TAXREP 57/13

(ICAEW REP 146/13)

ICAEW TAX REPRESENTATION

CONSULTATION ON THE TRANSFER OF ASSETS ABROAD DRAFT GUIDANCE

Comments submitted on 10 October 2013 by ICAEW Tax Faculty in response to HM Revenue & Customs request for feedback on the Transfer of Assets Abroad Draft Guidance published on 2 August 2013

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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the *Transfer of assets abroad: draft guidance* published by HM Revenue & Customs (HMRC) on 2 August 2013.

2. The 18 July 2013 consultation document *Reform of an anti-avoidance provision: Transfer of assets abroad* introduced this revised guidance on the TOAA rules and sought views on it. The consultation document contained eight questions (some of which make reference to the draft guidance) and also a general request for comments on the draft guidance with the request being made that these comments should be provided in a document separate to any response to the consultation document.

3. We have submitted a specific response to the consultation document, which given the questions asked does contain some key comments on the draft guidance. This response, as instructed is solely concerned with the draft guidance.

4. On 6 September 2013 we attended a working party meeting with HMRC on possible changes to the matching rules with respect to benefits received and relevant income. During the course of this meeting the draft guidance was discussed and we made reference to the fundamental concerns that we have with the draft guidance. We are taking part in a specific working group on the draft guidance and will go into further details about our concerns as part of our participation in this working group.

5. The draft HMRC Guidance runs to around 150 pages. Our comments herein outline our key concerns and some preliminary comments. They are not exhaustive and our silence on any part of the guidance should not be taken to mean that we agree with the technical views expressed by HMRC.

6. Information about the Tax Faculty and ICAEW is given below. We have also set out, in Appendix 1, the Tax Faculty's Ten Tenets for a Better Tax System by which we benchmark proposals to change the tax system.

WHO WE ARE

7. ICAEW is a professional membership organisation, supporting over 140,000 chartered accountants around the world. Through our technical knowledge, skills and expertise, we provide insight and leadership to the global accountancy and finance profession.

8. Our members provide financial knowledge and guidance based on the highest professional, technical and ethical standards. We develop and support individuals, organisations and communities to help them achieve long-term, sustainable economic value.

9. The Tax Faculty is the voice of tax within ICAEW and is a leading authority on taxation. Internationally recognised as a source of expertise, the faculty is responsible for submissions to tax authorities on behalf of ICAEW as a whole. It also provides a range of tax services, including TAXline, a monthly journal sent to more than 8,000 members, a weekly newswire and a referral scheme.

KEY POINT SUMMARY

10. The transfer of assets abroad (TOAA) regime is complex. The 2007 re-write by setting out the original brief legislation in much greater detail, rather than making the legislation clearer actually, exposed its flaws and highlighted the areas where the legislation is incoherent. The flaws in the legislation are such that trying to explain it in detail is a very difficult task as there is not necessarily one clear interpretation. Although we have made a number of observations in relation to the draft guidance it is important to appreciate that simply because we have not

commented on every part of the guidance does not represent tacit acceptance on any aspect on our part.

11. Providing clear detailed guidance is not, therefore, an easy task and this is why in our response to the consultation document we recommend a detailed review of the legislation as we do not think it is possible for HMRC to improve the position through non-statutory guidance. A root and branch reform of the legislation is required (as Schedule 12 of FA 2010 did, after extensive consultation, with the transactions in securities legislation).

12. We have fundamental concerns with the current draft guidance as we feel that the concern on the part of HMRC to not allow any opportunities for tax avoidance has led to unbalanced and extreme interpretations being put forward in several important areas (most notably the matching of relevant income to benefits).

13. We feel that the comments at INTM601680 and in other places take an extreme view that is unfair to taxpayers who, if this interpretation were correct, would find themselves faced with significant tax liabilities in connection with income they cannot benefit from.

14. We have significant concerns with the sections in the draft guidance that discuss EU law. As we have stated in earlier responses, we believe that the limitations within s742A ITA 2007 (post 5 April 2012 exemption for genuine transactions) are not in keeping with the underlying EU case law. The EU case law is not limited to goods and services but instead looks to see whether there is a business carried on through a genuine establishment (see eg *Cadbury Schweppes*). As we have stated before it is not helpful to taxpayers (who must be prepared for expensive litigation) nor indeed HMRC (who may be faced by taxpayers asserting rights) for there to be only partially compliant legislation. The underlying European law will always prevail to the extent there is a conflict with UK law. This is another example of a situation that the draft guidance cannot remedy and where legislative reform is required (see paragraph 11).

15. The lack of balance in the draft guidance is a significant practical issue. Rather than providing certainty it will lead to greater uncertainty in this area as advisers see that what they thought was accepted practice is not now accepted by HMRC. We also feel that is has EU law issues. We have stated that we do not think that the FA 2013 changes were sufficient to make the TOAA legislation compatible with EU law. The complexity and lack of balance in the draft guidance is further evidence that the provisions are not proportionate.

