FIELD COURT TAX CHAMBERS

FCTC DIGEST

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EDITORIAL

Katherine Bullock

Welcome to the second edition of the *FCTC Digest*.

This edition delivers an eclectic range of topics for reflection and action by all tax practitioners, as we investigate the new, predict the future and scrutinise the old, reinvigorated by recent change.

New law, effective from 6 April 2020 brings in two elephant traps for the unwary. Firstly, UK residents must pay the CGT on the disposal of UK residential property within 30 days of completion. All solicitors and accountants beware. See the article by **Patrick Soares,** *The New 30 day Notification and Payment Rules on Disposals of Residential Property after 5 April 2020 by Persons Resident in the UK*. Secondly, now that non-resident landlord companies are within the corporation tax regime, they **must** get a new unique tax reference (UTR) number from HMRC: see the second article by Patrick Soares *The New Non-resident Company Landlord Regime*.

Clients may not be domiciled in the UK under general principles but there are 4 occasions when they will be deemed to be domiciled in the UK for IHT purposes.

A taxpayer can even elect to be domiciled in the UK. Why on earth would someone want to do that? Read Patrick Soares' third article, *My Client is not Domiciled in the UK- when is he Deemed to be Domiciled in the UK for IHT Purposes?*

When does the motive defence apply for the purposes of the Transfer of Assets Abroad code? Of the three recent decisions, Queen's Counsel at Field Court Tax Chambers were involved in two. With *Davies* not being appealed, **Patrick Way QC** is now free to comment on why he thinks the Upper Tribunal's decision was wrong. See the article, *Transfer of Assets Abroad: The Lessons from Davies*.

A decade of international tax litigation and arbitration ended this month with the award in *Vodafone v India*. I caught up with **Philip Baker QC** to discuss his experiences as expert witness. For a unique glimpse into the world of international tax arbitration, join our conversation in *Vodafone v India: In Conversation with Philip Baker QC*.

There can be no doubt that HMRC are looking more closely at taxpayers who claim to be non-domiciled in the UK for tax purposes even though they may have lived in the UK for many years and may even have been born in the UK to a non-UK domiciled father. Read **Imran Afzal's** article *Domicile Packs: Preparing for a Challenge by HMRC* to prepare for an HMRC attack and save your client penalties if all goes wrong.

The government will soon be looking for ways to collect huge sums of money to finance the costs of the corona virus. They may simply raise the rates of tax on income and capital gains and IHT. They may go for something far more exciting. Is a UK Wealth Tax on the cards? See what **Peter Vaines** has to say about this in *Wealth Tax: The Spectre Looms Once More*.

Finally, a topic which every tax adviser at some time will deal with – the incorporation of a property letting business by individuals. Whether to obtain limited liability or perhaps to reduce the tax on rent from 45% to 19%, it has been done successfully for many years without CGT and SDLT charges. Now practitioners must take account of the recent cases of *Ramsay* and *Project Blue*. See my article *Janet and John Incorporate their Property Letting Business*, **Katherine Bullock.**

Happy reading!

THE NEW NON-RESIDENT COMPANY LANDLORD REGIME

Patrick C Soares

INTRODUCTION

From 6 April 2020 non-resident company landlords (NRCLs) pay corporation tax (presently 19%) on their UK rental profits (CTA 2009 s5) instead of income tax (presently 20%) (ITTOIA 2005 s269).

It is estimated there are some 22,000 NRCLs in this situation.

They must get used to a new taxation regime and new compliance oblifgations.

The new legislation is in FA 2019 Schedule 5 and in the Finance Act 2020 Schedule 5.

Note the effect of the changes is not to make the company UK resident. Thus NRCLs do not pay UK tax on their foreign income, their accounts do not have to comply with the Companies Act 2006 (see FA 1998 Sch 18 para 11) and in determining the source of any payments made by the company (interest on foreign borrowings) this is done on the basis of the company not being resident in the UK.

The final self-assessment income tax returns for the year 2019/20 (forms SA700) must be submitted no later than 31 January 2021.

After that NRCLs are in the corporation tax regime.

<u>WHAT THE CHANGES MEAN</u>

<u>Compliance</u>

HMRC will have written to the NRCLs in January/February 2020 giving them new corporation tax unique tax reference numbers (CT UTRs). See HMRC's Agent Update Issue 75.

The new filing form is CT600 and it can only be filed online. CTA 2010 s5(1) requires the CT600 to be expressed in sterling. Either an average exchange rate or a spot rate can be used provided this is done consistently (CTA 2010 s11).

There is no requirement to register at Companies House.

HMRC must be notified in writing if the accounts are to be prepared to a date different from 5 April.

Computational changes, losses, transitional provisions

Losses

Business losses can be carried forward against any future profits from the same UK property business even though the losses arose under the income tax regime and the profits under the corporation tax regime.

Capital allowances

Any capital allowances pool can be carried forward into the corporation tax regime without giving rise to a balancing charge or a balancing allowance.

Interest relief

The corporate interest restriction which restricts allowable interest to £2m per annum will apply (it only applies to corporation tax and not income tax).

Land remediation relief

Land remediation relief for expenditure incurred after 5 April 2020 will be available.

The non-resident landlord scheme will continue.

Under the non-resident landlord scheme (see The Taxation of Income from Land (Non-residents) Regulations 1995 (SI 1995/2902) the NRCL may register with HMRC to avoid a tenant or the rental agent deducting tax at source from the rental payments. The trusted NRCL then settles the tax bill with HMRC. It is to be noted, however, that if the tax borne by deduction matches or is more than the charge to corporation tax the landlord may decide not to come within the new corporation tax regime and simply bear the tax deducted at source. If a landlord has few deductible items (such as interest) he may consider this route. HMRC in their Guidance Note of 17 February 2020 state at para 4.3 thus:

> **4.3 Exception to duty to give notice**
>
> A non-UK resident company landlord will not be required to give notice of its coming

within the charge to Corporation Tax or to notify its chargeability to Corporation Tax if:

- it has not been given a notice to file a tax return,
- it has borne (or it will bear) Income Tax by deduction on all the income on which it is chargeable to Corporation Tax for the accounting period,
- its liability to Corporation Tax for the accounting period will be fully offset, for instance by the amounts withheld under the Non-residents Landlord Scheme, and
- it has no chargeable gains for that period.

CONCLUSIONS

The changes are not too radical. The tax rate is slightly lower under the new regime and losses can be carried forward. The restrictions on interest relief is only a problem for the cases where the borrowings are large and the changes do not affect the source of the interest payments and whether tax has to be deducted at source. The taxpayer must get use to a new tax filing regime.

MY CLIENT IS NOT DOMICILED IN THE UK – WHEN IS HE DEEMED TO BE DOMICILED IN THE UK FOR INHERITANCE TAX PURPOSES?

Patrick C Soares

INTRODUCTION

The general rule is if an individual has a non-UK domicile he does not pay inheritance tax on his non-UK located assets (IHTA 1984 s6(1)).

Generally, a person's domicile of origin is that of his father at the time of the child's birth. That can be overridden by a domicile of choice if the taxpayer is an inhabitant of a country and intends to live their permanently or indefinitely. HMRC call those forms of domicile "common law domiciles" and the Contributor will use the same terminology.

Thus, if a Frenchman born and bred of a French father takes up residence in the UK without the intention to live in the UK permanently or indefinitely he will retain his French domicile of origin.

There are circumstances, however, where the common law domicile of origin or choice can be overridden by a deemed UK domicile for IHT purposes and taxpayers dealing with HMRC IHT returns on, say, a death, must be aware of these. There are only four headings to consider.

DEEMED DOMICILE 1 – THE 3 YEAR RULE

If a UK domiciled taxpayer, for example, leaves the UK to live permanently in a State in the USA, so he immediately breaks his UK domicile, he will be deemed to be UK domiciled for IHT purposes for 3 year from his taking up his new domicile (IHTA 1984 s267(1)(a)).

