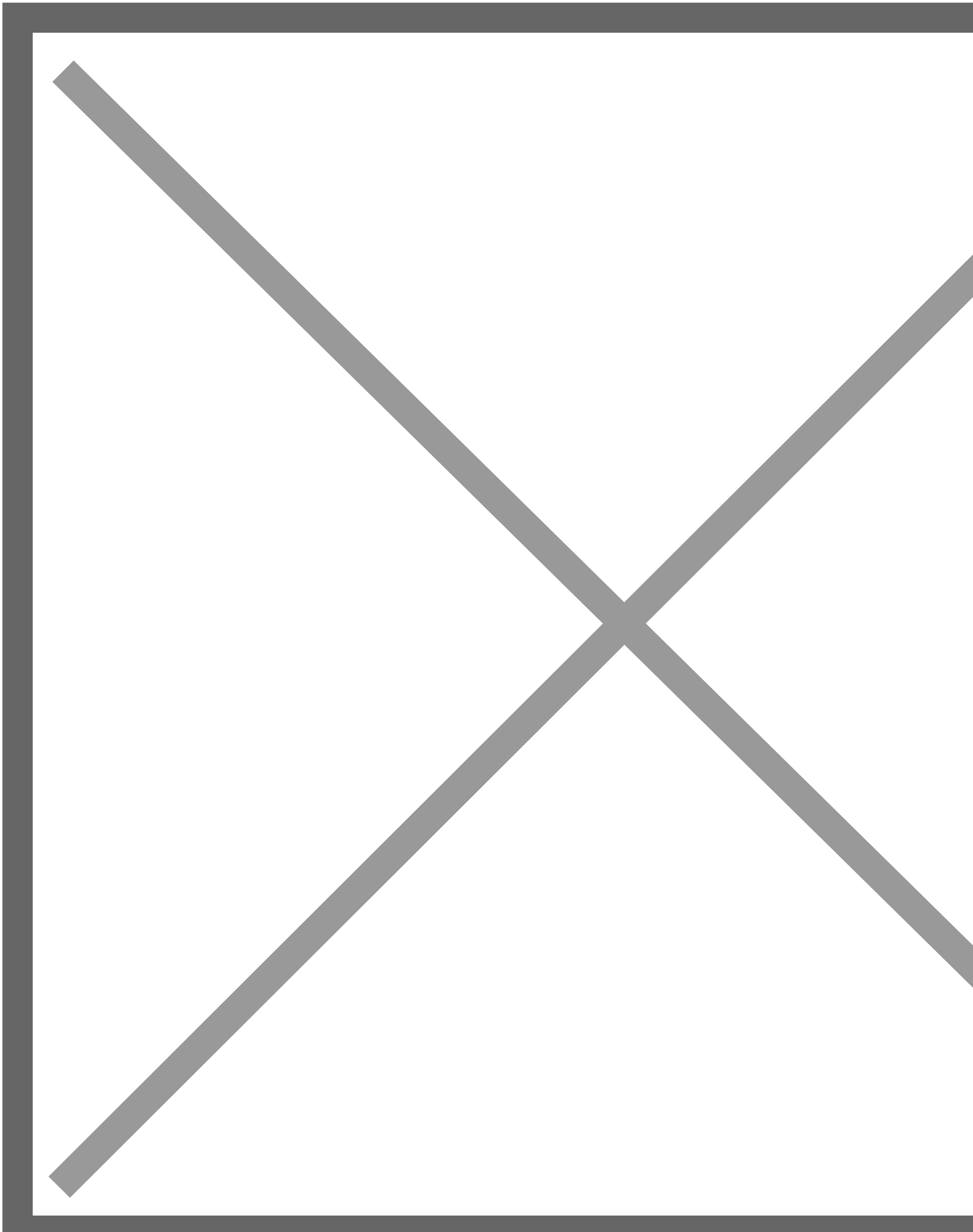
# Terms of procurement

Personal tax



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Keith Gordon looks at a case which considers the scope of the transfer of assets abroad legislation

## Key Points

**What is the issue?**

The transfer of assets abroad (TAA) rules impose a charge in circumstances where an asset has been transferred and, as a result of the transfer, income has become payable to a person abroad.

**What does it mean for me?**

The Rialas case considers the question of to what extent is it necessary for the individual who might be liable to income tax
under the rules to be involved in the prerequisite transfer of assets.

**What can I take away?**

The Rialas decision represents a welcome endorsement of a more limited scope of the TAA rules, contrary to the position currently being pursued by HMRC. However, we must await the Court of Appeal's consideration next year.

