as a matter of tax law. This meant that the Claimants could not only set aside the resulting tax charges, but they could also benefit from rollover relief on disposals by the trustees which were related back to them; this was on the basis that the settlors were treated as making the disposals of property which had in fact been made by the trustees and, since they were trading, rollover relief applied.

In *Abadir* the Court held that advice had been sought from Credit Suisse who had confirmed that the structure was tax efficient. This advice was relied upon in setting up the Trust and in making contributions. This was a mistaken belief which justified the transfer being set aside. *Abadir* is of note in that most of the trust property had already been distributed and the reason for the application was, clearly enough and understandably so, solely tax. Nevertheless the claim succeeded.

TAX AVOIDANCE PURPOSE WINNER TAKES ALL (AGAIN)

Nikhil V. Mehta

I. The Early Tax Bird

Tax specialists learn (or should learn) very early in their careers the importance of persuading others to involve them early on prospective deals. In professional firms, the adviser usually has two clients-the external client and the internal client-for example, in the law firms, tax lawyers work with corporate and finance colleagues. It is important to get "buy-in" from both internal and external clients. You would think that getting that from your own colleagues would be easy enough, but it is not. There could be any number of reasons for this, including simple ignorance of the weight to be given to tax advice, keeping costs down by not involving your own specialists on "your" client files, and assuming that another firm is doing the tax or that it is being done inhouse by the external client. And unless the client relationship emanates from the tax practice, there is the task of getting the external client on board too-which often involves the help of your internal colleagues to do the job of persuasion.

Tax managers working in internal departments of corporates have similar issues with their colleagues working in other areas like treasury, finance, and corporate execution.

Barristers tend to be relatively insulated from these issues. Once in a while, a barrister may get involved in informal mediation between different parts of an institution, sometimes without knowing it! It is also quite common for a barrister never to know what happened to the advice given in conference or by written opinion.

When I was a City tax practitioner, I recall a large group call on a transaction where one banker, presumably unaware that tax specialists were on the call, referred to us as "pond life". Whatever one may think of pond life, the banker was clearly unimpressed with it. I think (and hope) that his is an extreme view, but there is no doubt that we are not always valued as much as we would like to be, and being brought in early can go some way to softening the relationship.

In other situations, there is undoubtedly a judgment call to be made as to whether it is prudent to bring in a tax adviser at a particular point in time or not. In the heady days of tax-based structured finance, when loan relationships were capital assets for corporates, a number of banks set up investment, not trading, subsidiaries to invest in debt instruments on the basis that they were capital assets for those companies. The investment "product" was developed by structured finance teams within the banks, and then put to the investment company board for consideration and approval. The whole process, although done inhouse within the banking group, was quite rigorous and the investor's board took separate legal and tax advice on whether the investment was a "good thing". I remember attending board meetings regularly as an external adviser to the board and being asked for my independent view. In that situation, it made sense for someone like me to be on the record as having advised at the board meeting. But for a tax adviser to attend board meetings in many other situations is perhaps not a good thing, particularly where the impression can be created of placing too much importance on the tax aspects of the subject-matter. HMRC are very alert to this when reviewing documentation in the course of an enquiry, and sometimes get carried away. I have a current enquiry for a multinational client where one of the many points taken by HMRC to demonstrate the tax motivation for a cross-border deal done years ago is the fact that a tax manager from one of the Big 4 attended certain meetings, as part of a large cast. Just like the pond life commentator, HMRC are taking things a bit too far with that sort of reaction to the presence of a tax person.

II. The Late Bird

You would think that, if it is a good thing to bring in tax specialists early, it must be a bad thing to bring them in late. But that is not always the case, as was demonstrated by the First-tier Tax Tribunal in its decision in *Euromoney Institutional Investor PLC v HMRC [2021] UK FTT 61(TC)*. I will come on to what the case was about shortly. But the point I want to make first is that the facts involved an internal tax specialist, the tax director of a corporate group, being brought into a corporate share sale at a very late stage on the seller's side; he then suggested a tweak to the consideration in order to get a tax benefit, and his advice was accepted to by his corporate colleagues as well as the purchaser! Even more impressively, the FTT upheld the availability of the added benefit sought.

III. The Euromoney Facts

So, what happened in the case? The facts can be summarised as follows:

- The taxpayer company, EPLC, was 63% owned by another company, DGMT. The tax director, Mr Flint, was DGMT's tax director, but also provided tax support to group subsidiaries including EPLC;
- EPLC had equity stakes in two joint venture companies, CDL and CNL, of 50% and 49% respectively;
- The other principal shareholder in both companies was DL, a company owned indirectly by DHPLC and directly by DTL-the decision does not expressly say so in terms of DTL's involvement, but this seems to make sense;
- A well-known private equity group, CG, wanted to

buy DHPLC and its underlying investments, including the stakes in CDL and CNL. Negotiations began in September 2014;

- CG also wanted to buy out EPLC's stakes in CDL and CNL;
- EPLC, on the other hand, wanted to acquire a large stake in its fellow joint-venturer, DL; it saw great potential in DL and wanted to be in a position to acquire it in a few years' time. I suppose acquiring DL (or DTL) was a feasible goal as, if CG successfully bought DL, it would have a private equity owner whose aim would be to increase the value of DL with a view to an exit in a few years. A trade buyer would not have the same goal of divestment, so there clearly seemed to be a realistic opportunity for EPLC in the future.

In order to bring together the aims of both seller and buyer, the deal struck was that CG would buy EPLC's stakes for a mixture of equity and cash. The final deal consisted of EPLC selling its holdings in CDL and CNL for US$85m, to be satisfied by a 15.5% equity stake in DTL (reflecting DL's value) and a cash consideration of US$26m. Commercial negotiations were concluded on that basis in October 2014 without any involvement from Mr Flint, or any other tax person.

Mr Flint was then told about the deal and had an idea. What if, instead of the cash element of the consideration, EPLC got preference shares which effectively behaved as deferred cash and were redeemable after an agreed period of months, not years? The idea was neat enough-to get full rollover relief for the sale by turning it into a 100% share exchange, and then to be eligible for the substantial shareholdings exemption ("SSE") when the preference shares were redeemed. The earliest redemption date was fixed so that the shares clearly satisfied the minimum period of holding condition in the SSE conditions. The net result was that payment of the cash element would be deferred but received tax-free on redemption.