GENERAL COMMENTS

16. We think that the structure of the guidance can be improved. We appreciate fully that the subject matter is complicated but we think that because of this it is even more important that the guidance is written in a way that is accessible. The current introduction is overly complex and we are concerned that it will just confuse non-specialists. A gentler, less technical introduction is required.

17. We think that to make it more accessible to non-specialists the general ordering of the guidance needs to be reconsidered. The explanatory material which is less technically demanding (such as INTM600640) could be moved forward. with very little modification, to form part of the introductory division and we think that this would greatly assist non specialists.

18. We appreciate that with subject matter so complex that guidance has to run to in excess of 150 pages there will inevitably be typological issues, issues with respect to the clarity of the drafting and repetition.

19. We found that significant parts of the draft guidance were repetitive. We accept that sometimes repetition can be helpful but think that there are a number of cases in the draft guidance where repetition detracts from comprehension (for example INTM600580 and INTM600820).

20. We appreciate that HMRC may have been under some considerable time pressure to finalise the draft guidance. As such, we understand that it may not have been possible for the guidance to be proof read. As our detailed comments show, in addition to standard typos, we have identified a number of areas where sentences do not appear to have been completed or there appears to be some doubt as to what the final text should be (we assume that square brackets and question marks indicates doubt). We would suggest that prior to finalisation of the guidance the entire document is proof read.

21. We note that for the purposes of this draft guidance HMRC have introduced the concept of the jigsaw. Whilst we accept that visual representation can be helpful we are not sure that the jigsaw concept adds anything and think a flow chart would be more easily understood.

22. We make various suggestions with respect to additional issues that need to be considered below. As a general comment we would say that it would the guidance more user friendly if rather than just concentrating on explaining the provisions it also has sections seeking to apply the provisions in practical cases. The TOAA legislation and claiming the exemption is a significant problem for the private equity industry and we think that a section covering the generic practical issues that arise would be helpful. For example, the HMRC approach when considering an exemption claim in a situation where an individual manager has shares in one or more offshore companies because of a requirement imposed by the private equity house he or she is employed by.

DETAILED COMMENTS

INTM6000040 – General Introduction

23. The last paragraph of this section appears to be incomplete.

INTM600220 – General Conditions All Cases: Relevant Transaction: Relevant Transfer

24. The final paragraph of this section states that there will be cases where both the settlements' legislation (ITTOIA 2005, Part 5, Chapter 5) and TOAA can apply. As well as including a reference to the settlements' legislation guidance it would be helpful to state that HMRC accepts that where both charges can apply the charge under the settlements' legislation has priority since under s 624 ITTOIA 2005 the income is treated as that of the settlor alone for income tax purposes.

INTM600260 - General Conditions ALL Cases: Relevant Transaction: Assets

25. Reference the section 'What are assets?'- it would be clearer if this section were expanded. For example, including the fact pattern in *CIR v Brackett* would make the rationale much clearer to understand as regards contracts of employment.

INTM600300 - General Conditions All Cases: Relevant Transaction: Associated operations

26. In the context of the TOAA provisions the "associated operations" concept is both fundamentally important and extremely difficult. The draft guidance on this subject is very limited, which is disappointing. We would suggest that the section is expanded and that it includes examples of what HMRC considers to be associated operations.

27. The penultimate paragraph of the text at INTM600300 states:

'With effect from 6 December 2005 the words "It does not matter whether the operation is effected before, after or at the same time as the transfer" were added after the definition making clearer the fact that to be an associated operation the action does not have to chronologically follow a transfer of assets."

28. We think it is important to emphasise that there has to be some connection between the operations. Random steps taken possibly by different individuals are not necessarily associated. For example in Corbett's Executrices v IRC [1943] 25 TC 305 the Court made the following observation:

"The interval during which….were thinking about their 'associated operations" could not make any difference to the legal conclusion unless the Special Commissioners had found as a fact that it negative the 'conjunction' or association between the two operations.'

This supports the view that the actions must have some linkage or relevance.

29. We also think it is important that there is a full (balanced) discussion of the implications of *IRC v Herdman (1969) 45TC* (see our comments in paragraphs 82 to 83 below on draft INTM601780). This is another area that would benefit from being discussed during a meeting of the guidance working party.

INTM600400 – General Conditions All cases: Income becomes payable to person abroad: Income

30. It would be helpful to provide further details of income that is outside the remit of the provisions, because otherwise taxpayers may mistakenly self-assess the income concerned.

INTM600460 – General Conditions All Cases: The Individual: Introduction

31. Heading 'The individual to who the legislation is directed' - this is an area where there has been a great deal of confusion and we feel that the draft guidance is inadequate. In particular we do not feel that the following sections (our highlighting) provide any additional guidance to readers:

"HMRC gave some comment on this aspect in April 1999 in a published Tax Bulletin article which said:

"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 section 739 [ICTA 1988] by virtue of the provisions of section 743(3) [ICTA 1988]."

