FIELD COURT TAX CHAMBERS

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Please visit www.fieldtax.com/fctc-digest for short videos accompanying the articles.

EDITORIAL

Katherine Bullock

Welcome to the fourth edition of the *FCTC Digest* and our first edition of 2021.

This edition features our usual broad range of topics for reflection and action by all tax practitioners. At the heart of each is the quest to give clients clarity amidst increasing change and uncertainty. We look forward to doing the same at our first **virtual** FCTC Conference, **Offshore Tax 2021** on 27th April. You will find more details inside.

Our first article is essential reading for every practitioner pondering how best to word the buyer's covenant where shares in a property development company are sold as opposed to trading stock. You will find the answer in the article by **Patrick Soares**, *Sale of shares in a property trading/ development company – when the capital gain can be taxed as income under ITA 2007 S517B et seq (45%) – the giving of the "golden covenant"*

With the start of the next tax year, there is a major shift in the responsibility for assuming that an "IR35 arrangement" is satisfactory from the worker to the end user. **Patrick Way QC** considers the implications, how best to prepare and the essential steps required to defend your client's position. See the article, *IR35 – All change on 6th April 2021.*

The Rule of law and the principle of legal certainty require that people must be informed in advance of the legal consequences of their behaviour. In his article *When is retrospective legislation lawful?* **Philip Baker QC** argues that the Arbitral Tribunal in *Cairn* has provided clarity and certainty to taxpayers, their advisers and tax administrations on the permissible scope of retroactive tax legislation.

HMRC has awesome powers to strike down egregious tax schemes. But has the GAAR taken us a step too far? What of the Rule of Law and the protection of the taxpayer? Is it time that some judicial control were exercised to mitigate the repressive nature of the GAAR? See what **Peter Vaines** has to say in *The General Anti - Abuse Rule: Have we gone too far?*

In my article, I take a look at how to determine whether business property relief is available or not. If you are unsure whether to split a business to guarantee 100% relief on part or keep the business together and seek relief on the whole, you'll find the essential checklist here. See my article: *The Art of securing Business Property Relief: "applying a not altogether precise standard to features of varying, importance"*, **Katherine Bullock.**

Finally, **Dilpreet Dhanoa** has Einstein on her side when she proposes that time may be the critical factor in applying the SDLT anti-avoidance code to a series of transactions, particularly as the code does not require a tax avoidance motive. See Dilpreet's first article for the FCTC Digest, *Stamp Duty Land Tax – Living with Section 75A.*

Happy reading!

SALE OF SHARES IN A PROPERTY TRADING/ DEVELOPMENT COMPANY – WHEN THE CAPITAL GAIN CAN BE TAXED AS INCOME UNDER ITA 2007 S517B ET SEQ (45%) – THE GIVING OF THE "GOLDEN COVENANT"

Patrick C Soares

Property Trading Ltd (PTL) may be a property development company which had not been set up by the owners with a view to selling the shares; the intention was the property would be sold by the company as trading stock.

As it turns out PTL is to be sold to an unconnected buyer while it still owns the trading stock. The stock is thus indirectly sold for a capital sum. The taxpayer must consider the land transactions code in ITA 2007 s517A et seq. which is designed to convert capital into income.

The unconnected buyer company will need to give a covenant. Under the old taxation of land legislation (now found in ITA 2007 s752 et seq) the buyer would covenant that PTL would dispose of the property in the normal course of its (PTL's) trade and all opportunity of profit in respect of the property will arise to PTL. Under the new land taxation code (ITA 2007 s517A et seq applicable to disposals after 4 July 2016) the purchaser and PTL should give a different covenant. Putting the old and new law together the new covenant can be:

> *any profit or gain arising from the disposal of the property will be brought into account as income in calculating the profits of PTL for corporation tax purposes and the property will be disposed of in the normal course of the trade of PTL and all opportunity of profit or gain in respect of the property will arise to PTL.*

The latter 2 parts of the covenant go beyond the requirements of the new legislation but they cover, the writer feels, the circumstances envisaged by the new legislation and help guard against any contention by HMRC that there has been tax avoidance.

<u>TWO HEADS OF CHARGE – THE LEGISLATION</u>

FIRST HEAD

[517B Disposals of land in the United Kingdom]

(1) Section 517C(1) (FIRST HEAD OF CHARGE) applies .. if—

(a) a person........realises a profit or gain from a disposal of any land in the United Kingdom, and

(b) any of conditions A to D is met in relation to the land.

(2) The persons referred to......are—

(a) the person acquiring, holding or developing the land,

...

(5) Condition B is that the main purpose, or one of the main purposes, of acquiring any property deriving its value from the land was to realise a profit or gain from disposing of the land.

(6) Condition C is that the land is held as trading stock.

(7) Condition D is that (in a case where the land has been developed) the main purpose, or one of the main purposes, of developing the land was to realise a profit or gain from disposing of the land when developed.

517C Disposals of land: profits treated as trading profits]

(1) The profit or gain is to be treated for income tax purposes as profits of a trade carried on by the chargeable person.

……

(3) .. subsection (1) does not apply to a profit or gain so far as it would (apart from this section) be brought into account as income in calculating profits (<u>of any person</u>)—

(a) for income tax purposes, or

(b) for corporation tax purposes.

(4) .....

(5) This section applies in relation to gains which are capital in nature as it applies in relation to other gains. (writer's emphasis)

SECOND HEAD

517D Disposals of property deriving its value from land in the United Kingdom]

[(1) Section 517E(1) (SECOND HEAD OF CHARGE) applies.. if—

(a) a person realises a profit or gain from a disposal of any property which (at the time of the disposal) derives at least 50% of its value from land in the United Kingdom,

(b) the person is a party to, or concerned in, an arrangement concerning some or all of the land mentioned in paragraph (a) (“the project land”), and

(c) the arrangement meets the condition in subsection (2).

(2) The condition is that the main purpose, or one of the main purposes, of the arrangement is to—

(a) deal in or develop the project land, and

(b) realise a profit or gain from a disposal of property deriving the whole or part of its value from that land.]

[517E Disposals within section 517D: profits treated as trading profits]

[(1) The relevant amount is to be treated for income tax purposes as profits of a trade carried on by the chargeable person.

(2) If the chargeable person is non-UK resident, that trade is the chargeable person's trade of dealing in or developing UK land.

(3) But subsection (1) does not apply to an amount so far as it would (apart from this section) be brought into

account as income in calculating profits (of any person)—

(a) for income tax purposes, or

(b) for corporation tax purposes.

(4) The profits are treated as arising in the tax year in which the profit or gain is realised.

(5) In this section the “relevant amount” means so much (if any) of the profit or gain mentioned in section 517D(1) as is attributable, on a just and reasonable apportionment, to the relevant UK assets.

(6) In this section “the relevant UK assets” means any land in the United Kingdom from which the property mentioned in section 517D(1) derives any of its value (at the time of the disposal mentioned in that subsection).

(7) This section applies in relation to gains which are capital in nature as it applies in relation to other gains.] (writer’s emphasis)

COMMENTARY ON LEGISLATION AND THE HMRC MANUAL

First Head: ITA 2007 s517B and s517C – disposal of the land

This head only applies if the UK land is disposed of.

Also, if the land is disposed of and the profit is brought into account as income in calculating the profits *of any person* for income tax or corporation tax purposes, then the profit cannot be assessed on the chargeable person under this head of the legislation and this head is irrelevant. The chargeable person is generally the person who realises the gain. However, if all or part of the profit accruing to the person who made the gain (P) is derived from value provided directly or indirectly by another person (B) then B is the chargeable person (ITA 2007 s517G(4)). Also D may be the chargeable person if D provided the opportunity of making the gain to P (ITA 2007 s517G(6)). Thus the provision can in principle apply to situations such as a share sale but not if the land sale proceeds are liable to corporation tax (as income).

Second Head: ITA 2007 s517D and 517E – disposal of property deriving its value from the land

If a person realises a profit from the disposal of property which derives at least 50% of its value from UK land (e.g. a shareholder in a property company sells his shares – ITA 2007 s517N) and that person is part of *an arrangement* the main purpose of which or one of the main purposes of which is to (1) deal in the land or develop the land (whether or not as a dealer), and (2) realise a capital profit or gain from a disposal of the property deriving the whole or part of its value from the land (e.g. shares in the property company) then that gain (the gain on the share sale) can be assessed under the new code.