Now, there are certain bits in the factual description in the Decision which are a bit unclear. While Mr Flint appears to have suggested that his "pref trick" (who remembers what that really was?) could be implemented for the full $26m of cash, it looks as if it was actually only implemented for $21m, and the balance remained as cash consideration attributable to the sale of the CNL holding. In other words, I think the transaction which was the subject of the appeal to the FTT was the exchange of EPLC's shares in CDL for ordinary and preference shares in DTL. CNL did not feature in this part.

As I alluded to earlier, Mr Flint's recommendation, subject to the variation from $26m to $21m for the preference shares, was adopted by his commercial colleagues-including in particular, Mr Fordham, who was EPLC's Group Managing Director, and who gave evidence along with Mr Flint. The variation was also accepted by CG with no objection-everyone assumed this was an optional extra which had no downside for anyone.

The amended deal was agreed on 5th November 2014. On the same day, Mr Flint applied to HMRC for rollover clearance under Section 135 of the Taxation of Chargeable Gains Act 1992 ("TCGA"). It is a little puzzling that HMRC raised questions on the clearance application on 9th December 2014 because this was outside the 30-day statutory period prescribed in Section 138(2). Perhaps they had asked other questions earlier, so that the period ran afresh from the previous request. Anyway, no-one seems to have objected to what, at first blush, looks like a late response. But the substantive response was dated 19th December and consisted of a refusal to grant clearance. As it turned out, the parties had implemented the exchange on the previous day, i.e., before the outcome of the clearance application was known.

HMRC refused to grant clearance on the basis that they considered that the exchange did formed part of a scheme or arrangements within Section 137(1) TCGA.

To fall outside Section 137(1), the exchange must be effected for bona fide commercial reasons and must not form part of a scheme or arrangements "of which the main purpose, or one of the main purposes, is avoidance of liability to capital gains tax or corporation tax".

I should say now, so that it requires no further consideration, that there was no dispute regarding the "bona fide commercial" limb of the wording, which HMRC accepted. The battle waged was over the second limb regarding tax avoidance. For brevity, I am going to refer to "the main purpose, or one of the main purposes" as "the predominant purpose".

There is no impermissible tax purpose to be found in the benefit of rollover treatment itself within Section 135. What appears to be objectionable is for that treatment to be coupled with another tax benefit, and for the obtaining of that second benefit to be a predominant purpose.

The preference shares in DTL (the Decision mistakenly refers to DL) were redeemed for cash on 17th January 2016. EPLC claimed the benefit of the SSE on that disposal. It also claimed rollover treatment for the 2014 share exchange in full despite HMRC's earlier refusal to grant clearance. The net result was that no tax was payable on either the share exchange or the redemption of the preference shares.

HMRC, on the other hand, took the view that Section 135 did not apply to the share exchange so that, in 2014, EPLC had disposed of its shareholding in CDL and the gain on that disposal was taxable.

The evidence before the FTT, in particular the evidence of both Mr Fordham and Mr Flint, was commendably clear. From Mr Fordham's viewpoint, the commercial deal was as notified to Mr Flint. The preference share variation was only worth considering if it was straightforward, did not alter the commercial deal, and had no downside. Mr Flint did not think the variation would jeopardise rollover relief for the share exchange consisting of the CDL shares being exchanged for 15.5% of DTL's ordinary shares as had been negotiated before his involvement. His introduction of the preference shares would only have upside. It was no more than "nice to have".

If there had been a risk of rollover relief on the ordinary shares for ordinary shares part of the exchange being denied, Mr Fordham said he would have rejected the preference share variation.

So, the commercial cake had effectively been baked before Mr Flint's involvement: everyone regarded the preference shares as nothing more than icing on the top, with no alteration to the taste of the cake, and the icing only making it look a little prettier. In fact, so unimportant was the availability of the tax benefit that the parties completed the deal a day before HMRC refused clearance.

IV. FTT Findings

The FTT made some strong findings of fact, which may benefit EPLC on appeal:

- The potential tax saving from the preference shares variation was nothing more than a bonus to EPLC;
- Tax was not the main driver of the transaction, which would have gone ahead anyway;
- Had the preference shares been rejected by CG, EPLC would have proceeded with the cash deal anyway (this seems like just another way of expressing the previous finding, but no matter);
- EPLC devoted little time to tax aspects: Mr Flint himself spent no more than 1-2 days in total on the tax planning;

- The clearance application did not hold up the commercial timetable;
- EPLC believed there was no tax downside, which is why the transaction was completed before HMRC's decision. The risk of clearance being refused was regarded as acceptable.

I could not help being amused by the finding about how little time Mr Flint spent on the transaction. It reminds me of the old adage that a tax adviser's worth should be measured by the value added, not by the number of hours spent. You cannot value the "Eureka" moment in the bath by applying an hourly rate.

V. Arguments

EPLC's main argument was simple: the arrangements implemented were entirely commercial. They were driven by commercial, not tax, purposes; those purposes were merely implemented in a tax-efficient way. They did not fall foul of Section 137(1).

Alternatively, the tax avoidance purpose inherent in the preference share variation, was not a main purpose of the arrangements, which must mean the overall arrangements for the exchange including the consideration consisting of ordinary shares in DTL.

HMRC contended that the arrangements were the arrangements for the issue of the preference shares i.e., those arrangements which came into being as a result of Mr Flint's late involvement. The whole of the exchange formed part of that arrangement, the predominant purpose of which, was tax avoidance.

The middle ground which EPLC had assumed would apply if clearance was denied, did not apply according to HMRC. That middle ground entailed saying that the arrangements were indeed those relating to the preference shares, but if they had a predominant tax avoidance purpose, then that should only affect the ordinary shares for preference shares part of the exchange, not all of it.

Two points agreed as common ground between the parties are interesting:

- Section 137(1) was an all-or-nothing provision. If it applied, none of the shares exchanged could qualify for rollover relief, including the ordinary shares;
- The whole exchange formed part of the "arrangements". However, the parties did not agree what the arrangements were.

VI. All-or-Nothing in Section 137(1)

The first point agreed is interesting because it seems to contradict the approach of EPLC to the deal negotiations. The preference shares were only built in on the basis that if Section 137(1) applied, the ordinary shares part of the exchange would survive. It could hardly do so on an "all-or-nothing" approach, as I explain below.

