# TAX AVOIDANCE BY TRANSFERS OF ASSETS ABROAD: THE REVENUE VIEW

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## 1 Introduction

### 1.1 The Interpretation

The United Kingdom Revenue has published in the Inland Revenue Tax Bulletin Issue 40, April 1999, an Interpretation: 'Transfer of Assets Abroad - taxation of income under the provisions of TA 1988 ss.739-746'. The Interpretation is an important one, not least because some of it is arguably more beneficial to taxpayers than the strict law. As the provisions are teeming with problems, it is not surprising that the Interpretation does not deal with all of them.

The Interpretation is not always a model of clarity. One is tempted to cry out, in a parody of Juvenal, "But who will interpret the Interpretation?" Some parts of it, particularly those relating to relevant income for section 740 purposes, need a construction summons - or whatever *Dominus Lupus* calls it nowadays.

The introduction to the Interpretation states:

> "TA 1988 ss.739–746 are anti-avoidance provisions aimed at certain transactions involving transfers of assets abroad. These notes provide guidance on how the Inland Revenue interpret various aspects of this legislation at the time of writing, in cases where the courts have not given a definitive interpretation of particular statutory wording."

### 1.2 The Provisions

Broadly speaking, the provisions are aimed at transfers of assets in consequence of

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which income became payable to a person domiciled, incorporated or resident outside the United Kingdom. They are contained in Part XVII (tax avoidance) Chapter III. Taxes Act 1988 section 739(2) deems the income of such person to be that of the transferor if the transferor is ordinarily resident in the United Kingdom and has "power to enjoy" the income.[2] "Power to enjoy" is very widely defined. If, for example, the transferor were a discretionary object of a power of appointment over income reposed in offshore trustees, he would have "power to enjoy" that income, even though he never received it.

Section 740 applies to a person, such as the beneficiary of an offshore trust, who receives a benefit provided out of assets which are available for the purpose by virtue or in consequence of the offending transfer or of any associated operations. The amount or value of any such benefit is in principle treated as taxable income of the beneficiary (if it would not otherwise constitute taxable income), but only to the extent to which it falls within the amount of "relevant income" of past, present, or future years. "Relevant income" is any income which arises in a year of assessment to a person resident or domiciled outside the United Kingdom which, by virtue or in consequence of the offending transfer or associated operations, can directly or indirectly be used for providing a benefit for the individual or for enabling a benefit to be provided for him.[3]

## 2 Section 739

### 2.1 Quantum of Income of Non-UK Person Caught by Section 739

The Interpretation states, under the heading "Section 739":

> "It has been established by the courts (in *Lord Howard de Walden v IRC* [25 TC 121]) that "power to enjoy" the income of a person resident or domiciled outside the UK is not restricted to the income or benefit actually received. However, it has not been determined by the courts whether all the income of the overseas person should be assessed, or only the income of that person to the extent that it arose by virtue or in consequence of the relevant transfer of assets and any associated operation(s). It has been the Revenue's practice (since the decision in *Vestey v IRC* [[1977] STC 414]) to assess on the second of these two possible bases."

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2 Section 739(3) can also apply, with the same effect, in certain situations where the transferor does not have "power to enjoy" the income but receives or is entitled to receive a "capital payment".

3 Section 740(3).

In my view, the Revenue are right to assess on the second ground, as it is the only one justified by the plain wording of section 739(2):

> "Where by virtue or in consequence of any such transfer, either alone or in conjunction with associated operations, such an individual has, within the meaning of this section, power to enjoy, whether forthwith or in the future, any income of a person resident or domiciled outside the United Kingdom ..."

Incidentally, the reference is to the *Vestey* decision at first instance. It was finally determined by the House of Lords, reported at [1980] STC 10, (1979) 54 TC 503.

2.2 Who is a Transferor?

The Interpretation states:

> "The Section 739 can potentially apply not only to an individual who transfers assets but to someone who is "associated with" a transaction (according to the decision of the courts in *Vestey v IRC*). The Revenue regard this as including anyone who procured the transfer of assets."

This is overstating what was actually said in *Vestey*. Lord Wilberforce said, at the end of his judgment:

> "My Lords, we have not, I hope, in recent years become so habituated to fiscal severities or to 'overkill' sections as to be insensitive to those proprieties which were so eloquently stressed by Walton J in his judgments. It is respect for these and for the fabric of our fiscal law which persuade me that *Congreve*, as to its principal ratio and the following cases, should be departed from or overruled and the section interpreted as applying only where the person sought to be charged made, or, *maybe*,[4] was associated with, the transfer."

This aspect of the law has not been developed. I agree with the Revenue that this could include a person who procured the transfer, but only if it could be said that in substance that person was the transferor. An example would be the case where the sole shareholder of a company were to procure that the company made a gift to an offshore trust. It could not in my view apply to, say, a tax adviser who advised a person to make an offshore settlement.

2.3 Multiple Transferors

The Interpretation continues:

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4 Italics supplied.

