

EU LAW AND CHARGES ON NON-TRANSFERORS UNDER S732 ITA AND ON INVESTORS IN OFFSHORE FUNDS

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1. Introduction

- 1.1 The vast majority of decision on the compatibility of the UK tax code with EU law have arisen in the corporate sphere: *Fisher v HMRC* [2014] UKFTT 804 (TC) is a notable exception to this general rule. It is likely that the issue arises more frequently in a corporate sphere because of the cost and time involved in disputing the compatibility of tax legislation with HMRC.
- 1.2 A frequent issue arising when debating EU law issues with HMRC is their refusal to even contemplate that UK legislation may not be compatible with EU law, or that EU law might disapply UK legislation. As a result of this in the past few clients have been willing to take on the financial and time costs of pursuing a case that is likely only to win if it is pursued all the way to the European courts.
- 1.3 Increasingly, however, there is an awareness of how EU law may be relevant in a tax context, and following the commencement of infringement proceedings by the European Commission on 24 October 2012 in relation both to the transfer of assets abroad code and the Taxation of Chargeable Gains Act 1992, section 13, there is an increasing awareness of the relevance of EU law to anti-avoidance provisions.
- 1.4 In this article, and by addressing two sets of anti-avoidance provisions, I discuss the practicalities of using EU law in disputes with HMRC, and

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how this can assist in disputes with HMRC, both in the Tribunals (including the CJEU) and before the matter progresses to the Tribunal, including in negotiating a settlement with HMRC under the Litigation and Settlement Strategy.

- 1.5 The two sets of anti-avoidance provisions to be addressed are:
 - 1.5.1. the charge on non-transferors under the transfer of assets abroad code (the Income Tax Act 2007 (“ITA”), section 732); and
 - 1.5.2. the offshore income gain provisions (in the Offshore Funds (Tax) Regulations 2009).

2. The key freedoms

- 2.1 In relation to the freedoms protected by EU law (in the context of direct taxes, one is usually talking about the free movement of capital (TFEU, Article 63) and freedom of establishment (TFEU, Article 49)) it is possible that these freedoms can be restricted where there is a relevant “justification”. Before going on to consider the relevant UK anti-avoidance provisions, I first of all explain some of the justifications that might impact on anti-avoidance provisions.
- 2.2 Before considering justifications, it is first necessary to consider the nature of these two most essential freedoms.
- 2.3 There is an extensive prohibition on restrictions on both the movement of capital and also on payments in Chapter 4 of Title IV TFEU (Articles 63 to 66). It prohibits such restrictions not only between Member States but, unlike the other freedoms of movement, *also between Member States and third countries*.
- 2.4 The application of the right to free movement of capital to third countries is highly significant as it means that free movement of capital has a much wider potential significance than the other freedoms. However, the extent to which the freedom can be relied upon in the context of movements involving third countries is more restricted than the right to free movement of capital between Member States.
- 2.5 The basic provision setting out the freedom of movement of capital is contained in Article 63 TFEU which provides as follows:
 1. *Within the framework of the provisions set out in this Chapter,*

all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited.

2. *Within the framework of the provisions set out in this Chapter, all restrictions on payments between Member States and between Member States and third countries shall be prohibited.*
- 2.6 The Article refers to both restrictions on of movement of capital and also to restrictions on payments. As such, to the extent that there is any doubt that a payment may not amount to a movement of capital it is dealt with separately.
- 2.7 The Article prohibits measures restricting the movement of capital between Member States. This includes measures restricting foreign persons from raising capital in a Member State and also measures dissuading taxpayers of a Member State from investing their capital in other Member States². Capital is not restricted to cash for these purposes³.
- 2.8 It is clear that a restriction on movements of capital need not relate directly to the movement of capital but need only be likely to deter such movement. For example, the tax treatment of income deriving from an investment will not relate directly to the making of the investment, but since at least part of the purpose of making the investment is likely to be to earn income, the tax treatment of such income will be relevant to the free movement of capital⁴.
- 2.9 In the context of gifts and inheritances measures which reduce the value of a gift or which taxes the gift of that property can amount to restrictions on the free movement of capital⁵.
- 2.10 Turning to the freedom of establishment, the right of establishment is contained in Chapter 2 of Title IV TFEU (Articles 49 to 55) and sets out the framework within which EU nationals are permitted to set up and pursue economic activities in any other Member State. The right

2 C 513/03 *van Hilten-van der Heijden v Inspecteur van de Belastingdi-enst* at paragraph 44 and C 436/08 *Haribo Lakritzen Hans Riegel Betriebsgmbh v Finanzamt Linz* at paragraph 50

3 C 318/07 *Persche v Finanzamt Lüdenscheid* at paragraph 29

4 See for example C 319/02 *Proceedings brought by Manninen* [2004] STC 1444

5 C 510/08 *Mattner v Finanzamt Velbert* at paragraphs 25 and 26

applies to nationals as individuals, typically self-employed persons working abroad, as well as companies and firms. It provides that any person should be able to set up an establishment abroad in any manner such person desires; whether by the creation of branches, undertakings or subsidiaries or any other company.

