

All bets are off(shore)

Gordon Watt considers recent cases on the transfer of assets abroad legislation and the defences that may apply.

The transfer of assets abroad code (TOAA) is a wide-ranging anti-avoidance measure that taxes UK-resident individuals on income earned by non-resident entities. It has been part of income tax since 1936 but, despite its long pedigree, there have been relatively few cases delineating its parameters. HMRC's record with TOAA is also rather mixed. It has been invoked in circumstances in which it has no proper application with, it has to be said, somewhat unjust results. So, two recent decisions are a welcome addition to the jurisprudence.

Outline

Reflecting amendments over the years, particularly in ITA 2007, Pt 13 ch 2 which rewrote and expanded provisions previously in TA 1988, there are two branches to the code.

The first imposes liability to income tax on an individual (together with any spouse or civil partner) who has transferred property or assets if, as a result of the transfer or associated operations, income is payable to a non-resident person (ITA 2007, s 720 et seq and s 727 et seq). Liability depends on the transferor either having the power to enjoy income, or having received or being entitled to receive a capital sum connected with the transfer. UK residence in the tax year triggers liability, not residence at the time of the transfer. An individual's deemed income potentially equates to *all* the income of the person abroad which derives from the original transfer, with some exceptions for non-domiciled residents. Even receipt of a small capital payment can, it seems, mean that all resulting foreign income is attributed to the transferor.

Key points

- The two branches to the transfer of assets abroad code.
- Case law and the concept of a 'quasi-transferor'.
- The rules deter UK resident individuals from avoiding tax by moving income-producing assets offshore.
- The *Rialas* and *Fisher* cases.
- The two motive defences and the burden of proof.
- There should be a reasonable correlation between liability and economic reality.
- Does the transfer of assets abroad legislation infringe the EU's free movement principles?



The second branch, in essence, imposes liability on a UK resident individual who receives a benefit provided out of assets available for the purpose because of a transfer by virtue of which income is payable to a non-resident entity (ITA 2007, s 731 et seq). For example, think of the beneficiary of a non-resident trust who receives a capital payment or enjoys the use of assets. Income of the non-resident equal in value to the benefit is attributed to the recipient and taxed accordingly, capped if the relevant income is less.

If a transfer was not at market value there is an exemption from liability if tax avoidance was not the purpose or one of the purposes of the arrangement (s 737, condition A). If the transfer was on arm's length commercial terms there's an exemption conditional on the transaction having been no more than incidentally designed to avoid tax (s 737, condition B).

Liability arises unless the taxpayer discharges the onus of showing one of the exemptions applies.

Transferors and quasi-transferors

ITA 2007, s 720 expressly imposes liability on individuals who transfer assets even if there are associated operations involving legal persons by virtue of which a power to enjoy arises. The concept of a 'quasi-transferor' derives from several cases.

- *Pratt v CIR* [1982] STC 756 suggests it includes, in relation to a transfer by a company, a shareholder with a controlling stake.
- *Carvill v CIR* [2000] STC (SCD) 143 contemplates, as an exceptional example, one shareholder's influence being so strong that they are to be treated as transferor of another's shares.
- *Rialas* (TC7316) – considered below – concerned what might be described as transactional influence.

The Rialas case

Mr Rialas owned 50% of Argo (UK resident) and was assessed to additional income tax by reference to dividends paid to a Cypriot company, Farkland. Mr Rialas had set up Argo with his business partner, Mr Cressman. Relations between them deteriorated and they agreed a price for Mr Cressman's stake.

Mr Rialas set up Farkland (registered in the British Virgin Islands and resident in Cyprus) to acquire Mr Cressman's shares. Farkland was owned by a discretionary trust (also resident in Cyprus) of which Mr Rialas, his wife and son were beneficiaries, and which he had also set up for the purpose. Mr Rialas was the driving force and HMRC contended that he had procured the transfer of the sale shares and was therefore liable to income tax under what was then TA 1988, s 739(1) – now ITA 2007, s 720 – on the dividends paid to the BVI company on what had been Mr Cressman's shares.

However, the company constitution gave Mr Rialas no power to compel Mr Cressman to sell his shares, and neither had a controlling stake. Nor was Mr Rialas legally responsible, say as principal, for what Mr Cressman decided as regards the sale. Mr Rialas had some degree of personal practical influence over Mr Cressman but, fundamentally, what Rialas did was to make the arrangements as regards the corporate and trust structure and funding. The case shows that controlling the purchase side of a transaction will not make for liability as a quasi-transferor of assets.

