Transfer of assets abroad: the boundaries of the rules

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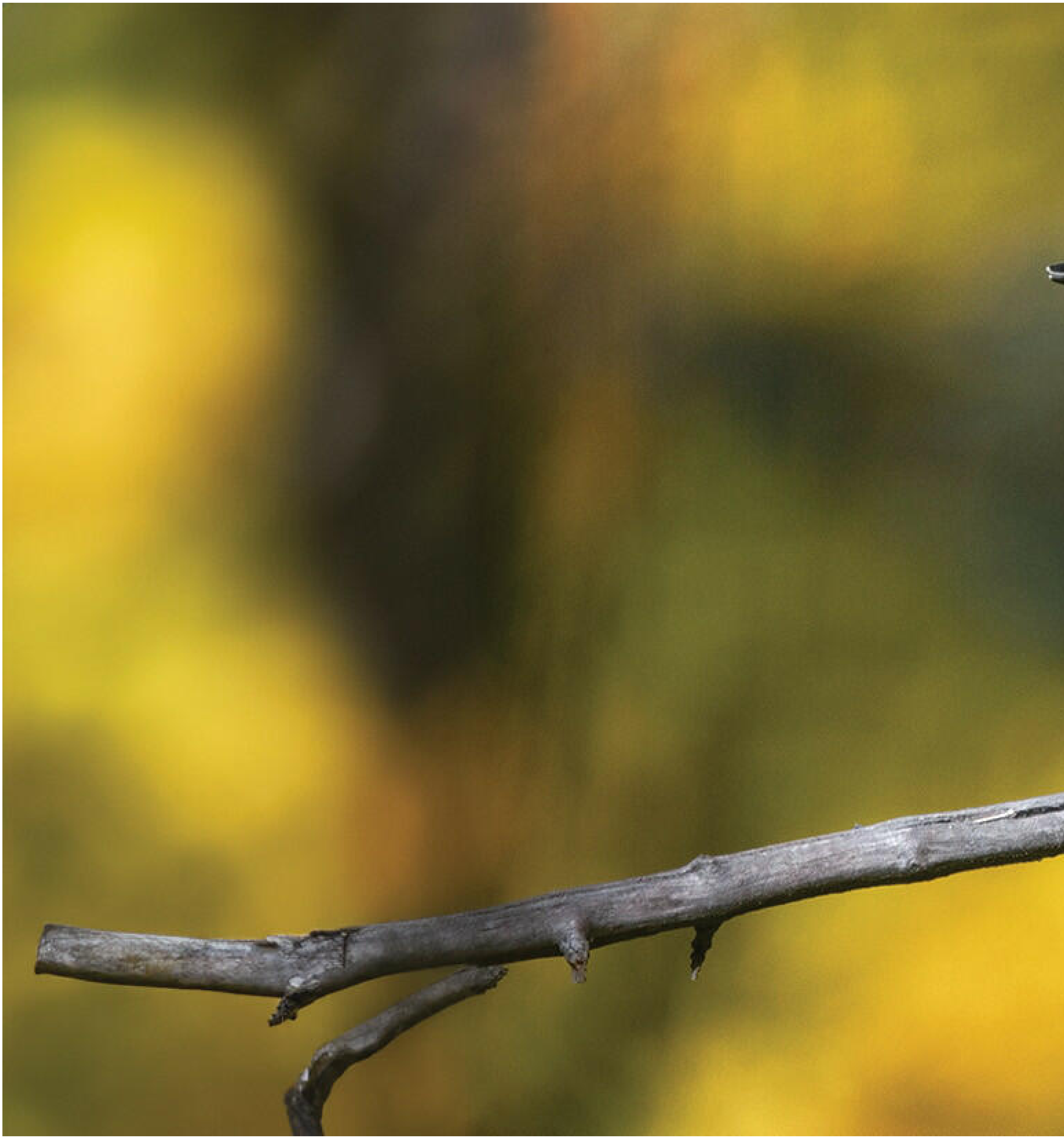

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We examine how the Supreme Court approached the transfer of assets abroad legislation to define the boundaries of the rules.

Key Points

What is the issue?

In *Fisher v HMRC,* the business of a UK trading company was transferred to a Gibraltarian company. As the Fishers had 'power to enjoy' the profits, HMRC assessed them on the overseas company's income on the basis that the Fishers (as major shareholders) had, for all practical purposes, effected the transfer of assets abroad.

What does it mean to me?