- 2.11 The basic provision setting out the right of establishment is contained in Article 49 TFEU which provides as follows:

Within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited. Such prohibition shall also apply to restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State.

Freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms within the meaning of the second paragraph of Article 54, under the conditions laid down for its own nationals by the law of the country where such establishment is effected, subject to the provisions of the Chapter relating to capital.

- 2.12 The provision is framed in terms of a prohibition on restrictions on freedom of establishment. It is clear from case law that the right prohibits restrictions by a Member State which either serve to prevent or discourage foreign EU nationals from establishing themselves in that Member State as well as restrictions which serve to prevent or discourage nationals of that Member State from establishing themselves in another Member State. In the context of UK tax provisions which tend to be aimed at preventing UK nationals from moving their economic interests to a lower tax jurisdiction, it is the latter element which will be most relevant. It also prohibits discrimination on grounds of nationality in relation to the exercise of the right to freedom of establishment.

- 2.13 A restriction on freedom of establishment can be shown where the conditions imposed on a person exercising his right of establishment in another Member State are more onerous than the conditions which would apply if the person exercised the right of establishment in the Member State where the establishment is set up. That is, however, subject to the possibility that such restriction might be justified.

- 2.14 Such restrictions can operate in a number of ways: imposing a tax charge which would not otherwise have been suffered⁶ restricting availability of reliefs⁷, a requirement to provide security for tax⁸ or pay tax earlier than would have been the case⁹. In this respect, it is sufficient that legislation is capable of restricting the exercise of that freedom in a Member State by persons established in another Member State. There will be no need to establish that the legislation in question has actually had the effect of leading some of those persons to refrain from acquiring, creating or maintaining a company in the first Member State¹⁰.
- 2.15 Although the right to freedom of establishment can only be relied upon by nationals of a Member State, such nationals may be affected indirectly by restrictions on non-nationals. Thus, a restriction that persons resident outside the EU or persons who are non-EU nationals may not be directors of certain companies can amount to a restriction on the freedom of establishment as it relates to companies. This is because EU nationals wishing to operate in the form of a company with a director who is a national of or is resident in a non-member country are prevented from doing so¹¹.

3. Justifications

- 3.1 There is a number of discrete grounds that the CJEU has accepted are capable of amounting to an overriding reason in the public interest and therefore justify a restriction on freedom of movement. In that regard the CJEU has developed the manner in which these justifications must apply in different circumstances, such that the availability of the justification will very much depend upon the nature of the tax provision in question.

6 C 196/04 *Cadbury Schweppes plc v IRC*

7 C 440/08 *Gielen v Staatssecretaris van Financiën*

8 C 9/02 *de Lasteyrie du Saillant v Ministère de l'Économie, des Finances et de l'Industrie*

9 Joined cases C 397/98 and C 410/98 *Metallgesellschaft Ltd v Inland Revenue Commissioners; Hoechst AG and another v Inland Revenue Commissioners*

10 C 524/04 *Test Claimants in the Thin Cap Group Litigation v IRC* at paragraph 62 and C 311/08 *Société de Gestion Industrielle (SGI) v État belge* at paragraph 50

11 C 299/02 *Commission v Netherlands*

- 3.2 The different justifications considered are:
- 3.2.1. fiscal cohesion;
 - 3.2.2. preventing tax avoidance;
 - 3.2.3. balanced allocation of taxing rights;
 - 3.2.4. effective fiscal supervision;
 - 3.2.5. prevention of tax evasion
- 3.3 Each justification can apply individually, or can be applied together in certain cases¹².
- 3.4 Safeguarding of fiscal coherence of a national tax system is often cited as a justification for derogating from the freedoms in the TFEU¹³.
- 3.5 The CJEU has referred to maintaining the coherence of a tax system is where it is engaged in comparing the position of the taxation of national and foreign situations. Rather than considering simply one provision of the taxing code, it compares the tax system as a whole in considering the extent to which it is necessary that the wholly internal context should be modified to take account of a foreign element to achieve the same result. For example, where national dividends are exempted, rather than comparing the taxation of dividends it is necessary to consider the taxation of the economic profits as a whole.
- 3.6 The second context in which the fiscal coherence justification arises is where as part of the discrete code a tax advantage has been granted and the provisions provide for that tax advantage to be offset by a charge. Although the charge, when viewed on its own, might be considered to restrict freedom of movement, when viewed in the context of the code as a whole, it can be seen that it is necessary to protect the integrity of that code. This can be referred to as a ‘true’ coherence justification.
- 3.7 The CJEU has restricted the scope of this justification. In order for it to apply there must be:
- 3.7.1. a tax advantage which is offset by a tax levy; and
 - 3.7.2. a direct link (examined in light of the objectives of the

12 C 414/06 *Lidl Belgium GmbH & Co KG v Finanzamt Heilbronn* at paragraph 40

13 C 204/90 *Bachmann v Belgian State*

legislation) between the tax advantage in question and the offsetting of that advantage¹⁴.