DEEMED DOMICILE 2 – THE 15 TAX YEARS RULE

If an individual, for example, takes up tax residence in the UK he will be deemed domiciled in the UK for IHT purposes from the beginning of a tax year (year X) if he has been tax resident for at least 15 of the 20 tax years preceding that tax year and for at least one of the four tax years ending with year X (IHTA 1984 s267(1)(b)). This provision must also be considered if a taxpayer is leaving the UK. Note the IHT provisions deal in whole tax years: so if a taxpayer is UK resident for part of a tax year he is treated as resident for the whole of that tax year (see IHTA 1984 s267(4), *Cotter v HMRC* [2013]UKSC 69 [17] and IHTM13024).

DEEMED DOMICILE 3 – SPECIAL RULES FOR FORMERLY DOMICILED RESIDENTS (FDRs)

If a taxpayer has a foreign domicile of choice and was born in the UK and had a UK domicile of origin he is deemed to be domiciled in the UK for IHT purposes if he takes up tax residence in the UK – he is deemed to be domiciled in the UK for IHT purposes from the beginning of his second year of residence even though he has retained his foreign domicile of choice. Thus, if such an individual takes up UK tax residence in the tax year 2020/21 he will become deemed domiciled in the UK (i.e. he becomes a FDR) on 6 April 2021. As well as being deemed to be domiciled in the UK, special IHT penalties are reserved for FDRs if they have set up settlements before becoming FDRs.

DEEMED DOMICILE 4 – ELECTING TO BECOME DOMICILED IN THE UK TO GET THE SPOUSE EXEMPTION

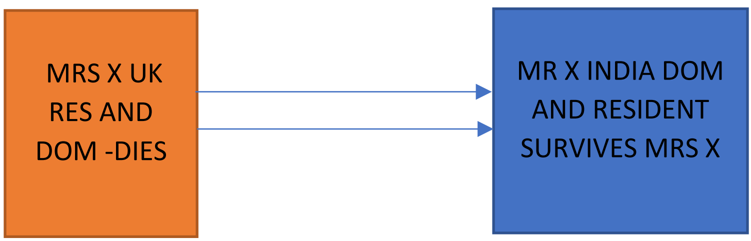
The spouse exemption for IHT is not available if a UK domiciled spouse leaves assets to a non-UK domiciled spouse (IHTA 1984 s18(2)).

There are provisions in IHTA 1984 ss267ZA and 267ZB which enable the non-UK domiciled spouse to elect to be UK domiciled to secure the spouse exemption on death and the exemption for lifetime gifts between spouses (such lifetime gifts would be PETs if the spouse exemption is not available).

Thus, if a UK domiciled husband leaves assets on his death to his surviving Greek domiciled spouse the election can avoid an immediate IHT charge. The surviving spouse will remain domiciled in the UK for IHT purposes once the election has been made but note the possible 4-year cut-off period mentioned below.

The election gives rise to some further planning points if the surviving spouse is domiciled in a treaty country such as India.

PET OF SHARES (£5m)



FREE ESTATE LEFT IN WILL (£10m)

Assume Mrs X is domiciled and resident in the UK. She is married to Mr X who is resident and domiciled in India. Mrs X dies having made a large gift of shares to Mr X two years previously (worth £5m) and leaving the balance of her estate to Mr X of £10m in her will.

Under general principles the free estate of Mrs X is chargeable to IHT (IHTA 1984 s18(2)) and the £5m gift is chargeable to IHT as a failed potentially exempt transfer (PET) (IHTA 1984 s3A(4)).

Mr X can save the day by, for example, making a "death election" under IHTA 1984 s267ZB(1)(b) (see IHTM13043) which must be made within 2 years from the death of Mrs X and must be specified to take effect from a date prior to when the PET was made (date W): Mr X will be deemed to be domiciled in the UK from date W and will only cease to be so domiciled in the UK if he has not been resident in the UK "for a period of four successive tax years beginning at any time after the election is made." See IHTA 1984 s267ZB(10). Let us call the date he ceases to be UK deemed domiciled date Y.

The attraction in the death election is the GB/India death duty treaty (3 April 1956 SI 1956/998) overrides the effects of the deemed domicile election on the death of Mr X with regards to non-UK located property provided it does not pass under a "disposition or devolution regulated by the law of some part of Great Britain." (article III(3) of the death duty treaty).

During dates W to Y, Mr X is UK deemed domiciled and he must not, for example, have made or make any chargeable transfers e. g. gifts into settlement (see IHTM13049) as these are not protected by the death duty treaty.

Note when Mrs X made the lifetime gift of shares to Mr X, CGT will not be in issue provided they were living together (TCGA 1992 s58(1)(a) and IHTM13047).

CONCLUSIONS

Practitioners must check that a taxpayer who is not domiciled in the UK under common law is not deemed to be domiciled in the UK for IHT purposes and they must also see if the domicile election has to be exercised in appropriate cases.

Note individuals can also be deemed to be domiciled in the UK for income tax and capital gains tax purposes (ITA 2007 s835BA).

THE NEW 30 DAY CGT NOTIFICATION AND PAYMENT RULES ON DISPOSALS OF RESIDENTIAL PROPERTY AFTER 5 APRIL 2020 BY PERSONS RESIDENT IN THE UK

Patrick C Soares

INTRODUCTION

After 5 April 2020 disposals of UK residential properties by UK residents are subject to a new reporting **and payment** regime contained in FA 2019 Schedule 2.

The new rules are similar to those which have applied to non-residents since 6 April 2019 (those provisions however are wider and cover direct and indirect disposals (e.g. sales of shares holdings in UK land companies) and apply whether or not a gain accrues) (see FA 2019 Sch 2 para 1(1)(a) and HMRC Guidance "Tell HMRC about CGT on UK property and land if you are non-resident" 6/4/2015, updated 6/4/20).

THE NEW RULES AND DISPOSALS BY UK RESIDENTS

Direct disposals of **UK residential property**, by **UK residents**, after **5 April 2020**, if a **gain accrues**, and the disposal is **not an excluded disposal**, must be reported to HMRC and the CGT paid within 30 days of legal completion.

Solicitors and accountants should put this on their checklist to warn clients.

Direct disposals

These provisions only cover direct disposals of UK land (FA 2019 Sch 2 paras 1(1)(b) and 2(2)). This includes freehold sales and leases at premiums.

UK Residential property

Residential property includes a dwelling and land enjoyed with the same as a garden or grounds (TCGA 1992 Sch 1B para 5).

Disposals of non-residential properties are outside the scope of the new provisions and certain residential properties are specifically excluded from the new provisions such as care homes and boarding schools (TCGA 1992 Sch 1B para 5).

Sales of dwellings which qualify for the principal private residence exemption in TCGA 1992 s222 do not need to be notified as no gains will accrue.

UK residents

The new rules apply to all UK residents within the capital gains tax regime including individuals, PRs, trustees and partners.

The disposal must be after 5 April 2020

If unconditional contracts were entered into before 6 April 2020 the new rules do not apply.

Example

X, a UK resident individual, contracts to sell unconditionally his buy to let property on 31 March 2020 and completes on 25 May 2020. The 30-day filing requirements do not apply. Any gain must be reported in the 2019/20 self-assessment return in the usual way.

A gain must accrue

The provisions only apply if a gain accrues on the disposal. In this present coronavirus environment many properties may be sold at a loss

Any gain will be computed in the usual way for residential property disposals. Brought forward losses from previous tax years are allowable as well as the annual CGT exemption (£12,300 for 2020/21).

In the normal case the disposal of trading stock will not result in a capital gain so these provisions will not apply (TCGA 1992 s37(1)).

Excluded disposals

Excluded disposals are gifts to spouses (and other no gain/no loss disposals), disposals by charities, and pension scheme disposals and arms-length lease grants without premiums to unconnected persons (FA 2019 Sch 2 para 1(2)).