If one can show that it was not part of the arrangement to sell the shares the second head (which is the most relevant one) may not apply but arrangement has a wide definition (s517Q) so the HMRC practice is important. It provides thus:

> BIM60595:
>
> Where shares in a trading company are disposed of and all of the land is held as trading stock there will be no charge as profits from disposal of the land will be chargeable on the company in the absence of avoidance arrangements.
>
> ....

Example

Mr A holds the shares in a family land development business. The company holds the land as a trading asset. There are no avoidance arrangements. The company pays the tax on the profit from disposing of the land so the profits are not included in any computation of charge in respect of any profits from disposal of the shares held by Mr A.

One must be cautious when relying on cases on the old legislation but in *Chilcott v IRC* 55 TC 446 Vinelott J said of the exemption referred to in BIM60595 (but not specifically repeated in the new legislation) thus:

It seems to me that a transaction under which shares in a company holding land as trading stock are sold and the sale is made conditional upon the company selling the land in the ordinary course of its trade at full value falls outside the intended scope of s 488 so ascertained.

CONCLUSION ON THE LEGISLATION AND MANUAL

It is felt the Manual clearly covers the situation envisaged.

If HMRC resile on the statement there will be an outcry from many a taxpayer and the courts will be sympathetic to the taxpayer and may well seek to interpret the second head – s517D (2)(b) – in favour of the taxpayer and say that if it was no part of the original intention to sell the shares the second head does not apply. One cannot be assured of that approach being taken by the courts but it is felt HMRC will not resile on their clear statement backed up with a clear example unless some sort of tax avoidance is involved.

JUDICIAL REVIEW IF HMRC RESILE ON THE MANUAL

Judicial review is available if HMRC's decision (to resile on a statement) is "so unfair as to amount to an abuse of power" (see *Preston v IRC* [1985] STC 282, [1985] AC 835, *R v IRC, ex p Unilever plc* [1996] STC 681 and *R v IRC, ex p M F K Underwriting Agencies Ltd* [1989] STC 873, [1990] 1 WLR 1545: see also: *R v North* (2000) 3 ALL ER 850 CA para 57; see also *Hanover Company Services Ltd v R&CC* [2010] UKFTT 256 (TC) 9 June 2010 TC00550.

In *Fletcher v Thompson* (2002) STC 1149) at [47] Lawrence Collins stated: "the manual makes it absolutely clear that readers should not assume that the guidance is comprehensive or that it will provide a definitive answer in every case; and that where the Revenue considers that there is, or may have been, avoidance of tax the guidance will not necessary apply."

In *R (Aozoral) v R and CC* [2018] STC 11 the court held that if the taxpayer had not relied on Manual then he cannot get a judicial review.

Judicial reviews are not easy to win as one is accusing HMRC of maladministration but an action can be considered if HMRC resile on a clear statement which one is relying on.

OVERALL CONCLUSION

The writer feels the taxpayer should rely on the manual which is clear.

A successful judicial review may be difficult but not impossible to obtain if HMRC resile on the manual: even if that route is not pursued the tribunal and courts will be sympathetic to a legal argument based on s517D(2)(b) if HMRC sought to resile on their statement and example.

The writer's advice is to go ahead with the simple share sale and covenant approach as the taxpayer is well within the guidance provided by HMRC and it is not felt HMRC will resile on that guidance (which reflects their position under the old law which has been applied for very many years without any problems arising).

IR35 – ALL CHANGE ON 6TH APRIL 2021

Patrick Way QC

What is happening to IR35 on 6th April 2021?

With effect from 6th April 2021 there is a major shift in the responsibility for assuming that an "IR35 arrangement" is satisfactory. Broadly speaking, the responsibility for deciding the efficacy of the arrangement shifts from the worker to the end user.

As is well understood, the position has been, in the past, that individuals (for example, workers in the IT sector) have been able to contract with third party end users through the use of the individual's own personal service company ("PSC") or some other form of intermediary. In these circumstances, it has been "down to" the worker to ensure that the arrangements were satisfactory from a tax point of view. The change, which applies with effect from 6th April 2021, is that thenceforth it will be for the end user (rather than the worker) to determine whether the worker is effectively in a self-employed relationship and, if not, then it will be for the end user to operate PAYE and National Insurance Contributions when making payments to the PSC.

There, however, is an important exception where the end user is “small” or has no UK connection. Here it remains the case that the worker is responsible for applying the correct “IR35” treatment.

These new rules were originally intended to apply with effect from 6th April 2020 but following the problems produced by the Covid-19 pandemic they have been postponed to 6th April 2021.

Terms

IR35 was an Inland Revenue press release published to deal with avoidance in this area. That description has “stuck” and IR35 now applies to all arrangements where:

(1) there is an engager/client/end user (in this article “end user”);

(2) an intermediary which can include a PSC or a partnership or some other non-corporate relationship (in this article a “PSC”); and

(3) a consultant/worker (in this article a "worker").

What has not changed

It is important to bear in mind that the rules for determining whether there is, effectively, a self-employment arrangement (notionally between the end user and the worker) or, by contrast, a notional employment relationship have not changed. All that has changed is the responsibility for deciding this and then the obligation for applying the correct tax treatment.

When and in what circumstances do the new rules apply?

As mentioned, the new rules apply from 6th April 2021.

The new rules apply where the end user:-

(a) is medium or large; and

(b) has a UK connection.

These new rules mirror the existing rules which already apply to the circumstances where the end user is a public authority.

More specifically, therefore, the new rules do not apply if the end user is:-

(a) "small", such as a "small company"; or

(b) has no UK connection.

What is a small company?

A small company must meet at least two of the following conditions:-

(a) annual turnover must not be more than £10.2m.;

(b) the balance sheet total must not be more than £5.1m.;

(c) the average number of employees must not be more than 50.

So, to be clear, if the end user is "small" (including a "small company") then the new rules do not apply and it will remain the responsibility of the PSC/worker to deal with any tax implications in relation to the "IR35" arrangements. Further, in the circumstances the "small" end user can (continue to) make gross payments to the PSC.

No UK connection

End users who are not UK tax resident and who supply their services outside the United Kingdom are not affected by the new rules whether they are "small" or not. The "connection" rules are complicated, however, especially if some (but not all) of the services are provided within the United Kingdom.

How do the new rules work?

Under the new rules the end user must assess whether the worker is (effectively) employed or self-employed. In so doing it must act reasonably and it will have to confirm to the worker its analysis in a "status determination statement ("SDS")". The SDS must be provided to the worker before the first payment is made.

It is important to note that if an agency is involved then the SDS must also be provided to the agency.

Obviously, disagreements as to the status of a worker may well arise and therefore it will be necessary for the end user to have a mechanism in place by way of dispute resolution so that the worker can disagree with the status determination outcome.

If the status determination process concludes that the worker is effectively in a self-employed relationship then the payments to the PSC can be paid without deduction of tax; otherwise the end user (as the *fee payer*) is responsible for operating PAYE and NICs and in these circumstances the *fee payer* will also have to pay its own (employer) NICs.

I have used the expression "fee payer" here deliberately because if a UK agency is involved then that will be the party that has the "paying" relationship with the PSC and it will then be the agency that will have to account for the tax as described. Even if an agency is involved, however, it still is the responsibility of the end user to make the status determination.

Further, if an agency is involved which fails to operate PAYE and NICs (as the fee payer) then in those circumstances HMRC has the power to move that responsibility "back" to the end user after all. It seems that this will be a "last resort" situation for HMRC.

Nevertheless, it can be seen that where agencies are involved the position will need to be carefully analysed.

What has not changed

What has not changed is that it is still necessary to apply the relevant “status” tests to ascertain whether the notional arrangement between the end user and the worker is one of self-employment or one of employment.

The sort of tests that are applied are as follows and some of these are relatively new in the writer’s experience.

Labelling

It is plain that HMRC look carefully at “labelling” and are suspicious in circumstances where the labels that are applied are simply inappropriate. For example, calling the relevant contract a “self-employed contract” will be ignored if the label involved is unjustified.

Flexibility

Typically HMRC want to see that the individual worker could work in a number of different circumstances and not just the one in question. This can often be difficult as a matter of practice where workers are given long-term engagements lasting for perhaps six months or more.

An ability to reject work

The ability to reject work is becoming a big issue from HMRC's point of view. The worker must be in a position where they can turn work down if they want to.

