The Offshore & International Taxation Review

ATTRIBUTION OF CAPITAL GAINS OF NON-UK RESIDENT COMPANIES

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1 Scope of the Article

This article is concerned with the capital gains tax anti-avoidance provisions contained in the United Kingdom Taxation of Chargeable Gains Act 1992 sections 13 and 14, which attribute capital gains of non-UK resident quasi-close companies to their "participators", direct and indirect. I shall refer to these sections as "the OCC Provisions". They were considerably strengthened by Finance Act 1996, with effect from 28th November 1995. While the main change was to extend the attribution from shareholders to all participators, and in particular to catch companies limited by guarantee and other corporations with members who are not shareholders, the amendments had some unfortunate side effects which were, it is to be hoped, unintended. In this article, I discuss only the current law.

2 Companies to which Provisions Apply

Section 13(1) provides:

> "(1) This section applies as respects chargeable gains accruing to a company—
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> (a) which is not resident in the United Kingdom, and
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> (b) which would be a close company if it were resident in the United Kingdom."

Hence, the provisions do not apply a to a company which is dual resident, even if its gains are protected from UK tax by a double taxation convention. While the provisions

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are aimed primarily at corporations, "company" is defined (unless the context otherwise requires) to include "any body corporate or unincorporated association" but so as not to include a partnership.[2] It also includes a "unit trust".[3]

The definition of "close company" is the same as in Taxes Act 1988 sections 414 and 415, which is, broadly speaking a company under the control of five or fewer participators or of participators who are directors.[4] This definition is extremely complex indeed; in particular it adopts an extremely extended test of "control" which can lead to surprising results.[5] One vital and necessary difference is that while a company cannot be a close company unless it is UK resident,[6] that requirement is dispensed with for the purposes of the OCC Provisions.[7]

It is possible for a company to be under the control of one person without being a close company. Typically, this could be achieved through trustee shareholders. The OCC Provisions would in that case fail to bite *in limine*.

3 Width of Provisions

The OCC Provisions are needlessly wide. There is no motive defence. Contrast even the Draconian transfer of assets abroad provisions, contained in Taxes Act 1988 Part XVII Chapter III, especially section 741. They apply in principle to all offshore companies, even ones in high tax jurisdictions. Contrast the Controlled Foreign Companies legislation, contained in Taxes Act 1988 Part XVII Chapter IV, especially section 747(1)(c).

4 Persons to Whom the Provisions Apply

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2 Taxation of Chargeable Gains Act 1992 section 288(1).

3 Taxation of Chargeable Gains Act 1992 section 99.

4 Taxation of Chargeable Gains Act 1992 section 288(1).

5 It is discussed in my forthcoming publication *The Control of Companies.*

6 Taxes Act 1988 section 414(1)(a).

7 I shall refer to a company which would be a close company if it were UK resident as a "quasi-close" company.

4.1 Residence and Domicile

Section 13(2) provides:

> "(2) Subject to this section, every person who at the time when the chargeable gain accrues to the company is resident or ordinarily resident in the United Kingdom, who, if an individual, is domiciled in the United Kingdom, and who is a participator in the company, shall be treated for the purposes of this Act as if a part of the chargeable gain had accrued to him."

The section can apply not only to individuals, but also to companies, trusts and personal representatives[8] resident in the United Kingdom. It does not apply at all to a non-UK domiciled individual, even if he is UK resident and ordinarily resident. There is no exemption for UK resident companies, trusts or estates which have a foreign connection, e.g. a company incorporated and therefore "domiciled" abroad or a trust established by a non-UK settlor and/or governed by a foreign proper law.[9] Likewise, a person resident both in the UK and another jurisdiction is caught, although he may be able to claim double taxation convention relief.

The provisions can apply in principle to attribute gains to a UK resident company for the purposes of corporation tax. Where the company is itself an "open" company, however, that will normally mean that the non-UK resident company is not a quasi-close company, so that the Provisions will not in that case apply at all. If they do not, it should be noted that there is not in general any other means of apportioning the gains of the non-UK resident company. Neither the Controlled Foreign Companies legislation nor the new transfer pricing provisions apply to capital gains.[10]

It should be noted that the Provisions do not apply on a yearly basis. An apportionment has to be made in principle each time a chargeable gains "accrues to", i.e. is realised by, the company.[11] It is the domicile and residence status of a participator at that time and at that time only which is relevant. Hence, if an individual ceases to be resident or ordinarily resident within a year of assessment, the Provisions will not apply to a gain

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8 For some reason, the Inland Revenue Capital Gains Tax Manual omits to mention personal representatives in the enumeration, at 57251, of persons to whom the Provisions apply.

9 On the other hand, it must be remembered that a trust or estate may be treated as non-UK resident because of the "foreign"status of the settlor or decedent: see Taxation of Chargeable Gains Act 1992 sections 69(2) and 62(3).

