REMITTANCES, CONSIDERATION AND DIVORCE SETTLEMENTS

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Introduction

Many advisors have been dealing with the major changes to the taxation of foreign domiciliaries introduced by the Finance Act 2008 for almost two years now and a thorny question remains as to whether the application of the proceeds of a divorce settlement can constitute a remittance under the new rules.

The first question to be addressed is whether a transfer of property on divorce is for consideration for tax purposes. This seemingly straightforward question does not have an immediately obvious answer, particularly in the light of the case law and HMRC practice.

In principle, it might be considered that, for capital gains tax purposes, there would only be consideration in a contractual context and that, therefore, where a divorce settlement is reached, whether pursuant to a court order or by agreement between the parties, this would not constitute a binding contract. In the context of capital gains tax and the availability of hold-over relief in divorce proceedings, in *G v G* [2002] EWHC 1139, Coleridge J applied this principle on a transfer under a Court Order following a contested hearing. He stated that:

> "*'[43] This transfer is ordered on the footing that business hold-over relief will be available to the husband; that the wife will receive the shares at the husband's base value; and that, accordingly, no liability to CGT will arise on the husband as a result of the transfer. I have seen an extract from an Inland Revenue manual which confirms that a court-ordered transfer of business assets does in principle satisfy the conditions for a claim for hold-over relief; but which goes on to suggest that actual consideration given by the donee may reduce the gain potentially eligible to hold-over relief to nil. The view of the Inland Revenue appears to be that the actual consideration*

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is the surrender by the donee of rights which she would otherwise be able to exercise to obtain alternative financial provision. I do not share their view about that and I have to say that this view seems to me to be based on a misconception. In an ancillary relief hearing neither party has any 'rights' as such at all: all the powers are vested in the court which may or may not exercise them. The parties may make suggestions as to how those powers are to be exercised. That is all. So when I order a transfer of shares in favour of the wife on a clean break basis she is not 'giving up' her claim for maintenance as a quid pro quo. I am simply exercising my statutory powers in the way I consider to be fair. This would be equally the case where the court was making a consent order, for although the parties may have made their agreement it is for the court independently to adjudge its fairness: see Xydhias v Xydhias [1999] 1 FLR 683 at 691 where Thorpe LJ stated:

An even more singular feature of the transition from compromise to order in ancillary relief proceedings is that the court does not either automatically or invariably grant the application to give the bargain the force of an order. The court conducts an independent assessment to enable it to discharge its statutory function to make such orders as reflect the criteria listed in s 25 of the Matrimonial Causes Act 1973 as amended.'

Although I cannot, of course, ultimately bind the Inland Revenue, I am satisfied that, at least in this case, the wife gives no consideration for the transfer of the shares I order in her favour; and that, accordingly, hold-over relief should be available".

As a result of *G v G*, HMRC changed their practice in 2006, as set out in the Capital Gains Tax Manual at paragraph 67192 as follows:

"***67192. Consideration [March 2006]***

The disposal of an asset from one spouse or civil partner to the other in the circumstances described in CG67191 [that is, a disposal in the year after separation, which does not qualify for the capital gains tax spouse exemption] is, where there is no recourse to the courts, usually made in exchange for a surrender by the donee of rights which they would otherwise be able to exercise to obtain alternative financial provision. In such cases we take the view that the value of the rights surrendered represents actual consideration of an amount which would reduce the gain potentially eligible for hold-over relief to nil. 'Consideration' is not limited to money or money's worth.

Exceptionally, it may be possible for the parties concerned to demonstrate that there was a substantial gratuitous element in the transfer. It should be made clear that the onus is on the parties concerned to demonstrate that this was the case, and in particular that the amounts transferred were

substantially in excess of what the recipient's spouse or civil partner could reasonably have expected to have received as the result of a contested court case.

However, in cases where there is recourse to the courts and a court makes an order

- *for ancillary relief under the Matrimonial Causes Act 1973 which results in a transfer of assets from one spouse to another, or*
- *for property adjustment under the Civil Partnership Act 2004, or*
- *formally ratifying an agreement reached by the divorcing parties or by the civil partners of a dissolved civil partnership dealing with the transfer of assets,*

we take the view that the spouse or civil partner to whom the assets are transferred does not give actual consideration, in the form of surrendered rights, for their transfer. A Court Order, made in these circumstances, reflects the exercise by the court of its independent statutory jurisdiction and is not the consequence of any party to the proceedings agreeing to surrender alternative rights in return for assets.

This approach represents a change in the Revenue's prevailing practice, following consideration of judicial observations made in the case of G v G [2002] EWHC 1339 and applies with effect from 31 July 2002. Therefore, where assets are transferred between divorcing parties or between civil partners of a dissolved civil partnership by reason of a Court Order as described above and a claim for gift hold-over relief is made, or remains unsettled, on or after that date, the relief should not be restricted in accordance with Section 165(7) TCGA 1992 on the grounds that actual consideration has been given by the donee".

It should be noted that in HMRC's view, therefore, an inter-spouse transfer which is not made under a Court order is made for consideration but a transfer made under a Court order (including a consent or *Tomlin* order) is not made for consideration.