- 3.8 Since the principle of coherence is intended to protect the integrity of the system, the question of coherence has to be looked at in light of the aim and logic of the tax regime at issue¹⁵.
- 3.9 In relation to prevention of tax avoidance, the CJEU has made clear that a restriction on freedom of movement can in certain circumstances be justified on grounds that the restriction applies to prevent what is described as tax avoidance. The CJEU accepts that taxpayers are entitled to plan their affairs to reduce their tax burden and as a consequence of this acceptance, the prevention of tax avoidance justification is still relatively narrowly drawn.
- 3.10 Unless a balanced allocation of taxation justification is in point as well, the tax avoidance justification will only be available to a Member State seeking to restrict a freedom of movement where the legislation implementing the restriction is specifically aimed at preventing such tax avoidance¹⁶.
- 3.11 Although the CJEU has not spelt out what it means by tax avoidance in this context, it is apparent that the term does not have the same technical meaning as when it is used by the UK Courts¹⁷. It is clear that it is not a wide “catch-all” for all arrangements aimed to save tax. As has been noted, preventing a reduction in tax revenues will not justify legislation which restricts a person’s exercise of one of the freedoms of movement¹⁸ and therefore something else is necessary.

14 C293/06 *Deutsche Shell GmbH v Finanzamt für Großunternehmen in Hamburg* at paragraphs 37 to 39 and C 182/08 *Glaxo Wellcome GmbH & Co KG v Finanzamt München II* at paragraph 78

15 C 446/03 *Marks & Spencer plc v Halsey* per A.G. Poiares Maduro at paragraph 70. Although he was not considering a true fiscal coherence justification, the point is nevertheless plainly correct.

16 C303/07 *Aberdeen Property Fininvest Alpha Oy* at paragraphs 64 and 65

17 Contrast, however, the discussion of the term as it appears in article 11 of Directive 90/434 in C352/08 *Modehuis A. Zwijnenburg BV* and in particular the comments of A.G. Kokott at paragraph 45 where the approach to the meaning of the term is more in line with UK jurisprudence:

“Conduct merely taking advantage of the options presented by Community law ... cannot by itself justify suspicion of abuse or tax avoidance”.

18 C 196/04 *Cadbury Schweppes plc v Inland Revenue Commissioners* per A.G. Leger at paragraph 52 and the cases and passages cited there.

- 3.12 Tax avoidance in this context requires some objective verification. It cannot be inferred merely from the fact that a taxpayer uses his freedoms of movement to establish his residence in another Member State¹⁹¹⁸ or takes a loan from a related company²⁰. This is in contrast to many parts of the UK legislation, which seem to assume tax avoidance merely by virtue of the fact that an offshore element is involved.
- 3.13 What the CJEU has said in this context is that legislation can be justified on grounds of preventing tax avoidance where it specifically targets arrangements which are:
- 3.13.1. wholly artificial arrangements and which do not reflect economic reality; and
- 3.13.2. designed to circumvent the legislation which would otherwise operate to tax activities carried out in the Member State concerned²¹.
- 3.14 The effect of such legislation must also be proportionate to the aim pursued.
- 3.15 The CJEU has held that ensuring a balanced allocation of taxing rights is an additional justification for restricting fundamental freedoms²² albeit in some instances there appears to be a significant degree of overlap with other justifications, such as the prevention of tax avoidance²³ and maintenance of fiscal coherence²⁴. Where there is an overlap, it can appear that the Court is taking a more relaxed approach to the requirements of those other justification.

19 C 451/05 *Europeene et Luxembourgeoise d'investments SA v Directeur general des impots ("ELISA")* per A.G. Mazak at paragraph 102

20 C 524/04 *Test Claimants in the Thin Cap Group Litigation v IRC* at paragraph 73

21 C 196/04 *Cadbury Schweppes plc v Inland Revenue Commissioners* at paragraphs 50 and 55 and C 524/04 *Test Claimants in the Thin Cap Group Litigation v IRC* at paragraphs 72 and 74

22 C 231/05 *Oy AA (Proceedings brought by)* at paragraph 62 and C 311/08 *Société de Gestion Industrielle (SGI) v État belge* at paragraph 66 and see also the Opinion of A.G. Kokott at paragraphs 59 to 61 where after noting that "abusive arrangements ... constitute a particular form of interference in the power to tax between Member States" she went on to state that "the safeguarding of a balanced allocation of the power to tax may be decisive either in itself or in conjunction with other grounds of justification".

23 C 524/04 *Test Claimants in the Thin Cap Group Litigation v IRC* at paragraph 76 and 77 and C318/10 *SIAF v Belgium* at paragraph 41, 42 and 45