10 See Taxes Act 1988 section 747(6)(b) and Schedule 28AA paragraph 13(b).

11 I point out at 5 below some of the problems which can arise in making apportionments and how those problems are magnified if there is a change of circumstances within a year of assessment.

realised later in that year. By contrast, had the individual realised an actual gain at that time, it would in strict law still be taxable. While the Revenue might by concession not tax the gain, the Revenue reserve the right not to apply the concession in a case of tax avoidance.[12]

There is an important exception to the rule in the case of migrant trustees. This is the, possibly unintended, effect of section 13(10), which provides:

> "(10) The persons treated by this section as if a part of a chargeable gain accruing to a company had accrued to them shall include trustees who are participators in the company, or in any company amongst the participators in which the gain is apportioned under subsection (9) above,[13] if when the gain accrues to the company the trustees are neither resident nor ordinarily resident in the United Kingdom."

The purpose of this provision is no doubt to ensure that the gain is as much within the purview of the Offshore Settlor Provisions and the Offshore Beneficiary Provisions as is a gain actually realised by the trustees. Should, however, the trustees have been UK resident or ordinarily resident at another time in the same year of assessment, then neither the Offshore Settlor Provisions nor the Offshore Beneficiary Provisions would apply. Instead, the trustees would be taxable at the trust rate on the gains imputed by the OCC Provisions, just as if they had been UK resident at the time the imputed gain was realised.[14] There is no question of any concessionary relief being available.

4.2 Participators

Section 13(12) provides:

> "(12) In this section "participator", in relation to a company, has the meaning given by section 417(1) of the Taxes Act for the purposes of Part XI of that Act (close companies)."

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12 See *R v IRC ex parte Fulford-Dobson* [1987] STC 344. The charging provisions on temporarily non UK resident individuals, introduced by Finance Act 1998 would also need to be taken into account. The Extra-Statutory Concession, D2, was amended in March 1998.

13 Sub-apportionment is dealt with at 11 below.

14 Even if the settlor is UK resident in the year and "has an interest in the settlement", it would appear that the UK Settlor Provisions would not apply so as to deem the gain imputed to the trustees to be his, as it does not accrue to the trustees "from the disposal of any or all of the settled property". The Inland Revenue Capital Gains Tax Manual assumes, without argument or reasons, at 57252, that the UK Settlor Provisions will apply. It is possible that the writer did not appreciate the difficulty.

Taxes Act 1998 section 417(1) provides:

> "(1) For the purposes of this Part, a "participator" is, in relation to any company, a person having a share or interest in the capital or income of the company, and, without prejudice to the generality of the preceding words, includes—
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> (a) any person who possesses, or is entitled to acquire, share capital or voting rights in the company;
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> (b) any loan creditor of the company;
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> (c) any person who possesses, or is entitled to acquire, a right to receive or participate in distributions of the company (construing "distributions" without regard to section 418) or any amounts payable by the company (in cash or in kind) to loan creditors by way of premium on redemption; and
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> (d) any person who is entitled to secure that income or assets (whether present or future) of the company will be applied directly or indirectly for his benefit.
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> In this subsection references to being entitled to do anything apply where a person is presently entitled to do it at a future date, or will at a future date be entitled to do it."

The concept of "loan creditor" is further explained by section 417(7)-(9):

> "(7) Subject to subsection (9) below, for the purposes of this Part "loan creditor", in relation to a company, means a creditor in respect of any debt incurred by the company—
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> (a) for any money borrowed or capital assets acquired by the company; or
> (b) for any right to receive income created in favour of the company; or
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> (c) for consideration the value of which to the company was (at the time when the debt was incurred) substantially less than the amount of the debt (including any premium thereon);
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> or in respect of any redeemable loan capital issued by the company.
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> (8) Subject to subsection (9) below, a person who is not the creditor in respect of any debt or loan capital to which subsection (7) above applies but

nevertheless has a beneficial interest therein shall, to the extent of that interest, be treated for the purposes of this Part as a loan creditor in respect of that debt or loan capital.

(9) A person carrying on a business of banking shall not be deemed to be a loan creditor in respect of any loan capital or debt issued or incurred by the company for money lent by him to the company in the ordinary course of that business."

It will be appreciated that although the definition of "participator" is extremely complex, a full discussion of it is well beyond the scope of this article.[15] One interesting point which arises is whether, when trustees are shareholders in a company, and are therefore clearly participators, their beneficiaries can also be said to be participators by virtue of their beneficial interests in the shares. Where the trustees have no power of sale of the shares and a beneficiary is absolutely entitled to them on the termination of a prior limited interest, the beneficiary is literally entitled to acquire the shares at a future date. See section 417(1)(a). Where a person has an interest in possession in the trust fund then, whether or not the trustees have a power of sale, he is literally a person who possess a right to receive distributions of the company. An argument might even be presented that any beneficiary of the trust is entitled to secure that income or assets of a company will be applied directly or indirectly for his benefit, in that he is entitled to require the trustees properly to perform their duties as trustees, which duties include exercising their rights as shareholders for the general benefit of their beneficiaries. It may well be that the answer is that the beneficiary is not a participator in the company because vis-à-vis the company he has no rights whatsoever, the company being bound by articles, assuming them to be in standard form, to recognise the trustees, as registered holders, as the only persons interested in the shares: see *Bibby & Sons Limited v Inland Revenue Commissioners*.[16] Further, a case can be made out on a purposive construction that it cannot have been intended that two or more persons should each be participators in respect of the same shares or rights over the company.

