Chartered Institute of Taxation.

Finance Bill - Clause 22

1. Introduction

1.1 It is a reasonable inference that clause 22 has been put forward as a response to HMRC's defeat in the Supreme Court in HMRC v Fisher [2023] UK SC 44. The background to Fisher is set out in an annex at the end of this note. It is important to note that the Supreme Court did not consider that their decision opened up a loophole and further that the proposed legislation goes way beyond anything that could be regarded as a mischief caused by the decision in Fisher.

1.2 For the reasons deployed below clause 22 is neither fair nor appropriate and it is arguably not workable for either HMRC or taxpayers. The transfer of assets abroad regime ("the TOA regime") is being extended to a much greater body of taxpayers with the abolition of the remittance basis from April 2025. In the light of this it is particularly important that the TOA regime is fit for purpose and does not give disproportionate or unclear powers to HMRC which a court is later likely to curtail in line with previous case law on TOA.

2. What clause 22 does

2.1 The drafting of clause 22 is not entirely clear. However a fair reading of the proposed s 720A is that clause 22 applies to a UK resident individual if the following conditions are met:

(1) The individual ("the Taxpayer") was or is a participator in a company or in its direct or indirect parent.
(2) The company ("the Transferor Company") is close in the sense that that term is used in the Corporation Tax legislation (the term "participator" also bearing its corporation tax meaning).
(3) The Transferor Company makes a relevant transfer, i.e. a transfer of assets as a result of which income becomes payable to a person abroad ("the Corporate Transfer").
(4) The Taxpayer was involved in the Transferor Company, i.e. he had direct or indirect involvement in the decision making of the Transferor Company ("the Involvement Condition").
(5) The Taxpayer was aware or ought reasonably have been aware of the Corporate Transfer ("the Knowledge Condition").
(6) The Taxpayer was aware or ought reasonably have been aware that one of the consequences of the Corporate Transfer was the avoidance of taxation ("the Avoidance Condition").
(7) The Taxpayer did not object to the making by the Transferor Company of the Corporate Transfer ("the Objection Condition").

2.2 The final four conditions may together be referred to as the "Conduct Conditions". On any view there is wide overlap between the Involvement Condition and the Knowledge Condition.

2.3 The proposed s 720A does not state what tax consequences flow where the conditions set out in para 2.1 above are satisfied. However clause 22(4) applies ITA 2007 s 721. As such the income that arises to the person abroad as a result of the Corporate Transfer is taxed as if it were the income of the Taxpayer if he has power to enjoy it and is UK resident. The term "power to enjoy" is widely defined in the TOA regime and embraces virtually all cases where there is any possibility of the Taxpayer benefitting from the income.

2.4 Clause 22 also applies in relation to the charge the TOA legislation makes where an individual who has made a relevant transfer receives a capital sum in any way connected with the relevant transfer ("the Capital Sum Charge"). In such a case ITA 2007 s 727, at least on a literal reading, makes the individual taxable on all present or future income of the person abroad even if he has no power to enjoy it. Clause 22 inserts new s 727A in the same terms as the new 720A. The result is that if the Corporate Transfer satisfies the conditions summarised in para 2.1 above, an individual participator who has received a capital sum in any way connected with the Corporate Transfer may be taxable on the income of the person abroad even if he has no ability to benefit from that income. This is so even if the person abroad has no power to reimburse any tax the individual has to pay).

2.5 The term "transfer of assets" has been widely construed in decided cases on the TOA code. As a result transactions potentially brought into scope by clause 22 include the following:

(1) Sale by the Transferor Company of some or all of its assets to a non UK resident company that is not its subsidiary. These were the facts of Fisher and they are potentially in scope if the Taxpayer is a shareholder in the transferee company or otherwise has power to enjoy its income.
(2) Any transfer of assets, whether for value or gratuitously, between the Transferor Company and a non UK resident member of its group. This would inter alia include:

  (i) Capitalisation of a non-resident subsidiary.
  (ii) Dividend or liquidation distribution paid by the Transferor Company to a non-resident corporate shareholder.

2.6 Such transactions are potentially in scope to clause 22 whether the Transferor Company is UK resident or non UK resident.

2.7 Any UK resident participator is potentially in scope no matter what the size of his participation is. Further it should be kept in mind the term "participator"

includes not merely shareholders but also loan creditors and fixed interest beneficiaries under trusts owning shares in the Transferor Company (see CTA 2010 s 454 and R v IRC ex parte Newfields [2001] UK HL 27).

2.8 It should also be kept in mind that partnership holdings effectively count as a single holding in determining whether a company is close (CTA 2010 s 448(1)(a)). Thus certain companies which economically are widely held can find themselves counted as close, most notably in the private equity arena.