24 *National Grid Indus* at paragraph 80

- 3.16 This does of course raise a question as to how taxing rights are to be allocated in the first place. It has been suggested that the allocation of taxing rights is purely a matter for the Member States and this justification is not about allocating taxing rights, but merely *preserving* the balanced allocation of such rights²⁵. This analysis does, however, presuppose that taxing rights have been allocated as between Member States and not unilaterally asserted. However, while there are situations where Member States have negotiated taxing rights that does not appear to be a prerequisite of the justification.
- 3.17 Another ground which can in certain circumstances constitute an overriding reason in the public interest capable of justifying a restriction on the exercise of the freedoms of movement is the need to maintain effective fiscal supervision²⁶. In this respect effective fiscal supervision means the ability of a Member State to ascertain and/or verify factors relevant to the taxation of a person falling within that Member State's fiscal jurisdiction. It is closely related to the prevention of tax evasion discussed below.
- 3.18 It is to be noted that this justification will not be available where the difficulties which the Member State with fiscal jurisdiction faces would apply equally to taxpayers within its jurisdiction but they are not made subject to the provision giving rise to the restriction²⁷.
- 3.19 Furthermore, it is not enough that the Member State may wish to have more information on persons. That information must be relevant to the restriction in question²⁸ and by extension to the tax charge which is to be enforced. As with other justifications for restrictions on freedoms of movement, for a restrictive measure to be justified on grounds that it maintains effective fiscal supervision it must also be a proportionate approach to obtaining its objective.
- 3.20 Subject to the requirements that information should be relevant and proportionate, the tax authorities of a Member State are entitled to

25 C 48/13 *Nordea Bank Danmark A/S v Skatteministeriet* at paragraph 35 per A.G. Kokott

26 C 120/78 *Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwein (Cassis de Dijon)* [1979] ECR 649 at paragraph 9 and C 383/05 *Talotta v Belgium* at paragraph 35

27 C 383/05 *Talotta v Belgium* at paragraph 36

28 C194/06 *Orange European Smallcap Fund* at paragraph 92

require such proof as they may consider necessary for the administration of the tax system of that State, notwithstanding that such a requirement may impose a restriction on freedoms of movement. A Member State is entitled to apply measures enabling it to ascertain in a clear and precise manner whether a body meets the conditions imposed by national law in order for a given tax treatment to apply. It can also apply measures to monitor its effective management, for example, by requiring the submission of annual accounts and an activity report.

- 3.21 In the context of Member States, it has often been stated that information can be verified by request under Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation (“the Mutual Assistance Directive”) which lays down reciprocal obligations of mutual assistance.
- 3.22 A good deal of reliance has been placed on the existence of this Directive by the CJEU. Even to the extent that the obligation to provide assistance under the Mutual Assistance Directive is limited, it remains relevant because it establishes a framework for co-operation between the competent authorities of Member States. As such, it will be very difficult to justify a restriction on freedom of movement between Member States on grounds of an inability to maintain effective fiscal supervision.
- 3.23 The tax evasion justification is linked with and overlaps with that justification concerning effective fiscal supervision. Such supervision, often being intended to prevent tax evasion.
- 3.24 It is generally accepted as a matter of UK law that a distinction exists between tax avoidance and tax evasion²⁹. The former refers to a person arranging his affairs so that he is liable to pay less tax. The latter refers to a person not paying tax which the law charges on his income³⁰. In the following, we consider tax evasion in the above sense, while noting that the CJEU on occasion uses the terminology of tax evasion to refer to tax avoidance.

29 *Craven v White* (1988) 62 TC 1 at 197

30 It is, however, to be appreciated that even now this is not a distinction which is always recognised by the Courts: see for example paragraph 5 of the judgment of Stanley Burton LJ in *Test Claimants in Thin Cap Group Litigation v HMRC* (CA) where thin capitalisation legislation is described as being aimed at “deliberate evasion of tax”)

- 3.25 Justifications based upon the prevention of tax evasion in this sense are clearly linked to justifications based upon the maintenance of effective fiscal supervision. Nevertheless, this justification, to the extent that it is separate, can be accepted as justification for a measure restricting freedoms of movement only if it concerns purely artificial contrivances, the aim of which is to circumvent tax law. A general presumption of evasion or criminality is insufficient to justify a tax measure which adversely affects the objectives of the Treaty³¹. In particular, it is not permissible to raise a presumption of tax evasion simply because the arrangements involve non-residents³².
- 3.26 HMRC will, particularly in regards to the tax avoidance justification, frequently cite justification as a response to an argument that EU law is in point, i.e. that the EU law can continue to be ignored because there is a justification for the national legislation in point being drafted in the way in which it has been. Frequently, there will be little thought given to the case law on the justifications, and whether or not the measures taken are proportionate.
- 3.27 So, what can be done? Of course, there is always the “long-stop” option of fighting HMRC on these points in the Tax tribunal and/or the CJEU. If, however, such points are being raised in the course of an enquiry or in negotiations, it is important to highlight the difficulties with applying justifications, the nuanced case law background and the different definitions of “tax avoidance” in national and EU law.
- 3.28 Additionally, in relation to the proper fiscal supervision heading, in addition to the Mutual Assistance Directive, it is now worth remembering that the UK has an extensive network of TIEAs and other information exchange arrangements (such as the “FATCA” arrangements with the Channel Islands and Isle of Man) and consequently, that the balance of proportionality in respect of this justification may well be shifting in favour of the taxpayer.