NOTIFICATION AND PAYMENT REQUIREMENTS

The return must be made to HMRC within 30 days following legal completion (FA 2019 Sch 2 para 3(1)) and tax must be paid in that timescale (FA 2019 Sch 2 para 6) on account of the final tax bill which will be included in the normal tax return (which must be delivered by the end of January following the end of the tax year in which the gain was made). The provisional tax calculation must include a declaration that the tax has been calculated to the best of the taxpayer's knowledge at the time of the filing date (FA 2019 Sch 2 para 16).

Example

Mr UK resident contracts to sell his residential investment on 1 October 2020 and legal completion takes place on 28 October 2020. By 27 November 2020 the taxpayer must complete his return and pay the CGT. It may be when he completes his normal tax return (for the year 2020/21) by 31 January 2022 he has further tax to pay as the earlier payment may have to have been adjusted.

PENALTIES

There is £100 fine for a late filing. There are further penalties if the filing is 6 months or more late or 12 months or more late.

COMMENTS

It is very easy for professionals and clients to overlook provisions such as these.

HMRC must also set up a system to deal effectively with possibly a great number of returns.

Taxpayers must also ensure they have all the relevant CGT information to complete the return and calculate the tax within 30 day – the base cost figures including professional fees, improvement expenditure including non-reclaimable VAT, deductible professional fees on the sale etc. (TCGA 1992 s38).

TRANSFER OF ASSETS ABROAD – THE LESSONS FROM *DAVIES*[1]

Patrick Way QC

What it decided – treaty protection was not available under the TOAA rules

In the case of *Davies & Others v. HMRC*[2] the principal point was as to the relevance of a double tax treaty in the context of the transfer of assets abroad legislation. I was counsel for the appellants in this case and as it is not to be appealed I am now in a position to comment.

The Tribunal decided that the income which was exempt, under the UK:Mauritius double tax treaty (the "treaty"), in the hands of the overseas recipient did not enure for the benefit of the UK taxpayers even though the income in question (in respect of which the exemption applied initially) was deemed to be the income ("warts and all") in the hands of the relevant individuals. The treaty was given effect by the Double

[1] First published in Patrick Way QC's Tax Brief July 2020
[2] [2020] UKUT 67 (TCC)

Taxation Relief (Taxes on Income) (Mauritius) Order 1981 (SI 1981/1121).

The case seems wrongly decided

In my view the decision that exempt income under the treaty does not remain exempt when deemed to be received by someone else is wrong. More particularly, it is a misunderstanding of the way in which the treaty (and treaties in general) operate in these circumstances.

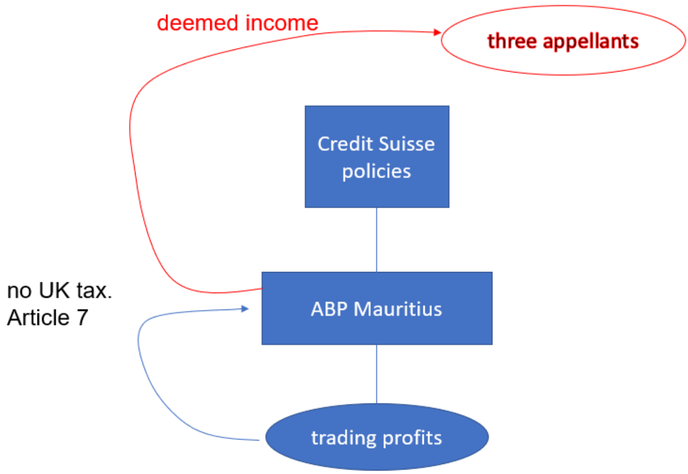
Treaties – particularly in relation to the business profits article – look to the particular income involved and apply relief to *that* income even if it is deemed to become the income of someone else. The exemption remains because it “attaches” to the income, in my view.

The Tribunal, instead, looked to the relevant separate persons and said that the taxpayers who were deemed ultimately to have received the income were not the same as the (initial) recipients. That is plainly the case. The Tribunal then went on to say that therefore those UK individuals could not have the benefit of the treaty. They were not the same persons to whom the treaty applied in the first place.

This in my view is not what treaties say and in my opinion the decision is flawed.

The facts

Briefly, the facts were that three individuals (the appellants) were shareholders in a UK property investment company which acquired a property. Following exchange of contracts it became plain that the property in question was to be trading stock, rather than held as an investment, and therefore it was decided that completion of the transaction should not take place: the holding of a property which was trading stock, in an investment company, might taint the tax treatment of that company (*receipts taxed as gains not income profit*).



Accordingly, the three individuals were advised that a trading company should complete the purchase. Additionally, the opportunity was taken at the same time to make pension provisions for the three individuals. This was effected by arranging for the new trading company to be resident in a jurisdiction (Mauritius) which would benefit from double tax relief. Further, the shares in the company were attributed to three life policies which the individuals took out with Credit Suisse.

In other words, on the one hand the individuals would have pension arrangements in that the new Mauritian company which should escape from UK tax on its profits and on the other hand the new Mauritian company could take over and complete the contract entered into by the investment company.

In due course other properties situated in the United Kingdom were bought and sold by the Mauritian company and the question arose as to whether the trading income, which arose from time to time to the Mauritian company, fell to be taxed under the transfer of assets abroad legislation in the hands of the three individuals. The relevant legislation was found in the Income and Corporation Taxes Act 1988 (Taxes Act 1988) at s.739 and subsequently in the Income Tax Act 2007 at s.720.

Three principal arguments

The taxpayers ran three principal arguments as follows:-

(a) the first was that the motive test should apply such that on the basis (so they argued) that there was an absence of tax avoidance the charging provisions within the transfer of assets abroad rules should not apply.

The motive test is found, in these circumstances, at Taxes Act 1988 s.741 and at Income Tax Act 2007 at ss.737, 739 and 740; and

(b) secondly their submission was, as mentioned, that the treaty operated to afford them an exemption from tax on the basis that the income was exempted in the first place and then deemed to be theirs. This position was changed in respect of income arising on or after 12th April 2008 (Taxes Act 1988 s.815AZA – now TIOPA 2010 s.130). From then on the treaty could not apply to any such deemed income;

(c) thirdly it was argued that since it had not been put to the witnesses at first instance that they had any avoidance motive it was wrong for the First-tier Tribunal to find that they had – this ground was lost by the appellants before the Upper Tribunal and I now focus on the other two principal arguments in turn.

The motive test

The appellants' submissions in relation to the motive test were that the facts were on all fours with the facts of the *Willoughby* case (*CIR v. Willoughby & anor)*[3]. In that case Professor Willoughby, as part of his retirement planning, had invested in a single premium bond with an Isle of Man company. Cutting a long story short, the Inland Revenue issued assessments to tax under what is now ITA 2007 s.720 on the basis that Professor Willoughby and his wife had sought to avoid income tax by the transfer of assets abroad: investing in the overseas bond. The House of Lords held that relevant transfers had not been made for the purpose of *avoiding* liability to taxation. As has already been mentioned, Lord Nolan said that there was an important distinction between "tax avoidance" and "tax mitigation" and that it would be absurd "to describe as "tax avoidance" (when Professor Willoughby opted for tax-efficient pension arrangements) the acceptance of an offer of freedom from tax which Parliament had deliberately made." More particularly, he said that tax avoidance

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[3] HL 1997 70 TC 57

should be construed as “a course of action designed to conflict with or defeat the evident intention of Parliament”.