> "Where the same assets are transferred by several individuals, the Revenue's practice is to assess the transferors in proportion to their share of the assets transferred. Thus where, for example, shares of a UK company are held by three shareholders in the proportion 40%, 40% and 20% and there is s.739 liability in respect of the income of an overseas person to which the shares are transferred, the liability is assessed on each of the three shareholders in proportion to their respective holdings."

This paragraph does not grapple with the real problem. The illustration given is not of the same assets being transferred by several individuals. Instead, each of the individuals makes their own separate transfer. The difficulty arises where the transfer is an indirect one, as where it is made by a close company the participators of which are individuals ordinarily resident in the United Kingdom. This difficulty is explored, if not resolved, by Walton J in *Inland Revenue Commissioners v Pratt* (1982) 57 TC 1, [1982] STC 756.

2.4 Non-UK Domiciled Transferors

Under the heading "Section 740" the Interpretation states firstly:

> "A non-UK domiciled individual who transfers assets but is outside the charge to tax under s.739 by virtue of the provisions of s.743(3), is not assessed under s.740."

This has been an unresolved question since 1981. See my *Non-Resident Trusts* 7th edition at 16.5.5. The situation under consideration is where income with a foreign source has arisen to the non-UK resident and has not been remitted to the United Kingdom. In that case, if a non-UK domiciled settlor would not be liable to tax if the income were actually his, because he is taxable on the remittance basis and it has not been remitted, he similarly escapes tax under section 740. A non-UK domiciliary can, however, be taxable under section 740 in respect of foreign source income which has not been remitted to the United Kingdom provided he receives a benefit in the United Kingdom. The receipt of such a benefit need not involve the remittance of income to the United Kingdom, as it could be paid for out of capital. If section 740 could apply to, for example, a non-UK domiciliary, ordinarily resident in the United Kingdom, who was a discretionary beneficiary of an offshore trust, he could be worse off by making the trust. For had he retained the trust assets in his own ownership, he could have lawfully avoided liability to income tax by keeping foreign source income offshore and remitting only capital to the United Kingdom. The Revenue interpretation confirms that there is in fact no problem.

2.5 Non-UK Resident Transferors

The Interpretation continues:

> "Similarly, a transferor of assets who is outside the charge to tax under s.739 in respect of income arising before 26th November 1996 through being not ordinarily resident in the UK at the time of the transfer, is not assessed under s.740."

It was held by the House of Lords in *Inland Revenue Commissioners v Willoughby,*[5] that section 739 did not apply unless the transferor was ordinarily resident in the UK when he made the transfer. I took the view that in such a case there was little to stop the settlor being caught by section 740 to the extent to which he received a relevant benefit.[6] There was no argument that he was chargeable under section 739. One would therefore have to rely on the side note to section 740 "liability of non-transferors", which was a very weak argument in view of the decision of the House of Lords in *R v Schildcamp.*[7]

The Revenue Interpretation is thus, in my view, extremely kind to taxpayers on this point.

The *Willoughby* decision was reversed by statute with effect from 26th November 1996.[8] Hence the problem does not arise in relation to income arising on or after that date.

## 3 Section 740

### 3.1 Benefits for Section 740 Purposes

The Interpretation continues:

> "For the purposes of s.740(1)(b) a benefit is treated as not including either the giving of a life interest to a beneficiary or the receipt by a beneficiary of the proceeds of selling a life interest. But it is otherwise treated as including all benefits taken into account in determining whether an individual has power to enjoy income for the purposes of s.739. It therefore includes for example receipt of a loan at less than a commercial rate of interest, and the use of trust property

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5 [1997] STC 995; (1997) 70 TC 97.

6 See my *Non-Resident Trusts* 7th edition, 16.5.5.

7 [1971] AC 2.

8 See section 739(1A), inserted by Finance Act 1997.

at less than an open market rental."

In my view, the conferring on a beneficiary of any interest, short of an absolute interest, by the trustees of the settlement or, indeed, by anyone else, such as an Appointor or Protector, does not involve a benefit being "provided out of assets which are available for the purpose by virtue or in consequence of the transfer or of any associated operations".[9] The assets remain undiminished. I therefore agree with the Interpretation in so far as it refers to the conferring of a life interest. A similar point arises in the context of the capital gains tax Offshore Beneficiary Provisions, contained in Taxation of Chargeable Gains Act section 87 onwards. See my *Non-Resident Trusts* 7th edition at 14.7.4.

I also agree that where a beneficiary sells his interest under a trust, the proceeds are likewise not "provided out of assets which are available for the purpose by virtue or in consequence of the transfer or of any associated operations". Indeed, this has always been a sound way of beneficiaries avoiding tax under section 740. The Revenue are not unduly concerned because the disposal by the beneficiary will normally give rise to a charge to capital gains tax. The exemption of a disposal of an interest under a trust has not since 1981 been available in the case of a non-UK resident trust.[10] Since 9th March1998, it has not been available in the case of a trust which has at any time been non-UK resident.[11] In fact, various strategies exist, the efficacy of which depends on the precise circumstances, for ensuring that no capital gains tax is payable on such a disposal.