4. The charge on non-transferors

- 4.1 Having set out the EU law background in which UK anti-avoidance provisions must be considered it is now possible to consider what

31 C540/07 *Commission v Italy* paragraph 58 and C386/04 *Centro di Musicologia Walter Stauffer v Finanzamt München für Körperschaften* at paragraph 61

32 C318/10 *SIAF v Belgium* at paragraph 38

impact such law has on the three sets of anti-avoidance provisions mentioned earlier. First, the transfer of assets abroad charge on non-transferors: ITA, sections 731 and 732. ITA, section 731 provides:

- (1) *Income tax is charged on income treated as arising to an individual under section 732 (non-transferors receiving a benefit as a result of relevant transactions).*
- (2) *Tax is charged under this section on the amount of income treated as arising for the tax year.*
- ...
- (3) *The person liable for any tax charged under this section is the individual to whom the income is treated as arising.*

4.2 ITA, section 732 provides:

- (1) *This section applies if—*
 - (a) *a relevant transfer occurs,*
 - (b) *an individual who is UK resident for a tax year receives a benefit in that tax year,*
 - (c) *the benefit is provided out of assets which are available for the purpose as a result of—*
 - (i) *the transfer, or*
 - (ii) *one or more associated operations,*
 - (d) *the individual is not liable to income tax under section 720 or 727 by reference to the transfer and would not be so liable if the effect of sections 726 and 730 were ignored, and*
 - (e) *the individual is not liable to income tax on the amount or value of the benefit (apart from section 731).*
- (2) *Income is treated as arising to the individual for income tax purposes for any tax year for which section 733 provides that income arises.*
- (3) *Also see that section for the amount of income treated as arising for any such tax year.*

4.3 Thus section 731 imposes a charge on income “treated as arising” to an individual, and section 732 sets out the conditions under which income will be treated as arising. They are the following:

- 4.3.1. there is a relevant transfer (as defined in ITA, section 716);

- 4.3.2. a UK resident receives a benefit (in the same tax year as he is UK resident);
 - 4.3.3. the benefit is provided out of assets available as a result of the transfer or one or more associated operations;
 - 4.3.4. the individual is not liable to income tax under one of the “transferor provisions” (ITA, section 720 or 727); and
 - 4.3.5. the recipient is not otherwise chargeable to income tax on the amount or value of the benefit.
- 4.4 One of the commonest incidences of the use of this provision is where there has been a relevant transfer (and associated operations to set up an offshore trust) and then a UK resident beneficiary, who is not otherwise chargeable under the transfer of assets abroad provisions, because they did not make the initial transfer or an associated operation, i.e. is not the settlor, receives a benefit from the trust. Where the benefit is provided as capital it may well be the case that it is not otherwise chargeable to income tax, and consequently, it will likely come within IA, section 731.
- 4.5 In considering this provision, there is a number of factors to take into account:
- 4.5.1. does *Fisher* alter the position in relation to non-transferors, or indicate an argument that might be made in relation to non-transferors based on EU law;
 - 4.5.2. does the non-transferor charge breach, or potentially breach, the EU law freedom of establishment; and
 - 4.5.3. does the non-transferor charge breach, or potentially breach, the EU law free movement of capital.
- 4.6 In relation to the first, *Fisher* did not deal with any non-transferors, and consequently it is not directly on point. It may be the case, however, that matters of general principle can be extrapolated. *Fisher* confirms some established principles. In relation to freedom of establishment it says:
646. *In the case of Anne Fisher, HMRC say she is not establishing from Ireland to Gibraltar. Her Irish nationality is irrelevant to the application of the TOAA provisions which apply to her as a UK resident.*

647. *As discussed above the Walloon case suggests to us that legislation may be capable of restricting the establishment right of a Member State national from another member state even if they reside in the Member State imposing the restriction.*
648. *While it is correct that Anne Fisher as an Irish national, resident in the UK who establishes in Gibraltar, is treated no differently as a result of her nationality to a UK national resident in the UK establishing in Gibraltar it does not follow from that that there cannot be a restriction on her establishment right. Article 49 TFEU (formerly Article 43 EC) prohibits “restrictions on the freedom of establishment of nationals of a Member State in a territory of another Member State”. In addition to prohibiting discriminatory restrictions it is clear that even if the provisions are non-discriminatory and apply equally as between nationals of a Member State provisions could still breach the freedom if they amount to restrictions on the freedom because they are liable to inhibit or dissuade the exercise of the freedom. (The CJEU’s decision in Walloon at [45] refers to case-law supporting the proposition that the free movement of workers and freedom of establishment articles “militate against any national measure which even though applicable without discrimination on ground of nationality, is capable of hindering or rendering less attractive the exercise by Community nationals of the fundamental freedoms guaranteed by the Treaty”.)*
649. *Anne Fisher’s freedom to establish in the UK (albeit a part of the UK given we are in this section of the decision assuming the freedoms do not apply as between the UK and Gibraltar) is so restricted in our view. She is a national of one Member State (Ireland) who is dissuaded from establishing in part of another Member State (the UK for the purposes of this argument) by being charged to UK tax on the profits of SJG and being charged at a higher personal tax rate.*
650. *It does not matter that the restriction is in respect of establishing in one part of the territory of the Member State. In Walloon the facts concerned a scheme which covered only part of the national territory but was nevertheless found to be a restriction on free movement and freedom of establishment. Further it was a restriction on the establishment rights of other Member State nationals who resided in the part of the territory not covered by the scheme.*

651. *We are satisfied that the TOAA code restricts Anne Fisher's right of establishment...*
(Emphasis added).