However, in *Hill v Haines* [2008] Ch 412, the Court of Appeal held that a transfer pursuant to a transfer on a contested hearing *was* made for consideration. In ancillary relief proceedings, the Court had made an order under section 24 of the Matrimonial Causes Act 1973 ordering the husband to transfer his beneficial interest in the former matrimonial home to the wife. The order for transfer became effective seven days after the decree absolute was granted. A bankruptcy order was subsequently made against the husband on his own petition. The matrimonial home was later sold providing £220,000 in respect of the husband's share. The husband's

trustees in bankruptcy applied to the County Court for a declaration that the transfer of the husband's beneficial interest was a transaction at an undervalue within the meaning of section 339 of the Insolvency Act 1986 and as such was void against the trustees. The District Judge dismissed the trustees' application, holding that the transfer had been made for consideration, namely the satisfaction of the wife's claims for ancillary relief, the value of which was not significantly less than the value of the consideration provided by the husband. On the trustees' appeal to the High Court, Judge Pelling QC held that the transfer had been made for no consideration and exercised his discretion to make the declaration sought by the trustees.

The Court of Appeal allowed the appeal, holding that the ability of one spouse to apply to the Court for financial provision and property adjustment under the 1973 Act was a right conferred and recognized by the law which had value in that its exercise might lead to Court orders entitling one spouse to money or property from or at the expense of the other, the money or property being the measure of the value of the right. Therefore, the District Judge had been right that consideration had been given.

The next question is where that leaves the decision in *G v G*, which was considered by the Court of Appeal. Unfortunately, the judges approached the decision in *G v G* in different ways. Morritt C held:

> "*... the fact that a transfer ordered by the court does not give rise to a payment of consideration so as to reduce the value of hold-over relief for capital gains tax [does not dictate] a conclusion that a property adjustment order must be regarded as made for no consideration*".

In other words, "consideration" has a different meaning for capital gains tax purposes than for ancillary relief proceedings. It should be noted that in the latter context, Morritt C candidly stated that "*I stray into that unfamiliar territory comforted by the knowledge that Thorpe LJ will have corrected my errors before the judgments of the court are handed down*".

In principle, Thorpe LJ agreed with Morritt C.

Rix LJ held that *G v G* was wrongly decided:

> "*As for G v G, the view expressed by Coleridge J stated at para 43 regarding potential consequences for the purposes of capital gains tax can hardly be regarded as authoritative in the absence of the revenue. As Coleridge J stated, his view that the wife gave no consideration for the shares transferred to her because "neither party has any 'rights' ... cannot, of course, ultimately bind the Inland Revenue": he merely proceeded "on the footing" that business hold-over relief would be available to the*

> *husband. In doing so, he appears to have drawn an unnecessary inference from the decision of this court in the Xydhias case*".

In the *Xydhias* case, the Court of Appeal had held that, absent a court order approving the same, the compromise of ancillary relief proceedings was not contractually binding.

However, Rix LJ also agreed with Morritt C and Thorpe LJ!

It is respectfully suggested that the reasoning of Morritt C is to be preferred and that rights under the MCA 1973 are not assets for capital gains tax purposes and, therefore, there is no consideration for capital gains tax purposes. It is also suggested that, in principle, there should not be a distinction in this area on the basis of whether the transfer is made under a court order or not, as contended by HMRC.

HMRC have not revised the capital gains tax manual after *Hill v Haines* and as some time has now elapsed since the decision became final it might be taken as the continuing HMRC view.

Further, it should be noted that the capital gains tax analysis is a special case and a transfer on divorce in other contexts (including the Income Taxes Act 2007 remittance rules) is, in principle, made for consideration.

This brings us to the next question as to whether there is a remittance for the purposes of section 809L of the Income Tax Act 2007 of relevant foreign income when assets are transferred from one party to a divorce to the other as part of the divorce settlement.

There is a remittance if, broadly, Conditions A and B [2] are satisfied. Condition A is that either:

(a) money or other property is brought to, or received or used in the UK by or for the benefit of a relevant person, or

(b) a service is provided in the UK to or for the benefit of a relevant person: section 809L(2) ITA 2007.

Condition B is that either:

(a) the property, service or consideration for the service is (wholly or in part) the income or gains, or

2 There are also Conditions C or D which can be satisfied for a remittance to be made, but these are not discussed further in this article.

(b) the property, service or consideration derives (wholly or in part, and directly or indirectly) from the income or gains, and in the case of property, it is property "of" a relevant person, and in the case of consideration for a service, it is consideration "given by" a relevant person, or

(c) the income or gains are used outside the UK (directly or indirectly) in respect of a relevant debt, or

(d) anything deriving (wholly or in part, and directly or indirectly) from the income or gains is used as mentioned in (c): section 809L(3) ITA 2007.

If, for example, one party to a marriage transfers relevant foreign income to the other party as part of a divorce settlement, in principle it is suggested that the funds are not "derived from" the income in the hands of the receiving party as they are received for full consideration in the light of the principles discussed above.

If this is correct, remittance Condition B is not satisfied even if the sums are remitted by the receiving spouse whilst still a relevant person (i.e. before the decree absolute) or if the funds are applied for the benefit of other relevant persons, such as the minor children of the marriage.

To be safe, however, it is the author's view that the receiving spouse should not remit the funds to the UK until *after* the decree absolute, by which time they will have ceased to be a relevant person for the purposes of the ITA 2007 remittance rules and Conditions A *and* B are not satisfied. Care also needs to be taken in timing of the use of the funds for the benefit of other relevant persons and in repaying relevant debts.

Conclusion

Although there is some conflict between the issue of consideration in a divorce context for capital gains tax and other taxes, in the author's view, it should be possible to arrange remittances in settlement of divorce proceedings without triggering an additional charge under the Income Tax Act 2007 provisions.