Control

An important question which remains is the amount of control that the end user has over their destiny including, in particular, the hours they work and the place where they work.

Substitution

If the worker has the right to substitute a different person to carry out their activities at their own expense then that is a helpful example of self-employment. HMRC remain sceptical, however, in relation to substitution clauses which, as a matter of fact, are never likely to be exercised.

Mutuality of obligation

Mutuality of obligation is something of a two-edged sword. The question is really the nature of the arrangements between the entities and whether it can be said that in consideration of the payment of a fee the obligations are effectively those of self-employment.

Integration into the business

It can be difficult for an individual to claim that they are self-employed if they have become "part of the furniture" of the end user's business. This can often be the case where they have been involved in a business for many months.

Financial risk

The more financial risk which the worker takes on themselves the better.

Generally

HMRC have a "check employment status for tax" (CEST) on-line tool the latest version of which is November 2019. It is not essential to use this but HMRC do look at it. It is unfortunately by no means an infallible checking system.

Steps to take

An end user now will need to be able to demonstrate carefully the conclusions that they have come to in relation to engaging with PSCs (and other prescribed intermediaries). This will, of course, involve good systems by reference to clear rules which are implemented and which are carefully documented.

Impact

All in all, merely by switching the obligations from the worker to the end user (except in circumstances where the end user is "small" or has no UK connection) the changes are likely to be very significant and, certainly in the early months or so, to require very careful implementation.

Legislation

The legislation which is relevant to this article is principally found in ITEPA 2003 Part 2, Chapter 8 (starting to read at s.48) and Chapter 10 (starting to read at s.61K). The new heading for Chapter 8 is "Workers' services provided through intermediaries to small clients". And the new heading for Chapter 10 is "Workers' services provided through intermediaries to public authorities or medium or large clients". Where relevant these chapters implement the changes which are found in Finance Act 2020 s.7 and Schedule 1.

WHEN IS RETROACTIVE TAX LEGISLATION LAWFUL?

Philip Baker QC

In what circumstances is retroactive tax legislation lawful? This question is of relevance both to taxpayers and their advisers (who want to know when they enter into transactions – particularly those that might be characterised by a revenue authority as involving tax avoidance – whether there might be a retroactive change to the tax treatment) and to tax authorities (who wish to know whether retroactive legislation – to counter a perceived avoidance scheme, for example – will survive a legal challenge). In this context, the recent award by the Arbitral Tribunal in the case of Cairn Energy Plc and Cairn UK Holdings Limited v Republic of India issued on 21st December 2020, is particularly significant.[1] The Award

[1] The arbitration was held under the aegis of the Permanent Court of Arbitration – PCA case no. 2016-7 – and the award is available to download at various websites. Websites where it is available include the following: https://images.assettype.com/barandbench/2020-12/ff4782ab-e580-400b-9c07-baacbb8119d6/Cairn_v_Republic_of_India.pdf

contains what may become the classic guidance under international law in relation to the lawfulness of retroactive tax legislation.

The Arbitral Award arose out of the same retroactive change to Indian tax law that was at issue in the Vodafone saga.[2] Both cases involved offshore indirect transfers, where a non-Indian-resident company transferred shares in another non-Indian-resident company which gave ultimate control over a business situated in India. The Indian tax authorities sought to impose a withholding charge on Vodafone in respect of its indirect acquisition of a telecoms business in India in 2007. Vodafone challenged the withholding tax claim and was successful before the Indian Supreme Court in January 2012. Less than three months later, however, in March 2012 the Indian Government sought to reverse that decision with retroactive effect by way of "clarificatory" legislation taking effect from 1961. Vodafone challenged the retroactive legislation under the Bilateral Investment

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Cairn v. India, Final Award, 21 Dec 2020 (jusmundi.com)

[2] The decision of the Supreme Court of India is reported at (2012) 14 ITLR 431. Unlike the Cairn arbitral award, which has been made public, the arbitral award in Vodafone has not been made public. In fact, the Vodafone award is significantly shorter and does not contain an equivalent discussion of the principles relating to retroactive tax legislation as the Cairn award.

Treaty ("BIT") between the Netherlands and India and was successful before the arbitral tribunal.[3]

In 2006 Cairn had carried out a reorganisation of various offshore (i.e. non-India) shareholdings that ultimately controlled various resources in India. After the March 2012 retroactive change to Indian tax law, it too was the object of a tax assessment which it challenged under the BIT between the United Kingdom and India. The Award, issued on 21st December 2020, found in favour of Cairn, specifically that India had breached the "fair and equitable treatment" ("FET") undertaking in the BIT.

The particular aspect of the Award that is considered here is the discussion of the lawfulness of retroactive tax legislation.[4]

By way of introduction to the discussion of the lawfulness of retroactive tax legislation, three points might be made.

First, a distinction may usefully be made between "retroactive" tax legislation and "retrospective" tax

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[3] Arbitral award of 25th September 2020, PCA case no. 2016-35 – not currently available publicly.

[4] The Cairn award is lengthy – some 582 pages long – but is extraordinarily well written and merits the time spent in reading it. The paragraphs that are perhaps of most relevance are as follows:
Paragraphs 18-93 (the facts); paragraphs 763-836 (the tax exclusion from BITs); paragraphs 1289-1424 (the meaning of tax avoidance in India); paragraphs 1701-1823 (retroactive tax legislation).

legislation.[5] Retroactive tax legislation changes the law with effect from the past, so that a transaction that was previously not taxable (or taxable at a lower rate) is now regarded as taxable (or taxable at a higher rate). Retrospective tax legislation, in contrast, changes the law for the future, but with respect to income, for example, that flows from a previously completed transaction. For example, a taxpayer may have purchased a particular investment anticipating that the return would be subject to a lower, capital gains tax charge on an eventual disposal; retrospective legislation changes this so that, when the return is realised, it is subject to a higher, income tax charge.

The Arbitral Tribunal in Cairn noted that the use of the terminology of "retroactive" as opposed to "retrospective" tax legislation is not uniformly maintained by authors or courts and governments. However, the distinction is thought to be a useful one for analytic purposes. What the Cairn Tribunal said about it is as follows:

> 1080. Given the lack of clarity surrounding the concept of "retrospectivity" and the Parties' agreement that it can be used interchangeably with the term "retroactivity", the Tribunal will adopt the following terminology going forward:

[5] The distinction in the terminology is discussed in the Cairn award at paragraphs 1066-1080.

> a. The Tribunal will use the term "retroactive" to refer to a law which "deems the law at the time of a past event to have been as provided in the subsequent statute, where the law at the time of the event was actually something different." Stated differently, it will consider a law to be retroactive if it changes the content of the law in the past, so that the law is deemed to have always had such (new) content, and applies to transactions that took place in the past.
>
> b. The Tribunal will consider that a law that operates prospectively but modifies the effects of transactions occurring in the past has "immediate" effect … . It will not use the term "retrospective" to refer to this situation.

Whether or not one makes the distinction between retroactive and retrospective tax legislation, the March 2012 amendment to Indian tax law was found by the Arbitral Tribunal to be retroactive in that it changed what had previously been the position under Indian law and introduced a tax charge that was not previously recognised under that law.

Secondly, domestic legislation, including national constitutional provisions, on retroactive legislation vary quite widely.[6] There are some countries where retroactive tax legislation is prohibited under the constitution, or is permitted in only limited circumstances. There is no constitutional prohibition of retroactive tax legislation as such in India; *a fortiori* there is no prohibition in the United Kingdom, where there is no written constitution. Under the European Convention on Human Rights there is no prohibition as such, though recent case law has sometimes found a breach of the Convention where retroactive legislation has been introduced.[7] It is reasonable to speculate that the position under the European Convention may merit reconsideration in the light of the discussion in the Cairn award.[8]

Thirdly, even within those countries where there is no constitutional prohibition of retroactive tax legislation as such, practice varies widely. There are some countries where retroactive tax legislation is not adopted. There are some countries where it is occasionally adopted, usually

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[6] On this see *The Practical Protection of Taxpayers' Rights* (2015) Cahiers de Droit Fiscal International 54-55.

[7] On this see the author's article, "Retrospective Tax Legislation and the European Convention on Human Rights" [2005] BTR, and also the author's article on "Retroactive Tax Legislation" (2012) 6 International Taxation 780.