2.9 In paras 2.5 – 2.7 above the transactions are said to be potentially in scope. They are in scope only potentially because clause 22 does not apply unless the Conduct Conditions are met. However the onus is on the taxpayer to satisfy HMRC or, on appeal the FTT that those conditions are not met. In the case of the Involvement Condition this is expressly stated in s 720A(4) and the new s 751(za). In the case of the other Conduct Conditions the same result will in practice follow because on any appeal to the FTT the onus will be on the Taxpayer to displace any assessment raised by HMRC on the basis the Conduct Conditions are met.

3. Why Clause 22 is not appropriate

(a) ***Clause 22 is not fair***

3.1 Clause 22 applies regardless of when the Corporate Transfer was made insofar as income resulting from the transfer arises after 6 April 2024. It is thus retroactive. On any view clause 22 by extending the scope to any close company would include transactions not previously thought to be within TOAA, even in HMRC's view. Such would include the 30% shareholders in IRC v Pratt [1982] STC 756, where it is noteworthy HMRC did not appeal.

3.2 Clause 22 applies regardless of whether the Taxpayer was UK resident at the time of the Corporate Transferor. This is so even if at the time of the Corporate Transfer he had no plans to become UK resident.

3.3 Where the Transferor Company is UK resident, the effect of the Corporate Transfer will normally be to displace corporation tax on any profits resulting from the Corporate Transfer. And yet the tax charged where clause 22 applies is not corporation tax but income tax at potentially higher rates. Further such tax is charged not the person who in fact made the Corporate Transfer but on somebody else.

3.4 Clause 22 would not apply to a transfer by a close UK company to a non UK subsidiary which falls within the CFC rules. The avoidance required to put those rules into play may be much more artificial than the avoidance which engages TOAA rules. And yet the CFC rules result in tax at only corporation tax rates.

3.5 The Avoidance Condition means the Taxpayer is caught even if the tax liability whose avoidance is a consequence of the Transferor Company's actions is not income tax or corporation tax. This is because the word "taxation" includes any form of UK tax, as in Fisher itself where the tax avoided was betting duty. To the layman, one of the puzzling features of HMRC's pursuit of the Fishers was that the tax found to be avoided was not income tax, the explicit statutory target of the TOAA code, but betting duty. Further the result of HMRC's argument (had it been upheld) was that the Gibraltar profits, which had passed out of the UK corporation tax net, would have ended up being taxed at the much higher income tax rates. Many would regard that as unfair and yet if enacted clause 22 will perpetuate that outcome. Moreover any avoidance motive however small can lead to the TOAA code applying. This is not comparable to the rules in s136 TCGA 1992 where the main purpose has to be tax avoidance.

3.6 Where the Corporate Transferor is non UK resident there will already have been a relevant transfer that already engages the TOA code. It is unclear why a subsequent transaction should result in a fresh relevant transfer rather than simply being an operation associated with the original relevant transfer.

3.7 The Objection Condition gives a let out from clause 22, but this only applies to the Taxpayer if he did not object to the corporate transfer. Further the Knowledge Condition means that the fact that he did not object may not be a defence if the reason he did not object is that he did not know about the corporate transfer. He is caught if he ought reasonably to have been aware of the corporate transfer and of the fact that one of the indirect consequences is the avoidance of taxation. This is a new hypothetical factual test where the burden is on the participator to demonstrate a negative – that he could not reasonably have been aware of the transfer and the avoidance of any liability to UK taxation.

3.8 The test as propounded in the legislation leaves too much discretion to HMRC, compounding uncertainty and no doubt leading to increased enquiries and potentially appeals to the FTT. The taxpayer should not have to satisfy HMRC on every transaction however, commercial. Given the proposed extension of the code even to transfers by a UK company setting up a foreign subsidiary this could seriously curtail the UK as an international headquarters. Families with large international groups and a UK holding company will now be forced to consider the code every time a subsidiary is set up. Those foreigners who may be resident here for longer than four years will suddenly find that in relation to every transfer by their holding companies they will need to prove there was no indirect consequence of avoidance. In the absence of a clearance procedure and given that the proposals have wide commercial ramifications it is suggested that more objective measurable criteria are used which do not depend on the exercise of HMRC discretion or

the taxpayer having to prove a negative. Some alternatives are set out in section 4.