It is not entirely clear what the basis for the "all-or-nothing" approach is since there was no argument about it.

The approach may be based on the Upper Tribunal's decision in *Coll v HMRC [2010] UKUT 114*. This case was mentioned in the Decision, along with the High Court's decision in *Snell v HMRC [2007] STC 1279*. Both cases involved exchanges of shares for loan stock, with the loan stock redeemed by the exchanging shareholders at a point in time when they had become non-resident so as to be outside the UK tax net. The planning for non-residence was found to be a predominant purpose at the time of the exchange. There are no other cases on Section 137(1) decided in higher courts than the High Court. The relevant passage in *Coll* is as follows:

> *"The starting point is that if there is a reorganisation of a company's share capital within s 126 then by s 127 the original*

> *shares and the new holding are treated as a single asset. Either there is a reorganisation of the share capital of a company or there is not; if there is, the same treatment must apply to all the shares. Section 135(3) applies the same approach to a share exchange by treating both companies involved as a single company and the exchange as a reorganisation of the share capital of that deemed single company. Again, this treatment must apply to all the shares if it applies to any of them…. Section 137 says that s 135 shall not apply to any issue in the exchange unless the conditions there set out are satisfied, except that an unconnected shareholder holding 5% or less will in any event qualify under s 135. This also points to all the shareholders being treated in the same way."*

There is a little bit of circularity in this reasoning. For a share exchange to get the 126/127/135 single asset treatment, it needs to be a share exchange satisfying Section 137(1). If it does not do so, then the single asset treatment cannot apply. So, when you are considering the application of Section 137(1) to an exchange, you cannot start with the proposition that it already represents a single asset. That seems to me to beg the question. And if you do not presume singularity, then you look at the actual exchange to see if it is all fine within Section 137(1) or if any of it is not. If the latter, that means you need to identify the arrangements and to see whether the predominant tax purpose colours the whole exchange or just part of it.

I note the UT placed emphasis on the word "any" in Section 137(1) as somehow validating the proposition that the 137(1)-treatment applied to the whole exchange. But this is unconvincing: after all, the word "any" could mean a smaller part of the exchange than the whole. Had it said "all issues" in the exchange or "each and every issue", I can see the force of the *Coll* reasoning.

Unlike *Euromoney*, there was more than one selling shareholder in *Coll*: Mr and Mrs Coll were the two sellers. It is worth noting that the judges' comments in *Coll* reproduced above were made in response to a new argument taken on behalf of the taxpayers that Mr Coll's perceived tax avoidance purpose should not affect Mrs Coll's treatment on the exchange if she did not have the same purpose. This was rejected on the basis that all shareholders should have the same treatment under the "all-or-nothing" approach. To my mind, it does not necessarily follow that the same approach should apply where there is one selling shareholder, but the exchange consists of two different forms of paper consideration, one of which is inserted for tax avoidance purposes. Neither *Snell* nor *Coll* addresses this at all. The *Coll* approach, applying as it did to different shareholders, was more in the nature of "all for one, one for all" rather than "all-or-nothing" in relation to the exchange. The tax avoidance purpose in the *Coll* scenario applied to both shareholders. In *Euromoney*, this was academic since there was only one shareholder: indeed, in *Snell*, there was also in practice a single shareholder-Mr Snell, who owned 91% of the company. The case concerned only his tax position. So, there was no need for the "all for one, one for all" approach, and no need to spell out that the whole of the exchange was affected: Mr Snell exchanged all his shares for loan notes with a view to redeeming them when he had become non-resident. The predominant tax purpose extended to the whole exchange.

EPLC appears to have concluded that the partial approach to Section 137(1) was legitimate. If EPLC had known that the preference share variation could have affected the tax treatment of the whole exchange in a negative way, then it would not have proceeded. This is leaving aside any question of defining what the "arrangements" were. I deal with this next.

VII. Identifying the Arrangements

The passage from *Coll* set out above was in fact adopted by the FTT in *Euromoney* as authority for the proposition that the whole of the exchange, consisting of a single asset, had to form part of the arrangements within Section 137(1). This is not quite what the Upper Tribunal said in *Coll*, but there are probably other ways of arriving at the same conclusion.

The relevant statutory wording requires that the "exchange", which the FTT and the parties took to mean the whole exchange, "does not form part of a scheme or arrangements of which the main purpose, or one of the main purposes, is [tax avoidance]". Now, if the arrangements are those relating only to the preference shares, it is hard to see how a bigger arrangement, consisting of the overall exchange, can form part of this smaller arrangement. Arguably it cannot as a matter of plain English. The only way in which one might get there is to say that the SSE availability in the future on redemption of the preference shares depends on the status of the ordinary shares, so there is some cross-contamination between the two parts of the exchange such that the ordinary shares part also acquires a tax avoidance purpose. This again can only have happened once the parties decided to go with the preference shares. Until then, there was clearly no tax avoidance purpose.

But that is not what HMRC argued. They said, more simply, that the arrangements were only those involving the replacement of the cash consideration with the preference shares and holding them until the SSE became available on redemption. I struggle with how the wider exchange can form part of this smaller arrangement without some cross-contamination.

So, if you take HMRC's view of the arrangements, they are the preference shares variation of the exchange only. Since that variation is purely tax driven, the arrangements have a predominant tax purpose. On the all-or nothing approach to Section 137(1), it follows that the whole of the exchange did not qualify for rollover treatment.

EPLC, on the other hand, argued that the arrangements cannot be less than the whole exchange as a matter of plain construction of the statutory language. If the whole exchange forms part of the arrangements, then there cannot be a predominant tax purpose. So, on this view of things, the all-or-nothing approach meant that the whole exchange should get the benefit of rollover relief.

The FTT preferred EPLC's view of the arrangements and concluded that, while there was a predominant tax purpose for the preference shares, when one looked at the arrangements as a whole, the predominance did not extend to the ordinary shares part of the exchange, which was a much bigger part. Accordingly, EPLC would be entitled to rollover relief on the exchange and the subsequent redemption of the preference shares qualified for the SSE.