This statement indicates broadly the approach that will be taken to individuals and their spouses or civil partners in relation to the application of these provisions. In general (unless there are wider arrangements) HMRC will not use transfer of assets to charge tax on one spouse or civil partner in respect of income arising to the other spouse or civil partner, where that spouse or civil partner has made a transfer of assets but is, for example, outside the charge because say of the application of non-UK domicile provisions. In effect, the general approach will be to apply the word individual (where the individual has a spouse or civil partner) in a way that is consistent with the individual who has the power to enjoy income of a person abroad, entitlement to capital sums or who receives benefits as a result of relevant transactions. But it may be equally valid in this context to use the term in a way *that is consistent with an individual who, by means of relevant transactions, seeks to avoid a liability to income tax. Where spouses or civil partners are therefore in some way connected with relevant transactions and the results of such transactions, regard will be had to the particular facts where the extended meaning of individual may impact upon the potential charge."*

32. It is not clear what HMRC consider to be "wider arrangements". However, it does seem clear that an understanding of the HMRC practice in this area cannot be arrived at without knowing how HMRC interprets the phrase. Bearing in mind that to be compatible with European Law the provisions should be proportionate, it is not helpful to have guidance that is unclear.

33. It would be helpful if HMRC gave some indication (preferably examples as well as explanatory analysis) as to what is and what is not caught in their view. We consider that the guidance is not sufficiently clear to enable taxpayers to complete their tax returns.

INTM600500 – General Conditions All cases: The Individual: residence status

34. There appears to be a typo in the example, the final line of which should read as follows:

"was not resident in ~~further~~ either 2010-11 or 2011-12, but was resident in 2012-13"

INTM600560 – The income charge: introduction

35. We accept that often where the s727 ITA 2007 capital sum charge conditions are met the s720 power to enjoy conditions will also be met. However, this does not mean that the charging provisions are the same and so we do not think that the statement that the two charges broadly lead to the same result is necessarily correct. As such, we think this statement should be omitted.

INTM600580 – The income charge

36. Heading 'The transfer' - part of the text follows that set out at IHTM600820, but differs in some critical respects which we assume is simply an oversight:

"In most cases determining whether the individual has made a transfer of assets will be relatively straightforward, but what is meant by 'or may be, was associated with' the transfer? This is likely to depend on the facts and circumstances of the matter. For example, an individual may wholly own and direct a company. If the company makes a relevant transfer which results in the individual who wholly owns the company having power to enjoy the income of a person abroad, even though the individual has not made the transfer, by virtue of his position HMRC would take the view that he, may be, was associated with it and thus that the individual can be regarded as having made the transfer such that the connection is made and the income charge applies. Equally if an individual in someway 'procured' a transfer to be made HMRC may regard the relevant connection as made."

37. The omission of the word wholly is a material one; we do not think that a minority shareholder who was not acting in concert with other shareholders could be said to have procured anything.

38. We are puzzled as to why the word "may" is included in the sentence: "Equally if an individual in someway 'procured' a transfer to be made HMRC may regard the relevant connection as made." It seems to us that the use of the word "may" in this context downgrades the comment to such an extent that it is virtually useless.

39. We feel that this part of the guidance needs to address the decision in *IRC v Pratt [1982] STC 756.*

INTM600660 – The income charge: General conditions

40. Heading "Income charge – receipt of/entitlement to capital sum" - the operation of the anti avoidance provisions is extremely severe once triggered. This means that proportionality is an issue. At a minimum in order for the legislation to act in a proportionate manner it must be clear to a taxpayer when it will be triggered. The legislation is not, however, clear and the draft guidance rather than improving the situation raises a number of points that it does not answer. For example it states that:

> *"It should be noted that no liability can arise under this charge for a tax year before receipt or entitlement to a capital sum. But where there is such a receipt or entitlement liability continues for any subsequent year for which there is income (there need be no further receipt of a capital sum). If, however, entitlement to a capital sum completely ends, and there are no other grounds for an income charge, liability under this charge will not normally be extended beyond the tax year in which that entitlement ceases."*

41. It is not clear what is meant by the word "normally". It would also be helpful to have confirmation that the liability to tax would cease where the debtor ceases to exist, and also where the individual dies.

42. It is also not clear what happens when an individual makes a loan to non-UK resident discretionary trust under which he is ineligible to benefit. The debt is repaid. The receipt of the repayment is a capital sum. What is the position going forward? Will the individual be taxed until he or she dies on the income attributable to the original loan or the trust comes to and end?

INTM600680 – The income charge: General Conditions

43. It is not surprising that there are overlapping anti-avoidance provisions, but in order for the provisions to be proportionate it is important that HMRC makes it clear that it will not seek to operate the capital sums provisions in preference to the general power to enjoy rules. This is because there is potentially no limitation in terms of time as regards operation of the capital sums rules as the guidance itself acknowledges, as follows:

> ***"Which charge applies?***
>
> *It is possible that for the same tax year an individual could meet the conditions to be potentially chargeable under either of the income charge provisions. The 'no duplication of charge' provisions described at INTM602360 ensure that the same income cannot be taken into account more than once for the purpose of an income charge. The result would be that if the conditions for both charges were in fact met, only one charge would be made."*

INTM600780 – The income charge

44. Unless we have misunderstood the position, paragraph 5 of this text might be improved as follows (suggested addition in bold and underlined):

