The Offshore Tax Planning Review

DOUBLE TAXATION TREATIES AS A DEFENCE TO TAXES ACT 1988 SECTIONS 775-777

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The United Kingdom Taxes Act 1988 contains a small code of anti-avoidance provisions,[1]consisting of ss.775-777, aimed at certain schemes which convert taxable income into capital or non-taxable income. Section 775 is concerned with the situation where arrangements have been made to exploit the earning capacity of an individual in any profession or vocation and in consequence of the arrangement any "capital amount" is obtained by the individual for himself or for any other person. Section 776 was enacted to prevent the avoidance of tax by persons concerned with land or the development of land. It applies, inter alia, where land is acquired with the sole or main object of realising a gain from disposing of the land and any gain of a "capital nature" is obtained from the disposal of the land by the person acquiring the land, or by certain other persons. This provision too applies where any such person obtains the gain for himself or for any other person.

These provisions can often apply in an offshore context. Typically, arrangements are made so that a gain accrues to a non-UK resident person, such as a trust or company, which for one reason or another is not liable to UK income tax. Sometimes, the driving force behind the arrangements will be caught by some anti-avoidance provision. Perhaps he will be a beneficiary under the trust, in which case he may well be caught by the income tax settlement provisions contained in TA 1988 Part XV. Or he may own shares in the company, in which case he could well be caught by s.739 TA 1988 (transfers of assets abroad). Yet in many other cases he could not otherwise be caught.

In this article, I wish to consider the position where the gain is realised by an entity which is prima facie liable to UK income tax on the relevant gain but is a resident of a jurisdiction which has a double taxation treaty or double taxation arangement with the UK under the terms of which that gain is eligible for relief. Jersey, Guernsey and the Isle of Man all have such arrangements.

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1 First introduced by FA 1969.

Suppose, for example, that I set up a Jersey resident trust for my adult children under which I and any spouse of mine are excluded from benefit.

I am a dealer in land and sell for cash to the trustees at its current low market value development land forming part of my trading stock which the trustees buy with the sole or main objective of selling at a huge profit when the economy recovers. In due course their expectations are fulfilled and the Revenue assess me to tax on their gain under s.776. The trustees are clearly trading in the land.[2] Suppose further that while they are trading in the UK, they do not have a permanent establishment in the UK.

Now the trustees are prima facie assessable under Schedule D Case I. Equally clearly, they are entitled to claim relief by virtue of Article 3(2) of the UK-Jersey Double Taxation Arrangement of 24th June 1952, which provides:

> "The industrial or commercial profits of a Jersey enterprise shall not be subject to United Kingdom tax unless the enterprise is engaged in trade or business in the United Kingdom through a permanent establishment situated therein."

In my view, it follows equally that *they* would be eligible to claim relief from any liability to tax under Schedule D Case VI in consequence of the operation of s.776. Article 3(2) gives relief by reference to the nature of the profit, not the Schedule and Case under which it falls to be charged.

It is a moot point whether *I myself* might not derive protection from the Arrangement as I am being assessed to tax on profits falling within Article 3(2) and the Article confers relief on profits of a certain description, rather than on a person of a certain description. Let us assume for present purposes, however, that I would not.

Let us instead assume that my only defence in this case is that the trustees have not derived a "gain of a capital nature" from their disposal of the land. Now "capital nature" falls to be construed in accordance with "capital amount", which is itself defined by s.777(13) to mean "any amount ... which ... does not fall to be included in any computation of income for purposes of the Tax Acts ...".

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2 Or, which amounts to the same thing for present purposes, conducting an adventure in the nature of trade.

The learned authors of *Whiteman on Income Tax* Third Edition state, at page 961:

"4 Where a non-resident person realises a profit which would be taxable as income in the United Kingdom but for the exempting [sic] provisions of a double tax treaty the profit would in the authors' view be a gain of a capital nature for the purposes of section 776. While this would not render liable to tax under the section the non-resident person protected by the treaty it might enable another person to be taxed under the section if that other person had provided the non-resident with the opportunity of making the gain."

Not surprisingly, the Inland Revenue rely on this statement. Yet, with respect, the learned authors do not appear to have appreciated the full subtlety of the argument to the contrary. The profits are not *exempted* from tax by virtue of the double taxation treaty. They remain taxable, but the non-United Kingdom resident is entitled to claim *relief* from tax.[3] Unless and until he does so, the profits are still taxable profits and fall to be computed. In the case where relief is given but at a lesser rate than 100%, the position is even clearer, as where, for example, a resident of one Contracting State is relieved from withholding tax on dividends in the other Contracting State beyond a certain percentage limit.

Hence, in the example taken, the sale monies do come into computation of income tax for the purposes of the Taxes Acts. The trustees are liable to tax under Schedule D Case I. The amount of their taxable income falls to be computed for the purposes of the Taxes Acts. While it is true that they are entitled to make a claim for relief from tax by virtue of s.788(3)(a) and (6) TA 1988, and that the relief will in the circumstances be 100% relief, the proceeds of sale still need to enter into the computation of what the taxable income is in order to determine the amount of the taxable income and of the relief, or, for that matter, the amount of tax payable if no claim for relief is made.

What, it might be asked, of *Yuill v Wilson*[4] Was not the appellant in that case held liable by the House of Lords on the grounds that he had transmitted the opportunity of making a gain to a Guernsey company? Was not the Guernsey company protected by the double taxation arrangement, and, if so, why was the point not argued? The short answer is that one does not know why the point was not argued. Possibly, there was a very good reason, which does not appear from the reported facts, why it could not have succeeded. The Guernsey company

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3 For a recent case in which the distinction was sharply drawn by Aldous J, see *Sheppart v IRC* [1993] STC 240 at page 254 b-d, a case on the application of the transactions in securities anti-avoidance provisions to charities.

4 52 TC 674.

might, for example, not have been a resident of Guernsey. Then again the point might not simply have occurred to the eminent Counsel for the taxpayer, who, despite his undoubted intellect, ability and experience, does not devote the whole of his professional time to Revenue matters and who might therefore understandably have missed this somewhat esoteric point. What is important is that, as the point was not argued in the case, the decision is no authority whatsoever that it is a bad one.