The way in which the appeal was argued raised the stakes considerably higher than the way in which Mr Flint had, with some justification, thought about his own idea. The safest way of concluding there was no downside would have been to say that the exchange itself could be split between a good bit and a bad bit and, if the arrangements, whatever they were, had a predominant tax purpose, then that would taint only the bad bit. But accepting the all-or-nothing approach meant that the splitting treatment was unavailable and the battle had to be won by EPLC on defining the arrangements. As it turned out, EPLC was victorious.

Neither party argued as a fallback that the denial of rollover relief should be restricted only to the exchange for preference shares.

As I said earlier, the case has gone on appeal, and I would expect it to be heard in the summer. Since the UT judge(s) will have the same seniority as the judges in *Snell* and *Coll*, I hope the new judges will take the opportunity to clarify a number of points, both on the "all-or-nothing" approach and on the scope of arrangements. Of course, they may not get a chance to do so on the first topic if it is again agreed as common ground by the parties.

While EPLC succeeded in the FTT, I think another successful outcome is far from clear; but, as a matter of plain common sense, it would be harsh for EPLC to be denied relief for the ordinary shares part of the exchange. Getting to that conclusion, on the basis of the current authorities, is not easy.

VIII. BlackRock

The *Euromoney* case has been lumped together by a number of commentators with an earlier decision of the FTT: *BlackRock HoldCo 5 LLC v HMRC [2020] UKFTT 443 (TC)*. The relevant part of that case relates to tax avoidance purposes again, but this time in relation to the "unallowable purposes" provision for loan relationships in Section 441 of the Corporation Taxes Act 2009. In a nutshell, companies are denied loan relationship deductions which, on a just and reasonable basis, are attributable to an "unallowable purpose" which is not within the business or commercial purposes of the company. A tax avoidance purpose is capable of being a business or commercial purpose, but only if it is not a main purpose, or one of the main purposes, for the company either being a party to the relevant loan relationship or entering into a related transaction e.g., terminating the loan.

The facts of *BlackRock* are complex, and the main thrust of the appeal related to transfer pricing: I suppose I should use the word "main" guardedly given the current topic, but I do so on the basis that the transfer pricing issue took up paragraphs 56-106 of the decision, and the unallowable purpose issue took up only paragraphs 107-122. Whether the unallowable purpose issue had to be adjudicated on at all also depended on the outcome of the transfer pricing issue.

The question at issue was whether a BlackRock special purpose investment company, LLC5, was entitled to tax deductions in relation to loan relationships entered into as part of a larger series of transactions within the group to facilitate a substantial corporate acquisition.

The judge found that LLC5 had both commercial and tax avoidance purposes for entering into and being a debtor party to the loan relationships, and that both those purposes were main purposes. This led him to state that a just and reasonable apportionment was required by Section 441 between the two main purposes. He concluded that, since the tax avoidance purpose did not generate any larger relief than that generated by the commercial purpose on its own, a just and reasonable approach meant that the deduction claimed did not have to be reduced because of the tax avoidance purpose. Quite simply, that purpose did not enhance the amount of the deduction. He had found earlier that LLC5 would have entered into the transaction whether or not the tax relief was available, a little like EPLC. In adopting this approach, he followed the approach of another FTT judge in the decision of *Oxford Instruments UK 2013 Ltd v HMRC [2019] UK FTT 254 (TC).*[1]

BlackRock and *Euromoney* are notable for the fact that the taxpayer was successful in a notoriously difficult area of law involving the sensitive topic of tax avoidance purposes. Both cases will be heard on appeal later this year, so it remains to be seen whether that success survives. Although the relevant statutory provisions in each case are different, there is some commonality in having to identify the approach to be adopted where both commercial and tax avoidance purposes are to be found in the facts. Section 441 requires one to look at a just and reasonable apportionment between the two: there is no such provision in Section 137(1). What is interesting about the just and apportionment approach is that, to this day, there is not a single case where this apportionment was made arithmetically, so as to give the taxpayer a partial tax deduction. Even on a just and reasonable apportionment, as demonstrated by *BlackRock* itself, we remain in "all-or-nothing" territory. In *BlackRock*, the taxpayer got all and HMRC nothing, whereas in *Oxford Instruments*, the position was reversed. To me, this is too much of a lottery even for litigation. We need the higher courts to determine a rational approach to statutory justice and reasonableness.

But if Section 137(1) had a just and reasonable feature, and one asked what would have happened without the preference shares, the answer is that rollover relief would only have applied to the ordinary shares-for-ordinary shares exchange, with the cash consideration giving rise to a tax charge on any gain.

If you build in the preference share feature, then, apparently unlike Section 441, the tax benefit is increased because rollover relief applies to the full exchange. On that basis, it seems just and reasonable to deny relief only for the increase in the rollover brought about by the preference shares.

As it happens, in *Euromoney*, the all-or-nothing pendulum swung towards the taxpayer, so the question of downside risk has so far proved academic. But pendulums can swing the other way.

Finally, given how I started, I thought I should consider what might have happened had Mr Flint been brought in much earlier in the discussions i.e., at the structuring stage. You may say that I am bound to say this, but I believe that EPLC could have been on even stronger ground if the preference share variation had developed as part of the commercial discussions. Of course, evidence is key. As I understand it, CG, the purchaser, originally made a cash only offer, which was then modified by EPLC looking for an equity stake in DTL. Had the preference shares been included in that counter-offer, the commerciality would have looked that much stronger-and the main purpose of securing the SSE might even have been relegated to a tax consequence, not a purpose. This might even have prompted

HMRC to grant clearance. But I accept this is speculation: I just do not want to end with the impression that *Euromoney* is authority for the proposition that it does not matter how late you leave it to bring in tax specialists. Pond life matters!

Endnotes

1. For a detailed discussion of this case, please see my article "Judicial Unallowable Purposes", published in January 2020 in GITC Review, Vol. XVI, No. 2.

THE LIMITS OF LIMITED LIABILITY

Michael Firth

For individuals operating "through" an English company limited by shares, great comfort is often derived from knowing that the principle of "limited liability" stands between him/her and the creditors or potential creditors of the company. Indeed, it is understandably easier to take entrepreneurial risks when the downside is limited to what you, as an investor, have chosen to contribute to the company. If the risk pays off, nobody will be left out of pocket. If it does not, and the company faces insolvency, the company's counterparties can usually be assumed to have known that they were dealing with a limited liability company and considered the risks involved.