> *"What this means is that where the individual was not ordinarily resident in the UK at the time when the relevant transfers were made only income arising on or after 26 November 1996 can be taken into account in arriving at the income charge **<u>where the individual was ordinary resident at that time prior to the changes introduced by the FA 2013</u>**."*

INTM600800 - The income charge: power to enjoy – Multiple Income charges

45. Heading 'Multiple Transferors' - we think that the following text (paragraph 5) needs to be revised:

> *"HMRC's practice (Tax Bulletin 40 and RI 201) where the same assets are transferred by several individuals is to assess the transferors in proportion to their share of the assets transferred. For example, where the shares of a UK company are held by three individuals in the proportions of 40%, 40% and 20% and there is a liability under section 720 ITA 207 in respect of the income of an overseas person to which the shares are transferred, the liability is assessed on each of the three individuals in proportion to their respective holdings."*

46. The text should make clear that minority shareholders cannot be taken to procure anything if the transfer was procured by a majority shareholder. For example, if a transfer is procured by a shareholder who owns 90% of the share capital, we would expect that the remaining shareholders would not be treated as quasi transferors irrespective of whether they voted against the transfer in general meeting or not, provided that they were not acting in concert with the majority shareholder. We think that this needs to be made clear.

INTM600980 - The income charge: Power to enjoy: Special rule relating to benefits

47. We refer to the following text (paragraph 3 of the section):

> *"This provision was considered in the case of CIR v Botnar (72 TC 205). Although it did not affect the outcome in that case, there is some helpful comment on it. The views expressed there appear to confirm that in the case of actual receipt of a benefit (as opposed to mere entitlement to receive) the provision is determinative of the charge to tax which could produce a radically different result than what might otherwise be the charge under the income charge. Further that where the power to enjoy arises on this basis the tax is charged not on the income which the individual has power to enjoy but on the value of the benefit. This may bear no relationship whatsoever to the income of the person abroad as long as it originated from it even indirectly. The Commissioner rejected the view that the provision only operates where the benefit received in a year exceeds the income of the person abroad. From this it seems clear that where the conditions are met the provision could have the effect of either extending the amount of charge for the tax year beyond the actual income of the person abroad of that year or of limiting the amount of the charge to the amount or value of the benefit where that is less than the income of the person abroad of the tax year."*

48. We found the text highlighted particularly difficult to follow and suggest that it is rewritten.

INTM601040 – Transfer of assets: the income charge: meaning of 'capital sum'

49. Heading 'Meaning of capital sum' - this is a very complex area, which means that the guidance needs to set out very clearly what the limitations of charge might be. We do not think that the current draft guidance is sufficiently clear.

50. We think that the example would be clearer if an explanatory sentence is added to the end as follows (suggested additional text in bold and underlined):

> *"Example*
>
> *In years 1 to 4 income arises to a person abroad as a result of a relevant transfer by an individual A. The individual does not have any power to enjoy the income or entitlement to a capital sum; but in year 2 receives a loan. In year 3 the loan is repaid in full and there is no on-going entitlement to further loans or other capital sums. In these circumstances there would be an income charge in years 2 and 3. There would also be on-going charge for year 4 because of the terms of (a)(ii) in INTM601020 but for the proviso above relating to repayment of a loan where that is in effect the only feature that triggers the income charge - receipt of/entitlement to capital sums.* ***<u>However, that does not apply where the only trigger for the income charge is receipt of/entitlement to capital sums in respect of a loan which has been repaid in full before the start of the tax year."</u>***

51. We do not think the following text (the last paragraph of this section) is sufficiently clear:

> *"Not only is the receipt of a loan by the individual a capital sum, the making of a loan by the individual to a person abroad can also satisfy this meaning, carrying as it does an entitlement to repayment. That entitlement would be entitlement to a capital sum and thus the condition would be met from the time that the loan is made to the person abroad. Any repayment of such a loan would itself be a capital sum, it is not however itself a loan and thus will not stop the income charge from running under the proviso described in the first paragraph above. In order to stop this income charge from continuing the individual would need to demonstrate that there was no on-going entitlement of any description to a capital sum."*

52. We would like to be absolutely clear that in HMRC's view the repayment of the loan by a non UK resident debtor, whilst being a capital sum, will mean that the creditor would cease to be liable for the income arising following the year of assessment in which the repayment takes place. For example a settlor makes a loan to a non-UK resident discretionary trust from which he is excluded from benefit; he is entitled to receive a capital sum, with the result that the income arising is attributed to him under s727 ITA 2007. The loan is subsequently repaid. The receipt of the repayment is itself a capital sum. Is it HMRC'S position that as there is no continuing entitlement to receive a capital sum the provisions at ITA 2007, s727 cease to apply? Presumably it is also HMRC's position that if the debt was repaid and the old debtor ceased to exist, for example the assets of a trust were completely distributed, s727 could have no basis of application?

53. We think that the overlap with the settlement provisions should be dealt with in this guidance (as stated in paragraph 24 above). For example, if the loan in the above example was interest free and repayable on demand it is arguable that any income attributable to it would be taxed under s624 ITTOIA 2005. This would mean that the income attributable to the loan would fall outside of the provisions of the transfer of assets abroad rules, as it would be the income of the settlor within s624, so it could not be the income of the non-resident person.