The statement that "[Benefit] is otherwise treated as including all benefits taken into account in determining whether an individual has power to enjoy income for the purposes of s.739" is on odd one. Given that section 740 does not in terms refer to section 739 or to the definition of "power to enjoy" in section 742(2), it is highly questionable where either of these latter sections has any relevance at all to the interpretation of section 740. Indeed, only one of the five limbs of the "power to enjoy" test refers to a "benefit", namely section 742(2)(c): "the individual receives or is entitled to receive, at any time, any benefit provided or to be provided out of that income or out of moneys which are or will be available for the purpose by reason of the effect or successive effects of the associated operations on that income and on any assets which directly or indirectly represent that income". This, with respect, throws no light on the meaning of "benefit".

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9 Section 740(1)(b).

10 Taxation of Chargeable Gains Act section 85(1).

11 Taxation of Chargeable Gains Act section 76(1A). See generally, my *Non-Resident Trusts* 7th edition, Chapter 15.

That the Revenue are firmly of the view that "receipt of a loan at less than a commercial rate of interest, and the use of trust property at less than an open market rental" constitutes a benefit for section 740 purposes is well known. They take a similar view in relation to the capital gains tax Offshore Beneficiary Provisions, where they are in my view on decidedly weaker ground. This is a question which will have to be resolved by the Courts sooner or later. Indeed, it is amazing that in the eighteen years since both provisions were introduced, by Finance Act 1981, the matter has not already been litigated at least at High Court level.[12]

3.2 Washing of Relevant Income

In the case of the Offshore Beneficiary Provisions, it is quite clear that a trust gain can be "washed", that is, imputed to a person who is not liable to be taxed as a result of the imputation, e.g. because he is non-UK resident, with the result that it cannot thereafter be imputed to any other person.

In the case of section 740, it is to my mind clear that as a matter of strict law the only way in which relevant income can be likewise washed is by being imputed to a settlor, spouse of the settlor or beneficiary who is "charged to tax" under either section 739 or section 740. The reasons are given in my *Non-Resident Trusts* 7th edition:

> "16.5.2 The Anti-Avoidance Technique
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> Taxes Act 1988 section 740 is designed to counteract such avoidance. It applies to beneficiaries ordinarily resident in the UK who receive capital payments from funds which are available as a result of the offending transfer. This would clearly catch the payment of capital by the trustees to a beneficiary, whether in the exercise of their discretion or under the fixed terms of the trust. As often happens with anti-avoidance provisions, the mechanism used is far too blunt and unwieldy and can result in a large measure of overkill.
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> One first ascertains in relation to each beneficiary the "relevant income". This is income arising within the settlement structure which can be used, directly or indirectly, to confer a benefit on him. Thus, in the case of a wide discretionary offshore trust of the type which was in vogue before the introduction of capital transfer tax, all the income arising to the trustees would be relevant income in relation to each and every one of the income beneficiaries and, if there was a power to accumulate, as there usually would have been, each of the capital

12 Since writing this passage, the Special Commissioners have decided that an interest-free loan repayable on demand confers no appreciable benefit for the purposes of the Offshore Beneficiary Provisions: *Cooper v Billingham (Inspector of Taxes)*, *Fisher v Edwards (Inspector of Taxes)* (unreported, 10th May 1999).

beneficiaries.

One then determines the value of the capital payment(s) which the beneficiary has received from the trustees in the year and so much thereof as is equal to the relevant income is deemed to be taxable income of the beneficiary. If there is an excess of relevant income, this is carried forward to the next year. Similarly, if there is an excess of capital payments, the excess is carried forward to the next year, and so on.

"16.5.3 No Tracing

There is no necessity to show that the income which was relevant income has passed to the recipient beneficiary in any shape or form. The exercise is an accounting one, not a tracing one. For that reason, it is difficult to establish a limitation on the taxability of the beneficiary on the grounds that the relevant income has in fact been used for purposes which are inconsistent with his benefit, for example by being paid to another beneficiary absolutely. The only express limitation in the Act is that the same relevant income cannot be taken into account more than once for the purposes of section 739[13] or section 740. Yet that does not prevent a beneficiary who receives from the trustees what is pure capital being taxed on that capital as income where the trustees distributed the relevant income either (a) as income to another beneficiary resident in the UK (so that it became his taxable income quite apart from section 739 or section 740) or (b) whether as income or as capital to a non-resident individual or a charity (neither of whom are caught by section 739 or section 740). It is understood that in practice the Revenue do not always insist on a strict application of the law."

I also remarked, at 10.7.2.4:

"As a matter of strict law, if income arising to the trustees has been deemed to be that of the settlor by virtue of some provision other than section 739,[14] section 740 can still apply in relation to such income.[15] Moreover, income which is "relevant income" in relation to Beneficiary A when it arises does not cease, as a matter of strict law, to be such simply because the trustees pay it out as income to Beneficiary B, who is charged to UK income tax in respect of the

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13 See 16.4.2. of *Non-Resident Trusts* 7th Edition.

