TRANSFER OF ASSETS ABROAD
Part 2

Robert Venables QC

This is the second in a series of articles on the anti-avoidance legislation now contained in TA 1988 Part XVII Chapter III "Transfers of Assets Abroad."[1] In this article I consider the condition precedent to the application of s.739 contained in s.739(1), sometimes referred to as "the preamble".

The Preamble

S.739(1) explains that the purpose of the section is to prevent the avoidance of liability to income tax "by means of transfers[2] of assets by virtue or in consequence of which, either alone or in conjunction with associated operations, income becomes payable to persons resident or domiciled outside the United Kingdom." In many cases, it will be clear that there has been a transfer of assets. For example, if I subscribe for shares in a company neither resident nor incorporated in the United Kingdom and the company then places the money subscribed on deposit, there has been an offending transfer whereby income has become payable to a foreign person.

Wide Definitions

Both "assets" and "transfer" are given an extended meaning. "Assets" includes property or any rights of any kind and "transfer", in relation to rights, includes the creation of those rights: s.742(9)(b). Suppose my aunt who is domiciled and ordinarily resident in Monaco and not resident or ordinarily resident in the United Kingdom, sets up with £1000 of her own money a trust resident in the Isle of Man for the benefit of myself and my family. Suppose the trustees then by means of a bank loan buy income-producing property situate in the Isle of Man. The bank loan is made possible by my personally guaranteeing it. I have made an offending "transfer of assets". For I have created a right, namely the guarantee, which is itself an asset. The creation of that asset is deemed to be a transfer of an asset. In consequence of the giving of the guarantee income has arisen to the trustees.

---

1 The first article appear in Volume 1 Issue 1 page 19 under the title *What did the Second Vestey Case Really Decide?*

2 Butterworths Yellow Tax Handbook 1991/92 contains the same misprint of this subsection as did previous editions. The CCH text is accurate.

Identity of Transferee

In the above example it is irrelevant that the guarantee is given to the bank whereas the income arises to the trustees. There is absolutely no requirement that the transfer of assets shall have been to the person to whom the income arises. All that is necessary is that it is the cause of income arising. The width of subs (1) is often overlooked by offshore practitioners.

Associated Operations

The income need not become payable as a result of the transfer of assets alone. As an alternative, it can become payable as a result of the transfer of assets in conjunction with "associated operations". This is a term which occurs often in Chapter III. It is defined by s.742(1) to mean "in relation to any transfer, an operation of any kind effected by any person in relation to any of the assets transferred or any assets representing, whether directly or indirectly, any of the assets transferred, or to the income arising from any such assets, or to any assets representing, whether directly or indirectly, the accumulations of income arising from any such assets."

By way of illustration, I transfer gold ingots to the trustees of a non-United Kingdom resident trust. Sometime later they sell the gold and place the money on deposit in a bank account. The income arises as a result of the original transfer and the associated operations consisting of the sale of the gold by the trustees and the placing of the proceeds on deposit.

If the trustees then lend the money to a wholly-owned company which invests in equities on which a dividend is declared, the dividend is similarly income payable as a result of the transfer and associated operations. In this case, there were two associated operations. There is no limit to the number of associated operations which may be involved.

It should be noted that it is not necessary that the associated operations be carried out by the transferor. The fact that not all of the operations were carried out by the transferor, however, may be relevant in determining whether he can escape the effect of s.739 on account of his motive. This depends on s.741, which is discussed in a later article.

Income Resulting from Transfer

It is absolutely essential for s.739 to apply that there has been an offending transfer which results in income becoming payable to a foreign person. It is not enough that the result of the transfer is that the transferor has power to enjoy income payable to a foreign person. This is a serious defect in the effectiveness of the section. Contrast two situations. Firstly, I set up a Guernsey incorporated and resident company and use cash to subscribe for shares. The company then buys various income-producing investments. In this case, there has clearly been a transfer of assets as a result of which income becomes payable to a foreign person. Suppose, however, an individual domiciled and resident in Guernsey has set up, for his own purposes, a Guernsey company owning investments. Suppose I then purchase from him the share capital of the company at a fair valuation. I have made a transfer of assets and I have power to enjoy the income of the Guernsey company. Yet the income which becomes payable to the Guernsey company does not become payable as a result of my transfer of assets. The income was payable to the company both before and after my transfer. As a result of my transfer of assets, income may or may not arise to the vendor of the shares, depending on what he does with the purchase price. Even if income does so

arise, however, I will not normally have any power to enjoy it.