One entity that does not get to choose or consider its "customers" is HMRC. Companies build up tax debts through the ordinary operation of a business, even a loss-making one, for instance, can incur liabilities for PAYE and VAT. In general, there is very little that HMRC can do to stop a company carrying on business, and if the company goes into insolvency owing HMRC significant sums, that is not usually a risk HMRC has had the opportunity to consider.

There are various provisions in the tax code that allow HMRC to seek to protect themselves to some extent. For instance, transferring PAYE liabilities from employer to employees (SI 2003/2682, rr.72 and r.81) or demanding security as a condition of trading (VATA 1994, Sch 11, para 4). A trend that has become more apparent in recent years, however, is the use by liquidators (directly or through litigation funders) of company law mechanisms for pursuing persons who were involved with an insolvent company to recover the losses of that company. It is the latter which are the subject-matter of the present article.

These mechanisms do not involve piercing the corporate veil, but, rather, rely on allegations that one or more individuals involved with the company have not complied with company law obligations and, as a result, have incurred a liability to the company for losses suffered. For instance, it might be alleged that a director was in breach of his/her duties as a director, in allowing the company to enter into a tax avoidance arrangement, without making provision for the potential tax liabilities, if the scheme failed and that he should reimburse the company for losses suffered as a result. Once the director gets over the initial shock of seeing that there are limits to limited liability, he/she will find that the underlying legal issues are complex, both in terms of the basis for making such a claim and the potential responses and defences.

The following areas are explored in this article:

(1) Piercing the corporate veil.

(2) Recovery of unlawful dividends.

(3) Breach of directors' duties.

(4) Other grounds of potential liability

(1) Piercing the corporate veil

Piercing the corporate veil means disregarding the separate personality of the company (*Prest v. Petrodel Resources Ltd* [2013] UKSC 34, §16). This might happen where the corporate veil is being abused to evade or frustrate the law:

> "[35] I conclude that there is a limited principle of English law which applies when a person is under an existing legal obligation or liability or subject to an existing legal restriction which he deliberately evades or whose enforcement he deliberately frustrates by interposing a company under his control. The court may then pierce the corporate veil for the purpose, and only for the purpose, of depriving the company or its controller of the advantage that they would otherwise have obtained

> by the company's separate legal personality. The principle is properly described as a limited one, because in almost every case where the test is satisfied, the facts will in practice disclose a legal relationship between the company and its controller which will make it unnecessary to pierce the corporate veil. Like Munby J in *Ben Hashem,* I consider that if it is not necessary to pierce the corporate veil, it is not appropriate to do so, because on that footing there is no public policy imperative which justifies that course. I therefore disagree with the Court of Appeal in *VTB Capital* who suggested otherwise at para 79. For all of these reasons, the principle has been recognised far more often than it has been applied. But the recognition of a small residual category of cases where the abuse of the corporate veil to evade or frustrate the law can be addressed only by disregarding the legal personality of the company is, I believe, consistent with authority and with long-standing principles of legal policy."

The limited nature of this exception is illustrated by *Hurstwood Properties (A) Ltd v. Rossendale BC* [2021] UKSC 16, which concerned a business rates avoidance scheme. Under that scheme, the registered owner of an unoccupied property granted a short lease to an SPV such that it was intended to become the 'owner' and liable for the tax. The SPV was then dissolved or put into liquidation at which point it was argued that either an exemption for companies in winding up applies (liquidation version) or that, upon dissolution, the lease and liability automatically transferred to the Crown as bona vacantia.

One argument for the local authorities was that the use of the SPV was an abuse of its separate corporate personality and the corporate veil could be pierced. The Supreme Court held that, even ignoring the fact that the registered owners were not shareholders of the SPVs (so it was not clear what piercing the veil would achieve), the corporate veil could not be pierced so as to visit the liability of the company onto its shareholder:

> "[72] Even if there is an "evasion principle" which may in "a small residual category of cases" (per Lord Sumption) justify holding a company liable for breach of an obligation owed by its controlling shareholder, we are not ourselves convinced that there is any real scope for applying such a principle in the opposite direction so as hold a person who owns or controls a company liable for breach of an obligation which has only ever been undertaken by the company itself…"

On the facts, however, the tax avoidance scheme failed because the SPVs did not became "owners" upon a proper construction of the legislation because they did not become entitled to possession of the demised property – the landlord remained the owner and liable for the rates.

It follows that in situations where a company becomes insolvent owing tax debts, piercing the corporate veil ranks highly for legal concepts with vivid, attention-grabbing names, but low for chances of being seen in real life.

(2) Recovery of unlawful dividends

The inverse of the limited liability of persons acting through companies is that there are important restrictions on how and when assets may be taken out of companies, so as to protect creditors from the dissipation of assets that would otherwise be used to pay their debts.

These restrictions include the principle that distributions may only be paid out of profits available for the purpose (CA 2006, s.830) and must be justified by relevant accounts (last annual accounts, interim accounts or initial accounts) (s.836).

This makes it important to know what is and is not a "distribution". In this respect, distribution is not limited to transactions purporting to be dividends but, equally, does not include every situation in which there is a transfer of value out of a company.

The general principle arising out of the case law is that it is necessary to inquire into the true purpose and substance of the impugned transaction. In some cases, it will be obvious on an objective appraisal that the payment is simply a transfer of value to a shareholder qua shareholder and a distribution, but in others, for instance a sale at undervalue, it will be necessary to consider subjective intentions:

> "[29] The participants' subjective intentions are however sometimes relevant, and a distribution disguised as an arm's length commercial transaction is the paradigm example. If a company sells to a shareholder at a low value assets which are difficult to value precisely, but which are potentially very valuable, the transaction may call for close scrutiny, and the company's financial position, and the actual motives and intentions of the directors, will be highly relevant. There may be questions to be asked as to whether the company was under financial pressure compelling it to sell at an inopportune time, as to what advice was taken, how the market was tested, and how the terms of the deal were negotiated. If the conclusion is that it was a genuine arm's length transaction then it will stand, even if it may, with hindsight, appear to have been a bad bargain. If it was an improper attempt to extract value by the pretence of an arm's length sale, it will be held unlawful. But either conclusion will depend on a realistic assessment of all the relevant facts, not simply a retrospective valuation exercise in isolation from all other inquiries." (*Progress Property Company Ltd v. Moorgarth Group Ltd* [2010] UKSC 55)

In *Re Implement Consulting Limited [2019] EWHC 2855 (Ch), payments into an employee benefits trust (EBT) were reclassified as unlawful dividends:*

> "[7] In my judgment although the payments of the Company's capital were made to the Respondents via a trust or interest in possession fund, they were in substance distributions. Due to a failure to comply with the statutory code they constitute unlawful distributions and are void. Later payments totalling £70,000 made to the shareholders in 2013 also constituted unlawful distributions. One shareholder and employee, Mr Flanagan, received £30,000 in expenses in March 2013. Such payments were made at a time when the Company was insolvent, and in breach of directors' duties."