The transfer of assets abroad rules, at their heart, ensure that any income deriving from the transferred assets can still be subject to UK tax, notwithstanding the fact that it is not directly enjoyed by a UK resident. Yet the rules continue to perplex those attempting to understand them.

What can I take away?

The court's emphatic judgment will remove one level of complexity to the transfer of assets abroad rules. However, the risk of legislation being rushed out means that any less aggressive company transfers might be best effected sooner rather than later.

The transfer of assets abroad legislation (variously abbreviated to ToAA and TAA) was first enacted in 1936. The essence of the rules is to ensure that an individual who is UK resident cannot avoid UK tax simply by transferring assets to a person who is not UK resident. The rules, at their heart, ensure that any income deriving from the transferred assets can still be subject to UK tax, notwithstanding the fact that it is not directly enjoyed by a UK resident.

The latest case to be argued at the highest court on this legislation is *Fisher v HMRC* [2023] UKSC 44. As the Supreme Court noted in the first paragraph of its judgment, the rules have been amended over the decades yet 'have continued to perplex and concern generations of judges faced with the task of construing them'.

Under the core provision (now enacted as the Income Tax Act 2007 s 720), UK tax is payable if a UK resident individual has power to enjoy the income that has been diverted abroad. Section 727 provides a corresponding charge to income tax where individuals receive a capital sum; and s 731 taxes individuals (who escape charges under ss 720 and 727) who receive a benefit as a result of what the legislation calls relevant transactions.

Focusing on s 720 for the time being, it is clear that the tax charge can arise even if the individual being taxed has not received the income in question. The mere fact that the taxpayer has power to enjoy the income is enough to engage the charge. As noted by the Supreme Court, 'a taxpayer who falls within the provisions can be charged to tax on a substantial amount of income that they have not actually received and which bears no relation to the value of the assets initially transferred'.

Although the paradigm target of the legislation is not in doubt, the case law shows that the predecessor to the Supreme Court (the 'appellate committee' of the House of Lords) struggled to define the boundaries of the scope of the rules.

The facts of the case

In the case of is *Fisher v HMRC*, the taxpayers were three members of the Fisher family. Together (but not individually) they controlled a UK trading company whose business was transferred to a Gibraltarian company which, again, they controlled together but not individually. (Ironically, the purpose for the transfer was to prevent the UK business haemorrhaging due to the incidence of betting duty.)

The Gibraltarian company made profits from the transferred business and, as the Fishers had 'power to enjoy' that income, HMRC assessed them on the overseas company's income on the basis that the Fishers (as major shareholders) had, for all practical purposes, effected the transfer of assets abroad.

The questions addressed by the Supreme Court

The case concerned only what is now Income Tax Act 2007 s 720.

A wide range of issues were debated through the course of the litigation, including questions of EU law as one of the Fishers was an Irish national. However, just two such arguments featured in the Supreme Court's decision, as they were sufficient to dispose of the whole case. The questions that the Supreme Court considered were as follows:

1. Does the individual who is taxed under s 720 have to be the transferor of the assets?
2. Did the Fishers transfer the assets?

The first question had been the subject of ambiguous (if not conflicting) decisions in two previous cases that had been argued before the House of Lords:

- In *Congreve v Inland Revenue Commissioners* (1946–1948) 30 TC 163, the House of Lords decided that the individual being taxed did not have to be the transferor.
- In *Vestey v Inland Revenue Commissioners (Nos. 1 and 2)* [1980] AC 1148), however, it was suggested that the person to be taxed had to be either the transferor or at least the quasi-transferor of the assets.

If the s 720 charge applied both to transferors and non-transferors, then it would not have mattered who actually transferred the assets. However, if the s 720 charge is limited to transferors (actual or quasi), then the Supreme Court would be required to move on to the second question; i.e. whether, in the circumstances, it could be said that the transfer was effected by the Fishers. This then puts into sharp focus the non-statutory concept of a quasi-transferor, also described in the case law as an individual who 'procured' the transfer.

The Supreme Court's decision

The single judgment was given by Lady Rose, with whom Lords Reed, Hodge, Sales and Stephens agreed.

Is the charge limited to transferors?

In respect of the first question, the Supreme Court noted in particular the provision now found in s 714(4) which, for the purposes of the transfer of assets abroad rules, extends the meaning of individual to an individual's spouse or civil partner. The court considered that this provision expressly extended the charge to non-transferors in a limited way and would not have been required if income could be assessed on non-transferors more generally.