[8] For a discussion of retroactive tax legislation countering a tax avoidance scheme see Huitson v United Kingdom (application no. 50131/12 – decision of 13th January 2015) and also the decisions of the UK Court of Appeal in R (Huitson) v HMRC [2011] EWCA Civ 893 and R (Shiner) v HMRC [2011] EWCA Civ 892.

only in very limited circumstances. Finally, there are countries where the government is known to employ retroactive tax legislation from time to time. The United Kingdom in principle falls into the latter category, though there have been relatively few examples of retroactive tax legislation in the last 50 years. India, on the other hand, is a country where retroactive legislation (to reverse the effect of decisions of the courts with which the tax administration are not content) is relatively frequently employed. The March 2012 legislation to reverse the decision of the Supreme Court in Vodafone was such an example.

Turning now to the Cairn Arbitral Award, the Tribunal first concluded that the March 2012 "clarificatory" change to the tax legislation was retroactive in that it effected a change from the previous law. The question that the tribunal then had to address was whether this retroactive change contravened the FET obligation in the BIT. This was not a question of whether the retroactive legislation was contrary to Indian constitutional law, nor whether it breached customary international law as such. Rather, it was specific to the FET obligation.

The Tribunal approached this question by considering the requirements of respect for the rule of law and the principle of legal certainty. Respect for the rule of law, and the requirement of legal certainty, are both aspects of the FET obligation. On this issue the Tribunal came to the following conclusion:

> 1757. On the basis of the Parties' submissions and the authorities reviewed above, the Tribunal finds that the principle of legal certainty (and its corollaries, stability and predictability) provides significant guidance when determining whether retroactive taxation is compatible with the FET standard provided at Article 3(2) of the BIT. As the Rule of Law Checklist of the Venice Commission makes clear, one of the essential elements of the principle of legal certainty is precisely that "[p]eople must be informed in advance of the consequences of their behaviour" and that laws should "enable legal subjects to regulate their conduct in conformity with it." For this reason, the rule is that the law operates prospectively. By their very nature, retroactive laws do not allow individuals to predict the legal consequences of their conduct. An individual that is subjected to retroactive legislation is thus deprived of the ability to make an informed choice and plan his/her activities in consideration of the legal consequences of his/her conduct, for the simple reason that it is impossible to alter events or actions that have already occurred. <u>Thus, in accordance with the principle of legal certainty, the general rule in a system governed by the rule of law</u>

is that the law applies prospectively. Subject to exceptions where this is justified by a specific public purpose as discussed below, the retroactive application of legislation constitutes a fundamental affront to the principle of legal certainty and runs afoul of the guarantee of predictability of the legal environment. (emphasis added)

Legal certainty links to the legitimate expectation of the parties. The Tribunal accepted that a taxpayer could have no legitimate expectation, for example, that abusive practices would not be tackled by legislation with retroactive effect. There were, therefore, clearly exceptions where retroactive legislation could be justified. The Arbitral Tribunal gave some non-exhaustive examples of this: these included, combatting abusive practices,[9] correcting inadvertent technical errors,[10] and avoiding the "announcement effect".[11] The Arbitral Tribunal had, therefore, to carry out a balancing exercise under which the retroactivity had to be specifically justified by a compelling public purpose. The Tribunal phrased this as follows:

1793. The practice of various jurisdictions that have grappled with the same balancing exercise in

[9] See paragraphs 1796 and 1979.
[10] Paragraphs 1798 and 1799.
[11] Paragraph 1800.

the context of retroactive taxation supports this conclusion. While that practice is not uniform as to the specific occasions at which retroactive taxation is allowed, the general rule is that retroactivity should be specifically justified by a compelling public purpose.[2253]

1794. ... While as a general matter it is not for investment treaty tribunals to question the wisdom of the public purpose chosen, tribunals do have the duty to determine whether a *bona fide* public purpose exists in the first place. When assessing the legitimacy of retroactive legislation, however, the Tribunal must determine whether the departure from the principle of legal certainty is justified by an additional public purpose that cannot be met without the measure being given retroactive effect. In other words, the retroactive nature of the measure requires that the Tribunal be allowed to assess the sufficiency of the specific policy objective sought by the measure.

2253 Hans Gribnau, Melvin Pauwels, *Retroactivity of Tax Legislation* (EATLP International Tax Series, 2013), CLA-381, see, e.g.,: for UK – RLA-282, for Germany – RLA-302, S. 3.8.5.2, for Italy - RLA-303, S. 3.11.4.1, for The Netherlands – RLA-304, S. 3.13.2.2; *Carlton*, US Supreme Court, US 26, 114 SCt 2018, cited at RLA-225, n. 25.

The concluding paragraph from the Tribunal on this point emphasises the need to assess the specific reasons given to justify retroactive tax legislation and to balance that against the taxpayer's interest in legal certainty. The key test is set out as follows:

> 1801. While it is not realistic to list all possible scenarios in which retroactive taxation may be justified, the above examples from the jurisprudence of municipal and international courts demonstrate that the appropriate balance between the individual's interests of legal certainty / stability / predictability, on the one hand, and the State's power to regulate in the public interest, on the other, should be struck by reference to the principles of reasonableness and proportionality, bearing in mind that the Tribunal is *ad hoc*, not part of the judicial machinery of the State, and not vested with a legislative or policy-making power. This balancing may be achieved by assessing the specific reasons given to justify the retroactive application of tax measures. If no viable "retroactivity specific" justification exists, the measures will likely constitute an unreasonable and disproportionate interference with the taxpayer's interest of legal certainty. Such measures will also be contrary to the FET standard, interpreted in line with those general

principles in accordance with Article 31.3(c) of the VCLT. (emphasis added)

Thus, concluded the Tribunal, retroactive legislation which could not be justified would infringe the FET standard, as interpreted in line with the general principles of law common to all nations (which are recognised as a source of international law and are applicable to the interpretation of international instruments, including BITs).

Having set out the balancing exercise, the Tribunal in the Cairn case concluded that India had failed to justify the retroactive legislation and, consequently, there was a breach of the FET standard.

This finding of the Arbitral Tribunal is significant of itself, but what is particularly significant is the reasoning of the Tribunal which led it to its conclusion. As the Tribunal acknowledged, this was the first international tribunal case to consider whether retroactive tax legislation in circumstances such as those here breached the FET standard. Both the manner in which the Tribunal reached its conclusion, and the clarity of its reasoning, mean that its decision is likely to be of much broader significance than simply the 2012 legislation in India.

While the Tribunal did not purport to be recognising a rule of customary international law with respect to retroactive tax legislation, the Tribunal's approach not only explains the FET standard and its requirements, but also links the balancing exercise that has to be carried out with general principles of respect for the rule of law, legal certainty and legitimate expectation.

It is reasonable to assume that the Tribunal's decision on this matter will be quoted not only in subsequent Bilateral Investment Treaty arbitrations, but more widely. For example, it has been suggested above that the European Court of Human Rights may wish to reconsider its approach to retroactive tax legislation in the light of the analysis in this Award.

Turning more specifically to the United Kingdom, the UK does from time to time enact retroactive tax legislation. One of the functions of the Tax Professionals Forum established by the Exchequer Secretary to the Treasury is to keep under review the enactment of retroactive tax legislation and to comment on whether that legislation is consistent with principles enunciated by the UK Government. In its reports the Forum has suggested certain principles to be applied by the UK Government in deciding whether or not retroactive legislation could be justified.[12] The Forum has recommended the principles to be adopted as follows:

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[12] See the Second Independent Annual Report of the Tax Professionals Forum, 27th March 2013, at pages 8-9, and the Third Independent Annual Report at Annex B.

Members of the Forum acknowledge that there can be occasions when a retroactive change to tax law is justified, appropriate and lawful. But they are rare. Any retroactive change must be compatible with the Human Rights Act and in this respect the jurisprudence of the European Court of Human Rights offers some guidance on the identification of such circumstances. Based on that jurisprudence, the members of the Forum would consider it appropriate that the Protocol adopt an approach under which an unscheduled announcement might envisage retroactive legislation in any of the following cases:

- tax avoidance schemes have come to the attention of HMRC which are highly abusive and involve such a large budgetary risk that the Government considers it appropriate to legislate to cancel the effect of the schemes with retroactive effect (and not simply to announce the reversal of those schemes from the date of the announcement and/or challenge those schemes under existing law, including any general anti-abuse rule). The existence of disclosure rules (enabling the Government to take swift action to close down abusive schemes) and, from 2013, of a GAAR should ensure that there is little scope for retroactive action on this account.