It was important in that case, however, that each of the beneficiaries was also a shareholder and the payments were calculated by dividing the capital paid out of the company to match the number of shares each of them held.

Where an unlawful distribution is identified, the recipient is liable to repay it, if they knew or had reasonable grounds for believing that it was unlawful (CA 2006, s.847). This test has been held to require knowledge of the facts that make the distribution unlawful, not knowledge of the law (*Re It's A Wrap* (UK) Ltd [2006] EWCA Civ 544, §50), although it is difficult to see how someone can know a dividend is unlawful without having some understanding of the law. It is suggested that the decision in *Tooth v. HMRC* [2021] UKSC 17 on the meaning of deliberate (which requires an intention to mislead) points in a different direction. The "reasonable grounds for believing" test would, however, cast the net wider.

If the recipient had actual knowledge that the distribution was unlawful, there may also be a constructive trust of the amount received, in favour of the company, to the extent that it can be traced (Precision Dipping Ltd v. Precision Dippings Marketing Ltd [1986] Ch 447, Dillon LJ).

The limits on this basis of liability depend upon the reason why the distribution was unlawful. For instance, if the dividend is unlawful because it is in excess of the distributable reserves, it is only unlawful to the extent of the excess (*Re Marini Ltd [2003] EWHC 334).*

(3) Breach of directors' duties

A number of duties owed by directors may become relevant in the context of an insolvent company with tax debts:

(1) Duty to act within powers/for the purposes for which they are conferred (CA 2006, s.171). In order to fall foul of this duty, the improper purpose must be the primary purpose (or, perhaps, a but-for cause) (*BTI 2014 LLC v. Sequana SA* [2019] EWCA Civ 112, §233).

(2) Duty to promote the success of the company (s.172). In *Re Vining Sparks UK Ltd* [2019] EWHC 2885 (Ch), it was held that contributions to an EBT tax scheme were not dishonest, in the sense that they were made otherwise than with a view to promoting the success of the company.

(3) Duty to exercise independent judgment (s.173).

(4) Duty to exercise reasonable care, skill and diligence (s.174).

(5) Duty to avoid conflicts of interest (s.175).

(6) Duty not to accept benefits from third parties (s.176).

(7) Duty to declare interest in proposed transaction or arrangement (s.177).

There is also a duty to consider the interests of creditors, but this is only triggered if the company is or is likely to become insolvent (*Sequana SA,* §220). This can catch dividends that are otherwise lawful if they leave the company unable to pay debts when due:

> "[224]...The problem facing his submission is that, even in the case of an insolvent company, Part 23 does not

> occupy the whole field. An example will show this. The latest accounts of a company show distributable profits and the directors propose to pay a dividend that does not exceed those profits. There has been no diminution in the value of the company's assets since the date of the accounts nor have the total liabilities increased since that date. The payment of a dividend would not therefore represent a return of capital. However, the dividend would exhaust the company's cash resources and, let it be assumed, the company would be unable to raise cash from other sources after the dividend was paid. Payment of the dividend would therefore leave the company unable to pay its debts as and when they fell due. The company would be insolvent on a cash-flow basis, but not on a balance sheet basis. Part 23 would not prohibit the payment of the dividend, but the creditors' interests duty established by the authorities would do so. It would be a breach of duty by the directors to pay the dividend, and it would not be open to ratification by the shareholders."
> (*BTI 2014 LLC v. Sequana SA* [2019] EWCA Civ 112)

It is not just persons who are formally appointed as directors who are subject to these responsibilities – so are *de facto directors, i.e. persons who act as directors, even though not formally appointed:*

> "[39]...All one can say, as a generality, is that all the relevant factors must be taken into account. But it is possible to obtain some guidance by looking at the purpose of the section. As Millett J said in *Re Hydrodam (Corby) Ltd* [1994] 2 BCLC 180, 182, the liability is imposed on those who were in a position to prevent damage to creditors by taking proper steps to protect their interests. As he put it, those who assume to act as directors and who thereby exercise the powers and discharge the functions of a director, whether validly appointed or not,

> must accept the responsibilities of the office. So one must look at what the person actually did to see whether he assumed those responsibilities in relation to the subject company." (*HMRC v. Holland* [2010] UKSC 51)

A common instance where liquidators seek to find breaches of one or more duties is where assets of the company are distributed on the basis of accounts that do not make provision for potential tax debts.

> "[95] I comment that from this date, to enter into an arrangement which sought to achieve a distribution of assets, without regard to the requirements of statute, and without making proper provision for creditors was, itself a breach of duties which directors owe to a company: *MacPherson v European Stategic Bureau* [2000] 2 BCLC 683 paragraph 48. Having reached the conclusion above, the expenses paid to Mr Flanagan in March 2013 constituted a breach of duties. The Company was not bound, at the date of the expense payment, to make the payment. The Company owed a duty to its creditors to keep its property inviolate and available for the repayment of its debts." (*Re Implement Consulting Limited* [2019] EWHC 2855 (Ch), ICCJ Briggs)

A provision is required to be made if the tax liability is more likely than not to exist (*HMRC v. Holland* [2008] EWHC 2200 (Ch), Mark Cawson QC, §§196 - 199). One judges this by references to a reasonably objective view of the facts as known or reasonably ascertainable by those taking the decision to pay the dividend.

The consequence of a breach of directors' duty is usually that the director is required to restore moneys wrongfully paid out – for instance, to compensate the company for the sum that was paid out by way of unlawful distribution.