Any doubt in this context is removed by section 13(14), which provides:

"For the purposes of this section, where—

(a) the interest of any person in a company is wholly or partly represented by an interest which he has under any settlement ("his beneficial interest"), and

(b) his beneficial interest is the factor, or one of the factors, by reference

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15 See my forthcoming book *The Control of Companies*.

16 (1946) 29 TC 167 (HL).

> to which that person would be treated (apart from this subsection) as having an interest as a participator in that company,
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> the interest as a participator in that company which would be that person's shall be deemed, to the extent that it is represented by his beneficial interest, to be an interest of the trustees of the settlement (and not of that person), and references in this section, in relation to a company, to a participator shall be construed accordingly."

Hence, it is clear for the purposes of the Provisions that a person is not a participator by virtue of his beneficial interest under a "settlement". "Settlement" is not specially defined and therefore bears its normal capital gains tax meaning of, in effect, a trust other than a section 60 trust. The draftsman of section 13(14), which was inserted by Finance Act 1996, appears to have considered that a beneficiary otherwise would be a participator and, possibly, that the trustees would not be. It is most unlikely that a court would be influenced by 13(14) in construing[17] Taxes Act 1988 section 416 which has been on the statute book, in one form or another, since 1922.

4.3 Non-UK Resident Trustees

Section 13(2) apportions gains only to United Kingdom residents. Section 13(10) extends the apportionment to no-UK resident trustees of settlements. It provides:

> "The persons treated by this section as if a part of a chargeable gain accruing to a company had accrued to them shall include trustees who are participators in the company, or in any company amongst the participators in which the gain is apportioned under subsection (9) above,[18] if when the gain accrues to the company the trustees are neither resident nor ordinarily resident in the United Kingdom."

Section 13(10) does not involve non-UK resident trustees in a charge to capital gains tax. That is precluded by Taxation of Chargeable Gains Act 1992 section 2(1). The gains imputed to such trustees may, however, be taken into account for the purposes of the Offshore Settlor Provisions and the Offshore Beneficiary Provisions. It is a moot point whether, in the case of a migrant trust, they can be taken into account for the purposes of the UK Settlor Provisions.

5 Method of Attribution

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17 Except in its application to the OCC Provisions.

18 For sub-apportionment, see 11.

5.1 The Statute

Subsection (2) states merely that part of the chargeable gain which has accrued to the company shall be treated as if it has accrued to such participators as are caught by the section. The method of apportionment is dealt with in later subsections which are not without their problems of interpretation.

Section 13(3) provides:

> "(3) That part shall be equal to the proportion of the gain that corresponds to the extent of the participator's interest as a participator in the company."

Section 13(13) provides:

> "(13) In this section—
>
> (a) references to a person's interest as a participator in a company are references to the interest in the company which is represented by all the factors by reference to which he falls to be treated as such a participator; and
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> (b) references to the extent of such an interest are references to the proportion of the interests as participators of all the participators in the company (including any who are not resident or ordinarily resident in the United Kingdom) which on a just and reasonable apportionment is represented by that interest."

5.2 Simple Cases

How does one ascertain what "proportion of the interests as participators of all the participators in the company" is "on a just and reasonable apportionment" represented by the interest of a given UK resident participator? Let us firstly consider only holders of equity in the company, i.e. disregarding loan creditors. Let us assume that the definition of "participator" is such that there can be no double counting.[19] Take the simplest case of a company with standard articles which has one hundred shares in issue, all with the same rights attached. Does one apportion rateably amongst the shares? Does one value the holdings and apportion on the basis of value? In that case, if A held half the shares but B had transferred his shares to ten trusts, one would value one fifty per cent interest and ten five per cent interests and the total gains to be apportioned to

19 Which is not the case: see below.

the trusts would be less than the gains apportioned to A.[20] There is no provision allowing shares of connected persons to be aggregated for valuation purposes, unless, possibly, this is authorised by the words "just and reasonable apportionment". Even if it is, the same problem would arise where the five per cent holdings were held by unconnected parties. If one apportions by shares rather than by value, the Provisions bear very heavily indeed on minority shareholders who will be taxable on a proportion of the gains of the company which they are unlikely ever to be able to realise by a sale of their shares. If one apportions by value, each shareholder will have to know how the other shares are held beneficially - not always an easy matter, even in the case of a UK resident company - and the valuations involved will be complex. This time, it may be the majority shareholder who will be taxable on a proportion of the gains of the company which he is unlikely ever to be able to realise by a sale of his shares.