54. We would also like to see reference made to the need for there to be a sufficient connection with a relevant transaction. For example in *Fynn v IRC (1957) 37 TC 629* the transferor had transferred investments to a company, which were used as security to acquire finance from a bank in order to purchase new investments. Some years later the transferor lent the company £12,000. Upjohn J held that neither this loan nor the right to repayment were connected with the original transfer or the pledging of the transferred securities. We like it to be made plain that there must be sufficient connection between a capital sum and a relevant transaction before there can be a liability to tax.

INTM601060 - Transfer of assets: the income charge: examples of capital sum

55. “A loan made by an individual” is included as an example of an item that is a capital sum. We think including this item in the list is unclear as it is only relevant where the individual is entitled to a repayment. The point should be made clear.

56. We note the reference in the text below to full consideration. Bearing in mind the onerous nature of the charge to tax under s727 ITA 2007 we think that it would be helpful for the guidance to confirm that slight differences in value will not cause HMRC to seek to invoke the provisions of s727 ITA 2007.

57. Our concern is that if the price paid for convertible loan notes was say £1m, and that HMRC subsequently and successfully argued that £1.2m should have been paid, that all of the income treated as being attributable to the initial investment could be attributed to the creditor under s727 ITA 2007. We appreciate that the loan notes might come within the general power to enjoy provisions, but we would like to establish that HMRC will not seek to apply the potentially more onerous provisions of s727 ITA 2007 in preference to the power to enjoy rules. We think that this is the case from the following comment:

> *“h. Where promissory notes or debentures payable on demand are issued to the individual as part of the consideration for the transfer of assets the amount payable under the notes, not being payable by way of loan, and being payable for full consideration is unlikely to be a capital sum for this purpose, as was found in the case of Lee v CIR (24 TC 207).”*

58. We would, however, like to see the point explicitly covered in this part of the guidance.

INTM601280 - Transfer of assets: the income charge: examples of the amount or value of a benefit?

59. We are unclear as to why there is a reference to the Corporation Tax Act 2009 in the text (paragraph 1):

> *“Where there is rental income, any profits should be arrived at in accordance with the rules in Part 3 ITTOIA 2005 [and Part 4 Corporation Tax Act 2009?].”*

We would have thought that the reference to the Corporation Tax Act is not relevant as the transfer of assets abroad rules are concerned only with income tax. We wonder whether this was also a concern of the author since the reference to the Corporation Tax Act 2009 is following by a question mark.

INTM601440 – Transfer of assets the benefit charge: background

60. We do not feel that the following text (taken from paragraph 1of this section) is phrased appropriately:

> *“This followed from the House of Lords taking the view that the existing income charge could only charge tax where the individual who was potentially chargeable had themselves made or been associated with the transfer of assets. The income charge is described in paragraphs INTM600520 onwards.”*

61. As the highest court in the UK at the time the House of Lords explained the law and we do not feel that it is respectful to refer to it as having “taken a view”.

INTM601480 - Transfer of assets: The benefits charge: General conditions

62. We are not clear whether the following text is complete:

> *"With the "abolition" of the concept of ordinary residence from 6 April 2013, from 2013-14 onwards an individual [only?] has to be resident in the United Kingdom."*

In particular we are not sure why "only" is in square brackets with a question mark. It may be that there is consideration as to whether "only" is necessary in the sentence. On balance to show the difference from 2013/13 onwards we think it is.

INTM601520- Transfer of assets: The benefits charge: Interaction with capital gains tax charge

63. For non-specialists the interaction of the various anti-avoidance provisions is highly complex and clear guidance is required. We do not feel that the current draft guidance is sufficient. Phrases such as "it will not normally…" and "appear possible…" are not comforting and clear numeric examples are required for non-specialists to understand how the provisions interact.

INTM601540 - Transfer of assets: The benefits charge: Receives a benefit INTM601560 - Transfer of assets: The benefits charge: What is a benefit?

64. There is an overlap in the material covered in these two sections and we think that it would be clearer if the two sections were rewritten to avoid this and ensure that the narrative flows in a more logical fashion.

INTM601600 - Transfer of assets: the benefits charge: examples of the amount or value of a benefit?

65. We have concerns with the following text (paragraph (c)) and would suggest the following addition (underlined and in bold) since the cost of making the provision is not the sole factor that has to be taken into account:

> *c. Asset made available for use: the principles to be applied where an asset is made available for use by an individual are likely to be similar to those described above for rent free accommodation. Where the benefit provided is on an ongoing and continuous basis it will generally be appropriate to look at the tax year as a whole and consider the 'annual value' of the use of the asset in relation to that tax year (or part thereof) together with any ongoing costs to the person providing the benefit of its provision for use by the individual.* ***<u>Part of this process is also to take into account the costs that the recipient is required to incur, which will amongst other things determine the market value of the benefit received.</u>*** *Subject to obtaining any necessary professional valuation advice, as a rule of thumb it might be appropriate to adopt methodology for the benefits charge in this area similar to that which may apply in the employment related benefits field where an asset is made available for use (see for example section 205 ITEPA 2003).*

66. We do not understand why it was felt necessary to caveat (our highlighting) the following commentary:

> *"f. Loans: INTM601620 gives examples where loans are involved.*
> *If the individual receiving a benefit makes any contribution towards that benefit the contribution will normally be taken into account in determining the amount or value of the benefit. For example, an individual is provided with accommodation that is a benefit for the*

purpose of the benefits charge. It is agreed that the value of the use of the accommodation based on rental is £10,000 for the tax year. In that year the individual pays a rental of £5,000. It will normally be appropriate to take account of the contribution such that the amount or value of the benefit is regarded as £5,000."

