SECTION 739 AND BENEFITS IN KIND

Robert Venables QC[1]

1 The Two Limbs

The Taxes Act 1988 section 739, which is contained in Part XVII Chapter 3 "Transfers of Assets Abroad", applies "for the purpose of preventing the avoiding by individuals ordinarily resident in the United Kingdom of liability to income tax by means of transfer 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."

It has two main limbs. Under section 739(2), if a transferor has "power to enjoy" income arising to a "foreign" person[2] as the result of an offending transfer, then all that income is prima facie deemed for income tax purposes to be his (subject in the case of a foreign domiciliary to its being remitted to the United Kingdom, if it is foreign income), no matter how small the benefit he actually receives.

Under section 739(3) where, "whether before or after any such transfer, such an individual receives or is entitled to receive any capital sum the payment of which is in any way connected with the transfer or any associated operation, any income which, by virtue or in consequence of the transfer, either alone or in conjunction with associated operations, has become the income of a person resident or domiciled outside the United Kingdom shall, whether it would or would not have been chargeable to income tax apart from the provisions of this section, be deemed to be income of that individual for all purposes of the Income Tax Acts."

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1 Chairman of the Revenue Bar Association, Bencher of the Middle Temple, Fellow and Council Member of the Chartered Institute of Taxation, Chartered Tax Adviser, TEP, Consulting Editor of The Offshore and International Taxation Review, The Personal Tax Planning Review, The Corporate Tax Review and The EC Tax Journal, Taxation Editor of The Charities Law and Practice Review. Chambers: 24 Old Buildings, Lincoln's Inn, London WC2A 3UP. Tel: + 44 (0) 20 7242 2744; Fax: + 44 (0) 20 7831 8095. E-mail: taxchambers@compuserve.com

2 i.e. a person who is resident domiciled or incorporated outside of the United Kingdom.

"Capital sum" means "(a) any sum paid or payable by way of loan or repayment of a loan and (b) any other sum paid or payable otherwise than as income, being a sum which is not paid or payable for full consideration in money or money's worth".

2 "Power to enjoy"

"Power to enjoy" is defined by section 742(2):

> "(2) An individual shall, for the purposes of section 739, be deemed to have power to enjoy income of a person resident or domiciled outside the United Kingdom if -
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> (a) the income is in fact so dealt with by any person as to be calculated, at some point of time, and whether in the form of income or not, to enure for the benefit of the individual; or
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> (b) the receipt or accrual of the income operates to increase the value to the individual of any assets held by him or for his benefit; or
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> (c) the individual receives or is entitled to receive, at any time, any benefit provided or to be provided out of that income or out of moneys which are or will be available for the purpose by reason of the effect or successive effects of the associated operations on that income and on any assets which directly or indirectly represent that income; or
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> (d) the individual may, in the event of the exercise or successive exercise of one or more powers, by whomsoever exercisable and whether with or without the consent of any other person, become entitled to the beneficial enjoyment of the income; or
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> (e) the individual is able in any manner whatsoever, and whether directly or indirectly, to control the application of the income."

3 Benefits in Kind

I am concerned with the situation where a transferor who does not otherwise have power to enjoy the income of a "foreign" person receives a benefit which falls within section 742(2)(c) and as to the quantum of the resultant charge to tax. If the benefit consists of the receipt of a "capital sum", then section 739(3) will normally kick in and the transferor will be taxable on the *whole* of the income which has arisen to a foreign person as a result of the offending transfer.[3] Let us concentrate therefore on a case where section 739(3) clearly does not apply, as where the benefit consists of accommodation which is afforded free or on beneficial terms.