5.3 More Complex Cases

Where there is more than one class of share capital, the position becomes more difficult still. There may be preference shares or deferred shares. There may be voting and non-voting shares. A just and reasonable apportionment must surely involve a reference to something more than their nominal value. Their actual value would appear to be more relevant. That then brings back the problems referred to in the previous paragraph. It also raises the question whether one should value shares of the class as a whole and then apportion that value rateably amongst the shares of the class or whether one should value the holding of each holder.[21]

5.4 Double Counting

As soon as one considers the possibility of double counting, the position becomes more complex. If I own 100% of the shares in a Sark resident company worth £1,000,000 and grant to an offshore bank an option to acquire them for £10,000,000, the bank will be a participator by virtue of Taxes Act 1988 section 417(1)(a). I possess all the shares and the bank is entitled to acquire them. Are the gains to be apportioned between us equally?

Double counting will occur in most cases where there are loan creditors. Suppose I own all the shares in a Nauru resident company which has gross assets worth £1,000,000 and no liabilities. All gains of the company not exempted from the Provisions will be

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20 The trustees would not be exempt from apportionment by virtue of section 13(4), discussed below, as they are connected with each other, assuming the settlor still to be alive: Taxation of Chargeable Gains Act 1992 section 286(3).

21 Having regard, in an appropriate case, to his complete holding where that comprises more than one category of shares: see *Attorney-General of Ceylon v Mackie* [1952] 2 All ER 775, discussed in my *Inheritance Tax Planning* at B.4.1.2, G.4.2.5, G.4.3.1 and G.7.3.1

apportioned to me. Suppose that the company then borrows £1,000,000 from a non-UK resident (other than a bank) and buys investments of that amount. If it then realises a gain, how should it be apportioned? If one has regard only to the net assets of £1,000,000, the whole of the gain is still apportioned to me. It could be said that it is just and reasonable that it should, as it is primarily and almost exclusively for my benefit that the gain enures. Yet on that basis one would ignore loan creditors altogether, even though they are expressly made part of the section 417 definition which is incorporated into the Provisions without any amendment in this respect. Does one then treat the rights of the loan creditor as equity and apportion, in this case, half of the gain to the creditor and half to myself? The Revenue can hardly have intended that consequence!

One could go on multiplying examples *ad nauseam* - and well beyond! This is yet another example of the lazy incorporation without adequate thought of an existing definition from a completely different context where it was intended to serve a very different purpose.

5.5. *Leedale v Lewis*

Does judicial authority provide the answer? Older practitioners may recall the decision of the House of Lords in *Leedale v Lewis*[22] on Finance Act 1965 section 42. The interpretation the courts gave to that section was thought to be so repugnant that it was repealed and replaced by what is now Taxation of Chargeable Gains Act 1992 section 87.[23] The material part of section 42(2) was:

> "(2) Any beneficiary under the settlement who is domiciled and . . . resident . . . in the United Kingdom during any year of assessment shall be treated for the purposes of this Part of this Act as if an apportioned part of the amount, if any, on which the trustees would have been chargeable to capital gains tax under section 20(4) of this Act, if domiciled and . . . resident . . . in the United Kingdom in that year of assessment, had been chargeable gains accruing to the beneficiary in that year of assessment; and for the purposes of this section any such amount shall be apportioned in such manner as is just and reasonable between persons having interests in the settled property, whether the interest be a life interest or an interest in reversion, and so that the chargeable gain is apportioned, as near as may be, according to the respective values of those interests, disregarding in the case of a defeasible interest the possibility of defeasance."

22 (1982) 56 TC 81, [1982] STC 835.

23 Section 42 had in fact been consolidated in Capital Gains Tax Act 1979 section 17. Section 17 was repealed after the decision in the Chancery Division. It was originally replaced by Finance Act 1981 section 80, which is now, with amendments, Taxation of Chargeable Gains Act 1992 section 87.

The wording was thus rather different in that the "value" of the interests was expressly referred to, which is not the case with the OCC Provisions. Section 42 was obviously going to be difficult to apply in the case of discretionary trusts, in which no beneficiary's interest was of any particular value.

It must be borne in mind in reading the speeches that the main argument was whether the *spes* of a discretionary beneficiary under a settlement was an "interest" within section 42, a question which does not arise in the context of section 13. The leading speech in the House of Lords was given by Lord Fraser of Tullybelton. He first rejected two arguments which, in my view, are equally invalid in the present context:

> "It is, in my opinion, clear that the amount to be apportioned is the whole amount on which the trustees would have been chargeable if they had been resident. Dillon J considered that there could be cases in which justice and reason would require that there should be no apportionment at all because the interests of those with interests were too remote. With respect that does not seem to me to be a sound construction; it involves reading the second part of the subsection as if it provided that the amount was to be apportioned "if and so far as is just and reasonable", but that is not what the section says. An alternative construction, which appealed to me at one time, would be to treat the subsection as providing for, or at least permitting, apportionment to a group of beneficiaries, such as the objects of a discretionary power, without making an immediate apportionment to any individual member of the group. But I have reached the view that that also would be wrong, both because the second part of subs (2) requires the amount to be apportioned between "persons" having interests in the settled property, and persons in the context of this personal tax must mean individual persons, and also because it would not permit the ascertainment of an apportioned part on which any individual beneficiary in the group could be treated as chargeable under the first part of the subsection in the year of assessment."