There is, however, a discretion to excuse a director for breaching his/her duties:

> "(1) If in proceedings for negligence, default, breach of duty or breach of trust against—
>
> (a) an officer of a company, or
>
> (b) a person employed by a company as auditor (whether he is or is not an officer of the company),

it appears to the court hearing the case that the officer or person is or may be liable but that he acted honestly and reasonably, and that having regard to all the circumstances of the case (including those connected with his appointment) he ought fairly to be excused, the court may relieve him, either wholly or in part, from his liability on such terms as it thinks fit." (CA 2006, s.1157(1))

In this respect, conduct can be reasonable, even if it amounted to a lack of reasonable care:

> "[225] In *Re D'Jan of London Limited* (supra) at 564, Hoffman LJ pointed out that the wording of Section 727 itself contemplates that conduct may be reasonable for the purposes of Section 727, despite amounting to lack of reasonable care at common law.
>
> [226] By extension, it seems to me that it would be at least possible for conduct to be held to be "reasonable" for the purposes of Section 727, even though the conduct complained of was of a failure to make provision, when, on a reasonable objective view, provision ought to have been made for HRCT." (*HMRC v Holland* [2008] EWHC 2200 (Ch), Mark Cawson QC)

It may also be particularly relevant to consider the extent to which the distribution could lawfully have been made:

> "[413] While I do not accept that the discretion in s.1157

> is fettered such that the court can never relieve a director from liability in circumstances where he or she is the recipient of the unlawful dividend, even where the company subsequently goes into liquidation so that the retention of the dividend can be said to be at the expense of creditors, I nevertheless accept that the fact that a director received an unlawful dividend at the expense of creditors is a powerful factor against granting relief. Whether that factor is enough to preclude relief being granted will depend upon matters such as the causal link between the dividend and prejudice to creditors, the length of time between the dividend and the action being commenced and whether the director retains the benefit of the dividend.
>
> [414] Of particular relevance, therefore, is the extent to which the Distribution could lawfully have been made in the circumstances existing at the time (this being recognised as a potentially relevant factor by Robert Walker LJ in *Bairstow v Queens Moat Houses plc* [2002] BCC 91, at [36], and by HHJ Seymour in Marini)." (*Burnden Holdings (UK) Ltd v. Hunt* [2019] EWHC 1566 (Ch), Zacaroli J)

This principle is often of significance in EBT cases, where the contributions to the trust were made at a time when the company had sufficient funds to have declared dividends, but, by the time the tax consequences have been determined, was insolvent.

Reliance on professional advice in respect of the tax consequences is also often a significant factor in demonstrating reasonableness.

By way of example, relief was granted when relying on professional advice regarding tax up until the point when leading Counsel advised that the scheme did not work in *HMRC v. Holland* (High Court, §§236 – 269), but was refused in Re Loquitur where there was no genuine belief that the scheme would work.

It is also important to remember that, although controlled by the liquidator, it is the company who has the right to bring a claim against the directors and it may be that the alleged breaches were ratified by the company (acting through its shareholders) at the time. This is often referred to as the "Duomatic principle", but that principle does not apply if the company is insolvent or likely to become insolvent at the time (*Burnden Holdings (UK) Ltd*, §402).

(4) Other grounds of potential liability

Apart from the above, liquidators will often consider whether a number of other grounds for recouping the company's losses are available. These include:

(1) Transactions at undervalue within two years before the onset of insolvency (IA 1986, s.238 onwards).

(2) Transactions at undervalue at any time for the purpose of prejudicing creditors (IA 1986, s.423).

It was held in *Sequana SA* that a dividend is a transaction within the scope of s.423. Furthermore, although a dividend is not a gift, it is for no consideration. On the other hand, employee remuneration packages are not generally regarded as transactions at undervalue.

In order to fall within s.423, the purpose of prejudicing creditors need only be a purpose, but must be more than a mere consequence.

(3) Unlawful preference of a creditor (IA 1986, s.239) – the preference must be influenced by the purpose of putting that person in a better position, but this is presumed if the person is connected with the company.

(4) Wrongful trading (trading when the person ought to have

known there was no reasonable prospect of avoiding insolvent liquidation) (IA 1986, s.214).

(5) Fraudulent trading (trading with the intent to defraud creditors or any other fraudulent effect) (IA s.213).

When faced with claims based on such grounds, the potential defences depend very much on the facts. The court has a discretion as to the remedy to grant, subject to not granting any remedy (IA, s.212, *HMRC v. Holland*, §§49 – 51) and this may be used in a similar way to the discretion to excuse directors from breaching their duties. Equally, and in every case, it is important to consider limitation periods for any claim, although these raise complex issues of their own.

Conclusion

It can be a seductive thought for persons involved with companies that have built up significant tax debts to simply let the company fall into insolvent liquidation and "walk away" in reliance on the principle of limited liability. Increasingly, the reality is that at some point such persons receive a tap on the shoulder from the liquidator (or a litigation funder who has purchased claims from the liquidator), that will quickly disabuse them of this notion.

The nature of negotiations with such liquidators/litigation funders is not similar to negotiation with HMRC. HMRC are bound by their litigation and settlement strategy and usually see no scope to split the difference or do a deal. Liquidators/litigation funders, however, are generally entirely commercial in their outlook. At the end of the day, they are interested in how much they believe they can claim, the strength of the claim and how much the proposed defendant can afford to pay. They are often very interested in doing deals, but getting the best deal depends upon proper strategy and understanding of the defendant's position.

A final point to mention in respect of company insolvency is the prospect of directors' disqualification. For some, the possibility of being barred from acting as a director for a number of years is something that can be lived with, but for others it can be a fundamental point that guides their whole approach to the potential insolvency of their company. Once again, proper strategy and understanding of the individual's legal position is essential, but identifying the risk in the first place (rather than, for instance, simply diving in with a liquidation) is key to being able to seek to manage it.

DISGUISED TAX

Sam Brodsky

My old university college rang me up a few weeks ago, asking for donations to support those on lower incomes attending the college free of tuition fees. Money raised would, they said, allow the college to offer more places to those who need them most, and those people wouldn't have to pay a penny to get one of the best university educations in the world.