Initial settlement

HMRC's alternative contention in the *Rialas* case was that the £10 Mr Rialas paid over when the trust was established was a transfer of assets abroad and the various additional transactions were associated operations which, ultimately, gave him power to enjoy dividend income associated with the shares.

The tribunal rejected this. It would have meant that the establishment of any non-resident trust by a UK resident individual, with however small an initial contribution, could lead to that individual being taxable on the income from any investments the trust might acquire, directly or indirectly.

This must be the right conclusion – the purpose of the TOAA rules, as regards transferors, is to deter UK resident individuals shifting ownership of income-producing assets offshore so as to avoid future UK tax on income from them. One sees immediately that Mr Rialas' £10 did not fit that description: the income-producing assets were the shares in Argo.

The Fisher case

In *Fisher v HMRC* [2020] UKUT 62 (TCC) there was an attempt to tax a transaction that saw a digital business relocate in the face of competition from abroad. In 2000, a UK resident company (SJA) sold the Stan James tele-betting business to a Gibraltar company (SJG). SJA had operated the business since 1988. Stephen and Anne Fisher, and their children Peter and Diane, were shareholders and/or directors in both companies.

The sale was to enable the business to trade without incurring liability to betting duty in the UK. Trading from Gibraltar was attractive because, until October 2001, betting duty was levied on the bets placed with a bookmaker in the UK and the cost was passed on to the punter. Foreign bookmakers had a competitive advantage because duty did not have to be imposed on the stake, but they were legally prevented from advertising in the UK.

In March 1999, one of Stan James' competitors moved its tele-betting business to Gibraltar and nine months later no major tele-betting operator was left in the UK. As business shifted online, the prohibition on advertising no longer prevented overseas bookmakers attracting UK consumers on terms that undercut those offered by UK bookmakers.

By July 1999, the Fishers knew that unless the method of imposition of UK duty changed the only way to save the business was to relocate. SJG was incorporated and the Fishers acquired its shares. SJG acquired the business from SJA at market value. In the years following SJG paid all the tax it was due to pay in Gibraltar. So far, so good.

“The case shows that controlling the purchase side of a transaction will not make for liability as a quasi-transferor of assets.”

However, Anne, Stephen and Peter, who were UK resident, were assessed as liable to income tax on the profits of SJG from 2000-01 to 2007-08 under TOAA. In fact, these profits were not distributed but re-invested so this was a somewhat harsh result, particularly because avoiding income tax was not a purpose of the transfer and no liability to income tax had actually been avoided. Even if the business had remained in the hands of SJA in the UK, the taxpayers would not have been liable to income tax on company profit. After the sale, that remained the case, dividends to UK residents from SJG would have been subject to UK income tax if they had been declared. None of that mattered, of course, because an intention to avoid income tax is *not* a pre-condition of TOAA applying.

This is one of the more troubling aspects of TOAA. Remember that the normal result when a tax avoidance scheme is undone is that liability for the particular tax that a party set out to avoid is imposed, so that tax is collected in line with its underlying substantive, economic reality. Broadly, the justification is that it is fair that a party should end up in the position it would have been in had it not attempted to avoid tax. There is a lack of symmetry when what results is liability to a tax that was never being avoided. This hints at potential unfairness in some cases.

It is all the more important to understand when the motive defences are available (see below) because that is the context in which whether and to what extent there was an intention to avoid tax is a relevant consideration.

Shareholders and directors as quasi-transferors

SJA was a long-established company which had owned and operated the tele-betting business for many years. So there was

LexisNexis webinars

Cross-border inheritance tax issues

Date: 28 May 2020 at 12:30 (BST)

Location: Book online at

www.lexiswebinars.co.uk/tax or call +44 (0)330 161 2401

no meaningful causal connection between its interest in the business assets and a transfer to it of those assets by the Fishers as individuals. That notwithstanding, the Fishers as shareholders and directors were assessed as 'quasi-transferors' on the grounds they had procured SJA's transfer of the business to SJG.

HMRC's case was not premised on the taxpayers having control of the whole of SJA's share capital, or even a controlling stake. HMRC relied on *Pratt v CIR* in which the key question on the application of TOAA was said to be: 'Was the reality that somebody else was the real transferor?'