Prima facie, in that case, all the income arising is deemed to be his, even though its amount exceeds the value of the benefit. The position is complicated, however, by section 743, the side note to which is "supplemental provisions". Section 743(1) provides:

> "(1) Income tax at the basic rate, the lower rate or the Schedule F ordinary rate shall not be charged by virtue of section 739 in respect of any income to the extent that it has borne tax at that rate by deduction or otherwise but, subject to that, income tax so chargeable shall be charged -
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> (a) in the case of income falling within subsection (1A) below, as if it were income to which section 1A applies by virtue of paragraph (2)(b) of that section; and
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> (b) in the case of any other income, under Case VI of Schedule D."

If section 743(1) stood alone, it would not displace the prima facie assumption that, once it is shown that an individual has "power to enjoy" the income arising, then it is all deemed to be his for income tax purposes. Nor would there be any question of the individual being taxed on any amount in excess of the income arising, simply because the benefit he has received was greater than that amount.

The position is complicated, however, by section 743(5) which provides:

> "In any case where an individual has for the purposes of that section power to enjoy income of a person abroad by reason of his receiving any

3 It is a moot point whether a transferor can be made liable in respect of income which arose at a time that he was not ordinarily resident in the United Kingdom

> such benefit as is referred to in section 742(2)(c), then notwithstanding anything in subsection (1) above, the individual shall be chargeable to income tax by virtue of section 739 for the year of assessment in which the benefit is received on the whole of the amount or value of that benefit except in so far as it is shown that the benefit derives directly or indirectly from income on which he has already been charged to tax for that or a previous year of assessment."

Now, it is clear that section 743(5) displaces section 743(1). Read *literally*, it appears to make the quantum of liability the value of the benefit, whether that is greater or lesser than the amount of income arising. In my view, on *purposive* construction it merely limits the quantum of the charge to the lower of the amount of income and the value of the benefit. The mischief at which section 739 and following is aimed is very clear: the avoidance "by individuals ordinarily resident in the United Kingdom of liability to income tax by means of transfer 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": section 739(1). In so far as no such income arises there is no avoidance and no need for the sections to bite. It would be odd indeed if a potentially larger liability were to be inflicted on an individual who did not have power to enjoy the income but who in fact received a benefit, than on one who did have power to enjoy the income all along.[4]

4 IRC v Botnar

4.1 The Principal Argument

In *IRC v Botnar* 72 TC 203, the Revenue's principal argument, which failed before the Special Commissioners, but succeeded before Evans-Lombe J in the Chancery Division and the Court of Appeal, was that, since the trustees of the offshore settlement concerned could lawfully transfer assets to another settlement under which Mr Botnar could benefit, he had power to enjoy the income under what is now section 742(2)(a) and (d). They provide:

> "(2) An individual shall, for the purposes of section 739, be deemed

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4 or who received or was "entitled to receive any capital sum the payment of which [was] in any way connected with the transfer or any associated operation", in which case irrespective of the quantum of the capital payment, "any income which, by virtue or in consequence of the transfer, either alone or in conjunction with associated operations, has become the income of a person resident or domiciled outside the United Kingdom shall, whether it would or would not have been chargeable to income tax apart from the provisions of this section, be deemed to be income of that individual for all purposes of the Income Tax Acts": section 739(3)

> to have power to enjoy income of a person resident or domiciled outside the United Kingdom if—
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> (a) the income is in fact so dealt with by any person as to be calculated, at some point of time, and whether in the form of income or not, to enure for the benefit of the individual; or
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> ...
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> (d) the individual may, in the event of the exercise or successive exercise of one or more powers, by whomsoever exercisable and whether with or without the consent of any other person, become entitled to the beneficial enjoyment of the income..."

4.2 The Special Commissioners

It was only the Special Commissioners who needed to determine whether Mr Botnar could alternatively be chargeable under what is now section 742(2)(c) and, if so, what was the quantum of his liability. They said, in the decision:

> " 244. The real question under s 742(2)(c) is the question of liability in the light of s 743(5). Mr Munby [for the Revenue] submitted that it widened the charge otherwise imposed whereas Mr Park [for Mr Botnar] submitted that it cut it down."