But that offering is a little confused. No one (or almost no one) pays tuition fees. University education in this country is free at the point of entry. No student at 18 is transferring their university £9000 a year in cash. (Maybe some ask their parents to do so, but that's a small minority).

"But what about the student loans" I hear you say. These are not real loans. There are no affordability checks, no home repossessions, no warnings about getting into debt. The money is not a real debt because does not need to be paid back unless you earn a specific amount and it is calculated as a percentage of your income. It is a Governmental charge levied as a percentage of your income: it is an income tax. And it is periodically raised by the government, whether by increasing tuition fees, the rate of "interest" on the "loan", or the rates by which it is repaid.

Indeed there is now a trend for calling taxes on income *anything but* income tax. We have national insurance contributions, student loans, child maintenance and various tricks and traps (like losing your personal allowance). It is a common pledge of those seeking power to say that they will not raise income tax, but wanting (in actual fact) to raise income tax.

This is a real problem. It is politically dishonest. If you campaign on a slogan not to raise income tax, then don't raise any taxes on income. The public see through it.

The second issue is that it disguises the true effect of these income taxes, which can be regressive and counter-intuitive. In 2019 complex changes to pension tax relief meant that doctors were financially forced to refuse to work extra shifts, as they would have been penalised significantly if their income hit a certain amount.

National Insurance Contributions are complex and outdated, with the majority of the public not entirely understanding what they are for or why they are paid. NIC rates generally go *down* for those on higher incomes.

Another disguised charge on income is the child maintenance payment. It is levied as a percentage of the income of "paying parent", irrespective of whether this amount is more or less than is required to support the child and the "receiving parent" is under no obligation to spend the money on the child or to account for how it's spent.

Some of these disguised taxes on income are very dangerous. The child maintenance system works in those (limited) cases where the specified percentage of the paying parent's income actually matches their share of their child's costs. But, in all other cases, it means either (a) the child's primary carer not receiving enough for the support of the child, or (b) a parent having to make gratuitous payments to an ex-partner for no real reason, with no way of making sure that the money actually goes to their child. The saddest part is that it gives one parent a financial incentive to limit the involvement of the other parent in the child's life.

And what about a student loan? It is a regressive tax on income, because (a) it generally charges younger people more (as university fees have risen sharply over the last 15 years) and (b) those who earn less, and so take a longer time to "pay back the loan", will pay more tax due to the "interest" charges.

The same is true of my old college's offer to pay off some students' loans, because that decision is effectively a decision to pay some people's tax in the future. So one beneficiary might go on to a highly paid job in the city, but pay less of this (disguised) tax than their friend who works as a nurse.

If we decide that graduates should pay more tax because they accessed a particular state service, then this tax (which should be called the *Graduate Income Tax*) should be levied at the same rate on all university graduates.

GIFT WITH RESERVATION OF BENEFIT? *NIL DESPERANDUM!*

Harry Winter

When I was a pupil tax barrister, possibly the only thing I knew more about than some of my pupil masters was Latin. This led to my being cited in oral submissions to the Supreme Court as an authority as to whether certain words in the traditional (Latin) definition of interest were in the accusative or ablative. Rather less publicly, one pupil master asked me to translate his personal credo into a snappy classical aphorism. That was "never give up". I was happily able to respond that no less a poet than Horace had already done the job – "nil desperandum". (As an aside to linguists who are considering the Bar, I was also called upon to give Sanskrit lessons to an existing tenant. *Sic itur ad astra.*)

Horace, of course, had somehow transferred from being on the losing side of a brutal civil war to a lovely villa outside Rome given to him by a grateful emperor, so perhaps had good cause never to give up. But not only is it generally very good advice, it is also particularly good advice on tax matters, where there is usually some argument to deal with even the greatest pickles. Gifts with reservation of benefit can fall into that camp. Take the following situation. A client's parents decided long ago that they would transfer his house to him and indeed did so. Naturally, they did not actually wish to leave the house and did not do so. The parents having died, the client is unpleasantly surprised that not only is there an inheritance tax bill, but the capital gains tax uplift on death does not apply when he comes to sell it.

The gift with reservation of benefit case law in the

Inheritance Tax Act contains a number of quirks and exceptions. The first port of call is, of course, to study those. But there are two options of last resort that may not occur to all. Before throwing in the towel, they are worth looking at.

First, setting aside the gift for mistake, such that the law operates as if no gift had ever been given. This option relies either on an order from the High Court, or, potentially, simply on arguing before the Tax Tribunal that Equity treats as done that which ought to be done (see *Lobler v HMRC* [2015] UKUT 0152 (TCC) and *AC v DC* [2012] EWHC 2032 (Fam) at [31]). HMRC are known to disagree with the proposition that no recourse to the High Court is necessary however, so unless there are severe financial pressures going straight to the Tax Tribunal is usually the less desirable option. The principles that the High Court applies are set out in *Van der Merwe v Goldman* [2016] EWHC 790 (Ch). Broadly a donor (or his estate) can rescind a gift by showing that he acted under some mistake of so serious a character as to render it unjust on the part of the donee to retain the gift. It does not matter if that mistake was due to carelessness nor that a mistake was about the tax consequences of a transaction. So, on our facts, if it can be established that the parents believed there were no adverse IHT consequences of giving away their house, then the transaction could be rescinded and the CGT uplift obtained.

Second, a resulting bare trust. Recall that bare trusts are (broadly) ignored for IHT and CGT purposes, such that if there is a bare trust then the tax statutes operate as if the property had always belonged to the donor. When a property is transferred gratuitously to another, there is a general legal presumption that the equitable interest is not transferred but merely the legal interest (*Westdeutsche Landesbank Girozentrale v Islington LBC* [1996] A.C. 669). On our facts, there is a complication by another presumption, i.e. the so-called presumption of advancement which assumes a parent does indeed wish to give his child an equitable interest (*Chettiar v Chettiar* [1962] A.C. 294, PC). However, evidence as to intention can overrule the presumption of advancement. Parents who continue to live in the property, do not pay rent, pay for bills, insurance, mortgage, repairs, renovations and so forth very arguably did not intend to benefit their children. Naturally, if the parents are still alive, they can give evidence of what their intention was.

While the title of this article referred to gifts with reservations of benefits, the two options outlined above apply more broadly whenever a transfer of property has potentially adverse tax consequences. *Nil desperandum* indeed!

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