

## **TAXREP 26/06**

### **TRANSFER OF ASSETS ABROAD FINANCE ACT 2006, SCHEDULE 7 PROVISIONS COMMENTS ON HMRC DRAFT GUIDANCE PUBLISHED JULY 2006**

*Comments submitted in September 2006 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to HMRC draft guidance issued informally in July 2006*

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## TRANSFER OF ASSETS ABROAD FINANCE ACT 2006, SCHEDULE 7 PROVISIONS COMMENTS ON HMRC DRAFT GUIDANCE PUBLISHED JULY 2006

### INTRODUCTION

1. FA 2006 recast the 'Transfer of Assets Abroad' provisions in particular to make it clearer how the exemptions work. The HMRC Explanatory Notes issued when the Finance Bill was published set out the purpose as follows:

'The new provisions recast the test for exemption in cases not involving a tax avoidance purpose (section 741A) to make its meaning clearer. Under the clarified test (section 741A) exemption will run where an individual broadly shows that it would not be reasonable to draw the conclusion, from all the circumstances of the case, that there was a tax avoidance purpose.

The new test requires individuals to show that they meet one or other of two conditions:

- condition A is concerned with cases where the transactions had no tax avoidance purpose whatever;
- condition B is concerned with cases where it is accepted that there was some element of tax avoidance underlying the transactions (so condition A cannot be met); but the transactions were all genuine commercial transactions, and the way they were designed is such that any tax avoidance purpose was no more than an incidental part of the design of any of the transactions.'

The revised purpose test is intended to ensure that all the relevant facts of the case, including the actual outcome of the transactions, are taken into account in deciding whether exemption is due. The view is sometimes put to HMRC that the existing test should be determined simply by looking at the subjective intentions of the individual, and that no account need be taken of any other facts, even if these included for example the objective outcome of the transactions that a significant amount of UK tax was avoided. By requiring all the circumstances of the case to be taken into account, the new test makes clear that exemption will not be due solely on the basis of an assertion by individuals that tax avoidance was not their subjective intention.'

2. HMRC circulated draft guidance to Representative Bodies, including the Tax Faculty, in July 2006 and the Tax Faculty submitted its comments in September 2006. The content of the comments is reproduced in this TAXREP together with the relevant sections of the draft guidance to which the comments relate.
3. Information about the Institute of Chartered Accountants in England and Wales and the Tax Faculty is set out in the Annex.

### COMMENTS

The Tax Faculty of the Institute of Chartered Accountants in England and Wales

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## Section 741A

### HMRC Draft Guidance – paragraph 13

4. 13. The individual must satisfy HMRC that it would not be reasonable to draw the conclusion that the transactions had an avoidance purpose. This does not mean the effect of the legislation is that only the view taken by HMRC has any validity, or that the Special Commissioners hearing an appeal have little choice but to find in favour of HMRC. The issue is whether the circumstances are such that a reasonable person, properly considering all the facts of the case, would conclude that tax avoidance was one of the purposes of the transactions. As mentioned in the discussion on section 741A(9), the appeal Commissioners have full power to consider decisions made by HMRC and overrule them if they decide that the taxpayer has in fact met the terms for exemption under the 'reasonableness' test.

### *Tax Faculty comment*

5. As the law stands, the individual must satisfy HMRC that it would not be reasonable to draw the conclusion that the transactions had an avoidance purpose i.e. he has to demonstrate that HMRC are being unreasonable if they conclude there was tax avoidance. Later in the same paragraph the guidance states

*“The issue is whether the circumstances are such that a reasonable person, properly considering all the facts of the case, would conclude that tax avoidance was one of the purposes of the transactions”*

6. Although this formulation of the issue is more favourable to the taxpayer it does not appear to be an accurate reflection of the law. The issue is more accurately stated as whether a reasonable person could conclude that tax avoidance was one of the purposes of the transactions. This clearly places a heavy burden of argument on the taxpayer. It would be better to have addressed this issue by reformulating the test in the primary legislation rather than in extra-statutory guidance.