(b) *__Clause 22 is not workable__*

3.9 Clause 22 contains no provision for allocating income resulting from the Corporate Transfer as between the participators. To judge by their argument in Fisher, HMRC will rely on ITA 2007 s 743(1) which states:

> "No amount of income may be taken into account more than once in charging income tax under this chapter"

Section 743(2) then states that if there is a choice as between individuals, the income of the person abroad:

> "is to be taken into account:
>
> (a) In relation to such one or more of them as appears to an officer of Revenue and Customs to be just and reasonable; and
> (b) If more than one, in such respective proportions as appears to the officer to be just and reasonable"

3.10 Respects in which the absence of allocation provisions make clause 22 unworkable include the following:

(1) Section 744 requires an officer of HMRC to make the allocation. Yet clause 22 does not provide for any mechanism by which the Transferor Company or the Taxpayer can agree the allocation with HMRC.
(2) Section 744 does not cover the position where some participators are in scope to clause 22 and some not. The latter would include non-resident participators (as in Fisher) and also all those who with the requisite knowledge do not object. Is the implication that all the income resulting from the Corporate Transfer is allocated to the resident participators who do not object? In many cases that would be neither fair nor appropriate and could provoke the kind of judicial language that so characterised the decision in Vestey more than 40 years ago.

3.11 One of the other potential problems identified by the Supreme Court in *Fisher* is the difficulty of determining whether the motive defence applies where there are multiple transferors/participators. One participator may have a tax avoidance purpose, but another may not. The way the motive defence is framed, it is not possible to draw a distinction between the different participators/transferors and so the fact that one participator has a tax avoidance purpose will mean that the motive defence is not available to another participator who has no tax avoidance purpose. A solution would be to amend the proposed s.720A(5)(b) to refer to tax avoidance being one of the purposes of the relevant participator in question. The Courts are unlikely

to want to tax participators adversely when they had no tax avoidance purpose.

3.12 Another allocation issue arises where the Corporate Transferor is non UK resident. What is the position if some participators are in scope to clause 22 and some not. Does that mean that some of the income of the transferee person abroad is allocated to participators in the Corporate Transferor who did not object and the rest to the individual who is transferor in relation to the original transfer to the Corporate Transferor (assuming he is UK resident and in scope).

3.13 A further cogent reason why clause 22 is not workable is that an individual participator cannot be treated as transferor if he can satisfy HMRC he has no direct or indirect involvement in the decision-making of the company. Here too there is no mechanism by which he can approach HMRC to secure agreement it is so satisfied.

3.14 More cogently the "involvement" concept bristles with the kind of difficulties identified in Fisher. It is sufficient to cite an extract from para 75 of the Supreme Court judgment as giving an illustration of the kind of factual conundrum that could arise:

> "During the hearing before this court, Mr Ewart struggled to express what was needed in order for a shareholder to become a transferor. At some points he seemed to be suggesting that the fact that the shareholders at a general meeting usually have the power to remove the board of directors was enough for them all to be transferors, by reason of them not exercising that power when the directors cause the company to transfer an asset. At other times he seemed to be suggesting that it was necessary for the shareholders to have been seen to get together, or to act in concert (though it was not clear what he meant by that) before they could be regarded as quasi-transferors. A myriad of different scenarios were suggested. What happens to a holder of, say, 30% of the shares who, knowing that all the other shareholders intend to vote to transfer the company's assets overseas, cannily votes against the motion, or abstains, or cries off attending the meeting? Does he or she thereby avoid the charge to tax whilst still having the power to enjoy the assets transferred pursuant to the motion passed by the other shareholders so that it is only the voting shareholders who are caught by the provision?"

3.15 A final point to note is that s 720A(1) and 727A(1) state that they apply:

> "for the purpose of preventing the avoiding of a liability to taxation"

In this they contrast with ss 720 and 727 which are said apply:

“for the purpose of preventing the avoiding of liability to income tax”

Does this mean that there could be circumstances where, construed purposively, s 720A(1) would apply and yet, if the same relevant transfer had been directly effected by the Taxpayer s 720 would not apply. And if that is right, how would that impact on scenarios of the kind postulated in para 3.11 above?

4. Examples of the problems caused by Clause 22

Example 1

Four brothers inherit UK Ltd in 2005 from their father, UK Ltd the parent of a successful UK trading group. The brothers are not transferors. Later the UK group decides to expand and starts to buy other companies. In 2008 in a new venture they decide to fund a property development in Dubai and set up a Dubai subsidiary for this purpose, fully recognising the Dubai subsidiary will not be subject to UK tax. By this time one of the brothers is non-UK resident but the rest are UK resident. One brother only has a 10% interest and is not a director of any company in the group. How should they self-assess from April 2024?

Example 2

Mr X is a non UK domiciled settlor of the A Trust, a Cypriot trust under which his son, Mr Z is life tenant. Both men are UK resident. The terms of the trust preclude any benefit to Mr X or his spouse. The trust assets are a directly held portfolio held in Geneva but in 2015 Mr Z asks the trustees to buy a London house for him to live in at a price of £15m. The trustees agree and incorporate a Cypriot company C Ltd as the purchase vehicle with the overt purpose of avoiding:

(a) IHT
(b) SDLT on any future sale (by selling the shares)

In 2023 C Ltd sells the house, the buyer accepting SDLT liability as he does not want a second hand company. C Ltd invests the proceeds.