The transfer of assets abroad (TAA) legislation is one of those long-established anti-avoidance provisions that should never be overlooked. However, as it comes up quite rarely in practice, it is easy for advisers to lose sight of the rules.

There are currently three strands to the TAA legislation:

- charging income accruing to persons abroad;
- charging the receipt of capital sums; and
- bringing benefits received from persons abroad into the charge to tax.

This article focuses on the first of those provisions, which lay at the centre of the recent case of HMRC v Rialas [2020] UKUT 367 (TCC).

This provision can be best explained by reference to an example of the mischief which the rules were designed to frustrate, although it must be emphasised that this is only an example and other scenarios fall squarely within the rules. The example is of a UK resident taxpayer who owns an income-generating asset. The UK resident is not in need of the income being generated and tries to take steps to avoid paying tax on this income.

A simple strategy (blocked by the TAA rules) would be to transfer the asset to an offshore entity (say, a company), allowing the income to accrue overseas.

Such a strategy is rendered ineffective by the TAA rules. These will impose a charge on the income paid to a non-resident in circumstances where an asset has been transferred and, as a result of the transfer (and/or one or more associated operations), income has become payable to a person abroad. Where the legislation applies, the income actually arising to the person abroad is treated as accruing to a person who has ‘power to enjoy’ (as defined) that income. In the above example, being a shareholder in the overseas company can satisfy the ‘power to enjoy’ test and therefore potentially bring the income of the person abroad back into the charge to UK tax.

The Rialas case considers the question of to what extent is it necessary for the individual who might be liable to income tax under the rules to be involved in the prerequisite transfer of assets.

**The facts of the case**

At the relevant times, Mr Rialas was both resident and ordinarily resident in the UK. He was domiciled outside the UK.

Mr Rialas was the 50% shareholder in a company, Argo, that carried on business as a fund manager. The other 50% was owned by a Mr Cressman.

Mr Rialas and Mr Cressman were minded to sell Argo’s business to a third-party purchaser. To reflect the purchaser’s preferences, Mr Cressman agreed first to sell his shares in Argo to Mr Rialas, who would then effect a share-for-share transaction with the purchaser. This was in the end structured by Mr Rialas establishing a non-resident company, Farkland, which would be wholly owned by a Rialas family trust. Farkland would then purchase Mr Cressman’s shares in Argo, together with those owned by Mr Rialas directly.

Mr Rialas was actively involved in the establishment of Farkland and, for example, in ensuring that Farkland was able to obtain funds to finance the purchase of Mr Cressman’s shares.

Prior to the third party’s purchase of the shares in Argo, Argo declared and paid an interim dividend, half of which went to Mr Rialas, with the other half being paid to Farkland (i.e. in accordance with the shareholdings at that date).

There was no dispute about Mr Rialas being liable to tax on the dividend income paid to him directly. However, HMRC took the view that Mr Rialas was also liable to tax on the dividend as paid to Farkland, such liability arising as a result of the Transfer of Assets Abroad legislation.

On Mr Rialas’s appeal to the First-tier Tribunal, the First-tier Tribunal concluded that Mr Rialas had not effected a relevant transfer of assets and was therefore not liable to tax under the rules. In other words, whilst there was undoubtedly a transfer of assets abroad (the sale of the Argo shares to Farkland), that transfer did not bring Mr Rialas within the scope of the rules. HMRC appealed against this decision to the Upper Tribunal.

> The TAA rules will impose a charge on the income paid to a non-resident where an asset has been transferred and, as a result, income has become payable to a person abroad.

**The Upper Tribunal’s decision**

The case came before Mr Justice Meade and Judge Jonathan Richards.

HMRC put forward two arguments to support its position. First, although it acknowledged that it was Mr Cressman who was the immediate transferor of his Argo shares to Farkland, HMRC took the view that Mr Rialas’s activities behind the scene meant that he was sufficiently involved in the process to be caught under the rules. HMRC’s alternative argument was that the relevant transfer abroad was Mr Rialas’s payment of the 10 Cypriot pounds (C£) used to establish the trust in the first place. HMRC argued that the subsequent incorporation of Farkland and its purchase of the Argo shares amounted to associated operations so as to bring Mr Rialas within the scope of the TAA rules.

The Upper Tribunal's analysis considered the main cases that have looked at these rules; in particular, the respective decisions of the House of Lords in Congreve v IRC (1948) 30 TC 163 and Vestey v IRC (1979) 54 TC 503. It was common ground that Vestey had partly reversed the effect of the Congreve case. The net effect of the two decisions is that the rules require the taxpayer to have been either:

1. the actual transferor; or
2. a person who procures the transfer abroad.