14 Or Taxes Act 1970 section 478.

15 It may thus be vital to determine, where either would be sufficient by itself, whether income is deemed to be the settlor's by virtue of section 739 or of the income tax settlement provisions (Taxes Act 1988 Part XV). On this question the statute is silent.

entire amount of the payment.

While it is by no means clear that the Revenue would in fact perform their statutory duty and charge tax according to the strict letter of the law, the wise taxpayer will hesitate before relying upon mere administrative inaction. It is so difficult to do anything to mitigate the effect of section 740, short of all recipient beneficiaries emigrating, that it is vital that the matter is tackled at the other end and the trust so constructed in the first place as to minimise the amount of "relevant income" which arises in relation to potential recipient beneficiaries.

Post Finance Act 1991, it may be advantageous in certain circumstances for a benefit to be received as taxable income.[16] Thus, the ascertainment of what is the position in strict law will become vital: the Revenue cannot collect tax by concession!"

It has been clear from 1981 that the Revenue do not interpret or apply section 740 as strictly as the law requires. Inconsistent rumours have abounded as to precisely what their practice was. The Interpretation states:

"For the purposes of s.740(3) the measure of "relevant income" is treated as not including such part of the income as has already been genuinely paid away to a beneficiary or to a bona fide charity."

Hence, at first blush, there is, it seems, in principle a complete "washing" of income. All that is required is that the income must have been "genuinely" paid away to a beneficiary or to a bona fide charity. This is hardly a serious limitation. By contrast with the Offshore Beneficiary Provisions, there is no need that the relevant income has been imputed to a beneficiary under section 740. It could, for example, simply be paid as regular income. On the other hand, the Revenue's interpretation *does* involve a tracing test. One must be able to show that the relevant income itself has been paid away. Contrast the Offshore Beneficiary Provisions.

When I first read the Interpretation, I assumed that there was no limitation as to the time of washing, provided, of course, it was before the relevant benefit was conferred. That was no doubt because any such limitation would not make sense at all and I always expect Revenue pronouncements to make sense, even if I might disagree with them. It is when one turns to the next part of the Interpretation that one begins to have serious doubts.

### 3.3 Capitalisation of Relevant Income

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16 See 14.12 of *Non-Resident Trusts* 7th Edition.

The Interpretation continues:

> "Once relevant income has arisen and continues to be available to provide a benefit, it must in the Revenue's view be carried forward year by year until extinguished by such a benefit, even if it is capitalised in the accounts of the overseas person."

I entirely agree that mere capitalisation in the accounts of the overseas person will not prevent the income from being relevant income. I also agree that it will in principle be extinguished by a benefit previously conferred, at least if it is conferred in a previous year. Will it, however, be extinguished by being in reality paid out to another beneficiary or to a charity? Reading the previous section by itself, one would think so. Yet if relevant income can be extinguished only by the conferring of a benefit, that cannot be the case.

It is technically possible to reconcile the two by looking at the position at the end of each year of assessment. If at that point income arising within the year has been paid out, then it cannot be relevant income, but if it has not, then it cannot cease to be relevant income by being paid out. So if income of a discretionary trust arises to trustees in March, and they pay it out to A as income, whether B can subsequently be charged to tax on a benefit received out of pure capital will (assuming there to be no other relevant income in relation to B) turn on whether or not the trustees make the payment to A before 6th April. That such could be the law seems unlikely, but at this point I am attempting to interpret not the law but the Revenue Interpretation.

Can it be that "capitalisation" makes, in the Revenue's view, all the difference? This would still not be sound in principle but would produce less anomalies. In the example just given, it would not matter that A did not receive the income until after 5th April provided that it has not been accumulated in the meantime. (I use "accumulated" in its technical sense of the conversion of income into capital and not its popular sense of "retention" of income.)

### 3.4 Non-UK Domiciled Settlor

Later in the Interpretation, under the heading "Section 743", it is stated:

> "Where a non-UK domiciled individual transfers assets but is not chargeable to tax under the provisions of s.739 owing to s.743(3), there is no bar in the Revenue's view on the application of s.740 to others who did not themselves make the transfer but were beneficiaries of it."

That is in my view correct. Of course, if the beneficiaries are themselves non-UK domiciled, they may be able to rely on section 740(5).

## 4 The Motive Defence

### 4.1 The Statute

Neither section 739 nor section 740 is to apply if the individual otherwise assessable shows "in writing or otherwise to the satisfaction of the Board either—

(a) that the purpose of avoiding liability to taxation was not the purpose or one of the purposes for which the transfer or associated operations or any of them were effected;

or

(b) that the transfer and any associated operations were bona fide commercial transactions and were not designed for the purpose of avoiding liability to taxation."(section 741).

The onus is thus on the taxpayer to make out the defence. Provided that he can show that the purpose of avoiding liability to taxation was not *one* of the purposes for which the transfer or associated operations[17] or any of them were effected, he is home and dry and it is irrelevant whether or not they were bona fide commercial transactions. If one of the purposes *was* the avoidance of liability to taxation, then he can still escape provided he can show that the transfer and any associated operations were "bona fide commercial transactions" and were not "designed" for the purpose of avoiding liability to taxation.