Their Lordships also rejected arguments that in making a just and reasonable apportionment the relative wealth or poverty of the discretionary beneficiaries or questions of hardship were to be taken into account. As Lord Fraser said: "I think the purpose of the direction [that apportionment was to be made "as near as may be according to the respective values of the interests"] is to show that the justice and reasonableness are to be judged by the respective values of the interests, and not by the relative wealth or poverty of the discretionary beneficiaries, except in a case where the poverty of the beneficiary might mean that he was likely to have the trustees' discretion exercised in his favour more generously than if he had been wealthy, and might thus increase the value of his interest." These comments would appear to be equally valid to an apportionment under the OCC Provisions.

Lord Fraser in a key passage stated:

> "The main reason why the Crown's contention [that the *spes* of a discretionary beneficiary was an "interest" within the meaning of section 42] is, in my opinion, correct, is that in the second part of subs (2), the primary direction is that the amount that would have been chargeable if the trustees had been resident, "shall be apportioned in such manner as is just and reasonable". The later direction that the gain is to be apportioned "as near as may be according to the respective values of [the] interests" is only a qualification of the primary direction. Accordingly, what is envisaged is not a strict apportionment by reference to the actuarial or market values of the interests, which would be impossible in the case of discretionary interests, but a much looser apportionment by reference to what is just and reasonable in view of the real probabilities under the particular settlement. That view is fortified by the final direction in subs (2) that the possibility of defeasance of defeasible interests is to be disregarded. Any attempt to arrive at precise values of the various interests, while disregarding the possibility of defeasance of those which are defeasible, would be likely to reach results that might well seem unjust and unreasonable in a case, such as the present, where the settlor's children have interests under clause 4 which are defeasible and which, according to evidence that was before the Special Commissioners, are almost valueless."

The reference to "the real probabilities" may be of some relevance in the context of the OCC Provisions. Of course, in the case of a company, the interests of the participators tend to be fixed, rather than discretionary. Where they are discretionary, the *Leedale v Lewis* "Who will probably benefit from the gain?" test could be very relevant indeed. Even where the interests are not discretionary, it would lend some support to the view I express below, that one should look to the person for whose benefit the accrual of the gain to the company will (or will probably) enure and in what proportions.

Lord Wilberforce said:

> "The words, in subs (2), "in such manner as is just and reasonable" and "as near as may be, according to the respective values of those interests" suggest a broad rather than an actuarial approach in which all relevant considerations may be taken into account. They permit (inter alia) consideration of the settlor's letter of intent which shows, at least, that the settlement was to be regarded as for the benefit of the grandchildren, not of the settlor's two children."

Lord Scarman said:

> "The governing words are "just and reasonable": they confer upon the Inspector and the Commissioners of Tax a wide latitude in judgment. The task is to

apportion the chargeable gain as near as may be, according to respective values. The language is apt to cover a valuation of interests where factors other than the market value of a property interest have to be considered. ...

"When one turns to the provision for valuation, the formula, with its emphasis on what is just and reasonable and its direction to apportion "as near as may be" according to the respective values of the interests in the settled property, is carefully drafted so as to admit into the valuation interests other than fixed property interests and to require, where appropriate, a valuation not tied to market values. It is a formula apt for the valuation of the interest of an object of discretionary trusts under a settlement where the expectation of future benefit is real, although the discretion to make a payment has not yet been exercised. For the purpose of valuation, the intention of the settlor, as evidenced by the deed and its recitals, is a significant factor to which value is to be attached to the extent that is just and reasonable and in a manner which, as near as may be, reflects the respective interests under the settlement. Further the letter of intent, though not by itself of great weight, is admissible as supporting the intention manifested in the settlement itself."

The decision in *Leedale v Lewis* was a very strong one. It was made at the height of judicial concern that tax avoidance was developing on such a scale that it would seriously erode the tax base. *Ramsay*[24] had been decided the previous year. The House of Lords had shown itself to be violently and unreasonably anti non-UK resident trusts in the dubiously reasoned decisions of *Roome v Edwards*[25] and *Chinn v Collins*.[26] What was quite extraordinary was that, even though section 42 directed that "the chargeable gain [be] apportioned, as near as may be, according to the respective values of those interests", their Lordships could hold that the "valuation" of the interests was not to be a valuation the like of which had ever been heard of before; for it would be based not upon what a purchaser might pay for the interest but on the benefit it was likely to confer on its owner. It is not surprising that Parliament intervened to put beneficiaries of such trusts in precisely the position they would have been had the taxpayers' appeal been allowed. I would hazard a guess that the courts nowadays would not be so unfair to taxpayers.