Pausing there, as an aside, the *Willoughby* judgment from 1987 shows just how much things have changed in the world of tax:-

(a) the distinction between (unacceptable) avoidance and (acceptable) mitigation has all but gone – both are equally unacceptable. See, for example, the *Rialas*[4] case. There an attempt was made to argue that steps which were taken to mitigate inheritance tax were not avoidance for the purposes of the transfer of assets abroad rules: they were acceptable mitigation taking account of the case of *Beneficiary v. CIR*[5]. This argument fell on deaf ears in *Rialas*; and

(b) (also in *Willoughby*) Lord Nolan refers to the “evident intention of Parliament” to support the notion of *acceptable* tax avoidance. It would be a brave judge now

[4] [2019] UKFTT 520 (TC)
[5] (SpC, [1999] SSCD 134 (SpC 190)

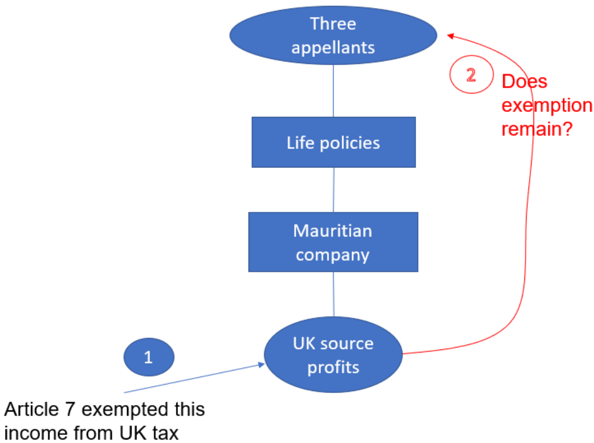
> who would consider that the evident intention of Parliament could ever result in tax avoidance being acceptable.

Carrying on with the motive defence, in the *Davies* case, the three appellants argued that the use of the Credit Suisse policies – and the involvement of the Mauritian company – had been, in effect, to mirror the position of Professor Willoughby since the three individuals were themselves engaged in pensions planning. As such, the motive defence should apply, so the submissions ran, as it had in the *Willoughby* case.

The Upper Tribunal held that the particular circumstances of the case (by which completion of the property had not taken place by the investment company but instead by the Mauritian company) was evidence of a tax avoidance motive such that the motive defence did not apply.

The treaty argument

The second argument submitted by the appellants was that the treaty should have application. The contentions were that it exempted income in the hands of the Mauritian company in the first place and, accordingly, so it was submitted, that exemption should automatically flow through – under the deeming provisions within the transfer of assets abroad rules – to the three UK residents. This, after all, was on all fours with the *Strathalmond*[6] case as its implications were very clearly (and positively) set out by Millett LJ in *Bricom*[7].



Cutting a long story short it was accepted by the Tribunal that, taking account of the treaty the business profits of the Mauritian company were to be

[6] Lord Strathalmond v. CIR, Ch.D 1972, 48 TC 537
[7] Bricom Holdings Limited v. CIR, CA 1997, 70 TC 272

accepted in Mauritius and nowhere else. This was because the treaty exempted those profits from UK tax in the hands of the Mauritian company. The question then was whether that exemption should enure for the benefit of the individuals pursuant to the provisions of the transfers of assets legislation which deemed *that* income to be theirs.

It is here that, in my view, the Upper Tribunal were in error in finding against the appellants on this aspect. The decision is not to be appealed however.

More particularly, the issue was whether the double tax treaty exemption applies to income rather than to the person. If the former (applying to income) the appellants would win; if the latter (applying to persons) HMRC would win. As far as I am aware this point (that you look to the persons not the nature of the income) has not been argued by HMRC before. In a nutshell, the appellants argument was that the exemption was automatically transferred to the appellants. After all, in the case of *Bricom*, it was common ground that the relevant article in that case exempted the interest itself and not merely the particular resident of the Netherlands who received the interest and indeed throughout the appeal in

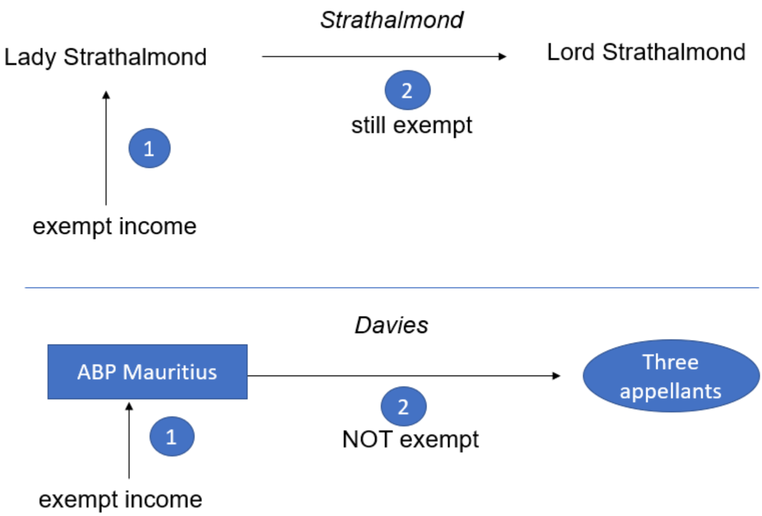
Bricom the Inland Revenue (as they then were) had accepted that the treaty protected the income in whosoever hands it was taxed. *Bricom* failed – however – for different reasons.

Further in the case of *Strathalmond* the income of a wife who was a US citizen was deemed under the rules then in play to be that of her husband. He was held, nevertheless, to be entitled to the treaty exemption as it applied to her as a US citizen. In other words, because the treaty exemption applied to the income of the wife in the first place when that income was deemed to be the income of the husband the exemption "stuck to the deemed income" and gave the husband the benefit of the exemption.

More particularly, it seems obvious that the treaty exemptions are not limited to persons in this case and can enure for the benefit of a third party and, as already mentioned, Millett LJ went to great lengths to explain how treaties operate in these circumstances and (in my opinion) made it plain that exempt income remains as such.

It is worth noting also that the Upper Tribunal said (in paragraph 65) that the purpose of the treaty (and treaties in general) was to confer relief against double taxation and not to confer double tax relief on the basis, so they assumed, that double tax relief was being afforded. That was not the case in the situation under review. The profits were taxable in Mauritius in any event. Thus, the treaty was not conferring two tranches of relief. It was conferring double taxation relief as treaties should.

Be that as it may, the case is not to be appealed but it is hoped that this aspect (that treaties of this nature apply to income and not to persons) will receive another airing at some point.



General overview

The case shows principally the following:-

(a) the difficulty of satisfying the motive test these days;

(b) leading on from this if individuals are claiming the motive test then they should make a declaration to that intent (in the white space on their tax return);

(c) the obtaining of double tax relief cannot apply to the transfer of assets abroad rules anyway since 11th March 2008; but

(d) it would be interesting to have tested the question of whether a double treaty exemption does continue to enure with the income or whether the fact there are different recipients rules out that possibility; and

(e) quite separately if ever double tax treaty relief is sought, however remotely, then a claim to that effect should be made with the relevant tax return to be on the safe side.

VODAFONE V INDIA: IN CONVERSATION WITH *Philip Baker QC*

Introduction

Over a decade of legal dispute, including court cases in India, a change in the law to retrospectively reverse a decision by the Indian Supreme Court, and then arbitration under international investment treaties finally resulted in a unanimous verdict in favour of Vodafone from an arbitration panel established under the administration of the Permanent Court of Arbitration at the Hague.

Philip Baker QC served as an expert both in the original proceedings in India and in the subsequent arbitration, ably assisted by Imran Afzal in the preparation of material for the case.

Katherine Bullock, editor of this edition of the *FCTC Digest*, caught up with Mr Baker to get his insights into the twists, turns and technicalities of this international tax rollercoaster ride.

Philip, could you explain how you first became involved with the Vodafone case?

I was involved from not long after the transaction that sparked the litigation took place - around thirteen years ago. The Revenue in India sought to claim income tax against Vodafone and I provided expert reports for all three hearings.

Would it be possible to take us through the stages of the litigation and arbitration?