- it has become clear (usually, but not exclusively, as a result of a court decision) that a generally understood tax treatment (understood in common both by HMRC and by the profession, and not by one group only) is not as it was previously understood to be, and the impact is likely to be significant in budgetary terms or in terms of the impact on existing arrangements;

- to rectify a manifest error in legislation, not merely an issue concerning construction which could be addressed by a court case, where again the impact is likely to be significant in budgetary terms or in terms of the impact on existing arrangements;

AND (in all three situations) the public interest in retroactive legislation outweighs the private interests of the taxpayers adversely affected by the retroactive change.

It is submitted that these principles enunciated by the Forum are consistent with the guidance as to the meaning of fair and equitable treatment set out by the Arbitral Tribunal in the Cairn award. Put another way round, retroactive legislation that cannot be justified on any of the grounds set out by the Forum risks contravening the FET standard, which the Arbitral Tribunal related to the rule of law, legal certainty and legitimate expectation. In deciding as it did, the Arbitral Tribunal in the Cairn Award may not simply have elucidated the meaning of the FET standard in the UK-India BIT, but more broadly has provided clarity and certainty both to taxpayers and their advisers and to tax administrations on the permissible scope of retroactive tax legislation.

THE GENERAL ANTI - ABUSE RULE

Have we gone too far?

Peter Vaines

The General Anti –Abuse Rule was introduced by the Finance Act 2013, following a detailed report on the subject by Graham Aaronson QC in 2011.

The primary objective of the GAAR is to deter taxpayers from entering into abusive arrangements which are defined as those "which cannot reasonably be regarded as a reasonable course of action in relation to the relevant tax provisions": section 207 Finance Act 2013.

The expression most commonly used at the time of the introduction of the GAAR was that it was expressly targeted at egregious tax planning – that is to say arrangements which were flagrant, conspicuously bad and shocking.

I have no time for egregious tax schemes but there comes a point when things sometimes get a bit out of hand – maybe only mission creep – and whatever the reason, they deserve examination.

Questions often arise regarding the double reasonableness test which is the bedrock of the GAAR – whether it is reasonable to regard the arrangements undertaken by the taxpayer as a reasonable course of action. Unfortunately we have no guidance about what is reasonable, or whose judgement is to be used in deciding whether something is reasonable, and this creates an unfortunate degree of uncertainty for everybody involved.

The ingenuity of citizens knows no bounds and nowhere is this more evident that in the field of taxation. People do not like paying tax and often seek to conduct themselves in a way which minimises their exposure to tax. Some, who we might describe as the Good Guys take the trouble to ensure that everything they do is in accordance with the law; others who are obviously the Bad Guys, don't care about the law and just lie and cheat.

Nobody would disagree that those who lie and cheat need to be pursued and punished with vigour. However what about the Good Guys who scrupulously abide by the law. Should they too be vigorously pursued and punished. Surely that cannot be right. And why am I even asking the question?

A little look at the General Anti- Abuse Rule may provide the answer. We need to start with the declaration by the GAAR Panel that they reject the approach taken by the Courts that taxpayers are able to reduce their tax bills by any lawful means.

This is a startling proposition.

I would like to reject the approach taken by the courts that when I go to Waitrose I have to pay for the goods in my trolley. Obviously I cannot do that – but how come the GAAR Panel can simply decide that they can reject the law?

People have always sought to minimise their tax. They have done so since the dawn of time – or at least since the dawn of fiscal imposts which is probably the same thing. For thousands of years, rulers imposed various tithes, and of course there was the well-known window tax, which caused people to make arrangements to reduce their liability to tax. However things have become more sophisticated as life has become more complex.

So now when a tax is introduced, it is discovered (inevitably) that it does not cover certain things; so it gets amended. But there are still things which are not caught by the tax so it gets amended again. And again... and so on. This has resulted in a kind of paranoia that if anybody, anywhere could avoid any element of the tax, the possibility must be eliminated – at almost any cost or collateral damage.

The problem is that the tax authorities have got fed up with finding out that they cannot levy tax on someone in the way they want, because the law does not allow it. And this is where the GAAR comes in.

The GAAR Panel is comprised of highly distinguished professionals who are knowledgeable and experienced in tax matters. They are appointed by HMRC - although they are entirely independent of HMRC.

Their task gives rise to highly complex issues so HMRC and the GAAR Panel have published detailed Guidance Notes (174 pages) to assist taxpayers in understanding how the GAAR Panel will approach its work.

Leaving aside the fact that members of the GAAR Panel are appointed by HMRC (a fact which certainly concerns some people), anybody who is in a dispute with HMRC will be less than entirely comfortable to find that consideration of issues by the GAAR Panel does not take place in open court where the parties are represented; it is all done behind closed doors. And they will be alarmed to find that if any matter comes to be determined by a court or tribunal they "**must** take into account HMRC's guidance".

The GAAR Panel is not a Court of course and the Panel members are not judges – but if they agree with the views of HMRC the taxpayer can face some pretty serious consequences. There is more than a danger that this can be used as a weapon against the taxpayer. HMRC are able to notify the taxpayer that he has the opportunity to "correct" his tax position, otherwise his arrangements will be referred to the GAAR Panel. If the GAAR Panel agrees with HMRC then the taxpayer can be liable to a penalty of 60% of the tax involved.

It should be remembered that these are circumstances where the taxpayer has conducted himself entirely in accordance with the law. No question. Otherwise the dispute would have gone to a real court. The issue is that HMRC don’t agree with the law and they want their view of what the law should be to apply instead. So when they say the taxpayer has the opportunity to “correct” his tax position, they mean just the opposite. They are encouraging the taxpayer to disregard the correct position and to do what HMRC tells him – or else.

The taxpayer is obliged to obey the law and he is entitled to be protected by the law if he abides by it. Well, that is the idea, but this is where it all goes wrong. HMRC acknowledges the law but says that Parliament got it wrong because they should have enacted a different law – so HMRC will ignore the law and apply their own version. They justify this position by saying that Parliament intended something else, or did not anticipate these circumstances. And of course it is HMRC and the GAAR Panel who decide what Parliament intended or anticipated. Which, without putting too fine a point on it, means that they decide what the law is - whatever Parliament may have said. Everybody happy with that?

We have waged wars (and in more modern times done other things) to protect or uphold the sovereignty of Parliament as our Legislature. I wonder what Parliament thinks when a department of state decides that they do not like the law of the land and impose on the citizens another set of rules which they prefer. (One almost expects a visitation from Montesquieu, who must be doing his nut).

We are all equal under the law (so it is claimed) so why cannot the citizen do the same and ignore the laws he does not like and substitute his own. Obviously that would be completely ridiculous. Why is it less ridiculous if HMRC or the GAAR Panel do so?

When the tax authority seeks to recover tax from somebody by applying their own view of what they think the law ought to be (while acknowledging that the law actually does not permit it), they take on the role of legislator which is surely a constitutional affront.

I seem to remember an important passage in the Bill of Rights 1689 that dispensing with laws without the consent of Parliament was specifically outlawed. It was the dispensing of laws by the Crown which led to a bit of domestic strife around that time, and this laid the foundation for the absolute sovereignty of Parliament.

And when we think of a tax dispute, and the suggestion that the court or tribunal MUST "take into account HMRC's guidance" that is to say the view of one of the parties, this sovereignty and indeed the Rule of Law is getting seriously stretched.

There is even a legal maxim (in Latin of course just to show that it is of long standing, and carries serious authority) ***Nemo judex in causa sua*** - "no one should be a judge in their own cause". It is said to be one of the cardinal rules of natural justice. (I wonder where that has gone).

It is right of course that when the decision of the GAAR is published, the taxpayer can ignore it and pursue his legal remedies. But that is too disingenuous. There would be no purpose in the GAAR if it had no effect on the position of the taxpayer. He ignores it at the risk of an eye-watering penalty. The decisions of the GAAR Panel are clearly influential and it could be argued that they interfere with the proper legal process.

It should not be thought that these comments are some kind of defence of egregious or abusive tax schemes. They certainly are not. They are merely a plea in support of the Rule of Law and for the protection of the taxpayer. HMRC already has awesome powers to strike down egregious tax schemes – and they are always keen to tell us that the vast majority of them fail anyway.

