The Personal Tax Planning Review

WHEN IS A COMPANY NOT A COMPANY?

Julian Ghosh[1]

The answer, according to some, is when a "company" is a unit trust. More accurately, the argument is that a unit trust cannot be a "close company" within the meaning of TA 1988, section 414 and therefore a non-UK resident unit trust is entirely outside the scope of TCGA 1992, section 13. To my mind, although the argument is perfectly respectable, I do not consider that it would succeed.

The argument that section 13 cannot apply to a non-UK resident unit trust would run, I think, as follows:

1. TCGA 1992, section 13 applies "as respects chargeable gains accruing to a company [which is non UK resident] and "which would be a close company if it were [UK resident] (section 13(1)(a), (b)).

2. "Company" is defined for TCGA purposes as "any body corporate... construed in accordance with [TCGA 1992] section 99" (section 288(1)). Section 99, in turn, provides that [TCGA 1992] shall "apply to any unit trust scheme [within FSA 1986, section 75] as if... the scheme were a company, the rights of the unit holders were shares in the company and, in the case of an authorised unit trust, the company were [UK] resident and ordinarily resident..." and goes on to provide that "nothing... shall be taken to bring a unit trust scheme within the charge to corporation tax on chargeable gains". Furthermore, section 100(1) provides that "gains accruing to an authorised unit trust... shall not be chargeable gains".

3. "Close company" is defined in section 288(1) as simply that which "has the meaning given to it by sections 414 and 415 of the Taxes Act".

4. TA 1988, section 414(1) defines, for the purposes of "the Tax Acts" a close company as "one which is under the control of five or fewer participators..."

[1] Julian Ghosh, Pump Court Tax Chambers, 16 Bedford Row, London WC1R 4EB. Tel: (020) 7414 8080 Fax: (020) 7414 8099.

[section 415 excludes certain quoted companies]. The "Tax Acts" comprise TA 1988, and all other provisions of the Income Tax Acts and the Corporation Tax Acts: section 831(2); this excludes TCGA 1992, other than those provisions relating to corporation tax on chargeable gains: section 831(1)(a).

5. For the purposes of the Tax Acts, given that section 414 provides that a "close company is *one which is under the control of five or fewer participators...*", the definition of "close company" must be [a company] which is under the control of five or fewer participators. For the purposes of the Tax Acts, a "company" is defined, in section 832(1), as, "any body corporate or unincorporated association [which] does not include a partnership, a local authority or a local authority association". The extension of the definition of "company" to unit trusts, which are not bodies corporate, or, for that matter, unincorporated associations, made for TCGA purposes by section 99 of TCGA 1992, does not apply for the purposes of the Tax Acts (and hence for the purposes of TA 1988, section 414(1)).

6. It follows that the "meaning" of "close company", within TA 1988, section 414, does not extend to unit trusts. It further follows, according to this argument, that the term "close company" cannot encompass unit trusts for the purposes of TCGA 1992, section 288(1), since this specifically refers to the TA 1988, section 414 definition of "close company". The fact that the term "company" extends to unit trusts, for all TCGA 1992 purposes, is neither here nor there. The term "close company" is a specific statutory term of art defined by reference to a specific provision (section 414), which excludes unit trusts. TCGA 1992, section 13 only applies to a "company" (which would include a unit trust), which would be a "close company" if it were UK resident. A unit trust can never be a "close company" (because it is not a body corporate, or an unincorporated association, within TA 1988, section 832(1)).

7. This is very good news for those individual taxpayers who hold assets through a non-UK resident unit trust. An unauthorised non-resident unit trust is subject to capital gains tax and will therefore have chargeable gains, within TCGA 1992, section 15, (unlike an authorised unit trust: see above) but section 13 can never apply to attribute those gains to the unit holder.