What amounts to 'procuring' for these purposes has been considered in subsequent cases, notably IRC v Pratt [1982] STC 756 and, most recently, Fisher v HMRC [2020] UKUT 62 (TCC). In Pratt, Walton J emphasised that procuring amounted to more than merely having a hand in, or being associated with, the transfer. In Fisher, the Upper Tribunal even queried the appropriateness of the term 'procure', given that it is not actually part of the statutory test. Ultimately, the Upper Tribunal (in Fisher) emphasised the importance of there being:

'some proper basis for ascribing the acts of the person transferring the assets to the individual concerned and treating him as being responsible for the transfer as if he had carried it out himself.'

Indeed, as the Upper Tribunal continued in Fisher:

'If the individual has no influence over what the actual transferor does with the assets, there is no good reason why he should be treated as the "real" transferor.'

In other words, merely playing some part in the transfer is not sufficient.

The Upper Tribunal in the present case recognised that the precise boundary remains unclear because of uncertainties as to the extent to which Vestey overruled Congreve. Nevertheless, it was content with the approach adopted in both Pratt and Fisher. This was particularly important because HMRC argued that Mr Rialas was the only serious contender for the purchase of Mr Cressman's shares and therefore he must have been, for want of a better word, the person procuring the transfer. However, the Upper Tribunal noted a finding of fact from the First-tier Tribunal's decision which made clear that 'Mr Rialas had no control over whether Mr Cressman sold his shares'; and similarly decided that the First-tier Tribunal's findings did not support the suggestion that 'Mr Rialas was so responsible for Mr Cressman's transfer of shares so that he should be treated as if he had carried it out himself'. As a result, the Upper Tribunal rejected HMRC's first line of argument.

The Upper Tribunal rejected HMRC's second line of argument as well. The Upper Tribunal recognised that the establishment of the trust and the settlement of C£10 were necessary preconditions for Mr Cressman's sale of his shares to Farkland. However, as the Upper Tribunal succinctly noted, 'the establishment of the … Trust, and the acquisition of the subscriber shares in Farkland, did not themselves enable Farkland to receive dividends on the Argo shares'. What enabled income to become payable to a person abroad (Farkland) was Mr Cressman's decision to sell his shares to Farkland and Farkland agreeing to pay for them.

HMRC had sought to argue that Farkland's borrowing of funds, which enabled it to finance the purchase of the Argo shares, amounted to an associated operation. However, the Upper Tribunal noted that the associated operation has to be 'in relation to' the transfer of assets abroad and concluded that there was insufficient connection between the settlement of the C£10 and Farkland obtaining loan finance.

**Commentary**

The UK tax code does not generally tax individuals on income received by other persons. There are, of course, exceptions to this but, when these exceptions arise, the legislation makes it clear that this is the effect of the rules and also makes clear the scope of any such deeming. The TAA code, in contrast, does not. It is my view that the Upper Tribunal has clearly reached the correct conclusion in this case, as well as coming to a decision which accords with common sense.

As a result, one could then wonder why HMRC has started pursuing these cases in situations where a charge under the TAA rules would be a rather unfortunate outcome for the taxpayers involved. The difficulty for HMRC, however, is that common sense is not usually the best way of interpreting the scope of a taxing provision and, in the case of the TAA legislation, there are genuine question marks over the precise scope of the charge.

Indeed, the Congreve case held that the person liable to tax under the TAA rules did not need to be the transferor in any sense, whereas the Vestey case decided that Congreve had gone too far and the extension to non-transferors was far more limited. However, the precise scope of the Vestey decision is itself uncertain and the scope of the TAA rules would probably merit the consideration of the Supreme Court in due course.
The Upper Tribunal was also conscious that the Fisher case is itself proceeding to the Court of Appeal next year and that there is merit in ensuring that the Fisher and Rialas cases are co-ordinated with the potential of both cases being heard together. In addition, and because it dismissed HMRC's appeal, the Upper Tribunal did not need to address the EU law arguments that also arise in both cases.

**What to do next**

If one has a live TAA dispute, the Rialas decision represents a welcome endorsement of a more limited (and in my view more sensible) scope of the TAA rules, contrary to the position currently being pursued by HMRC.

However, it must be recalled that the uncertainties are not fully resolved and, for that, one will need to await the Court of Appeal's consideration next year and possibly the Supreme Court's musings in about 2024.