It is very important to understand their decision in the context of the case. Mr Botnar had had the use of a flat comprised in the settlement. The value of that use was subsequently agreed at £134,000 but the relevant income arising in the two years in question was £57,000,000.[5] It cannot have been in the Revenue's interest to argue that Mr Botnar was taxable on the value of the benefit if greater than the income arising.

The Special Commissioners did indeed decide in favour of the Revenue on this point. They said, at paragraph 245 of their Decision:

> "245. It seems to us that in the case of actual receipt of a benefit (as opposed to mere entitlement to receive) section 743(5) is determinative of the charge to tax thus producing a radically different result. The subsection provides that the individual receiving a benefit provided out of

5 See the judgment of Morritt LJ in the Court of Appeal, paragraph 51

> the income of a non-resident under 742(2)(c)'shall be chargeable for the year of assessment in which the benefit is received on the whole of the amount or value of that benefit'. Where the power to enjoy arises the tax is charged not on the income which the taxpayer has power to enjoy but on the value of the benefit. This may bear no relationship whatsoever to the income of the non-resident as long as it originated from it even indirectly. We do not accept that s 743(5) only operates where the benefit received in a year exceeds the relevant income. It seems to us that the words 'notwithstanding anything in subsection (1) above' would have been better placed later in the subsection perhaps after 'the amount or value of that benefit'."

In other words, they were simply rejecting the argument that where section 742(2)(c) applies, the taxpayer is taxable on the whole of the income arising even if greater than the value of the benefit. They were not addressing their minds to the situation where the value of the benefit is greater than that of the income arising.

Evans-Lombe J did not find it necessary to deal with the section 743(5) point.

4.3 The Court of Appeal

In the Court of Appeal it is clear that the Revenue were contending that the charge to tax was on the value of the benefit if higher than the income arising. They had to put forward a construction of section 743(5) other than that contended for by the taxpayer, which would still leave it with some effect. Morritt LJ said, at paragraph 51 of his judgment:

> "51. The Revenue contend that the commissioners are wrong. It is submitted that once a power to enjoy is ascertained under any paragraph of s 742(2) then the whole of the income arising in that year of assessment is deemed to be that of the individual having such power to enjoy whether or not the power is exercised and whether or not the power to enjoy is co-extensive with the income deemed to be his. It is suggested that this is recognised by s 743(5) the ancillary purpose of which is to ensure that if 'the whole of the amount or value of that benefit' exceeds the income deemed to be that of the individual tax is also paid on the excess."

Morritt LJ, with whom the other members of the Court agreed on this part of the case, said, in paragraph 53 of his judgment:

> "53. The question, put shortly, is whether s 743(5) is a charging

> provision in substitution for or in addition to that contained in s 739(2). I prefer the first alternative. It is true that it is unusual to find a charging provision in the final subsection of a section entitled:'Supplemental provisions'. But as it deals specifically with the consequences of the actual receipt of benefit in my view it should be regarded as superseding the more general charging provision contained in s 739(2) unless there are clear words to the contrary. There are no such words. Moreover even in a penal section to tax a man on more than he actually received in cases where there is no power to enjoy apart from that actual receipt goes well beyond what Parliament is likely to have considered to be necessary for deterrent purposes. At least it would require even clearer words than are to be found in this legislation to make it plain that that is what Parliament did intend. The point does not arise for decision and I need say no more about it."

Thus, Morritt LJ was rejecting the argument of the Revenue that section 743(5) did not cap the charge to an amount of income equal to the value of the benefit, even if less than the income arising. At the very least he decided nothing about whether there could be a charge on an amount greater than the amount of income arising. More than that, he rejected the Revenue's argument that the charge under section 743(5) is on the greater of the value of the benefit and the amount of income arising. While it would still be open to the Revenue in another case to put forward a different argument, namely that the quantum of the charge under section 743(5) would be the value of the benefit, even if more than the amount of income arising, they did not do so in this case and in my opinion it would fail if they sought to do so, for the reasons set out above.