The first hearing was in the Bombay High Court (it is the Bombay High Court and not Mumbai!) and I prepared the original report for that hearing. I was then asked to be present in Mumbai (not Bombay!) to be available for cross-examination. As it turned out, the Indian Revenue did not cross examine me but I was present for the hearing. My report was referred to and I was offered for cross-examination, but that was all. Vodafone lost before the Bombay High Court and appealed to the Indian Supreme Court.

What was it like being involved in the Supreme Court litigation in India?

I was pretty much commuting between home and India for over two months! The trial lasted 11 weeks and I was present for much of that time – at least 7 to 8 weeks. The Supreme Court hears cases Tuesday to Thursday and on Monday and Friday hears applications for leave to appeal, so it took 11 weeks. My report was referred to and I was available for cross-examination but again no cross examination followed. Vodafone won but, of course, within a couple of months India passed retrospective legislation overturning the decision of the Supreme Court.

Definitely not cricket. Did that lead to the arbitration?

Yes, Vodafone brought an arbitration complaint under the Bilateral Investment Treaty (BIT) between the Netherlands and India – as a Dutch company was involved. Again, I provided the expert report but on a slightly different issue – retrospective taxation as well as international taxation. This time I was cross-examined for two hours by the American lawyer acting for India. As you know, Vodafone won; the arbitrators unanimously holding that India's conduct contravened the obligation in the BIT to give fair and equitable treatment.

A decade seems a very long time for the Vodafone case to conclude.

No! That's quick for India. And it isn't resolved yet. There is speculation that India may appeal or challenge the award and Vodafone may have to enforce their award via the courts in India.

The transaction was in 2006; there was some preliminary litigation in India and then the Bombay High Court case was in 2010; the Supreme Court case in 2011, and judgement was given quite quickly in January 2012. By March 2012 the retrospective amendments were passed. Vodafone triggered the arbitration in 2014 and the hearing in the Hague was at the beginning of 2019 and the arbitral award handed down in 2020.

Did any of the process surprise you?

I was a bit surprised by how long it took in the Hague, but there are only a very small number of international arbitrators and they are incredibly busy. The Vodafone arbitration required three. A lot was done by documents and by telephone hearings and they refined the matter down so that the actual hearing took four days, of which my evidence took half a day.

And the arbitration award?

The arbitration award isn't public. I would have been surprised if the arbitrators had not found for Vodafone; you cannot let a foreign investor litigate to the Supreme Court, win 3:0 in the Supreme Court, then reverse it two months later, and expect the arbitration body to decide that was fair!

Vodafone obtaining the right to arbitration wasn't straight forward; was it?

There were questions around competence, and India ran various arguments that Vodafone didn't come within the scope of the treaty. The arguments were dismissed.

Can you explain to me why the seat of arbitration was in Singapore – and the hearing in the Hague?

You elect for the seat of arbitration. So the physical hearing was at the Peace Palace in the Hague (the base of the International Court of Justice) – the physical building that they use – but the seat of arbitration is in an agreed country. You don't have to go there, but that country's courts supervise the arbitration. So if India challenges the award, it will be before the Singapore Court. India likes Singapore as a jurisdiction because it is accessible and its courts are independent. They couldn't choose the UK as Vodafone is a UK company and they needed neutral territory.

What was it like to be cross-examined by another advocate?

Well, I've been cross examined several times before. I used to give expert evidence in asylum cases regarding human rights in China. I've also been cross-examined in the US in connection with a couple of cases on UK law, and in a case in Norway on the meaning of "beneficial ownership".

But the Hague must be different?

Oh yes, the first time in the Hague – I've now been cross-examined in the Peace Palace, home of the International Court of Justice. A very grand building – in one of the main chambers.

[We are briefly interrupted by PB's cat who strolls elegantly by and having confirmed his presence disappears amongst PB's briefs and files]

How do you see the role of the expert?

When a barrister presents an opinion, they should be willing to answer questions to justify their conclusions. Expert evidence is no different. The purpose of cross-examination is not usually to show that you don't know your subject but to draw attention to a perspective that has not been considered and could lead to a different outcome. A great deal of work goes in beforehand to prepare your report – particularly in the Vodafone matter where there was a lot of background research. I was very ably assisted in the preparation by Imran [*Afzal of Field Court Tax Chambers]* who was instructed by Vodafone in that capacity.

What would you say the key requirement is (other than being one of the leading lawyers and academics in your field)?

Independence. You are not there as an advocate; you are there as an expert and a duty is owed to the Tribunal to assist the Tribunal to understand the particular area on which you are giving evidence. It is important that the Tribunal gets to ask any questions it wants to ask. There is a danger of an expert acting as advocate for the side that tenders him. That undermines the independence and validity of the evidence the expert is giving.

It seems to be different in the US. US experts tend to become very involved and to be expected to become more like advocates. I had a peculiar experience giving expert evidence in the US tax court. The judge turned to me and asked me to explain the US Government's case. I explained in turn that it was not for me to put their case; they had Counsel for that. My purpose was to explain the legislation. There wasn't much reaction – perhaps he was surprised.

Would you consider becoming an Arbitrator given there are so few in international tax and I'd very much like your room in Chambers?

There is a big growth in international arbitration of tax matters expected, and I have acted as a quasi-arbitrator in a shadow arbitration – but in big commercial cases, no.

Why do you think there is such a growth area in international tax arbitration?

The answer in part is the BEPS project. The Mutual Agreement Procedure (MAP) was developed in the 1920s, and to preserve sovereignty the competent authorities were not obliged to resolve a matter – only to endeavour to do so. Where they couldn't come to an agreement, a system of arbitration was introduced in the 1990s as a back-up. Gradually countries began to accept it as a mechanism by which a matter is resolved. Action Point 14 of BEPS expanded the opportunity for arbitration.

Do you think the Vodafone award has wider implications for doing business in India?

There was certainly a view that when the Indian Government pursued Vodafone, foreign investment into India was impacted. Foreign investors in India realised that they should be prepared for litigation of tax disputes. Also that a dialogue with government would become increasingly important.

Would you have a tip for would-be advocates considering acting as international tax experts?

[laughing] Don't do it! *[Reflecting]* There is an element of obligation to be an expert. In the same way as you and I as barristers owe our duty to the court and must expect to be examined on a matter on which we give an opinion. An expert is not that different and must be prepared to justify the conclusions they come to.

DOMICILE PACKS: PREPARING FOR A CHALLENGE BY HMRC

Imran S Afzal

The issue of where a person is domiciled is very fact sensitive. That is particularly so in relation to domicile as a matter of "general principle", i.e. based on the traditional rules of domicile of origin/choice etc. as opposed to domicile based on statutory deeming provisions, but it may also be the case in relation to the latter.

The range of facts relevant to a determination of domicile can be broad in many different ways. For example, the facts may relate to a large number of years, the facts may relate to a wide range of topics (such as details of a person's career, social ties, personal ties, finances, burial plans etc.), and the facts may relate to another person (such as the domicile of a person's father at the time of his/her birth).

The breadth of relevant facts can lead to practical difficulties in convincing HMRC that a person is non-UK domiciled. In this article I am, of course, assuming that the individual in question is non-UK domiciled, but it would be sensible to take professional advice to confirm the position and to identify steps that might be taken to bolster the position.

One practical difficulty flowing from the breadth of relevant facts is that information might be provided to HMRC in stages over the course of an enquiry, and that might lead to innocent inconsistencies in the details provided. Whilst one can see that the process of gathering and furnishing a wide range of facts might result in entirely innocent discrepancies between information provided on day 1 and information provided some time later, one can also see that this may cause HMRC to be concerned, in which case it might become more difficult to convince HMRC of the person's domicile.

Another practical difficulty is that some of the relevant facts may be from a long time ago, and in turn it may be hard to gather supporting evidence. For example, a person may not have kept copies of old passports, identity cards, financial records etc. but these may prove useful in the context of a challenge to the person's domicile status.