### *Tax Mitigation*

### HMRC draft guidance – paragraphs 26 & 27

7. 26. Expressing broad acceptance of propositions put forward by the Crown [in the 1999 case CIR v Willoughby [70 TC 57]], Lord Nolan said in effect that tax avoidance is where taxpayers reduce their liability to tax without incurring the economic consequences that Parliament intended to be suffered by those using an option afforded by tax legislation to obtain a reduction in their tax liability. The taxpayer follows a course of action designed to conflict with or defeat the evident intention of Parliament. Tax mitigation, by contrast, is where the taxpayer takes advantage of a fiscally attractive option afforded by the tax legislation, and genuinely suffers the economic consequences that Parliament intended to be suffered by those taking advantage of the option. He accepts an offer of freedom from tax which Parliament has deliberately made.
8. 27. It is sometimes argued in relation to sections 739 and 740 that any 'tax planning' must be 'mitigation' rather than tax avoidance if it is not expressly prohibited by the Taxes Acts. For example it is sometimes claimed that, since TCGA 1992 charges only UK

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domiciled beneficiaries of non-resident trusts, it follows that any use of non-resident trusts by or for UK resident but non-domiciled individuals must necessarily be acceptable mitigation. HMRC does not accept this argument. It is not the case that Parliament has by specific legislation provided exemption from taxation of income arising to non-resident trusts that exist for the benefit of UK residents. Indeed, the very reason Parliament enacted section 739 and 740 was because the use of non-resident entities for the benefit of UK residents in the way envisaged by the legislation was considered to be unacceptable tax avoidance.

## *Tax Faculty comment*

9. It is difficult to see how the terms of sections 86 and 87 cannot be characterised as an offer of freedom from CGT to UK resident but non-domiciled settlors and beneficiaries, given that the relevant sections expressly provide that they should not apply to non-domiciled individuals. In respect of a UK resident non-domiciled settlor there would be no need to invoke the provisions of section 739 in respect of income received by the non-resident trust as section 624 ITTOIA 2005 deems such income to be his in any case.
10. Similarly section 12 TCGA 1992 provides the remittance basis of taxation for non-domiciled individuals in respect of gains realised on foreign situs assets. If a UK resident non-domiciled individual establishes a foreign incorporated company to take advantage of the remittance basis of taxation on gains on foreign situs shares afforded by Parliament, would this be seen as acceptable tax mitigation if the company were otherwise UK resident by virtue of being centrally managed and controlled here and its profits were fully subject to corporation tax.

## *Definition of commercial transaction* *HMRC draft guidance – paragraph 37*

11. 37. Condition B for exemption includes the requirement that all the transactions must be "commercial transactions". This is explained in section 741A(5), which provides that a relevant transaction is a "commercial transaction" only if it is effected either in the course of a trade or business, or with a view to setting up and commencing a trade or business, and in either case for the purposes of that trade or business.

## *Tax Faculty comment*

12. Condition B provides that unless all relevant transactions are "commercial transactions" exemption under this condition will not be available. The guidance in paragraph 23 indicates that Condition B may still be satisfied, if the series of commercial transactions involve only a minor element of tax avoidance. Would HMRC also apply a de minimis test in considering the definition of a commercial transaction to permit the exemption if, for example, a series of transactions had no tax avoidance motive, but one of the transactions (which may be of little significance in the series) was not on arm's length terms.

## *Exemption provision applying where there are both old and new transactions* *HMRC draft guidance – paragraph 66*

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13. 66. For example suppose an individual receives the benefit of rent-free occupation of a house for the whole of 2005-06, and an interest-free loan for a period of nine months spanning 5 December 2005. These benefits are chargeable 'for' 2005-06 but Rule 3 ensures that any portion that is attributable to the period prior to 5 December 2005 is not taxed. Liability will arise only on the proportion of the benefit attributable to the period 5 December 2005 to 5 April 2006. (That is notwithstanding that the relevant income that franks the benefit may have arisen before 5 December 2005.)

## *Tax Faculty comment*

14. In this paragraph there is an example of benefits arising in 2005-06 which by definition must have been in place pre 5 December 2005. As such surely they were operations pre 5 December 2005 and therefore covered by old section 741? We are not clear how section 741A can ever apply to these if they were already in place and so the suggestion that section 740 can apply to the post 5 December 2005 benefit seems to us to be wrong. We would welcome clarification from HMRC on this.

## *Examples of how the legislation might apply in various circumstances HMRC Guidance – paragraph 79*

15. 79. [This section is blank except for a request from HMRC for representative bodies to put forward examples where it would be helpful to receive HMRC's guidance.]

## *Tax Faculty comments*

16. The following are put forward as examples on which it would be helpful to receive HMRC's comments on the application

## *Floatation on an overseas stock exchange*

17. A UK trading group wishes to obtain a listing on a foreign exchange principally on the basis that the main investors in the group were resident in the same overseas country and would want the group listed there.
18. The group is to be restructured with the shares transferred to a foreign holding company resident in the country of listing. Clearance is obtained from HMRC confirming that the restructuring would be treated as a genuine commercial transaction and not for the purposes of tax avoidance under section 138 TCGA 1992 and section 707 ICTA 1988.
19. UK resident shareholders (which largely comprised the management group) apply for exemption under section 741B in respect of the profits realised by the non-resident holding company.