As already noted, in the case of the normal company, the question of discretionary interests does not arise. The enduring significance of the case is in my view the wide interpretation which was given to "just and reasonable" apportionment. This allows a

24 (1981) 54 TC 101 (HL); [1981] STC 174.

25 (1981) 54 TC 359 (HL); [1981] STC 96.

26 (1980) 54 TC 311 (HL); [1981] STC 1.

wide latitude to a modern judge or Special Commissioner to interpret section 13(13) so as to produce a just and reasonable result. The method of doing so, however, will require a rather different technique than in *Leedale v Lewis*.

5.6 The Author's View

In my view, the best and only test which can be realistically adopted is: "For whose benefit does the accrual of the gain in question to the company enure and in what proportions?" Admittedly this test is much easier to state than to apply. Where the interests of participators are discretionary, it may involve a prediction of who is in fact likely to benefit. This would be warranted by *Leedale v Lewis.*

It might be objected that this is not what the OCC Provisions say. I agree. But then the interpretation of Finance Act 1965 section 42 by the House of Lords in *Leedale v Lewis* strayed much further from what the section literally said. Now that we are much more used to purposive construction, it should be much easier to construe the OCC Provisions in the way suggested.

It might be objected that on my view whole categories of participators would fall to be ignored. I concede that, if my view is upheld, while *routinely* whole categories of participators will fall to be ignored, yet there will be exceptional cases where they will not. Take the case of the loan creditor. If the company is solvent and there is no real risk of it defaulting on the loan made by him, no part of the gain will be apportioned to him precisely because it will not enure for his benefit. Yet if the company is hopelessly insolvent, then the gain can indeed be apportioned to him because he will be the main - possibly the only - beneficiary of it. Where such a structure has been set up for tax avoidance purposes, the courts would have no sympathy with him. Where the loan has nothing to do with tax avoidance but the insolvency of the company was a misfortune, it might seem rather harsh to tax him simply because his loan was being repaid. In defence of such taxation it might be said that in substance it was the gain of the company which was being taxed. Had the company been UK resident it would have had to pay corporation tax on the gain and the Revenue would have had a preferential claim to it so that if the company were insolvent the creditor would not have been repaid to the extent of the tax. Such a defence is only partial. Were the rights of the creditor secured, for example, he would be able to take the gross proceeds of sale of the security leaving the Revenue a worthless proof for the corporation tax due.

A similar case is that of the preference shareholder. Where the assets of the company are more than adequate to pay his preference dividend and return of capital on liquidation, then the realisation by the company of a capital gain may enure for the benefit of only the ordinary shareholders. *Secus*, if not. In the case of the preference shareholder, the hardship of his having to pay tax when the company does not have sufficient assets does not seem so great, in that, as a shareholder, he assumes a higher risk than the loan creditor and his claims on the company's assets are in all cases postponed to those of the Revenue.

5.7 The Revenue View

The Revenue's views are set out in their Capital Gains Tax Manual at 57260 to 57283. They accept, at 57261, that "it is quite possible for the application of the different factors by which persons are participators to produce different percentages for each of them. ... This can happen even with relatively simple company structures, for example where there are preference shares, or loans. The total amount of gains apportioned cannot exceed the chargeable gain of the non-resident company. In this situation the gain has to be apportioned as is just and reasonable."

This brings us to the key question of how to make a "just and reasonable" apportionment. They lay down at 57262 a test of "real economic interest":

> "In considering a just and reasonable apportionment you should take into account all relevant factors, and not simply make an arithmetical adjustment. It would not usually be correct merely to average out the interests using the different factors. The aim of the provisions is to ensure that the gain is attributed to the participators who have the real economic interest in the non-resident company and who will derive the benefit of the gain however indirectly. The just and reasonable apportionment prevents an inappropriate part of the gain being attributed to persons without real economic interests, for example commercial loan creditors ..."

In accordance with this principle, they accept, at 57265, that in a case where "a person or institution (such as a bank or similar financial institution) has loaned money to the non-resident company as a matter of business on commercial terms" then "the interest of such a loan creditor acting at arm's length will be limited to an expectation of repayment of the amount loaned together with payments of interest at a commercial rate. There will be no expectation that the loan creditor can or will benefit from the profits or gains of the non-resident company. In such a case it would not be just and reasonable to apportion any of the gain to a loan creditor of this type."[27]

At 57266, (headed "review of all the circumstances") they leave open the possibility of apportioning gains to loan creditors:

> "Where there are participators who are loan creditors it will be necessary to review all of the circumstances to satisfy yourself that the interests of the loan creditors can be excluded for the reasons in CG57265. In some cases the

27 An example to this effect is given at 57281.

> persons with the real economic interest in the non-resident company will be loan creditors whether or not they are participators under one or more of the other tests set out in CG57250. In such cases, where there is participation in more than one way, it may be appropriate, depending on the facts of the case, to aggregate the interests of those persons in reaching an apportionment that is just and reasonable.
>
> "In other cases the persons with the real economic interest in the non-resident company may be providing the funds which the loan creditor has loaned to the company, and may be persons who are entitled to secure that income or assets (whether present or future) of the company will be applied directly or indirectly for their benefit, see CG57250 last bullet, and may be participators in their own right by virtue of that test."