The foregoing points are compounded by the fact that a domicile dispute may arise after the relevant person has died – a key example being in the context of inheritance tax. That will make it harder to gather the relevant facts and evidence relating to the deceased. And, of course, the opportunity of first hand evidence from the relevant person will have passed.

On a related note, even if the relevant person is alive at the time of the domicile dispute, other people who can provide helpful evidence may no longer be alive. And even if they are alive their recollections of the relevant events may not be fresh.

In light of difficulties such as the foregoing I consider that a good way of preparing for a potential domicile challenge is to prepare early. More specifically, I recommend compiling what I call a "Domicile Pack", which will contain a range of helpful materials including the following:

1. A legal opinion confirming that the person is non-UK domiciled.

2. Documentary evidence in relation to the relevant facts. The range of documents will be broad, but some examples are copies of

passports or other identity cards, documents evidencing ownership of property, evidence of social ties such as club membership cards, documents demonstrating where a person's cash and other investments are located, a copy of a will etc.

3. Witness statements from the person in question and also from a range of other related and unrelated persons.

4. HMRC's Residence, Domicile and Remittance Basis Manual sets out a long list of information and documents which might be requested during an enquiry, and it is helpful to cover these (to the extent applicable) in the Domicile Pack.

Ideally the Domicile Pack would be updated periodically, say every five years: the precise frequency of updates would depend on how complicated the facts are and the sums at stake. When updating the Domicile Pack relevant evidence would be added to the bundle (although the evidence might be gradually compiled in advance), additional witness statements might be added, and a supplementary legal opinion would be inserted.

In due course if HMRC challenges the person's domicile status, then the Domicile Pack can be sent to HMRC. Of course, it may be that for some reason it is decided not to send the Domicile Pack in, e.g. it might be clear that HMRC only has one specific concern and it might be thought that the matter can be put to bed with a targeted response. As a general matter, however, sending a Domicile Pack to HMRC can be an effective way of responding to a domicile challenge for various reasons:

1. It should avoid the time and cost of protracted correspondence with HMRC. Hopefully HMRC will be convinced by the Domicile Pack. If not, then it might be possible to move swiftly to litigation without a lengthy and costly enquiry process in the interim.

2. Since a large body of relevant information will have been compiled and evidenced in the Domicile Pack, the risk of innocent inconsistencies which can arise from a piecemeal provision of information should be averted.

3. If the individual in question or someone else with relevant evidence has died by the time of the domicile challenge, but there is a witness statement from that person in the Domicile Pack, then the latter can be relied upon. Generally speaking evidence is more potent if the person giving it is alive and can be challenged by HMRC, but in circumstances where the person has died it is preferable to have a signed witness statement than nothing at all.

Another benefit of obtaining a Domicile Pack is that if a person's tax returns are being filed in reliance on his/her non-UK domiciled status, then the detailed nature of the Domicile Pack should give added comfort that the tax returns are being completed correctly.

Overall, the old saying "*by failing to prepare, you are preparing to fail*" may be something of a cliché, but nonetheless it rings true in this context. One can, of course, successfully defeat a domicile challenge even without a Domicile Pack. But it is better to have as many tools at one's disposal as possible, and a Domicile Pack may be a particularly potent tool.

FCTC Comments

These Packs have also been adopted by another member of Chambers successfully. The accountant sending in the return based on the client having a foreign domicile is comforted, that he or she is doing the right thing, if there is such a Pack. Penalties should also not be in issue. In one case HMRC raised a domicile query and the Pack was sent in by return ensuring that every question raised in the long HMRC questionnaire had been dealt with and evidenced, and HMRC accepted the position. There is something special in being able to reply quickly in such cases.

WEALTH TAX: THE SPECTRE LOOMS ONCE MORE

Peter Vaines

There is an increasing amount of discussion regarding the possibility of a wealth tax. This is not a new idea (I am sadly old enough to remember the Wealth Tax Green Paper in 1974) and it has been tried with various degrees of success elsewhere in the world. It it is clearly going to be a matter of serious debate in the UK.

In days gone by, the amount of material now being produced on the subject would have laid waste large amounts of forest – but mercifully now it is only the occasional inbox which will come crashing down. The various studies highlight the almost infinite problems which arise from the possible introduction of a wealth tax. Even those problems which are soluble, in the sense that a decision just needs to be made, (for example whether it should be paid individually or by household, what to do about children, trusts, non-residents, certain special assets, and what the threshold should be) will nevertheless give rise to endless argument and special pleading.

These issues are mainly philosophical, but there are a couple of practical issues: how to collect the tax and whether it would raise any money. (There is also the distracting question about the effect that such a tax would have on behaviour – which the advocates of a wealth tax and its opponents seem to have opposing and equally justifiable – but unprovable – views).

We already have various taxes on wealth – three examples being capital gains tax, inheritance tax and ATED – none of which yields an amount which touches the sides when compared with the receipts from income tax and national insurance contributions. But every little helps.

The various studies indicate that the majority of individuals' wealth is found in the value of their homes and their pension pots. But it is very difficult indeed to charge somebody a significant amount of money on the basis of the value of their home if they do not have the means to pay the tax. There are many people who are really struggling to bring up a family (or who are retired and living on a modest income) whose homes have become quite valuable. An annual tax of anything worthwhile would be quite impossible to pay. I think the expression is: Do the Math.

It is no good deferring the tax – you do not get any revenue that way - and the result is that you force people to sell their homes. Not likely to be a practical solution – and probably not very popular either. Furthermore, the effect that would have on the property market does not bear thinking about. And trying to take away chunks of people's pensions would be even more difficult. A pension might be valuable in theory but the pensioner cannot access that value to meet any tax - except of course the amounts he receives by way of pension on which he is already paying income tax. So one suggestion now is that primary homes and pension pots would be excluded, but that would virtually eliminate the tax base, ensuring that the potential revenue would be eliminated too.

In recent presentation on the subject, Lord O'Donnell explained that Denis Healey was Chancellor in 1974 when the green paper was published setting out many of the issues which are being debated now. Mr Healey was keen to introduce a wealth tax to achieve the Government's committed objective of redistribution of wealth - but apparently, he was never able to find a way of doing so which would yield more than the costs of collection.

However, maybe this is looking at the subject from the wrong direction.

None of these problems matter if the purpose is not to raise revenue but to achieve a social purpose. A wealth tax could simply be a Robin Hood tax whereby you take from the rich to give to the poor; this would certainly command some support. George Bernard Shaw sagely acknowledged that a policy of robbing Peter to pay Paul will always have the support of Paul.

However, if by taking money from the rich, the yield is so low that there is nothing to give to the poor, then it will not get the support of Peter or Paul. It would not be redistribution – it would simply be confiscation. Nevertheless, that may still be a legitimate purpose on the grounds that it reduces inequality. This was argued strongly by the FT journalist, Simon Kuper, in the FT magazine in July 2020. He suggested that it would be a good thing to confiscate the wealth of the rich – and the rich should welcome it because it would save their children from opprobrium and decadence. There may be two views on that.

If the confiscation of peoples assets as a means of reducing inequality is the aim, then it should be promoted honestly and not on the basis of a false prospectus that it will raise money to pay for things – or to plug a gap in the nation's finances. It should be promoted in the way that Simon Kuper has done, on the basis that confiscation is a good thing and not something to be ashamed of. It would obviously be wrong for the objective and the effect to be misrepresented by suggesting (or implying) that it would raise revenue to assist with public expenditure to any material extent.

Mr Kuper explains that taxing the rich may now be the most consensual proposition in politics. Of course it is. It will always be a popular idea to support a policy which involves somebody else paying tax. But not me of course. It may be a bad thing that some other people have more wealth than me, and for that reason alone it should simply be taken away from them, but that is hardly a legitimate economic (or even social) policy.