4.7 The interaction of the non-transferor charge and the right of establishment is discussed in further detail, below.

4.8 *Fisher* also provides guidance on the proportionality, as a whole, of the transfer of assets abroad provisions in a tax avoidance context. It says:

666. *In any event the appellants say that the TOAA charge goes far beyond what is necessary to attain a legitimate objective. One of its objectives is to penalise those who have transferred assets abroad (recognised in *Howard de Walden v CIR* (1943) 25 TC 121). This penal nature is incompatible with any justification for the restrictions on the freedoms which result from the application.*

667. *The appellants draw attention to the fact the whole of the profits of the Gibraltar company are taxable in the UK year after year on individuals in the UK when the business bears no resemblance to what it was when it was first transferred. There is no question of the activities carried out in the UK resulting in taxation abroad.*

668. *HMRC argue the legislation is proportionate because it is closely targeted on situations in which the transferor has a tax avoidance motive. It does not apply to transactions undertaken purely for commercial reasons.*

669. *We disagree with HMRC. Even if the objective of the legislation were articulated as the prevention of the avoidance in the European sense of the term, as can be seen from our earlier findings, it operates to catch persons who establish in Gibraltar in order to take advantage of the more favourable tax regime but who have not done so using artificial means. It is not therefore closely targeted at those situations (artificiality as described in *Cadbury-Schweppes*) which count as avoidance in European law but captures persons such as Anne Fisher who exercise freedom of establishment rights into Gibraltar and UK nationals who exercise their freedom of establishment into other Member States.*

670. *Further, even if the fight against avoidance of UK betting duty were to be a valid justification for the provisions, the provisions are not suitable for that objective and go far beyond it as the way in which the tax charged on the appellants is calculated goes far beyond the amount of betting duty avoided.*

(Emphasis added).

- 4.9 Thus in this passage the Tribunal expressly rejects the idea that the transfer of assets abroad provisions – as a whole – can be justified on a tax avoidance basis for the following reasons:
- 4.9.1. the penal nature of the provisions;
 - 4.9.2. the provisions operate to catch those taking advantage of a more favourable tax regime but who have not done so using artificial means; and
 - 4.9.3. the provisions extend beyond the scope of preventing UK betting duty, in this case.
- 4.10 The latter point, in particular, is interesting, suggesting as it does that the proportionality of the provisions is something to be considered on a case by case basis. Presumably the aim of the transfer of assets abroad provisions was never to prevent the avoidance of UK betting duty, but rather to prevent the avoidance of income tax, and consequently it is interesting to see how the Judge’s decision on this point will be treated by future decisions (including upon the appeal of the decision to the Upper Tribunal).
- 4.11 Thus the key provision here is that the tax avoidance justification will be unlikely to apply to the transfer of assets abroad provisions as a whole, because there is not the requisite level of artificiality required before the provisions “bite”. It is also interesting that the Tribunal gave no detailed consideration of the infringement proceedings in relation to the code, and how the amendments made to the code (primarily the insertion of a new defence to the charge in ITA, section 742A for “genuine transactions”) might impact upon the compatibility of the provisions with EU law.
- 4.12 But how does this help us in making a defence based on EU law to a charge under the non-transferor provisions? While the decision in *Fisher* could hardly be said to be taxpayer friendly, the Tribunal did concede some points of general principle:
- 4.12.1. the code as a whole is not justifiable under the “tax avoidance” justification because it catches transactions that are

not sufficiently artificial to constitute tax avoidance within the EU law meaning; and

- 4.12.2. freedom of establishment can be infringed by a mere dissuasion from establishing in another member state, nothing more is required.
- 4.13 In considering those general principles, it is convenient to first take the principle in relation to the tax avoidance justification. Since the Tribunal discussed this justification in the context of the transfer of assets abroad code as a whole there is a *prima facie* argument that the non-transferor provision cannot be justified, for the same reasons given. In this respect, however, it is likely that such an argument can be extended beyond merely pointing to what the Judge has said. Since the same defences apply to the non-transferor charges as to the transferor charges, the lack of a tax avoidance justification should apply equally there. Of course, such an argument against justification may have been removed by ITA, section 742A.
- 4.14 Turning therefore, to freedom of establishment. In the case of the non-transferor charge, the person being charged may well not be the person who has exercised a freedom of establishment (e.g., “amending” the *Fisher* facts, for example, if Anne and Stephen Fisher had moved their business to Spain, and payments had then been made to their grandchildren in the UK, the charge would be on the grandchildren, but the grandchildren would not have exercised any right of establishment).
- 4.15 In this respect it is important to remember the following:
- 4.15.1. the right prohibits restrictions by a Member State which either serve to prevent or discourage foreign EU nationals from establishing themselves in that Member State as well as restrictions which serve to prevent or discourage nationals of that Member State from establishing themselves in another Member State;
 - 4.15.2. a restriction on freedom of establishment can be shown where the conditions imposed on a person exercising his right of establishment in another Member State are more onerous than the conditions which would apply if the person exercised the right of establishment in the Member State where the establishment is set up; and
 - 4.15.3. Member State nationals may be affected indirectly by restrictions on non- nationals.