(In my view, it would be greatly preferable, and more effective, for HMRC to get that message across much more clearly, without spin and in an authoritative manner. Nobody (or virtually nobody) in their right mind will pay huge fees and risk years of litigation (at goodness knows what cost in time and money) in egregious tax planning if they really believed that they had an 80% chance of losing. However that is a debate for another day and another place).

There is a conundrum here which could usefully be given some wider consideration. The argument of HMRC is that where the taxpayer's fiscal arrangements are contrary to the intention of Parliament they should be struck down. However, if the taxpayer's arrangements really are contrary to the intention of Parliament, the courts will decide against the taxpayer and his arrangements will fail anyway. On the other hand, if the taxpayer's arrangements succeed, it is because they are *not* contrary to the intention of Parliament, and HMRC are wrong in claiming otherwise.

It is the same point. HMRC are very reluctant to accept that Parliament, the courts and the taxpayer, are right. And the GAAR Panel has expressed itself able to reject the approach of the Courts and the law when deciding whether a taxpayer is liable to tax.

For all these reasons, it may be thought to be high time that somebody progresses their arguments to the Courts despite an adverse finding by the GAAR Panel. They might still lose, but at least they would have had the opportunity for an open hearing in accordance with the law and with full representation and argument. It might also enable some judicial control to be exercised to mitigate the repressive nature of the GAAR. The courts are good at identifying unfairness – even in apparently clear legislation – and finding a way to prevent injustice.

It might be argued that by enacting the Finance Act 2013, Parliament effectively said to HMRC that they had a sort of medieval power to do whatever they liked to collect tax –

and that this took priority over all other rights that the citizen may have under the law. So what is the problem? HMRC is just following the will of Parliament. Maybe we should give the Courts the chance to apply a purposive interpretation here.

It is to be hoped that before too long some brave taxpayer gives them the opportunity.

FCTC Comments

The application of the GAAR is potentially so wide that taxpayers and tax practitioners ignore it at their peril. It is important to confirm and not assume that it does not apply. Already this year, one member has considered the GAAR in connection with a liquidation and another member in connection with the creation of a leasehold interest. It is critical that the tests are correctly understood and applied.

THE ART OF SECURING BUSINESS PROPERTY RELIEF: "APPLYING A NOT ALTOGETHER PRECISE STANDARD TO FEATURES OF VARYING IMPORTANCE"

Katherine Bullock

Business Property Relief sits under Miscellaneous Reliefs in Part V of the Inheritance Tax Act 1984. It is an innocuous setting for perhaps one of the most generous reliefs within the Inheritance Tax code. It is a relief that taxpayers are keen to retain – note the number of transfers into trust for this purpose; to obtain – note the number of cases on land transactions alone seeking to qualify for relief; and to maximise – note the impact that it can have on the amount of an estate subject to the nil rate band under IHTA 1984 section 39A as just one example.

The Basics

The relief applies to settlements and to individuals; lifetime and death transfers; foreign and UK businesses. There is no cap. It does not have to be claimed and, even better, HMRC will provide non-statutory clearance where the law or HRMC practice is materially uncertain and the transaction commercially significant. This can be hugely helpful both in terms of a lifetime transfer and in determining the most appropriate course of action on death or a subsequent transfer.

100% relief is available where property consists of a business or an interest in a business; unquoted securities in a company which the transferor controls; or unquoted shares[1]. 50% relief is available where land, buildings, machinery or plant are owned by the transferor but used in a company the transferor controls or a partnership in which he is a partner or held in an interest in possession trust for the transferor and used in his business.

Unquoted here means all shares and securities that are not listed on a recognised stock exchange. Alternative Investment Market (AIM) listed shares are unquoted for these purposes[2]. This alone creates a number of considerations for the practitioner: firstly, if a client holds AIM listed stock, the opportunity to claim BPR and to maximise it should be recognised; secondly if a client is exposed to IHT, investment in AIM listed shares may offer a shelter

[1] IHTA 1984 ss.105(1)(a),(b),(bb)
[2] IHTA 1984 s.105(1ZA)

from IHT after a two year period; and where an investment on AIM has been made, steps must be taken to confirm that the company meets the other conditions for relief.

The wholly or mainly test

The legislation does not require the business or the company to trade. Instead, there must be a business, profession or vocation carried on for gain[3]. Accordingly, a business that consistently makes a loss may not qualify[4]. No further guidance is offered by the legislation. Business clearly has a wider meaning than trade[5] but despite the considerable volume of case law on the meaning of an investment business, there is little guidance on what constitutes a business for IHT purposes.

Perhaps this is because the test applied by the legislation is a negative one. A business is not a relevant business if it consists wholly or mainly of:

i. Dealing in securities, stocks or shares
ii. Dealing in land or buildings

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[3] IHTA 1984 s.103(3)
[4] See also Grimwood-Taylor v IRC[4] [2000] STC (SCD) 39
[5] IT Commrs v Hanover Agencies Ltd [1967] 1 All ER 954

iii. Making or holding investments[6].

The first requirement is therefore that any business wholly or mainly consists of none of the above. Wholly or mainly for these purposes mean more than 50%. But 50% of what? *Farmer v IRC*[7] held that in applying this test it is necessary to consider the business in the round, including the capital employed, time spent by employees, turnover and profit. Although the comments in *Revenue & Customs Commissioners v Brander* (the Balfour case)[8] should be noted, in particular that whilst these are useful indications, it is ultimately a matter of general impression as to where the preponderance of activity lies.

This is an all or nothing test. Fail and none of the business will qualify BPR. Pass and there may be no IHT liability at all. The position is determined at the point of transfer and therefore must be closely monitored where the constitution of a business is borderline. Deciding whether to operate a single composite business or two separate businesses can significantly impact the ultimate IHT liability.

[6] IHTA 1984 s.105(3)
[7] [1999] STC (SCD) 639
[8] [2010] UKFTT 300 (TC)

Should the taxpayer separate his investment activity from his trading activity to guarantee 100% BPR on the trading element or should he retain a composite business which might qualify for 100% relief on the whole? Whilst the relief is generous, it is also complex with availability turning on how exactly a business or corporate group is structured.

Making or holding investments

So how best to determine on which side of the line a particular business falls? Not surprisingly there is copious case law on the meaning of the making or holding of investments. Businesses that share features of the three forbidden activities require careful and detailed consideration. What about money lending or financing businesses with significant cash on deposit to lend? What about insurance businesses that carry significant low risk investments to hedge the interests insured? What about businesses that are significantly dependant on or have a significant component of land – holiday homes, caravan parks, landed estates with composite businesses? Car parks? Self-storage? Bed and Breakfasts?

The facts in each case require careful and meticulous consideration. HMRC in their manuals recognise that often a property business may be a hybrid of development and the holding of let properties, where the outcome may depend on the application of the wholly and mainly test. Whilst there is a temptation to attempt to recreate situations where the taxpayer has been successful, such an approach needs careful consideration. In *Phillips v HMRC*[9] a lending company providing unsecured loans to other family investment companies repayable on demand was held not to be carrying on an investment business. Whilst it might be argued that a money lending business correctly structured and operated need not be an investment business and comments in the decision support that view, the factual position in the case itself is not necessarily one to emulate.

This high degree of sensitivity to the facts is both the blessing and the curse of this relief. It means that deriving meaningful guidance from the case law is like panning for gold. In my experience, investment in careful and thorough due diligence before rather than after a transfer pays dividends. Cosmetic

9 [2006] STC (SCD) 639

changes before or wishful reinterpretation after the event are unlikely to succeed. In William Gill (deceased) v HMRC[10] a claim for relief was allowed on the basis that the business considered in the round was a working farm, despite its apparent small size, lack of livestock, limited grazing and limited activity. A notable feature of the decision is the level of detail that witnesses were able to provide and the credibility of those witnesses.

Whilst the holding of let property may in specific circumstances constitute a business, the extent and regularity of the services required to ensure that this is not an investment business are extremely high and active management is crucial (contrast the services provided in Graham (deceased) v HMRC[11] with those in Cox v HMRC[12]). The owning and holding of land to obtain an income is generally investment activity (RCC v Lockyer (Pawson's Executors)[13]. The Court of Appeal set out some guiding principles in HMRC v George & Another (Executors of Steadman deceased)[14]. The business must be considered in the

[10] [2001] TC 7425
[11] [2018] UKFTT 0306
[12] [2020] UKFTT 442
[13] [2013] UK UT 050
[14] [2004] STC 163

round; services are not investment activity because they are provided in relation to an investment property; and the inclusion of services within the rent does not make a service automatically investment activity. In Estate of Maureen V Vigne v HMRC[15], a rare success for the taxpayer, the Upper Tier Tribunal commented that the test (quoting Lord Hoffman) "*involves the application of a not altogether precise legal standard to a combination of features of varying importance*".