There is also the issue of aspiration – seen most acutely in some successful economies where people see that others, just like them, have been able to build big businesses and become fabulously rich. They say: if they can do it why can't I? Many people aspire to be rich, and are willing to work hard to do so, creating jobs and wealth for themselves and others (including paying lots of tax) in the process. Others just aspire – and will do the lottery hoping that they will become rich without having to make the effort. But the aspiration is still there.

Some people will strive and make fortunes whatever the tax or confiscatory consequences – but economies are not built on such exceptions. Economies are based on the propensity of people to do things, and it is well-known that if you tax something, the propensity for people to follow that cause of conduct will be reduced. Taxes on tobacco, sugar and driving in London for example, are based entirely on that proposition.

One of the important points which arises, and which resonates with the unpopularity of inheritance tax, is that it is the older people who have more wealth. That seems likely to be accurate – and it would make sense. Older people have saved all their lives and paid off their mortgage and have done so in order to have enough money to live on when they stop working – and to assist and provide for their children and grandchildren. That does not immediately appear to be a bad thing or is an unfairness which requires correction. It might be thought self-evident that a person who has worked and saved for 50 years should have more money than the 30 year old who may have been working for only five or six years – if at all. The opposite view would be absurd. A wealth tax which by intention or design, disproportionately affects older people would no doubt be widely recognised as unfair and discriminatory – and widely perceived unfairness always sews the seeds of civil unrest. Just how serious that can be (and has been) is explained in chilling detail by Dominic Frisby in his recent book *Daylight Robbery: How Tax Shaped Our Past And Will Change Our Future.*

However, it might be possible to introduce a wealth tax as a replacement for inheritance tax. This might generate *some* revenue and may therefore have something going for it having regard to the unpopularity of inheritance tax. Abolishing inheritance tax would go down well and if it were to be substituted by a wealth tax which most people would not expect to pay, that might be popular too. Unfortunately, that double whammy might be a bridge too far because whatever the merits, abolishing a tax is much too difficult politically for any Government. But maybe they could achieve both objectives by revising inheritance tax (perhaps quite a lot) and changing its name to wealth tax; that could kill two birds with one stone.

The debate about whether we should have a wealth tax will no doubt rumble on with more and more erudite contributions – and who know what the outcome will be.

There is a place for taxation to fund the expenditure which the State requires and there is a place for taxation for the purpose of social engineering. Both are very important. But what is even more important is not to confuse the two.

FCTC Comments

There is an old adage that "every old tax is a good tax, every new tax is a bad tax." The problem with a wealth tax is the requirement to do valuations and how to deal with taxpayers who are asset rich but income poor: they may have to borrow to pay the tax or emigrate and take their assets with them. Better to tinker with the rates on the existing taxes. One member of Chambers has seen huge pressure to do commercial sales before the rates of CGT go through the roof. Note there is likely to be a forestalling provision; if a party has unconditionally contracted to dispose of assets because of a possible change in CGT rates and completion takes place after the change in rates, the new rates will apply.

JANET AND JOHN INCORPORATE THEIR PROPERTY LETTING BUSINESS

Katherine Bullock

After May 2018, HM Revenue & Customs (HMRC) will not normally give non-statutory clearance on the availability of incorporation relief. This, together with the growing uncertainty over the application of anti-avoidance provisions such as s75A FA 2003, has meant that many taxpayers may face concern over what tax is due at a critical point in the life cycle of their businesses and when structural change is needed to adapt to significant economic uncertainty. This is a story about Janet and John ...

A wife and her husband, Janet and John, built up a portfolio of a surprising number of buy-to-let residential properties over a number of years. Recent changes targeting residential landlords, both economic and tax, and the prospect of future changes on the horizon mean that they are now considering whether to operate through a limited company. Assuming this makes commercial sense and the timing is right, the tax consequences of incorporating the property portfolio may differ dramatically depending on what exactly Janet and John mean by "building up their property portfolio together" and how exactly they have presented their situation to HMRC.

The position without tax relief

If Janet and John co-own the properties as joint investments, on incorporation they will pay CGT at 28%[8] on the market value of the properties[9] within 30 days of completion. SDLT will also be payable at up to 15%.[10]

However, if Janet and John are operating a property letting business in partnership, they may be able to incorporate that partnership tax free.

Is there a partnership?

The Partnership Act 1890 s.1 defines a partnership as: "the relation which subsists between persons

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[8] TCGA 1992 s.1(1), 1H(1), 1I(1) assuming that they are higher rate taxpayers

[9] TCGA 1992 s.17; it is not possible to holdover any gain because TCGA 1992 s165 applies to chargeable assets used in a trade.

[10] FA 2003 s.53; Sch 15 FA 2003 applies to "higher rates transactions" entered into by partnerships and therefore the supplemental 3% charge of SDLT applies to additional residential properties purchased by a partnership.

carrying on a business in common with a view to profit.” To avoid doubt, s.2 provides: “joint tenants, tenants in common, joint property, common property or part ownership does not of itself create a partnership as to everything so held or owned…”

Partnerships may arise informally. There is no legal requirement for a partnership agreement. Where there is a genuine partnership, it is of course extremely helpful if there is a written record, preferably a deed, that can be shared with HMRC. However, please note, that a deed will not create a partnership where none exists[11]. Other factors to consider are the existence of a partnership bank account, agreements in the name of the partnership and preparation of partnership accounts. A history of filing a partnership tax return over a number of years will be another strong indicator.

It is also important to determine if the properties are held as a partnership asset or for use by the partnership. This can be difficult to decipher where land was acquired and is registered in sole names or in different combinations of partners. It is important to ensure that there is a partnership of capital and not

[11] Weiner v Harris [1910] 1KB 290.

just rent. The realisation of profit or use of an asset by a partnership does not of itself indicate that an asset is a partnership asset.

For there to be a partnership[12], there must therefore be a business and Janet and John holding land together is not in itself sufficient. Fortunately, business is a wider concept than trade.

Is there a business?

Letting property may be a business[13] but proving it can be an uphill battle. The presumption is that there is no business unless Janet and John can prove otherwise. HMRC's view is set out at PIM1030: "Joint letting does not, of itself, make the activity a partnership. Usually there will not be a partnership and the customer's share from the jointly owned property will be included as part of their personal rental business profits. Less commonly, the joint letting may amount to a partnership."

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[12] The position is different for limited and limited liability partnerships, but in any event a lack of business would cause our dynamic duo to fail at the next hurdle for CGT purposes; although not for SDLT.

[13] Griffiths v Jackson [1982] 56 TC 583

The evidential difficulty is that the level of activity may be low and sporadic and thus difficult to differentiate from an investment activity. A single rental property with little management activity, for example, is unlikely suffice.

In *Ramsay v Revenue & Customs Comrs.*[14], the Upper Tribunal decided that although a business usually calls for some activity on the part of whoever carries it on, that activity can be intermittent with long periods of quiescence in between. The quantity, not the quality of activity, was important. As a result, HMRC's Manuals state: "You should accept that incorporation relief will be available where an individual spends 20 hours or more a week personally undertaking the sort of activities that are indicative of a business. Other cases should be considered carefully". Careful records of time spent should be maintained.

To be a business, the undertaking must be seriously pursued and conducted on sound and recognised business principles. It will help if Janet and John have a business plan. In practice, HMRC tend to have fixed expectations as to how such a business

[14] [2013] UKUT 226

should be profitably run. An entrepreneur embracing a search for "clear blue water" in the property letting market may find themselves unexpectedly challenged, despite their considerable business expertise.

Carrying on the business through an agent should not prevent relief from applying[15] although there is some uncertainty surrounding the question. It is, of course, helpful if the taxpayer has no other employment or trade.

Incorporation relief

Relief from CGT is provided by TCGA 1992 s.162, which applies where a person who is not a company (a) transfers to a company a business as a going concern, (b) together with the whole of the assets of the business, or together with the whole of those assets other than cash, and (c) the business is so transferred wholly or partly in exchange for shares issued by the company to the person transferring the business. Where the relief apples, it is mandatory, although it is possible to elect out.