This last statement does not go far enough. The example at 57282 is more helpful in making it clear that where a shareholder is also a loan creditor, he is not on that account to have a greater proportion of gains apportioned to him if he does not by virtue of the loan agreement obtain any preferential rights to profits or gains, rather than a repayment of capital advanced.

An interesting statement is made as regards voting shares in the example 4, at 57283. This is a case of a company which has A and B shares. Both shares carry voting rights, but only the A shares carry rights to dividends or distributions in a winding up. In this case, the Revenue state that "it appears" that all the gain should be attributed to the A shareholders. While this is a possible solution, it does ignore the fact that the B shares might have a considerable value and that that value might be increased as a result of the gain accruing to the company.

In summary, I find the Revenue's interpretation of the Provisions extremely sensible and in accordance with my views of how the Provisions *ought* to work. It is a great pity that the Revenue did not ensure that section 13 was drafted so as clearly to give effect to their intentions. One can defend their interpretation only by a highly purposive construction which does considerable violence to the language of the section. One of the difficulties is that the Revenue's interpretation will work to the advantage of some taxpayers and to the disadvantage of others. It is not therefore a case of the Revenue adopting an interpretation entirely benevolent to taxpayers to which no one will object and which will therefore *de facto* become the law.

5.8 Frequency of Apportionment

Every time that a chargeable gain or a quasi-allowable[28] loss is realised by the company,

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28 As to which see 9 below.

there will need to be a separate apportionment.[29] If any of the relevant circumstances have changed, a fresh method of apportionment might have to be devised. This could be extremely expensive and time consuming.

5.9 Minority Shareholders

Where an offshore company is owned by one person or trust, it will not normally be difficult to obtain information about the company's attributable gains or to apportion those gains amongst the participators. Minority shareholders may often find themselves in a difficult position in that they will not always have access to the company's internal accounts. Moreover, it is very likely that the relevant computations will never have been made and that those running the company may not see why they should go to the expense of preparing them.[30] Minority shareholders may not even be able to discover whether the company is a quasi-close company. I have already remarked on the difficulties of apportioning gains amongst participators. A minority shareholder who is unaware how other shares and/or interests in the company are held might find it impossible to make the calculation, even if the basis of it were clear.

There is one scrap of comfort. Section 13(4) provides:

> "(4) Subsection (2) above shall not apply in the case of any participator in the company to which the gain accrues where the aggregate amount falling under that subsection to be apportioned to him and to persons connected with him does not exceed one twentieth of the gain."

The test of connected persons is very wide: see Taxation of Chargeable Gains Act 1992 section 286, which mirrors Income and Corporation Taxes Act 1988 section 839. Despite my arguments to the contrary, it was held by the Court of Appeal in *Steele v*

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29 See my comments above at 4.1.

30 The computations would involve the preparation of accounts on a year of assessment basis. Separate computations would have to be made within a year of assessment where the participator's domicile and residence status change within the year so as to bring him in or take him out of the Provisions. The computations would involve the identification of those gains which are (a) chargeable gains (b) not exempt from capital gains tax in general (c) not excluded from the application of the Provisions by section 13(5), discussed at 6 below. Where the accounts of the company are in a foreign currency, they would involve the conversion of all allowable expenditure and proceeds of disposal into sterling at the spot rate on the day the expenditure was incurred or, in the case of proceeds of sale, the day of sale (or possibly the date of actual disposal or possibly the date of receipt of proceeds).

EVC International NV,[31] to the consternation of corporate tax experts,[32] that two or more otherwise completely unconnected shareholders can be connected with each other in relation to a deadlocked company on the grounds that they are "acting together to secure or exercise control" of the company.

6 Exempt Gains

Section 13(5) provides:

> "(5) This section shall not apply in relation to—
>
> (a) ...
>
> (b) a chargeable gain accruing on the disposal of assets, being tangible property, whether movable or immovable, or a lease of such property, where the property was used, and used only, for the purposes of a trade carried on by the company wholly outside the United Kingdom, or
>
> (c) a chargeable gain accruing on the disposal of currency or of a debt within section 252(1), where the currency or debt is or represents money in use for the purposes of a trade carried on by the company wholly outside the United Kingdom, or
>
> (d) to a chargeable gain in respect of which the company is chargeable to tax by virtue of section 10(3)."