Corporate Groups

A company whose business consists wholly or mainly in being the holding company of a trading group is not carrying on an investment business. Further HMRC accept that these provisions extend to an intermediate holding company[16]. Groups therefore require particular care. A group for these purposes is a company and all its subsidiaries within the meaning of section 1159 and Sch. 6 of the Companies Act 2006.

Having determined that shares in the holding company qualify, the value of any subsidiaries that

[15] [2018] UKFTT 632
[16] IHTM25263

do not themselves meet the wholly or mainly test or whose business does not consist wholly or mainly in holding land or buildings mainly occupied by members of the group must be excluded. Accordingly, careful management of the position and the quantum of investments within a corporate group can significantly affect the BPR available. Remember though that a partnership is not transparent for IHT purposes and thus can radically affect the BPR position for shares held through a partnership structure.

Valuation

The value of a business is the value of the assets used in the business less the liabilities incurred for the purposes of the business, however secured[17]. Non-business borrowings secured on business property will also reduce the value of business property[18] and the relief available. Where a liability is incurred on or after 6 April 2013 to acquire, maintain or enhance the value of relevant business property, the loan is deducted from the relevant business property,

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[17] IHTA 1984 s.110; there is considerable case law, see Hardcastle v IRC [2000] STC (SCD) 532; IRC v Mallender [2001] STC 514

[18] s.162(4) IHTA 1984; IHTA 1984 s.162B

regardless of the property against which it is or may be secured.

Excepted assets

Having met the wholly or mainly test, the legislation then restricts that relief by leaving out of account the value that is attributed to any excepted assets. An excepted asset is one that was not used wholly or mainly for the purposes of the business concerned throughout the two years immediately preceding the transfer or is not required at the time of the transfer for future use for those purposes[19].

The definition of an excepted asset therefore requires that the asset is not used for the purposes of the business as opposed to the relevant trading activity. Where therefore a company carries on a composite trading and investment business, assets used for investment are not excluded. A company may carry on a composite business comprising wholly or mainly a trade, say 51%, and a property investment business, say 49%. The let properties will not be excepted assets provided that they have been owned for the requisite time, although care should be given to the

[19] IHTA 1984 s.112(1)

structure of the mixed business to ensure that it does form a composite business for these purposes and in particular the roles undertaken by management. For this reason, it may be better to hold an investment business within the main trading company rather than in a separate company or in the shareholders' own hands.

An asset is not deemed to be used wholly or mainly for the purposes of the business at any time when it is used wholly or mainly for the personal benefit of the transferor or a connected person[20]. It is important therefore to watch out for holiday homes, art, yachts and (on one memorable occasion) racing camels that may find their way onto the balance sheets of family businesses.

An asset that traditionally has consumed a great deal of thought in this regard is "surplus cash". Careful enquiry may determine that the cash is in fact a trading asset, perhaps there are seasonal variations or an identified future trading purpose for which it is required. An "excess buffer" held to weather unforeseen economic downturns (perhaps, a global pandemic) is unlikely to be viewed by HMRC as

[20] IHTA 1984 s.112(6); see also IHTM 25354

sufficiently specific. It is important that a contemporaneous minute evidences any such intention and makes commercial sense[21]. Cash held on long term deposit that may be required for a short term acquisition raises an eyebrow with HMRC. Cash that is genuinely surplus will be an investment, but if actively managed there may be grounds to argue that, contrary to HMRC's view, it is not necessarily an excepted asset.

The importance of timing

As with most things in life, timing is everything. For BPR the critical point is the point immediately before the transfer of value. The property must be owned by the transferor throughout the two year period immediately preceding the transfer[22]. However, whilst there must be a business, there is no requirement that the business was not wholly or mainly an investment business throughout that period[23].

Property that replaces other relevant business property is deemed to meet the ownership period,

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[21] IHTM 25352, IHTM 25342; see also Barclays Bank Trust Co Ltd b IRC [1998] STC (SCD) 532
[22] IHTA 1984 s.106
[23] IHTM 25303

where the replacement property and any property directly or indirectly replaced were owned by the transferor for periods that together comprise at least two years within the five years immediately before the transfer[24].

Where the transferor inherited the property, he is deemed to have owned it from the date of death. Where he inherited it from a spouse or civil partner, he is deemed to have owned it for any period during which his spouse or civil partner owned it[25]. There is a bear trap here. A spouse's period of ownership is only amalgamated on death. There is no such amalgamation on a lifetime transfer. There is also an opportunity in that business property inherited by a spouse can be gifted by the surviving spouse without waiting out the two year period.

Mind the gap!

There are two further rules that deserve a special mention. Where the business or shareholding transferred are subject to a binding contract for sale at the time of the transfer, it will not be relevant

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[24] IHTA 1984 s.107
[25] IHTA 1984 s.108

business property[26]. However, if the binding contract for sale is entered into immediately after the transfer, the relief will still apply. In Reynaud v IRC[27] a transfer into settlement occurred shortly after sale. An argument that the Ramsay principle applied was rejected on the basis that the sale was uncertain at the date of transfer and there were no inserted steps. It remains to be seen if the Courts would take the same view today.

Where the transferor dies within seven years of a lifetime transfer, the value of the chargeable transfer in the case of a PET or the additional tax charge in respect of a chargeable lifetime transfer is not reduced by the relief unless the original property was owned by the transferee throughout the period beginning with the transfer and ending with the transferor's death (or the transferee's death if earlier) and the property would have qualified as relevant business property if the transferee had transferred it immediately before the death[28].

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[26] IHTA 1984 s.113(a); cross options may however provide an elegant solution
[27] [1999] STC (SCD) 185
[28] IHTA 1984 ss.113A, 113B: these are particularly difficult sections to apply and to compute and often overlooked.

A way forward – risk and reward

Now more than ever with pressure on the Government to find revenues and tax policy, particularly around capital taxes, subject to increasing scrutiny and public debate, the ongoing availability of Business Property Relief, at least at its current level, is subject to doubt. Taxpayers will naturally look to secure and take advantage of the relief where it is available to them. For the tax practitioner, there is the dual challenge of navigating the provisions themselves to assess whether the relief is available and, having done so, to ensure that it is effectively used and maintained. Excavating the past is unlikely to yield hidden treasure. Ultimately the question is one of strategy: whether to avoid risk and secure relief or to seek reward and maximise the opportunity by combining activities. Advance planning is likely to be key with the possibility of HMRC clearance playing a valuable role.

FCTC Comments

One member of Chambers has successfully agreed in advance 100% BPR on a landed estate which held 48% investment properties relying on the *Balfour* case.

STAMP DUTY LAND TAX – LIVING WITH SECTION 75A

Dilpreet K. Dhanoa

"This is a question too difficult for a mathematician. It should be asked of a philosopher, when asked about completing his income tax form." So said, allegedly, Einstein, when asked about his income tax!

Some might argue that a similar position could be adopted in respect of the Stamp Duty Land Tax ('SDLT') when the taxpayer is trying to understand the anti-avoidance provisions in sections 75A-75C. This code seeks to serve as a general anti-avoidance rule for SDLT.

If the taxpayer manages to avoid ss75A-75C, HMRC can still apply the GAAR (FA 2013 s206(3)(f)). The provisions are so widely draft that they give HMRC virtually a discretion to apply the tax.

This article seeks to unpack some of the language in the ss 75A-75C code, and what pitfalls the taxpayer should be mindful of and where the few gaps in the legislation lie.

THE PROBLEM

Section 75A is widely drafted. The language is deliberately expansive and the traps it could set for the uninformed taxpayer were demonstrated most recently in the case of *Hannover Leasing*.[1] The case reinforced the position in the Supreme Court case of *Project Blue*[2] which caused taxpayers and their advisors to pause and seriously reflect on section 75A.