[15] Williamson v The Commissioners [1978] VATTR 90

Is there a transfer of a going concern?

The meaning of "going concern" was considered in the Australian case *Reference Under Electricity Commission (Balmain Electric Light CO Purchase) Act 1950*[16] where is was held that it "imports no more than that, at the point of time to which the description applies, its doors are open for business; that it is then active and operating, and perhaps also that it has all the plant etc which is necessary to keep it operating, as distinct from its being only an inert aggregation of plant." In CIR v Gordon[17], it was held that the correct test was whether the company takes over the business without interruption at the date of incorporation. It is therefore important to consider any contractual arrangements put in place before incorporation and it is prudent not to reorganise the business immediately after incorporation. Janet and John might also want to consider new contracts of employment with the company requiring them each to input at least 20 hours per week.

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[16] (1957) 57 (NSW) 100 at 131

[17] [1991] STC 174

Is there a transfer of all the assets except cash?

The position of any properties withdrawn from the partnership prior to incorporation needs careful thought. It is a question of fact[18] whether such properties should be regarded as included within the whole of the assets of the business. In practice, it may be worth drawing up accounts to evidence the balance sheet at the point of transfer.

Where the consideration is wholly shares, the total chargeable gain arising on the transfer of the business is deferred until the disposal of the shares. Where the consideration is only partly in shares, the net gain rolled over is restricted to the proportion that the consideration in shares bears to the total consideration, with the balance immediately subject to CGT. If Janet and John wish to retain flexibility, perhaps to facilitate the extraction of value from the company, redeemable preference shares may be an option that avoids this charge. Note that a charge can also arise where the net value of the business is less than the gain rolled over into the shares. This is

[18] CG65710

because the base cost of the shares cannot be less than zero.

When a partnership is incorporated, each partner's share is dealt with separately. It is therefore possible for Janet and John to receive a different combination of consideration for their partnership interest depending on their particular circumstances.

As the company acquires the chargeable assets of the business at market value, the base cost of the properties will be uplifted to market value as to the date of incorporation. If therefore the company sells a property shortly after incorporation, any chargeable gain may be minimal.

Novation of debt

In practice, the most difficult part of the incorporation process is the treatment of borrowings secured on the properties. If the company assumes the liabilities of the business, it will provide consideration that is not in the form of shares; ESC D32 prevents a chargeable gain from arising in these circumstances. It is therefore essential to fall within the wording of the concession. Granting new loans to the company and using those funds to repay the existing loans in the name of Janet and John will not comply with ESC D32.

The bottom line is that the loans should be novated to the company, but from a commercial perspective if the lender treats this as refinancing, the result may be arrangement fees and increased interest rates. Where the partnership has financed properties with different lenders, each secured on a particular property, lenders may be unwilling to lend to a company where their security may be accessible to others.

SDLT[19]

Where property is transferred to a company by a connected[20] seller or for consideration some or all of which consists of the transfer of shares in a company which is connected to the seller, the sale is deemed to take place at market value[21]. Finance Act 2003 Sch. 15 Part 3 applies a formula that overrides this rule on a transfer of property from a partnership to a

[19] There is only space in this article to consider the broad principles of SDLT in England; the regime in other countries in the United Kingdom requires careful and separate consideration.

[20] As defined by CTA 2010 s.1122

[21] Finance Act 2003 s.53

company[22] connected with it. This is not an exemption but a formula that can in certain circumstances lead to a nil charge.

Its operation is complicated at first glance but boils down to a five step process to calculate the chargeable proportion, broadly equal to the sum of the partnership shares held by any partners who are not the transferor or individuals connected with the transferor.

A company is connected with a person who, either alone or together with a person connected to them, has control over it. For these purposes, the connection between partners is ignored but close relatives are connected as are persons acting together to secure or exercise control of the company. As Janet and John are married, they are connected to the company and to each other and the amount subject to SDLT is zero. Note that SDLT is calculated on the market value. Actual consideration including the assumption of debt is ignored. The relevant partnership shares are the income shares ,as opposed to capital.

[22] SDLTM34170: where both para 18 Sch 15 and s.53 FA 2003 apply, para 18 takes precedence.

However, if Janet and John were not married but could be shown to be acting together to control the company, the same result would be achieved. This would be the case, for example, where the shareholders are deadlocked and must therefore co-operate.

For Sch.15 to apply, SDLT must have been paid or the transfer stamped when the property in question was acquired by the partnership. There are complex rules to determine the proportion on which this was the case, particularly where a partner's share has changed.

The wider rules regarding SDLT charges for partnerships will also need to be considered.

It should also be noted that where less than 100% of the market value is charged by virtue of these provisions, there is potential for future charges for a period of three years from transfer if Janet, John or anyone connected with them, withdraws capital from the partnership.

Where relief under Sch.15 is not available, all is not lost. It is still possible that SDLT may be mitigated.

Multiple dwelling relief[23] may apply in the case of residential property where more than two dwellings are transferred, with the result that it may be possible to make multiple use of lower rate tax bands. If the transfer comprises six or more properties, the transaction may count as a non-residential property transaction and qualify for lower rates of SDLT.

Janet and John decide to get creative

It may be tempting at this point for Janet and John to decide to put the matter beyond doubt and create a partnership with the intention of incorporating the business afterwards. Any such creative urges should be strongly resisted in light of the statutory approach to tax avoidance and the General Anti-Abuse Rule[24], which applies to both CGT and SDLT.

In addition, steps inserted to avoid SDLT are likely to be set aside under s75A FA 2003. Following the Supreme Court's ruling in *Project Blue Ltd* v *Comrs. for Revenue & Customs*[25], if tax avoidance is the result of a transaction or series of transactions, the motive behind the transactions does not matter. The

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[23] Sch 6B FA 2003
[24] FA 2013 s.206
[25] [2018] UKSC 30

effect of s.75A is to replace the actual transactions with a notional one at notional market value and the relief under Sch.15 Part 3 is specifically disapplied[26].

In January 2020, HMRC removed from its manual a series of examples (including that relating to incorporation of a partnership) where s.75A was unlikely to be applied. As there is no clearance procedure in respect of s.75A, this leaves Janet and John with a considerable level uncertainty.

Anything else?

It is unlikely in the case of residential properties that capital allowances will require much consideration, although if there are assets where a balancing charge may arise a s198 CAA 2001 election should be considered. Similarly, VAT should not be applicable, if the properties are residential or unelected; however, the VAT issues that may arise on a property from acquisition to incorporation are many and varied and always benefits from careful thought. In the same way, it will be important to check that no issues arise in respect of any losses carried forward. No charges under the Land Transaction code should

[26] FA 2003 s.75C

arise[27]. There should be no IHT implications, provided the shares are worth the same as the partnership interest or the transfer is not intended to confer a gratuitous benefit.

And a happy ending

Provided that Janet and John's partnership has been operating the property letting business for a number of years and care is taken to investigate and document the facts and return these to HMRC, Janet and John should be able to incorporate their business without either a CGT or an SDLT liability.

There are, of course, other options to consider where the reliefs do not apply or where there are corporate or mixed partners. Depending on the interest transferred to the company and the acquisition cost of the property concerned, the CGT and SDLT when calculated may not be high. Yet where a genuine partnership exists, the legislation provides a combination of relief that work together to elegantly eliminate the charge to tax.

[27] s517A ITA 2007

FCTC Comments

One member of chambers has successfully incorporated letting business for many years but it is necessary now to take into account the Ramsay v Revenue & Customs Comms case mention in the article. For non-residential lettings some non-UK domiciled taxpayers have incorporated the business into a non-UK incorporated company for IHT purposes – the shares will not be located in the UK for IHT purposes even though the company may be resident in the UK. One member of chambers has come across a proposal where effectively only the rents are revocably diverted into a company so the lower rate of corporation tax is payable without the properties having to go into the company.