- 4.16 Thus the non-transferor charge could be incompatible with EU law on the grounds that it infringes the freedom of establishment because it indirectly discourages UK nationals from establishing themselves in other EU Member States because of the increased charge to tax on any assets returned to beneficiaries in the UK. In the context of the non-transferor charge, however, the free movement of capital is likely to be a more important consideration.
- 4.17 Unfortunately, in *Fisher* the judge fails to distinguish between freedom of establishment and free movement of capital (and perhaps in the context of the transferor charges this was not necessary). It seems probable, however, that in the context of the non-transferor charge the provisions may well apply differently.
- 4.18 To recap:
- 4.18.1. freedom of movement can apply between a Member State and a third country, not just between Member States;
 - 4.18.2. it is relevant to both restrictions on of movement of capital and also to restrictions on payments;
 - 4.18.3. measures restricting the movement of capital between Member States are prohibited, including measures restricting foreign persons from raising capital in a Member State and also measures dissuading taxpayers of a Member State from investing their capital in other Member States; and
 - 4.18.4. a restriction on movements of capital need not relate directly to the movement of capital but need only be likely to deter such movement. For example, the tax treatment of income deriving from an investment will not relate directly to the making of the investment, but since at least part of the purpose of making the investment is likely to be to earn income, the tax treatment of such income will be relevant to the free movement of capital.
- 4.19 Thus free movement of capital is potentially highly relevant to the non-transferor charge. It is clear that the charge on non-transferors can potentially restrict free movement of capital by dissuading:
- 4.19.1. investment outside of the UK (by the original transferor, i.e. if I set up a non-resident trusts payments to my children/grandchildren might be caught by this provision);
 - 4.19.2. payment of capital into the UK (though the situation here is not as clear-cut).

- 4.20 It seems likely that, if arguing either that freedom of establishment, or free movement of capital is infringed by the non-transferor provision, HMRC will be likely to point both to ITA, section 742A and the tax avoidance justification to say that the treatment is justified, and therefore any infringement can be ignored. There are several possible responses to this, the two key ones being:
- 4.20.1. ITA, section 742A only applies after 5 April 2012, and consequently there is still a potential for the regime as previously applied to continue to infringe EU law; and
 - 4.20.2. ITA, section 742A is not sufficient to give wholesale compatibility to the transfer of assets abroad regime.
- 4.21 Both are arguments that will need to be put persuasively in correspondence (or in Court!) and counsel's advice should be sought on the best way to make such arguments.

5. Offshore Income Gains

- 5.1 The taxation of "offshore income gains" are dealt with in national legislation by the complex Offshore Funds (Tax) Regulations 2009 ("OFTR"). It is not possible to consider fully the regime, and in this section, I consider primarily the charges possible under OFTR, and whether or not they are compatible with EU law, and if EU law can be of assistance in resisting a charge purported to be made under the OFTR by HMRC.
- 5.2 A little introduction to the provisions is necessary. The legislation distinguishes two particular charges:
- 5.2.1. the "offshore income gain that arises upon the disposal of a non-reporting offshore fund, which is dealt with under the OFTR; and
 - 5.2.2. chargeable gains which arise within the scope of the Taxation of Chargeable Gains Act 1992 ("TCGA").
- 5.3 OFTR, Regulation 17(1) is the charging provision:
- (1) *There is a charge to tax if—*
 - (a) *a person disposes of an asset,*
 - (b) *either condition A or condition B is met, and*

- (c) *as a result of the disposal, an offshore income gain arises to the person making the disposal.*
- (2) *Condition A is that the asset is an interest in a non-reporting fund at the time of the disposal.*
- (3) *Condition B is that—*
 - (a) *the asset is an interest in a reporting fund at the time of the disposal,*
 - (b) *the reporting fund was previously a non-reporting fund (becoming a reporting fund as the result of an application under regulation 52),*
 - (c) *the interest was an interest in a non-reporting fund during some or all of the material period,*
 - (d) *an election under regulation 48 was not prevented by paragraph (5) of that regulation, and*
 - (e) *no election has been made under regulation 48(2).*

5.4 Thus a charge arises in two circumstances where an asset is disposed of:

5.4.1. where the asset disposed of is an interest in a non-reporting fund; or

5.4.2. where a non-reporting fund switches to reporting fund status.

5.5 Regulation 18 provides:

- (1) *The offshore income gain arising is treated for all the purposes of the Tax Acts as income which arises at the time of the disposal to the person making the disposal (or treated as making the disposal).*
- (2) *The tax is charged on the person making the disposal (or treated as making the disposal).*
- (3) *In the case of a person chargeable to income tax, tax is charged under Chapter 8 of Part 5 of ITTOIA 2005 (miscellaneous income: income not otherwise charged) for the year of assessment in which the disposal is made, but sections 688(1) and 689 of ITTOIA 2005 (income charged and person liable) do not apply.*
- (4) *In the case of a person chargeable to corporation tax, tax is charged under Chapter 8 of Part 10 of CTA 2009 (miscellaneous*

income: income not otherwise charged) for the accounting period in which the disposal is made.