### 4.2 *IRC v Willoughby*

This is not an easy section to interpret. The House of Lords in *IRC v Willoughby*[18] gave a restricted meaning to "avoiding taxation". In effect, the only tax planning which is caught is "a course of action designed to conflict with or defeat the evident intention of Parliament".[19] In that case, Professor Willoughby succeeded under head (a). It was therefore unnecessary for the House of Lords "to decide whether the Special Commissioner was equally entitled to hold that the taxpayers had established their claim

17 "Associated operations" is widely defined by 742(1). See below.

18 [1997] STC 995, 70 TC 57.

19 Per Lord Nolan. See my article 'Tax Avoidance after *IRC v Willoughby*' in *The Offshore Taxation Review*, Volume 7, Issue 3, page 139. For an account of the litigation from a unique point of view, see Professor Willoughby's article 'The Taxpayer's Tale' in *The Offshore Taxation Review*, Volume 8, Issue 1, page 17.

to the protection conferred by s.741(b) on 'bona fide commercial transactions ... not designed for the purpose of avoiding liability to taxation.' At first sight the point seems a straightforward one, but the precise scope of the phrase 'bona fide commercial' as it occurs in the related context of s.703(1) of the 1988 Act, which also deals with tax avoidance, has given rise to dispute in a number of cases of which *IRC v Goodwin* [1976] STC 28, [1976] 1 WLR 191, a decision of your Lordships' House, is an example. In the instant case your Lordships did not think it necessary to call upon counsel for the taxpayers, and in company with the Court of Appeal I think it better to defer consideration of s.741(b) until a case arises in which it is crucial to the decision."[20]

4.3 The Onus of Proof

The Interpretation states:

> "The legislation places the onus on the taxpayer to demonstrate to the satisfaction of the Revenue that the conditions for relief under s.741 are met, or likewise to the satisfaction of the Special Commissioners in a case where the taxpayer has appealed against a decision by the Revenue that relief is not due."

So far, so good. It is at this point that the Interpretation begins to go astray:

> "In either event the terms of s.741 in effect require the taxpayer to show that the transactions had a non-fiscal purpose, and did not also have a tax avoidance purpose."

While it is true of head (a) that the taxpayer has to show that the transactions did not have a tax avoidance purpose, it is not necessary in relation to head (b). In my view, provided the other conditions of head (b) are satisfied, the transactions can have had a tax avoidance purpose provided it was not the predominant purpose. For if it was not, the transactions would not have been "designed for the purpose of avoiding liability to taxation".

The Interpretation then continues:

> "Where the taxpayer has been able to establish that at least one of the purposes for undertaking the transactions did not entail tax avoidance, the Revenue will regard it as incumbent on them to indicate why in their view tax avoidance may also have been involved. They will explain their reasons to the taxpayer, after considering fully all the arguments he or she has advanced and all the documents submitted in support of his or her contentions, and will do so prior to any Special Commissioners' hearing."

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20 Per Lord Nolan.

This is more helpful to the taxpayer than the statute.

4.4 Objective Purpose

The Interpretation then becomes pedantic and erratic:

> "Although it is sometimes referred to as a "motive test", s.741 in fact refers to the "purpose" of a transfer and any associated operations. Consequently, it is only the purpose of a transaction that the Revenue consider in applying the section. "Purpose" is taken to be the end it is sought to achieve by the transaction. Furthermore, if a transaction involves tax avoidance, that is considered by the Revenue to be at least one of its purposes even if the transferor did not form the subjective intention of avoiding tax."

The words "motive" and "purpose" have different meanings, which overlap. Everyone who uses the phrase "motive defence" is quite clear as to its meaning. The second and third sentences quoted are thus correct, but pointless. The last sentence is alarming. It does not follow logically from the first three. Only a rational being can "effect" or "design" a transaction. Only a rational being can have a purpose and that purpose must be subjective. If I do not intend to do something, my purpose cannot have been to do it simply because that was the result of my actions. If I intend to drive my car from A to B and inadvertently kill a pedestrian en route, that was not the purpose of my actions, regardless of the seriousness of the consequence.

4.5 Whose Intention?

The Interpretation states:

> "The role of advisers is taken into account in assessing the purpose of the transaction when considering the application of s.741."

While the intention of the transferor - or, possibly, the person effecting a relevant associated operation - is the only one which can be relevant, the role of advisers is admittedly relevant if they advise the transferor that a certain course be pursued to enable tax to be avoided and he acts on that advice.

4.6 "Bona Fide Commercial"

As mentioned above, this phrase has given rise to considerable difficulties. The Interpretation states:

> "The expression "bona fide commercial" in s.741(b) is taken to apply only to the furtherance of trade or business, and not to the making or managing of

investments."

I can see no reason why such a limitation should be read in. Possibly, the Revenue are thinking of Taxes Act 1988 section 703(1)(b), which draws a distinction between the two.

The Interpretation continues:

> "The Revenue's view is that one of the essential conditions of s.741(b) would not be satisfied where there was a significant element of tax avoidance purpose in the design of the transfer and any associated operations."