67. Provided the £5,000 is genuinely paid as a rental contribution we do not see when it would not be appropriate to take it into account.

INTM601620 - Transfer of assets: the benefits charge: Examples of the amount or value of a loan

68. This section contains the following assertion, which we consider to be incorrect:

"The above assumes that monies made available to the individual were in fact by way of loan and, in appropriate cases, evidence of a loan having been made, should be obtained. If, on enquiry, it transpires that the payment was not a loan, or if a loan there is little likelihood of a demand for repayment (Williams v CIR 54 TC 257), then the payment should be treated as a cash payment, as referred to earlier."

69. The *Williams* case was involved with transactions in securities. We do not think that it is good authority for suggesting that where there is little immediate prospect that a loan is going to be called in it should be treated in effect as a payment of capital.

70. It is important to appreciate that s731 ITA 2007 is generally involved in cases where an offshore trust arrangement is involved. It is not involved in cases where the person receiving the loan controls the trustees or the offshore companies that the trustees own and so the facts will normally be very different to the *Williams* case. In that case three tax avoidance schemes were combined. The decision in relation to the loan aspect related to the third element. This final transaction was designed to enable the shareholders personally to obtain the benefit of the tax free monies in the form of interest free loans made to them by a company which they ultimately controlled, so that no liability arose under the provisions of section 75 of the Finance Act 1965. This led to the conclusion that Gristrim and Dolerin, being under the full control of the shareholders, were companies which did not, and never had, carried on any business and which never existed for any other purpose than for that of carrying through the tax avoidance scheme, and the practical likelihood of their debts being called in was negligible.

71. We accept that if trustees made a loan, which was repayable on demand, to a beneficiary who was insolvent and could not repay it in any circumstances that would be a payment of a capital sum. We do not, however, accept the far more general proposition outlined in the draft guidance.

INTM601640 – Transfer of assets: the benefits charge: benefits received out of assets

72. As stated above the legislation is extremely complex, lacks coherence in places and does not always provide a clear answer on fundamental points (see paragraphs74 to 80 below). For the legislation to appear proportionate it needs to be interpreted in a reasonable manner. It would assist in this if the HMRC Guidance were balanced (as stated in our key points the lack of balance in the draft guidance is a fundamental concern to us).

73. In this section, it would be helpful to list items that are not treated as being provided out of assets. For example, a sale by a beneficiary of his or her interest under a trust does not confer a benefit provided out of assets. In reality a beneficiary may not want to enter into transactions of this nature for inheritance and capital gains tax reasons, but s731 would have no application.

INTM601680 – Transfer of assets: the benefits charge: relevant income

74. As set down in our response to question 1 of the Consultation Paper we disagree strongly with the draft guidance at INTM601680. Specifically the following text:

> "*It should however be kept in mind that relevant income has to be considered on a tax year by tax year basis so that once an amount has been determined as being relevant income of a tax year it will fall to be taken into account as relevant income in any subsequent years benefits charge calculation. It cannot be amended by, for example, a subsequent disbursement, neither will it cease to be relevant income if, for example, it ceases to be regarded as income within the structure perhaps because it has been capitalised."*

We feel this takes an extreme view and seems to us to represent a significant change in the HMRC position (as explained below).

75. The issues with respect to identifying relevant income are highly complex. The "timing" issue is a particular problem as there is more than one time that one could use to quantify the "relevant income" in relation to the individual receiving the benefit. The current legislation is defective in that it does not provide a clear answer.

76. Our view, which we understand to represent current practice, is that one determines whether there is relevant income available to provide a benefit to an individual by looking to the position at ***the later of***:

- the end of the tax year in which the income arises; and
- the end of the tax year during which the benefit is received by the individual.

77. In practical terms this means that where income is segregated from capital the relevant income pool will be reduced where the income is paid away (whether this is to settle a disbursement or make a distribution). The reason is because relevant income is defined as income that can be used directly or indirectly for providing a benefit to an individual. Accordingly, paying it away in a later year assessment will ensure that the property cannot be applied to provide a benefit to other individuals and so accordingly must have the effect of reducing the overall pool of relevant income. Where the income is used to make an income distribution that will be subject to tax under normal principles.