In its submissions, HMRC addressed what the House of Lords had said in *Vestey*. In *Vestey*, the House of Lords had expressed concern that giving the rules a wider scope would be ‘so dramatically unjust’ that they could not consider such a meaning to have been intended by Parliament.

However, HMRC pointed out that this wider scope was subsequently imposed by Parliament when it later enacted what is now s 731. HMRC’s argument was on the basis that Parliament clearly has no problem with what the House of Lords described as ‘dramatically unjust’ and therefore the reasoning in *Vestey* could no longer stand.

The Supreme Court, however, considered that Parliament was entitled to ‘fill the gap created by *Vestey*’ but noted that this was done by providing a third strand to the rules (s 731) rather than by modifying the principal strand in s 720. The Supreme Court therefore felt that the approach to s 720 adopted by the House of Lords in *Vestey* remained intact.

As a result, the court concluded that, but for any limited extensions (such as the extension to spouses and civil partners), the charge under s 720 is generally limited to transferors.

Did the Fishers transfer the assets?

The decision in relation to the first question meant that the Supreme Court had to consider whether the transfer legally effected by their company could be said to have been effected by the Fishers themselves. As the Supreme Court put it:

‘Is there any reason to construe section [720] as applying to the shareholders of a company on the basis that they are associated with or that they procure the transfer of assets by that company?’

The starting point of the court’s analysis was the distinction between majority and minority shareholdings. Assuming that there was no problem with imputing a company transfer onto a majority shareholder, there were undoubtedly questions as to how to circumscribe the circumstances in which a minority shareholder should also be treated as a transferor:

- Would every minority shareholder (for example, those thousands of shareholders of a major PLC) be treated as a transferor if they (through a proxy) had voted in favour of the transfer?
- Alternatively, how should an individual with 30% of a company’s shares be treated if that individual abstained from approving a transfer, knowing that the remaining shareholders would vote for the transfer?

HMRC had argued that this uncertainty was a virtue of the drafting – the legislation acted as a warning mechanism without requiring bright lines that would enable individuals to devise a way around the rules. The court was not content, however, to leave the legislation ‘in some unclear state just to scare people’.

However, the court then went further and noted that the transfer of assets abroad legislation was silent about attributing company actions to shareholders, unlike other areas within the tax code. As a result, it felt that even controlling shareholders should not be routinely treated as if they were transferors in relation to transfers by the company. HMRC argued that this would leave a gap in the legislation but the Supreme Court identified three reasons why this was not so:

1. There is the s 731 charge on non?transferors, so transfers by companies cannot be completely disregarded under the rules.

2. If an individual simply used a company as a device to effect a transfer of assets abroad, the court considered that the substance of the transaction would most likely be that of an individual transferring assets abroad.
3. If the government felt that this was still insufficient, they could always invite Parliament to fill the gap, albeit suggesting that careful thought should go into ensuring that it is achieved ‘in a fair, appropriate and workable manner’.

In summary, the Supreme Court identified no reasons for construing the legislation in a way that automatically treated company transferors as effected by shareholders ‘and plenty of reasons not to do so’. For these reasons, the court allowed the Fishers’ appeal and dismissed that of HMRC.

Commentary

Academics might regret that the opportunity was not taken to address the plethora of issues that had been argued in the course of the *Fisher* litigation, but which proved to be unnecessary to resolve in the light of how the court concluded the above two issues.

The court’s emphatic judgment will nevertheless remove one level of complexity to the transfer of assets abroad rules, although I would not go so far as to say that the difference will necessarily be noted in practice.

Will HMRC now suggest that company transferors are ‘devices’? (Indeed, the court did not rule out the concept of quasi-transferors still being caught by the transfer of assets abroad rules.) And there is always the risk of new legislation being introduced to put the code back to where HMRC says it previously believed it was.

If new legislation is to be introduced, it will be interesting to see whether Parliament comes up with something that is fair, appropriate and workable. It will be noted that the idea of keeping legislation uncertain to scare people was deprecated by the court as having ‘a flavour of [an] unconstitutional approach’.

What to do next

It would be foolhardy to rush into artificial transfers of assets abroad by limited companies simply by focusing on the fact that the Fishers were held not to have been transferors in relation to the transfer effected by their company. However, the risk of legislation being rushed out (perhaps with effect from Budget Day, which has recently announced as 6 March) means that any less aggressive company transfers might be best effected sooner rather than later.