- (5) *Paragraph (1) is subject to—*
- (a) *regulation 19 (income treated as arising under regulation 17: remittance basis);*
 - (b) *regulation 20(1) (offshore income gain arising to non-resident trustees not treated as income of settlor);*
 - (c) *regulation 20(5) (application to gains of non-resident settlements); (d) regulation 24(6) (application of section 13 of TCGA 1992).*

5.6 From an EU law perspective, this should set some alarm bells ringing; regulation 24(6) relates to a provision that was recently the subject of infringement proceedings, and which may well continue to infringe free movement of capital. In this respect, Regulation 24 provides:

- (1) *Section 13 of TCGA 1992 (chargeable gains accruing to certain non-resident companies) applies for the purposes of this Part with the following modifications.*
- (2) *The section applies as if—*
 - (a) *for any reference to a chargeable gain there were substituted a reference to an offshore income gain; and*
 - (b) *for any reference to anything accruing there were substituted a reference to it arising (with similar references being read accordingly).*
- (3) *The section applies as if, in subsection (5), paragraphs (b) and (c) were omitted.*
- (4) *The section applies as if, in subsection (7), for the reference to capital gains tax there were substituted a reference to income tax or corporation tax.*
- (5) *The section applies as if subsection (8) were omitted.*
- (6) *If this regulation applies, the person to whom the offshore income gain arises is treated as the person making the disposal.*
- (7) *To the extent that an offshore income gain is treated, by virtue of this regulation, as having accrued to any person resident ... in the United Kingdom, that gain shall not be deemed to be the*

income of any individual for the purposes of Chapter 2 of Part 13 of ITA 2007 (transfer of assets abroad).

- 5.7 Of course, TCGA, section 13, has already been the subject of infringement proceedings. These infringement proceedings have not, despite the UK's amendments to the legislation, not yet been closed. However, it seems probable that in terms of arguing with HMRC, they may well see the issue of whether TCGA, section 13 is now compatible, as being cut and dried. This is discussed further below.
- 5.8 In terms of the incorporation of TCGA, section 13 within the OFTR, it remains as a matter of law doubtful as to whether or not the amendments made to TCGA, section 13 are sufficient to ensure EU compliance. Consequently there is a similar question mark over the compliance of OFTR. In this respect, it has been suggested that by increasing the threshold at which a section 13 (or OFTR) charge applies the provisions concerning free movement of capital are somehow excluded from applying.
- 5.9 This is based upon the approach of the CJEU in a series of cases in which it has held that the 25% holding is the threshold at which a person has an influence over a company, and that provisions which are aimed at persons who have an influence over a company properly fall within the scope of freedom of establishment, and reliance on free movement of capital is subsequently excluded (see for example C-31/11 *Scheunemann*).
- 5.10 The relevant principle, however, is that in considering which treaty freedom applies, regard must be had to the purpose of the legislation in question. The purpose of TCGA, section 13 is not to tax persons who have created an establishment in another country through a company (as such gains are expressly excluded) but to tax gains on investments and other assets in circumstances where a right of establishment may not have been exercised at all.
- 5.11 In this context it is not clear the 25% threshold excludes the provisions on free movement of capital (see in this respect *Schmelz v inanzamt Waldviertel* (Case C-97/09) [2011] STC 88). As such, there is an argument that TCGA, section 13 potentially continues to fall foul of the free movement of capital. Does that argument apply equally to OFTR, Regulation 24? In my view it does. This is because the underlying basis of TCGA, section 13 and of its incorporation into the OFTR is the same: the intent to tax gains on investments.

- 5.12 Turning, then, to freedom of establishment. Even if the right to free movement of capital is excluded (by the 25% threshold), this exclusion for economically significant activities will not necessarily ensure that restrictions on the right of establishment are removed. The reference to economically significant activities carried on through a business establishment is a stricter test than that of “participating in economic life on a stable and continuing basis” (A.G. Leger in *Cadbury Schweppes* at para 42).
- 5.13 Thus while it is not certain that the new section 13, and by extension OFTR meet the requirements of EU law, it is certainly an improvement on the previous provisions, which were the original subject of the infringement proceedings. However, it seems likely that there remains an argument that OFTR infringes free movement of capital, and in the right circumstances, freedom of establishment.
- 5.14 There may, of course, be other grounds upon which the OFTR could be challenged.

As a regime specifically aimed at non-UK situate assets there is significant potential for showing that the regime restricts freedom of movement, by preventing or discouraging the raising of capital in other Member States, and the freedom of establishment, by discouraging EU nationals from establishing themselves in another Member State. This offers an additional argument to be put to HMRC if arguing against an offshore income gain charge, either on the TCGA, section 13 basis, or upon the more general basis.

- 5.15 Practically, in deciding whether to put EU points to HMRC in this context it will be important to consider the facts of your individual case to see whether or not they give a clear indication of how the provisions are incompatible with EU law. If your facts give a clear example of the problems of the OFTR in the context of EU law, such a claim should be pursued vigorously (alongside any other technical points being put).