This is arguable.

## 5 Associated Operations

5.1 Use of the Concept of "Associated Operations"

The concept of "associated operations" is employed at various points in the Chapter for somewhat different purposes.[21] In section 739(1), section 739 is stated to be "for the purpose of preventing the avoiding by individuals ordinarily resident in the United Kingdom of liability to income tax by means of transfers of assets by virtue or in consequence of which, either alone *or in conjunction with associated operations*, income becomes payable to persons resident or domiciled outside the United Kingdom."

The " power to enjoy" test in section 739(2) also makes use of the concept. "(2) Where by virtue or in consequence of any such transfer, either alone *or in conjunction with associated operations*, such an individual has, within the meaning of this section, power to enjoy ..." Similarly, the "capital payment" test in section 739(3) provides: "(3) Where, whether before or after any such transfer, such an individual receives or is entitled to receive any capital sum the payment of which is in any way connected with the transfer or any associated operation, any income which, by virtue or in consequence of the transfer, either alone *or in conjunction with associated operations*, has become the income of a person resident or domiciled outside the United Kingdom shall ..." etc.

Section 740(1) applies only if "(a) by virtue or in consequence of a transfer of assets, either alone *or in conjunction with associated operations*, income becomes payable to a person resident or domiciled outside the United Kingdom; and (b) an individual ordinarily resident in the United Kingdom who is not liable to tax under section 739 by reference to the transfer receives a benefit provided out of assets which are available for

21 Italics supplied in all the following quotations.

the purpose by virtue or in consequence of the transfer *or of any associated operations*."

The test of "relevant income" in section 740(3) is "any income which arises in that year to a person resident or domiciled outside the United Kingdom and which by virtue or in consequence of the transfer *or associated operations referred to in subsection (1) above* can directly or indirectly be used for providing a benefit for the individual or for enabling a benefit to be provided for him."

The motive defence, too, involves associated operations. Section 741 provides that:

> "Sections 739 and 740 shall not apply if the individual shows in writing or otherwise to the satisfaction of the Board either—
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> (a) that the purpose of avoiding liability to taxation was not the purpose or one of the purposes for which the transfer *or associated operations* or any of them were effected; or
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> (b )that the transfer *and any associated operations* were bona fide commercial transactions and were not designed for the purpose of avoiding liability to taxation."

The definition of "power to enjoy" in section 742(2) uses the phrase:

> "(2) An individual shall, for the purposes of section 739, be deemed to have power to enjoy income of a person resident or domiciled outside the United Kingdom if—
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> ...
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> (c) the individual receives or is entitled to receive, at any time, any benefit provided or to be provided out of that income or out of moneys which are or will be available for the purpose by reason of *the effect or successive effects of the associated operations* on that income and on any assets which directly or indirectly represent that income; or
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> ..."

Still in the context of the definition of "power to enjoy", section 742(3) provides:

> "(3) In determining whether an individual has power to enjoy income within the meaning of subsection (2) above—

> (a) regard shall be had to the substantial result and effect of the transfer *and any associated operations*, and
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> (b) all benefits which may at any time accrue to the individual (whether or not he has rights at law or in equity in or to those benefits) as a result of the transfer *and any associated operations* shall be taken into account irrespective of the nature or form of the benefits."[22]

5.2 Definition of "Associated Operations"

The definition of "associated operations" is contained in section 742(1):

> "(1) For the purposes of sections 739 to 741[23] 'an associated operation' means, in relation to any transfer, an operation of any kind effected by any person in relation to any of the assets transferred or any assets representing, whether directly or indirectly, any of the assets transferred, or to the income arising from any such assets, or to any assets representing, whether directly or indirectly, the accumulations of income arising from any such assets."

The Revenue Interpretation states:

> "The wording of s.742(1) is interpreted as meaning that an associated operation does not necessarily have to take place after a transfer of assets. A transaction undertaken 'in relation to' a transfer of assets can precede the transfer."

While this view is a possible one, it is difficult to imagine many cases in which an associated operation would precede the transfer.

5.3 Power to Enjoy and Associated Operations

The Interpretation states:

> "The law was amended in 1969 following a decision of the Courts (in *IRC v Herdman* [45 TC 394]) that only the transfer and any associated operations giving a power to enjoy at the outset were relevant for determining whether the terms of s.741 were satisfied. The amendment to the legislation sought to bring

22 Reference is also made in section 745, which confers on the Revenue powers to obtain information.

23 I cannot fathom why this definition does not in terms apply for all the purposes of the Chapter. It is most unlikely that the courts would give the phrase a different interpretation in sections 742 and 745.

> all associated operations into consideration when s.741 was invoked. Because of doubts expressed as to the effectiveness of this amendment, it has been the Revenue's practice in considering whether a defence under s.741 is available to consider only the transfer and any associated operations which directly establish a power to enjoy the income of the overseas person under any particular sub-head in s.742(2)."