The Upper Tribunal agreed about the question, but disagreed about HMRC's use of the concept of 'procurement' in this context. This was partly because the term 'quasi-transferor' does not appear in the statute but more because the idea that someone who is instrumental in a transfer of assets by a company is automatically within the ambit of TOAA conflicts with the statutory rule that the transferor must be an individual. Further, this would ignore as a matter of course the separate legal personality of the company. There has to be a proper basis for ascribing the acts of a transferor to a separate individual. Simply because an individual has played a part in a transferor's decision-making process does not make the rules apply automatically.

“Simply because an individual has played a part in a transferor's decision-making process does not make the rules apply automatically.”

On the other hand, the TOAA rules would be undermined if they did not impose a liability on the architect of an avoidance scheme simply because the mechanics of a transfer were implemented by a third party. Where to draw the line? In most such cases the third party must be acting as an agent or 'instrument' of the individual. That is why an individual with a controlling member's interest in a company may incur liability. But even here, we learn from the Upper Tribunal, liability arises only if the circumstances justify lifting the corporate veil on ordinary principles, or if there was something 'said or done by the individual which was separate from and influenced what was done by the company itself, acting by its directors – for example where the individual in control gives instructions to the directors to implement the transfer'.

One thinks of a person in the position of a shadow director who exercises influence without being a member of a board, and incurs liability as a result. Bear in mind also that the corporate veil may be pierced if a company has been used as a device to avoid liability to tax.

Collective action

The next question is whether the TOAA legislation applies if there is a transfer by a company as a result of a decision of its board taken by directors who collectively owned a majority shareholding but individually did not.

HMRC argued that if two such director/shareholders procured a transfer of assets each should be treated as having transferred the assets in their entirety, regardless of the size of

their respective shareholdings and regardless of whether together they owned the entire share capital.

This argument was rejected on the grounds there is a conceptual difficulty in treating separate individual shareholders as if they had each individually transferred all the assets. That could not be achieved on a proper reading of the statute if none of the shareholders had done anything that could be construed as having used SJA as a mere conduit or instrument by which to bring about the transfer of the business abroad. There is a basis in statute for reasonable apportionment of liability between or among the parties if more than one person may be liable under TOAA (see now ITA 2007, s 743), but the existence of that power to remedy an unfairness arising from the operation of the charging provisions of the statute did not affect the Upper Tribunal's conclusion.

Arguably, the statute does not make it clear whether there is an implied limitation to the liability of each individual transferor if multiple transferors are involved, so that liability for income attaches to each according to the extent to which it derives from what each individually transferred. That outcome now seems more likely in light of the tribunal's view that it is not correct to treat multiple transferors as having each transferred the assets in their entirety. In particular, this is because the Upper Tribunal agreed that income from the original business and from new businesses later developed by SJG would all have been chargeable (if liability arose at all) since, in causal terms, it all ultimately derived from the transferred tele-betting business. It would have made no difference to the outcome that the income arising owed much to the expertise, business acumen and development input of those running SJG after the transfer.

The motive defences

There are two separate defences and the onus is on the taxpayer in each case to show that one of the two conditions mentioned in the outline section at the start of this article has been met.

- A. There is an exemption from liability if it would not be reasonable to conclude avoiding liability to tax was the purpose or one of the purposes of the transfer. This is relevant if a transfer is on non-commercial terms in which case, in effect, avoidance of liability is not tolerated if it features as a motivation to any material extent.
- B. Alternatively, under ITA 2007, if a transfer is on a genuinely commercial basis, there is no liability if it would not be reasonable to conclude that the transfer was more than incidentally designed for the purpose of avoiding taxation. Here, so long as avoidance of tax can be shown to be an incidental benefit and no more exemption arises.

In neither case does the statutory test refer only to the avoidance of income tax. There again is the potential disproportionality if, say as we saw in the *Fisher* case, avoidance of a duty was a motivation and the result is liability to income tax arises.

The transfer by SJA had been genuinely commercial and at market value, so the Fishers were attempting to establish it was no more than incidentally designed to avoid taxation. Betting duty counts as a tax and the arrangements were, in substance, that existing customers would be serviced by a bookmaker outside the UK not subject to the duty. That *did* amount to avoidance.

But had the transfer been ‘designed for the purpose of avoidance’? The taxpayers argued that when there is a *bona fide* commercial transaction, some element of avoidance may be present without disqualifying the taxpayer from benefiting from the defence. This argument succeeded, on the grounds there was a distinction between a taxpayer who voluntarily enters into an arrangement to avoid tax, and a situation in which the taxpayer is, in effect, forced to restructure in the same tax-efficient manner as its competitors to secure its survival. The whole point of the motive defence, said the Upper Tribunal, is to disapply TOAA in that situation.