## *Overseas property investment*

20. Overseas investment funds will often use companies based in low tax jurisdictions to achieve foreign tax savings. This will usually be to reduce the overall tax cost of the investment fund where the majority of investors will be non-UK resident and is not in any way motivated by the desire to reduce UK tax.

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21. UK resident individual investors who wish to subscribe for an investment in the fund are potentially within the scope of section 739 in that they are making a transfer of assets abroad on subscription. They will be fully subject to UK tax in respect of any distributions from the fund and on disposals of their interests in the funds. The investors apply for exemption under section 741A in respect of undistributed profits which may be accumulated within the fund by the managers.

## *Commercial reasons for setting up foreign companies*

22. A UK partnership has business interests in the middle east which, for local commercial/licensing reasons is better undertaken through a locally incorporated company. The company wishes to retain profits for further investment in its commercial activities in the area. The partners apply for exemption pursuant to section 741A

## *Offshore Trust*

23. An offshore trust was established some years ago by a wealthy non-resident family. At the time of its establishment no member of the family had any links with the UK and no thought was given by the family or its advisors as to UK taxation issues affecting the trust. The trust owns substantial assets and has accumulated significant income since its establishment.
24. One of the members of the family now wishes to move to the UK and it is contemplated that the trust may purchase a home for him and meet other living expenses of the individual whilst he is engaged in studies here. The financial provision could be made to the individual with no UK tax cost if a substantial distribution was made to him from the trust in the tax year before he became UK resident. However the trustees prefer to retain funds in the trust given the relative youth of the family member and would wish purchase the accommodation for him to live in and wish to make smaller distribution of capital to meet his expenditure needs and university fees after he became UK resident. The individual applies for exemption under section 741A once he becomes UK resident.

## *Other trust situations*

25. Suppose there is an existing interest free loan to a non domiciled beneficiary on which a clearance has been obtained under section 741, pre 5 December 2005.
26. The position may change in a number of ways after 5 December 2005:
- 1) The loan to the existing beneficiary is increased;
  - 2) A similar loan is made to another beneficiary;
  - 3) Capital or income payments are made to either of these beneficiaries; or
  - 4) The trust is wound up and the beneficiaries receive all the cash in the UK.
27. In relation to which of these events, if any, would HMRC take offence?

## *Other issues on which the Tax Faculty commented*

### *What level of disclosure will be necessary to claim section 741A exemption?*

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28. The Tax Faculty also put forward the suggestion that the guidance, when finalised, should indicate the level of disclosure required if exemption under section 741A is being claimed.

*Tax Faculty comment*

29. No mention is made in the guidance of the disclosure requirements where exemption under section 741A is being claimed. In its Tax Bulletin No. 40 of April 1999, the Inland Revenue outlined the disclosure that was required as follows:-

*Taxpayers are required to disclose clearly in their self assessment return if there is any income or benefit assessable under Section 739 or 740, and whether reliance is being placed on Section 741 to exclude income or benefit from assessment. Where such a disclosure has been made and exemption under Section 741 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 Section 741 exemption has to be reconsidered in later years.*

30. Further guidance on disclosure is given on page FN 13 of the Notes to the Foreign pages of the Self Assessment Tax Return.
31. In the light of the Court of Appeal decision in *Langham v Veltema* further guidance from HMRC on the necessary disclosure would be helpful in particular with regard to any modifications to the approach re discovery previously outlined in the April 1999 Tax Bulletin.

IKY  
September 2006



### ICAEW AND THE TAX FACULTY: WHO WE ARE

The Institute of Chartered Accountants in England and Wales ('ICAEW') is the largest accountancy body in Europe, with more than 128,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.

The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department of Trade and Industry through the Accountancy Foundation. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy, including taxation.

The Tax Faculty is the focus for tax within the Institute. It is responsible for tax representations on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter 'TAXline' to more than 11,000 members of the ICAEW who pay an additional subscription.

To find out more about the Tax Faculty and ICAEW including how to become a member, please call us on 020 7920 8646 or email us at [tdtf@icaew.co.uk](mailto:tdtf@icaew.co.uk) or write to us at Chartered Accountants' Hall, PO Box 433, Moorgate Place, London EC2P 2BJ.