Let us take the matter a step further. Suppose, that in the normal course of making and managing its investments, the Guernsey company sells securities and buys a commercial property in Guernsey which is let. Rent becomes payable to the company for the first time only after the sale of its shares to me. Can it be said that the rent has arisen as a result of my transfer of assets (money paid for the shares) coupled with an associated operation, mainly the selling of the securities and the use of the money to purchase the land? One must recall that the term is defined, in relation to any transfer, to mean "an operation of any kind effected by any person in relation to any of the assets transferred" - that would clearly not be the case here, as the securities were not transferred by the transferor - "or the assets representing, whether directly or indirectly, any of the assets transferred ... ". Now the asset transferred is the cash transferred by way of purchase price for the shares. Can it be said that the securities represent that cash? As a matter of strict law, this is not a tenable proposition. It is the shares in the company which represent the cash transferred. (It is immaterial that they also represent the assets of the company.) Nevertheless, it is not impossible that some pro-Revenue judge might say that as the value of the shares is attributable to the value of the assets of the company, the assets of the company (including the securities sold and the building acquired) directly represent the shares and hence indirectly represent the price paid.

Suppose I have money which I would simply like to place on deposit for a number of years, rolling up the interest tax free. I therefore make it known to a Jersey resident bank, which has ample funds of its own, that if it were to set up a company with substantial deposits of the type I would like to make, then I would consider buying the company from them at a market value. I would make it quite clear, however, that the company would initially belong beneficially to the bank and that any contract to purchase would come only a later stage. The bank sets up the company and I do indeed purchase its shares. Have I made an offending transfer?

At first blush, it appears that I have successfully avoided the section. The transfer of assets which I have made was a payment of cash to the bank. Can it be said that there was any associated operation in relation to payment of such cash? Can it be said that bank's subscription for shares in the company was itself an operation effected in relation to the price I later paid to the bank? While I am sure that this was not the draftsman's intention, it is not an entirely impossible construction. It involves giving "transferred" the extended meaning of "already transferred or to be transferred" and "in relation to" the meaning of "with a view to facilitating". Twenty years ago, no judge (except, possibly Templeman J) would have accepted this argument. Nowadays it would be worth the Revenue's while to give it a run.

Service Companies

Suppose an opera singer domiciled and ordinarily resident in the United Kingdom performs a great deal abroad. He enters into a service agreement with an offshore incorporated and resident company which is wholly owned by him as respects the services he performs wholly abroad. The company then hires out his services to third parties. The difference between the amounts received by the company and the amounts paid out by it to the singer are allowed to build up in the company. In due course, the singer will retire and liquidate the company at a time when he is neither resident nor ordinarily resident in the United Kingdom.

There has been a transfer of assets as a result of which income has arisen to the offshore company. For in entering into the service agreement the singer has created rights in the company. Moreover, it is by virtue of those rights that income has arisen

to the company. (The question whether income becomes "payable" to the company so as to bring the section into play, is a different point: see below.) A similar point arose in *Brackett v Chater* [1986] STC 521 and was decided accordingly by Hoffmann J. As the taxpayer was not legally represented, the issues cannot have been properly argued before the judge and the case is therefore of somewhat doubtful authority, whether it is right or wrong. In this respect, however, it seems to me to be unquestionably right.

On a simple view "income becomes payable" to a foreign person whenever such a person has income which either is taxable or would be taxable if he were resident in the United Kingdom. Much, however, has been made of the precise words "incomes becomes payable". It has been argued that this indicates that income must be actually paid over to the foreign person. It is therefore not apt to catch forms of income which do not become payable in the strict sense. The most obvious example is profits from a trade. No-one pays over to a trader his profits. His profits are simply the arithmetical difference between his receipts and his expenditure.