78. We consider the above to be an entirely equitable interpretation of the legislation and that the comments in the draft HMRC guidance at INTM601680 are extreme and could lead to unfair and disproportionate results as often trustees will not settle all expenses in the year they relate to (trust accounts often contain entries both for creditors and accruals) and may decide to wait until they have accounts for the year before making final decisions on distributions. Interpreting the legislation in the way suggested by INTM601680, such that relevant income can be reduced provided all expenses payments and distributions happen by the end of 5 April in the year the income arises, seems absurd in this context.

79. We accept that the statement at INTM601680 of the draft guidance that: *"once an amount has been determined as being relevant income of a tax year it will fall to be taken into account as relevant income in any subsequent years benefits charge calculation"* is one interpretation of the legislation. However, for the reasons stated, we do not feel that it is the better interpretation. Furthermore, it appears to be a departure from the accepted HMRC Guidance as set down in April 1999 in an interpretation article in Tax Bulletin 40 (and reproduced as RI 201) which states:

> *"For the purposes of Section 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.*
>
> *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."*

80. The emphasis here is correctly on the income continuing to be available to provide a benefit to the individual. The change of stance in the draft guidance at INTM601680 (and the paragraph at the start of page 17 of the Consultation Document) is disturbing, is not in our view an accurate representation of the law and has added to (rather than decreased) the uncertainty in this area.

INTM601760 – Transfer of assets: the benefits charge: Example

81. We find this example to be confusing. It seems to us that unless the assumption at the end as to the income arising for the formula being treated as being:

- £5,000 in year 1;
- £10,000 in year 2;
- £10,000 in year 3; and
- £5,000 in year 4

are appreciated fully the figures are unworkable. It might help to put this assumption in bold.

INTM601780 - Transfer of assets: The benefits charge: Example - where modifications apply

82. FA 2006 made a number of changes to the TOAA legislation with affect from 5 December 2005. Changes were made to the motive defence and the associated operations provisions. We appreciate that HMRC would like to interpret the FA 2006 legislation as reversing the decision in *IRC v Herdman (1969) 45TC 39* for both pre 5 December 2005 transactions and transactions on or after that date. This appears to be the line taken in the draft guidance.

83. We do not believe that it is correct technically as the FA 2006 modification to the legislation was only contained in the legislation for the new motive defence which should only be applied if the associated transfer is a relevant transfer and it is submitted that case law provides that where the original transfer occurred prior to 5 December 2005 it will be the *Herdman* principle that determines whether an associated transfer is a relevant transfer (that is whether the transfer has contributed to the charging provision conditions being met). In addition we feel that the HMRC interpretation is disproportionate and so there are EU law issues.

INTM602020 – Transfer of assets: Non-domiciled individuals: The position from 6 April 2008

84. We have concerns with the following part of the text:

> *"To ensure that the remittance basis rules work as they should in relation to ring fenced amounts the new transfer of assets provisions treat relevant income, or a benefit, that relates to any part of the foreign deemed income as deriving from that part of the foreign deemed income for the purpose of applying the remittance basis rules in Chapter A1 of Part 14 ITA 2007."*

85. We think it should be made clear here that once relevant income has been attributed to a benefit and ring fenced, it cannot be treated as being available relevant income in relation to any other beneficiary.

INTM602480 – Transfer of assets: General provisions: Just and reasonable basis

86. We refer to the following part of the text, and suggest that is revised as set out (change in bold and underlined):

> *"Where the same assets are transferred by several individuals **<u>acting together in concert</u>** the transferors would normally be assessed in proportion to their share of the assets transferred. For example, where shares of a UK company are held by three individuals in the proportions 40%, 40% and 20% and there is liability under Section 720 ITA 2007 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 example demonstrates both the requirement to avoid duplication of charge (INTM602380) and the 'just and reasonable' basis."*

87. We have concerns with the following part of the text, which we do not feel is sufficiently clear:

> *"However, in a case where it was clearly intended that A's benefit be provided out of the relevant income of the year, and B's benefit out of that of a subsequent year (if, for example, A's benefit was paid three quarters through the year and represented the whole income of the year, while B's benefit was paid nearly at the end of the year to deal with some unexpected contingency) then A might justifiably be taxed on the whole of the benefit in the year of receipt, and B taxed in subsequent year."*

88. We are not sure how HMRC envisage this working where there is a pool of brought forward trust gains within s87 TCGA 1992. It would appear that one beneficiary could suffer a charge on the benefit received under s731, with the other beneficiary being assessed to capital gains tax in relation to the benefit received in the later part of the year under s87 TCGA 1992 even though it was intended that the benefit in the latter case would be funded out of income arising in the subsequent year. Is that what HMRC intends?

INTM602520 – Transfer of assets: General provisions: Deductions and reliefs

89. A full stop has been omitted at the end or penultimate sentence of the pre-penultimate paragraph.

INTM602540 – Transfer of assets: General provisions: Double Taxation relief (DTA)

90. We have concerns with respect to the clarity of the following text, specifically we are not entirely sure what is meant by the word we have highlighted:

> *"No relief should be given for tax which is similar to Capital Gains Tax, nor on tax charged directly on the company/trust in respect of income it has received from another country."*

91. Does it refer to profits from a permanent establishment?

INTM602640 – Transfer of assets: Exemption from charge: Background

92. We have serious concerns with the following text as we are unclear about the point that HMRC is making:

"*CIR v Willoughby 70 TC 57*

In 1997 the Revenue lost the case when the courts decided that:-
Professor Willoughby was not chargeable because he was not ordinarily resident when he made the original transfer, and Professor Willoughby had taken advantage of an opportunity afforded by Parliament (via the get-out clause in section 741a) and that there was no tax avoidance purpose.