Suitably labelled 'Anti-avoidance', section 75A(1) sets out the cumulative elements of the circumstances in which the provision is engaged. Those elements are:

1. where the vendor (V) disposes of a *chargeable interest*, and the purchaser (P) acquires it or a chargeable interest deriving from it;

2. a number of transactions (including the disposal and acquisition) are involved in connection with the disposal and acquisition (*the scheme transactions*); and,

3. the sum of the amounts of SDLT payable in respect of the scheme transactions is <u>less</u> than the amount that would have been payable on a *notional land transaction*.

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[1] *Hannover Leasing Wachstumswerte Europa Beteiligungsgesellschaft MBH and Hannover Leasing Wachtumwerte Europa VI GmBH & Co. KG v Commissioners for Her Majesty's Revenue & Customs* [2019] UKFTT 262.
[2] *Project Blue Limited (Respondent) v Commissioners for Her Majesty's Revenue & Customs (Appellant)* [2018] UKSC 30.

The italicised terms are defined within the legislation. Importantly, for ‘scheme transactions’, the legislator has not provided an inclusive set of scenarios. Rather, the scenarios presented in section 75A(3) *“may include”* these – but the operative word ‘may’ clearly leaves room for more transactions to be considered as falling within the embrace of this provision. The types of transactions which may thus be caught by the legislation is open-ended.

Project Blue

Project Blue was essentially an arrangement in which a Qatari sovereign wealth fund, paid the Ministry of Defence £959m for a site in 2007, using Ijari finance (a Shari’ah compliant form of property purchasing finance) under a sub-selling and lease-back arrangement. The finance was obtained from a Qatari bank (Masraf al Rayan), which specialises in Islamic finance. Project Blue lodged a tax return in 2008, noting it was entitled to a ‘sub-sale relief’ (by virtue of section 45(3), Finance Act 2003) and so there was no liability to SDLT. In the same year, MAR also lodged a tax return claiming ‘alternative property finance relief (by virtue of section 71A, Finance Act 2003), and again stated there was no liability incurred to SDLT. HMRC sought to question the arrangement over a number of legal challenges, and in 2016 the Court of Appeal found in favour of the Qatari developers, and declaring that MAR was the actual purchaser and so HMRC should have pursued that entity for SDLT.

However, the Supreme Court stated that the Upper Tribunal was correct to have found Project Blue to be the vendor for the purposes of section 71A(2), and but for section 75A, the transactions would have relieved the sale to Project Blue, and exempted the onward sale to MAR from SDLT. Relying on *Mayes v HMRC*[3] to justify a departure from the purposive interpretation of the provision, the Supreme Court held that such interpretations were not always helpful in closing off *"lacunas in a statutory regime which enable tax avoidance"*.[4]

Hannover Leasing

The taxpayer (Hannover Co) wished to acquire a commercial property in England, and hold it in a German partnership (Hannover KG). The seller (Greycoat) held the property in a limited partnership of which a unit trust was the main partner. For commercial reasons, Hannover Co did not want to acquire the partnership, so over a few days the following transactions took place:

1. Greycoat sold the property to the unit trust and the partnership was removed.

[3] *Mayes v Revenue & Customs Commissioners* [2011] STC 1269.
[4] *Ibid.*, at [34].

2. Hannover Co then purchased the unit trust, wound it up and took the property.

3. Two months later, Hannover Co contributed the property to Hannover KG.

None of the above steps triggered the charge to SDLT. The Tribunal held that the steps fell within the embrace of 'scheme transactions', and they had been contractually or commercially *pre-ordained*. The Tribunal rejected Hannover's argument that 'scheme transactions' required a purposive interpretation. Instead, it concluded that the purpose of section 75A was to counter *any* arrangement that results in an SDLT saving to which section 75A can apply, irrespective of whether such a tax saving might otherwise be deemed tax avoidance.

Comments

The wording is clear, and both the Supreme Court and First-Tier Tribunal noted that section 75A has been widely drafted and is intended to catch a range of avoidance schemes. The problem lies in the Supreme Court's interpretation that stretches the even broad definition yet further, that section 75A is also engaged to *"prevent unintended tax losses by the use within a series of transactions of a combination of reliefs and exemption."*[5] The First-Tier Tribunal then applied a very mechanistic

[5] *Project Blue* [n 2], at [69]; *Hannover Leasing* [n 1], at [101].

approach with respect to the application of section 75A, noting that the order of the steps to be taken had to be carefully considered. For those taxpayers who have no intention to avoid tax, but may engage in a series of transactions over a period of time which could engage section 75A this is problematic. It deviates from applying the test purposively and instead casts a broad brush over what could be a 'scheme transaction' with little discernment as to whether this should properly be within the embrace of section 75A. Furthermore, it creates an additional issue: the First-Tier Tribunal stated that if the order of the steps had been different then the SDLT outcome may also have been different. This lends support to arrangements where the incentive is to avoid tax, and for such arrangements to be even more carefully thought through.

The clear absence of a need to establish a tax avoidance motive is seriously problematic.

The *Hannover Leasing* case and the literal approach taken by the First-Tier Tribunal, is at odds with the purposive test to be applied to section 75A. The Court's rationale was that, as the provision does not include words like 'avoidance' and 'mitigation', so introducing a tax avoidance motive test was not helpful – only the strict language should be looked at. This followed on from *Project Blue*.

The Courts in both *Project Blue* and *Hannover Leasing* concluded that HMRC cannot narrow the breadth of the provision, and neither does it have discretion in the application of the provision. The Supreme Court made the apt observation:

> "The heading of the section, "Anti-avoidance"...is relevant to assist an understanding as to the mischief which the provision addresses, but it <u>says nothing as to the motives of the parties</u> to the scheme transactions. There is <u>nothing in the body of the section which expressly or inferentially refers to motivation</u>. The provision was enacted to counter tax avoidance which resulted from the use of a number of transactions to effect the disposal and acquisition of a chargeable interest. It is sufficient for the operation of the section that tax avoidance, in the sense of a reduced liability or no liability to SDLT, resulted from the series of transactions which the parties put in place, whatever their motive for transacting in that manner."[6] [Emphasis added]

[6] *Project Blue* [n 2], at [42].

What is clear from Lord Hodge's judgment is that the courts have little scope to go beyond the express drafting of the statute. Motivation is not a requirement of the provision.

Following the Supreme Court's decision in *Project Blue*, HMRC decided to revise its guidance and whilst there is not much analysis of the provision and the wording contained therein, it reflects that HMRC will interpret 'scheme transactions' widely. Unfortunately for the taxpayer, this might even be in circumstances where there is no tax avoidance in the ordinary sense. HMRC's interpretation of section 75A is very wide. They have a very powerful instrument which has been tested and not found wanting in the courts.

THE SALE OF SHARES RELIEF

There is a key exclusion from the broad drafting of section 75A, and this would have typically protected the taxpayer when buying the SPV, as opposed to the business. Section 75C(1) clearly states in no uncertain terms:

> "A <u>transfer of shares or securities</u> shall be <u>ignored</u> for the purposes of section 75A if but for this subsection it would be the first of a series of scheme transactions." [Emphasis added]

This relief can be made use of in suitable cases. The share sale consideration cannot be added in as part of the land acquisition consideration in appropriate cases.

IS THERE A WEAKNESS IN S75A ?

It is felt that *time* is the one weakness in s75A. The offending steps must be "involved in connection with" the relevant disposal and acquisition. If transactions are not part of a plan they may not satisfy that requirement. HMRC seem to acknowledge this in their statement on de-enveloping (*Stamp Duty Land Tax on de-enveloping transactions)*. If a taxpayer capitalised a company to pay off a bank loan with the company then being liquidated SDLT on the amount of the bank loan is still payable (although the loan will have been discharged at the time of the liquidation) because of s75A. However, if liquidation was not planned at the time when the loan was discharged the SDLT charge is avoided. HMRC put it this way:

> "There will be cases where discharging the debt has not occurred as part of the arrangements for the transfer of the property from the company to the shareholders. Equally, there will be cases where the discharge of the debt was one of a number of

> transactions involved in connection with the disposal and acquisition of the property."[7]

So, back to Einstein the expert on time – he really had the solution!

FCTC Comments

Two members of Chambers have considered the application of s75A to the repayment of a loan in advance of a possible liquidation of a property holding company. In both cases, understanding the wider commercial necessities were critical to determining the likely application of the code.

[7] HMRC's SDLT Manual, SDLTM04042.