Might it be said the tribunal’s conclusion reflected the particular statutory wording (‘not designed’ in TA 1988, s 741A(b)) before it? Perhaps, but likely as not it would have reached the same conclusion if it had been concerned with the rewritten provisions in ITA 2007, s 737(4)(b) (‘more than incidentally designed’) because avoiding betting duty was the only means of achieving the main purpose of saving the business.

The consequences of the application of the TOAA rules for individual taxpayers bore little relation to the economic and indeed the fiscal reality of what happened. The rules would have fixed the taxpayers with an ongoing liability to pay tax in the UK on an arising basis on income being earned by a foreign company that had never been distributed, and which, moreover, had been earned by SJG using assets it had acquired for full value on the basis of an arm’s length commercial transaction.

The importance of fairness

This rather unjust practical result rightly influenced the Upper Tribunal. The migration of tele-betting was undesirable, but fairness to taxpayers is also important so that if liability to tax is imposed there is a reasonable correlation between the liability and underlying economic reality. In this instance, the real problem was not avoidance: technology had simply made it impossible to prevent offshore businesses trading at a competitive advantage from accessing UK consumers.

By way of comparison, Mr Rialas was also able to demonstrate a commercial purpose behind the purchase of the shares. However, a trust had only been interposed to reduce exposure to UK inheritance tax, there was no commercial basis for that particular step. This meant that the transaction had been designed to avoid liability to tax, so the exemption would not have been available to him.

Sometimes it takes a while for legislation to catch up with developing commercial trends. The underlying problem that made the UK unattractive to Stan James was eventually solved to some extent by amending betting duty so that bookmakers in the UK were taxed on their gross profits. That broke the link between duty and a punter’s overheads meaning UK-based bookmakers could compete again.

In due course, SJA re-established its UK tele-betting operation. It’s tempting to say you can’t say fairer than that.

Planning point

Has a transfer been ‘designed for the purpose of avoidance’? If there is a *bona fide* commercial transaction, some element of avoidance may be present without the transfer of assets abroad rules coming into play.

Proportionality and free movement

Meanwhile, the TOAA legislation remains a tricky proposition for HMRC. Not least in relation to EU rules, although who knows how much longer this will prove to be an issue?

In *Rialas*, the tribunal concluded that the legislation clearly infringed the principle of free movement of capital (Mr Rialas was Cypriot by nationality). As to whether that infringement was justified, potentially it was even though the TOAA legislation targeted transactions other than wholly artificial ones. But to be fully permitted under EU law, domestic anti-avoidance provisions must not only be justified, they must also be proportionate.

The consequence of the application of TOAA to Mr Rialas was that he was not simply put back into the position in which he would have been if he had not attempted to avoid a particular tax. On the contrary, he was in a worse position because TOAA looked through the corporate and trust structure and taxed him directly on corporate income of Farkland. That was not merely anti-avoidance, but penal, so the rules would have had to be disapplied, even if they had been engaged in the first place.

“The consequences of the application of the TOAA rules for individual taxpayers bore little relation to the economic and indeed the fiscal reality of what happened.”

Similarly, in *Fisher*, the Upper Tribunal reached the view that the TOAA legislation interfered with Anne Fisher’s freedom of establishment in a way that was neither proportionate nor justified. And, for good measure, her husband Stephen had rights under EU law. Although he was a UK national, the negative consequences for him under TOAA were a disincentive on Anne establishing a business in Gibraltar. So the TOAA provisions construed according to EU law did not apply to either of them. ●

Author details

Gordon Watt CTA is an advocate at Terra Firma chambers, Edinburgh, and focuses on taxation, trusts and executries. He can be contacted by phone on 0131 260 5830 or email: gordon.watt@terrafirmachambers.com.



FIND OUT MORE On [Taxation.co.uk](https://www.taxation.co.uk)

- A Davies, P McAteer, B Evans-Jones v CRC – no exemption from transfer of assets abroad provisions: tinyurl.com/y8rd4hsv
- Rialas decision on rules relating to transfer of assets abroad: tinyurl.com/yc3t6vql
- Benefits and pitfalls of offshore trusts: tinyurl.com/yab7ofm8