In responding to this:

a. was remedied by section 81 Finance Act 1997, but

b. has not been so easy to resolve. The judgement was clearly based on the facts of the case. However the view was clearly taken that this was mitigation rather than avoidance. There has been much debate as to what constitutes avoidance and also on whether the test for determining the presence of avoidance is objective or subjective."

93. Our position is that Professor Willoughby had genuinely incurred expenditure to purchase bonds to help fund his retirement. In a departure from previous practice (up until that time HMRC had accepted that such investments were protected by the motive defence) HMRC sought to argue that the substance was as if he had purchased the underlying assets personally. The House of Lords rejected the HMRC argument, saying that:

- this was mitigation and not avoidance; and
- the taxpayer had a right in contract against the life office who sold him the policy, as distinct to the underlying assets.

94. The rules relating to personal portfolio bonds are now set out in a separate and discrete code. It is our view, and the view generally espoused by advisers, that where (as with personal portfolio bonds) Parliament has established a separate and distinct tax code for dealing with special types of income, there is no room for the application of s720 ITA 2007. If HMRC does not agree it is important that this should be made clear.

INTM602660 – Transfer of assets: Exemption from charge: How an individual applies for exemption

95. We take issue with the text below:

"In view of these pre-requisites it is essential that individuals who may be relying on an exemption give a full and clear exposition of all the facts that would otherwise have resulted in a charge and how they satisfy the conditions for exemption, including applicable amounts, when completing their self-assessment tax return."

96. The quantum of the income is not relevant to the individual's UK tax liability where the conditions for exemption are met. We do not, therefore, believe that this (non-statutory) requirement is proportionate reasonable or fair. Furthermore, in many cases it simply will not be possible for individuals to quantify the amount (even if they wished to comply with the guidance). For example, many executives who hold carried interests in large venture capital investments have no means of being able to satisfy this requirement. The accounting information is not available to them, and even if it were the figures would have to be adjusted to an accounting standard recognised by HMRC and then further adjusted for UK tax purposes.

97. We also do not think that it is reasonable or acceptable for shareholders in foreign businesses to have to incur expenditure of this nature where it is perfectly obvious that s720 is not in point.

We think that a requirement of this nature is entirely disproportionate and unacceptable under European law.

INTM602860- Transfer of assets: Exemption from charge: Avoidance purpose exemption: Mixed relevant transactions INTM602880 – Transfer of assets: Exemption from charge: Avoidance from charge: Avoidance purposes exemption: Partial Exemption

98. We found the commentary in INTM602860 to INTM602880 to be unclear. The various issues with respect to the application of the motive defence and the practical issues associated with the FA 2006 changes (including the issues with respect to *Herdman* as discussed in paragraphs 82 to 83) are complex are should, we feel be explored in depth in a specific guidance working group session.

INTM603040 - Transfer of assets: Exemption from charge: Avoidance from charge: Avoidance purposes exemption: Design

99. We have concerns with the following text:

> *"It might happen in a particular case that a relevant transaction resulted in say the establishment of a non-resident company which carried on a genuine trade or business, but the evidence suggested that the choice of location was not entirely commercially motivated, but was influenced by the tax reduction that would be achieved by using an entity in that location as part of the structure. In those circumstances it might be reasonable to conclude that the choice of location meant that the transactions were designed at least in part, for the purpose of avoiding liability to taxation. For example, if an individual running a hotel business established a company in a low tax jurisdiction to operate a hotel in that territory it might be reasonable to conclude that the relevant transaction was a genuine commercial transaction not designed for the purpose of avoiding liability to taxation. However, if a similar company was established in the same low tax jurisdiction to own and operate a hotel in the UK, although due regard must be had to all the circumstances of the case, the choice of location of the company would be a circumstance potentially pointing to the conclusion that the relevant transactions were not all genuine commercial transactions and/or were more than incidentally designed to avoid tax. It therefore follows that establishing in a low tax regime is not of itself open to challenge but there must be other commercial reasons to support that choice and activity must be genuinely lined with it."*

100. We think it should be made clear that, if a UK resident invests in a EEA company that has UK investments and the rate of tax in the country of residence is lower than in the UK, HMRC will not seek to challenge an arrangement where a UK resident is exercising his or her freedoms under European law to make such an investment?

INTM603100 – Transfer of assets: Exemption from charge: Genuine transactions: Exemption: Conditions

101. We feel that this section needs to be rewritten as the current material is of little practical use.

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APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.

2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.

3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.

4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.

5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.

6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.

7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.

8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.

9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.

10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see icaew.com/en/technical/tax/tax-faculty/~/media/Files/Technical/Tax/Tax%20news/TaxGuides/TAXGUIDE-4-99-Towards-a-Better-tax-system.ashx)