The Revenue have shown considerable wisdom in not testing before the Courts the effectiveness of the amendment. *Herdman* concerned Income Tax Act 1952 section 412, one of the ancestors of section 739. Before the amendment made by Finance Act 1969, it read:

> "For the purpose of preventing the avoiding by individuals ordinarily resident in the United Kingdom of liability to income tax by means of transfers of assets by virtue or in consequence whereof, either alone or in conjunction with associated operations, income becomes payable to persons resident or domiciled out of the United Kingdom, it is hereby enacted as follows:-
>
> (1) Where such an individual has by means of any such transfer, either alone or in conjunction with associated operations, *acquired any rights by virtue of which he has, within the meaning of this section, power to enjoy,*[24] whether forthwith or in the future, any income of a person resident or domiciled out of the United Kingdom, which, if it were income of that individual received by him in the United Kingdom, would be chargeable to income tax by deduction or otherwise, that income shall, whether it would or would not have been chargeable to income tax apart from the provisions of this section, be deemed to be income of that individual for all the purposes of this Act."

Mr Herdman had, for the purpose of avoiding tax in Eire, transferred income-producing assets into a Eire company in return for debentures and shares in that company. The United Kingdom Revenue admitted that he satisfied the motive test at that point: avoidance of other people's tax is perfectly acceptable! They argued, however, that non-distribution of its income by the company was an associated operation. (The House of Lords did not hear argument on this point.) They then argued that that non-distribution was made for the purposes of avoiding United Kingdom tax. The Court of Appeal of Northen Ireland and the House of Lords unanimously rejected the point on the grounds that he had at stage 1 already obtained rights by virtue of which he had power to enjoy the income of the Eire company and that the non-distribution of its income did not give him any more rights: it merely made the rights he had already obtained more valuable. Although the reference to "rights" has now been removed, either a person has "power to enjoy" or he does not. I cannot for my part see why *Herdman* is not just as good law

24 Italics supplied.

now as it was when it was decided. If a person has power to enjoy by virtue of a transfer alone, then the fact that associated operations also give him power to enjoy, or increase the extent of his potential enjoyment, is irrelevant.

## 6 Spouses of Non-UK Domiciliaries

The Interpretation States:

> "Section 743
>
> Unless transactions are part of a wider arrangement, Revenue practice is not to seek to assess a UK domiciled individual on the income of a non-UK domiciled spouse, where that income arises from a transfer of assets by that spouse and would be outside the charge to tax under s.739 by virtue of the provisions of s.743(3)."

Section 743(3) provides:

> "(3) An individual who is domiciled outside the United Kingdom shall not be chargeable to tax in respect of any income deemed to be his by virtue of that section if he would not, by reason of his being so domiciled, have been chargeable to tax in respect of it if it had in fact been his income."

Section 742(9) states, enigmatically:

> "(9) For the purposes of sections 739 to 741—
>
> > (a) a reference to an individual shall be deemed to include the wife or husband of the individual ..."

The scope of this provision is uncertain. I very much doubt whether it requires husband and wife to be treated as one for all purposes. If a non-UK domiciled transferor would be exempt from the application of section 739 in respect of foreign source income so long as it had not been remitted to the UK, it would be odd if the Revenue could assess his spouse because she was UK domiciled.

## 7 Avoidance of Duplication of Charge

Section 744(1) provides:

> "(1) No amount of income shall be taken into account more than once in charging tax under the provisions of sections 739 and 740; and where there is a choice as to the persons in relation to whom any amount of income can be so taken into account—
>
> (a) it shall be so taken into account in relation to such of them, and if more than one in such proportions respectively, as appears to the Board to be just and reasonable ..."

The Interpretation states:

> "Section 744
>
> Where more than one person can be potentially assessable under ss.739, 740, the Revenue will seek to agree with the taxpayer under the terms of s.744 a 'just and reasonable' division of liability."

This does little more than recognise that the question may be a very difficult one to resolve.

One problem is that the only express statutory relief against a double charge is section 744, which simply avoids a double charge under section 739 and section 740. A person may be assessable on the income simply because it in fact becomes his income[25] or because of some other anti-avoidance provision, such as Taxes Act 1988 Part XV, the income tax settlement provisions.

Later on, under the heading "Miscellaneous", the Interpretation goes some way to ensuring that there is no double charge:

> "Where income could be fully assessed under both s.739 and the settlements legislation in TA 1988 Part XV, it will not in practice be charged under both. Similarly, income will not in practice be charged on both the beneficiary under s.740 and the settlor under the settlements legislation, where an assessment could in strictness be made on each of them in a case involving income that is accumulated within a discretionary offshore trust in which the settlor retains an interest, and then paid to a beneficiary as capital. However, in both cases this is subject to the proviso that the Revenue may sometimes raise alternative assessments, for example where a taxpayer has not provided full information.

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25 The fact that a beneficiary has an interest in possession in property will normally prevent the income arising being caught under section 739 or section 740.

> Moreover, where income arises in an offshore company underlying a settlement and the income is not paid up immediately to that settlement, the provisions of s.739 will be invoked where necessary to assess the income of the underlying company."