Until 6 April 2024 there is no 720 liability on the income generated by C Ltd. Does s 720A mean Mr Z is now liable as transferor?

5. Specific suggested amendments

5.1 For the reasons given by the Supreme Court in Fisher, the so called loophole identified in that case does not exist (see background below) and so clause 22 is not needed at all. If despite this there is felt to be a gap, the solution is to replace the TOA code with rules applicable to the fact patterns that occur today. The TOA dates back to the time when Neville Chamberlain was Chancellor, when air travel and modern communications were in their

infancy. The number of cases HMRC have lost in recent years is indicative of how uncertain in meaning the code is, to which further applications of sticking plaster are no solution.

5.2 If clause 22 is felt to be needed the following changes should be made.

5.3 Clause 22 should not be retroactive. People will find it difficult if not impossible to judge the effect of a Corporate Transfer many years ago.

5.4 It should contain specific rules as to how income resulting from the Corporate Transfer is allocated and to whom. It is suggested this should be based on the individual's shareholding interest as a participator.

5.5 Individual participations through a trust should be ignored. Thus a life tenant should not be regarded as a participator.

5.6 Close company status resulting from partnership control should be disregarded.

5.7 Individuals whose participation (when aggregated with connected parties) is below 25% should be excluded. This is in line with s3 TCGA 1992 and proves a clear bright line.

5.8 Only the relevant participator with the tax avoidance motive should be caught.

5.9 "Taxation" in s.721A(5)(e) should be limited to income tax and/or corporation tax in the same way that s 3 is limited to CGT and corporation tax.

5.10 Transfers between members of a trading group should be carved out of the proposed legislation. These changes would bring the TOA regime more into line with s3 TCGA 1992.

5.11 All transfers within a non-resident group should be carved out of the legislation. The original transfer of assets to the group is the relevant transfer.

5.12 Involvement in the decision making process should require the individual to be a director or shadow director of the Transferor Company. Mere awareness as a participator is not enough whether or not objection is made.

ANNEX: BACKGROUND

6. The facts of Fisher

6.1 In Fisher, 4 individuals owned a UK trading company, namely:

- Father 38%
- Mother 38%
- Son 12%
- Daughter 12%

In response to commercial pressures resulting from the betting levy, they incorporated and capitalised a Gibraltar company in the sum of £50,000. They owned the shares in the proportions:

- Father 26%
- Mother 26%
- Son 24%
- Daughter 24%

The UK trading company then sold its telebetting business to the Gibraltar company at a price advised to be market value, £500,000. Profits were made and HMRC sought to assess these on father, mother and son in the proportions in which they owned the shares in the Gibraltar company. Daughter was not assessed as she was non UK resident. In the Court of Appeal, HMRC succeeded in relation to father and son but lost in respect of mother on the basis she had no role in decision-making. The decision as respects father and son was reversed in the Supreme Court, on the grounds correctly construed, the TOAA legislation required an individual to have made the relevant transfer.

6.2 Prior to the decision in Fisher:

(1) As a result of Congreve v IRC [1948] I AIIER 948 it was thought a corporate transfer could in certain circumstances be attributed to an individual who controlled the company.
(2) In IRC v Pratt [1982] STC 756 Walton J had decided that 2 directors who owned nearly 30% of a company could not have a corporate transfer attributed to them.

Is clause 22 closing a loophole?

6.3 In the explanatory notes to clause 22, HMRC say (at para 28):

> "This clause aims to tackle avoidance arrangements and does so by closing a loophole in TOAA provisions. This loophole allowed for the use of a company to transfer assets offshore in order to avoid UK tax"

6.4 In fact there is no such loophole. The Supreme Court Fisher made it clear that a UK company incorporated to circumvent the TOAA code, i.e. used to transfer assets offshore, would not prevent the code from applying. The Supreme Court's words (at para 87 of its judgment) were as follows:

> "The second answer may lie in the point that the Upper Tribunal made at para 63 of their decision. They said a taxpayer could not avoid the operation of section 739 by simply transferring his income-producing assets to a UK company prior to the transfer of the same assets by the company to a foreign company or individual. The interposition of the UK company would be regarded as a device, and the substance of the transaction would still be a transfer of those assets by the individual to the foreign entity. Likewise, if a UK company was deliberately set up to circumvent a liability to income tax, that scenario might be treated as falling within one of the recognised exceptions to the distinct legal personality of the company. No such argument could be relied on by HMRC here because SJA was a bona fide company which had been trading for many years"

6.5 The Supreme Court went on to say:

> "Thirdly, if there is indeed a gap created by this ruling, then as Viscount Dilhorne said in *Vestey*, gaps in our tax law can be and usually are speedily filled. If the Government does not regard section 740 as adequately filling the gap, then it will need to think carefully about how to fill that gap in a fair, appropriate and workable manner".