The argument has a long history. It was considered by the House of Lord in one of the early cases, *Latilla v IRC* 25 TC 107. In that case, the foreign person was a partner in a foreign trading partnership. The House of Lords declined to adjudicate on the general question (thereby giving the argument a fair degree of credibility) but simply decided that in the case of a trading partnership, each partner's share of profits did in fact become payable to him within the meaning of the section.

The matter was considered more recently by Hoffmann J in *Brackett v Chater*. In that case the taxpayer had entered into a service contract within an offshore company owned by himself. The offshore company traded by providing his services to third parties and thereby made a profit. The judge held that the trading profits had indeed become payable to the company. The difficulty with the case is that it was argued by the taxpayer in person, who was not legally qualified.

While *Brackett v Chater* certainly cannot be regarded as the last word on the topic, my own view is that the House of Lords in the 1990's would listen to the argument with rather less patience and politeness than did their predecessors in 1943.

"Persons Resident or Domiciled Outside the United Kingdom"

The preamble requires that income becomes payable to "persons resident or domiciled outside the United Kingdom". This simple expression is not quite so simple as it looks.

Firstly, it should be noted that it is enough that the recipient of the income is *either* resident *or* domiciled outside the United Kingdom. He need not be both.

Secondly, if income arises to a person who is both resident in the United Kingdom and resident outside the United Kingdom, then he is still within the subsection.

Thirdly, in the case of a person resident in two jurisdictions, it is irrelevant that he might for the purposes of a double taxation treaty be regarded as resident only in the United Kingdom.

Fourthly, special rules apply to determine the residence status of the trustees of a settlement where at least one of them is resident in the United Kingdom and at least

one of them is not: FA 1989 s.110.[3]

Fifthly, where the personal representatives of a deceased person include at least one who is resident in the United Kingdom and at least one who is not, then another special rule applies to determine the residence status of the personal representatives as such: FA 1989 s.111.

Sixthly, where trustees or personal representatives are deemed to be *resident* in the United Kingdom for income tax purposes by virtue of FA 1989 s.110 or s.111, that does not mean that s.739(1) may not be in point. If all the trustees or personal representatives are *domiciled* outside the United Kingdom, then in my opinion they are within s.739(1). If at least one of them is domiciled outside the United Kingdom and at least one of them is not then the question is more difficult. Nothing in s.110 or s.111 affects the domicile status of trustees or personal representatives. While *Dawson v IRC* would throw some light on the question, it is by no means conclusive.

Seventhly, any body corporate incorporated outside the United Kingdom is to be treated as if it were resident outside the United Kingdom whether it is so resident or not: s.743(8). This provision is somewhat surprising. I would have thought it reasonably well established that a body corporate is "domiciled" in the state in which it is incorporated. As the point seems generally to have been assumed by judges rather than to have actually been decided by them, s.742(8) would have made sense if it had provided, for the avoidance of doubt, that a body corporate is deemed to be domiciled where it is incorporated. Instead, it is deemed to be resident where it is incorporated. In fact, this produces precisely the same result as there is nowhere in s.739 to s.741 a reference simply to a person resident outside the United Kingdom. Reference is always to a person "resident or domiciled" outside the United Kingdom.

Eighthly, it should be emphasised that s.739 does not come into play simply because there has been a transfer of assets abroad and income has arisen in consequence. It is essential that income has arisen to a foreign person. Suppose, for example, I transfer cash to the trustees of non-United Kingdom resident settlement. The trustees use the cash to subscribe for shares in a United Kingdom incorporated and resident company. Profits accrue to that company (on which it pays corporation tax in the usual way). The trustees do not extract any dividends. It is intended that in due course the trustees shall sell the shares in the company and realise a capital gain, tax on which will be deferred unless and until a capital payment is made to a beneficiary domiciled and resident or ordinarily resident in the United Kingdom. As no income arises to the trustees, s.739 is not in point.

---

3 This section largely nullifies the decision of the House of Lords in *Dawson v IRC* [1989] STC 473.