While this is helpful, it leaves unresolved several problems. Firstly, it is by no means clear which of section 739 and Part XV takes precedence. As the settlor has a statutory right of indemnity under Part XV but not under section 739, this could be very important. Secondly, if the income has already been deemed to be that of the settlor under section 739 or the settlement provisions "for all purposes of the Income Tax Acts", does that preclude it from being taken into account for section 740 purposes? In my view, it does.

There is no doubt that, in an appropriate case, the income of a company owned by a trust can be visited on the settlor under section 739, whereas it cannot be visited on him under Part XV. The last sentence quoted is fine as far as it goes. An old problem is whether, when income of such a company has been deemed to be that of the settlor, he (or anyone else) can then be taxed on a dividend paid out of that income. It would have been useful if the Interpretation has dealt with this point too. An impression has been created over the years that the Revenue are prepared to give a generous interpretation to section 743(4):

> "Where an individual has been charged to income tax on any income deemed to be his by virtue of section 739 and that income is subsequently received by him, it shall be deemed not to form part of his income again for the purposes of the Income Tax Acts."

The technical argument that this does not prevent the settlor being taxed on the dividend as well as on the underlying income is that the dividend is not the same income as the income of the company out of which it is paid. As further possible difficulty is that section 743(4) might arguably not apply where the settlor does not receive the dividend but it is paid to the trustees and merely deemed to be his for the purposes of Part XV.

Although the last sentence quoted from the Interpretation is far from explicit, one rather gathers that if the income of the company is dividended up and the dividend is or is deemed to be that of the settlor, then the Revenue will not assess the settlor under section 739 on the income of the company. How much further the Revenue would go is not clear.

I should add that there are good arguments that as a matter of law there can be no double taxation and that the taxpayer is not reliant on Revenue discretion. Unfortunately, one might have to go to quite a high level in the judicial hierarchy before these arguments were accepted.

## 8 Revenue Information Powers

The Interpretation states:

> "Section 745
>
> In the Revenue's view the introduction of a client to anyone responsible for establishing an overseas entity does not constitute the giving of professional advice to a client within s.745(3)."

Section 745 confers on the Revenue powers to seek information. Section 745(3) provides:

> "(3) Notwithstanding anything in subsection (2) above, a solicitor shall not be deemed for the purposes of paragraph (c) of that subsection to have taken part in a transaction by reason only that he has given professional advice to a client in connection with that transaction ..."

In my view, it is far from obvious why the introduction of one's client to a third party does not constitute the giving of professional advice, provided, of course, the solicitor uses skill and judgment in selecting the third party and/or the introduction is connected with professional advice the solicitor is giving.

## 9 Computation of Income

Under "Miscellaneous", the Interpretation states:

> "The Revenue's practice is only to allow trading losses in an offshore company to be carried forward to be offset against future trading profits of that company. They cannot be offset against investment income of the same, previous or future years."

The position is more complex. Under section 739, the Revenue are on stronger technical ground in not allowing trading losses to be routinely offset against income from other sources. Depending on the circumstances, however, the fact that investment income has to be used to defray trading losses might mean that the transferor had no power to enjoy it.

As regards section 740, the Revenue are on much weaker ground. If investment income has to be used to defray trading losses, as will usually be the case, it is difficult to see how it can "directly or indirectly be used for providing a benefit for" any individual "or for enabling a benefit to be provided for him" so as to constitute "relevant income" within the meaning of section 740(3)..

## 10 Self-Assessment Returns

The Interpretation also states under "Miscellaneous":

> "Because of their complex and specialised nature the provisions of ss.739–746 are applied in individual cases by the Revenue's Special Compliance Office and Financial Intermediaries and Claims Office (see Inspector's Manual para IM4622). It is incumbent on taxpayers or their advisers to draw the Revenue's attention to the implications of the legislation when submitting details of transactions to which it may potentially apply (in the light of the decision of the courts in *Regina v IRC ex parte MFK Underwriting Agents Ltd* [[1989] STC 873]).
>
> Taxpayers are required to disclose clearly in their self-assessment return if there is any income or benefit assessable under ss.739 or 740, and whether reliance is being placed on s.741 to exclude income or benefit from assessment. Where such a disclosure has been made and exemption under s.41 claimed, the Revenue will make any necessary enquiries about that exemption in the statutory period allowed, and will not seek to reopen that year's return on discovery grounds if the s.741 exemption has to be reconsidered in later years."

The first paragraph is fair comment. The second paragraph is particularly important in the light of the blank self-assessment return for 1998/99. The last sentence looks too good to be true and should be treated with caution. There is some ambiguity as to what is meant by "discovery grounds".

## 11 Conclusion

Chapter III continues to be one of the most difficult and intriguing parts of the Taxes Acts which has received much more than its fair share of attention from the courts, particularly the House of Lords. In April, the appeals in two criminal cases, *R v Dimsey* and *R v Allen*, were heard before the Court of Appeal, Criminal Division. These appeals turned to a considerable extent on the true interpretation of the Chapter. The Revenue claim that they have the option of taxing either the individual transferor or the "foreign" person to whom in reality the income belongs. At the time of writing, June 21st, judgment is still awaited.