As I have already said, this argument is perfectly respectable. However, I do not myself consider that it will succeed. Indeed, quite apart from any hostility on the part of the Commissioners/Courts to this highly technical loophole, I consider that the better technical view is that section 13 does indeed catch non-UK resident unauthorised unit trusts, so as to attribute any chargeable gains made by it to individual unit holders.

Firstly, TCGA 1992, section 288(1), in providing that "close company" "has the meaning given by sections 414 and 415 of the Taxes Act" is, to my mind, properly

read as providing that "close company" "[means] "one which is under the control of five or fewer participators". Further expanded, section 288(1) should be read as providing that "close company" means " [one, *i.e., a company*] which is under the control of five or fewer participators". In the context of TCGA 1992, the term "company" must include unit trusts because of section 99, as provided for in section 288 itself. In other words, the reference in section 288(1) to TA 1988, sections 414 and 415 is simply a word saving mechanism to save the draftsman some ink and not evidence of an intention to exclude unit trusts from one specific definition of a particular type of company, when TCGA 1992 includes unit trusts in every other definition of company.

This conclusion is strongly (and in my view conclusively) reinforced by the terms of TA 1988, section 831(5), which provides that [TA 1988], so far as it relates to capital gains tax, shall be construed as one with [TCGA 1992]". In other words, every single provision which is contained in TA 1988, relating to capital gains tax, is read together with TCGA 1992, as if they were provisions in a single Act. Thus TA 1988, section 414(1), insofar as it relates to capital gains tax, for example, in defining the term "close company" for the purposes of TCGA 1992, section 13, is properly read as a provision which comprises a single Act, with TCGA 1992. The reference in section 414(1) to "one which is under the control of five or fewer participators" must, on any view, be a reference to "[a company which is] under the control of five or fewer participators". Section 831(5) establishes beyond doubt the proposition that the "company" in question, in the context of TCGA 1992, includes a unit trust. It could, I suppose, be said that section 831(5) should be properly read as only referring to those provisions in TA 1988 which expressly deal with capital gains tax, so that section 831(5) has no application to provisions such as section 414(5), which are applied, by reference in TCGA 1992, for capital gains tax purposes. I do not think that this is right. Indeed, such a proposition has a slight aura of desperation. Section 831(5) deals with the provisions in TA 1988 so far as they "relate" to capital gains tax, not simply those provisions which "expressly deal" with capital gains tax. There is, quite simply, absolutely nothing in section 831(5) to suggest that it simply deals with provisions in TA 1988 which have *express* relevance for capital gains tax. Indeed, to suggest this deprives TA 1988, section 831(5) of virtually all effect. It appears to me to be slightly naive to suggest that those provisions in TA 1988 which deal expressly with capital gains tax require a further provision, namely, section 831(5), to have them be read "as one" with TCGA 1992.

In any event, as I observe above, I think the proposition that unit trusts are encompassed within the term "close company" for TCGA 1992, section 288(1) purposes (and hence section 13 purposes) is self-evident, even without section 831(5). The reference to TA 1988 of sections 414/415 is the word saving mechanism and nothing else. Section 831(5) merely conclusively determines the matter in favour of the Inland Revenue.

Finally, one must ask what conceivable reason the draftsman would have to exclude unit trusts from the ambit of section 13. This is not a rhetorical question. Neither is it the refuge of the intellectually dishonest when all else fails on a proper construction of the statute. If there is no good reason for the exclusion of unit trusts from section 13, then the analysis which I set out above becomes overwhelmingly attractive even if, contrary to my view, the exclusion of unit trusts from the ambit of section 13 is a conclusion which ought to find favour as a matter of construction. While there are clear policy reasons for excluding authorised unit trusts from the UK chargeable gains net, these policy reasons do not extend to unauthorised unit trusts; *a fortiori,* I cannot myself think of any good reason why the draftsman would wish to exclude individuals who hold assets through non UK resident unit trusts from the application of section 13, which is why, in addition to the reasons I give above, as a matter of legal policy and purposive construction, I consider that the argument in favour of such an exclusion, although perfectly respectable, will fail.