The reference to "movable and immovable property" corresponds roughly to the difference between chattels on the one hand and land and buildings on the other .

A debt is in general an asset on the disposal of which no chargeable gain (or allowable loss) is to accrue: Taxation of Chargeable Gains Act 1992 section 251(1). One major exception is the case of a debt on a security.[33] Another exception, contained in section 252(1), is "a debt owed by a bank which is not in sterling and which is represented by a sum standing to the credit of a person in an account in the bank." While section 13(5)

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31 [1996] STC 785, affirming the decision of Lightman J sub nomine *Steele v European Vinyls Corp (Holdings) BV* [1995] STC 31. The decisions are also reported at 69 TC 88.

32 The decision involved the virtual abolition of consortium relief, which was restored firstly by Revenue concession and then by legislative amendment!

33 A gain on the disposal of a debt on a security will not normally be a chargeable gain if it is a "qualifying corporate bond": Taxation of Chargeable Gains Act 1992 section 115.

exempts gains of this type from its scope, it does not exempt gains arising from the disposal of other debts which are not exempt, even if acquired for the purposes of a trade carried on outside the United Kingdom.

Even a non-UK resident company will, by virtue of Taxation of Chargeable Gains Act 1992 section 10, be within the charge to corporation tax, if it is carrying on a trade in the United Kingdom through a branch or agency, in respect of "chargeable gains accruing on the disposal—

> "(a) of assets situated in the United Kingdom and used in or for the purposes of the trade at or before the time when the capital gain accrued, or
>
> (b) of assets situated in the United Kingdom and used or held for the purposes of the branch or agency at or before that time, or assets acquired for use by or for the purposes of the branch or agency."

In such a case, there is no more need for section 13 to bite than there is in the case of a UK resident company.

Intangible assets of a company will not be exempt from the operation of the Provisions even if owned and used exclusively for the purposes of a trade carried on wholly outside the UK. In practice the most important of these is likely to be goodwill. This category also includes intellectual property rights, shares and securities.

7 Double UK Taxation

7.1 Comparison with UK Resident Company

Where assets are held in a United Kingdom resident company, a potential double charge to UK tax can arise in respect of the same gain, both on the company when it disposes of the asset and on the shareholders when they dispose of their shares, which in each case will happen at the latest on liquidation of the company. The injustice is to some extent mitigated where the gain is distributed by way of dividend, as an income tax credit is in general available to the shareholder of 20% of the amount of the grossed-up distributed part of the gain.[34]

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34 This is technically not entirely accurate, given the changes effected by Finance (No 2) Act 1997. It is, however, broadly accurate, provided there is no question of repayment of the tax credit. Nowadays, theoretically the credit is reduced to 10% yet the rate at which the dividend is taxed leaves taxpayers in the same position as if the credit had remained at 20%. The only persons really affected are (a) exempt taxpayers, such as charities and pension funds, (b) nil rate taxpayers whose personal reliefs have not been fully utilised, and (c) overseas residents

Where assets are held in an offshore company and part of the gain is apportioned to a United Kingdom resident participator, credit for the tax payable is greatly restricted. It is no longer possible to avoid a double charge simply by distributing the gain with two years of its having arisen.[35]

7.2 The Statute

The only possible forms of relief are under subsections (5A) or (7) of section 13 which provide:

> "(5A) Where—
>
> (a) any amount of capital gains tax is paid by a person in pursuance of subsection (2) above, and
>
> (b) an amount in respect of the chargeable gain is distributed (either by way of dividend or distribution of capital or on the dissolution of the company) within 2 years from the time when the chargeable gain accrued to the company,
>
> that amount of tax (so far as neither reimbursed by the company nor applied as a deduction under subsection (7) below) shall be applied for reducing or extinguishing any liability of that person to income tax in respect of the distribution or (in the case of a distribution falling to be treated as a disposal on which a chargeable gain accrues to that person) to any capital gains tax in respect of the distribution.[36]
>
> (7) The amount of capital gains tax paid by a person in pursuance of subsection (2) above (so far as neither reimbursed by the company nor applied under subsection (5A) above for reducing any liability to tax) shall be allowable as a deduction in the computation under this Act of a gain accruing on the disposal by him of any asset representing his interest as a participator in the company."

7.3 Alternative Relief

It is clear from the provisions that the relief they allow is alternative, not cumulative. It would appear that the taxpayer is entitled to make his election between them. It will

who can claim a refund under the terms of a double taxation convention.

35 Section 13(5)(a) having been repealed by Finance Act 1996.

36 Section 13(6) was repealed by Finance Act 1996.

normally be beneficial for him to obtain relief under section 13(5A) rather than under section 13(7), as in the former case he obtains a *credit* for tax paid whereas in the latter case he only obtains a *deduction* in computing his capital gains. Everything will, however, depend on the precise circumstances. Whether it will be advantageous for the capital gain to be distributed in the form of income, capital gain or pure capital will also depend on the circumstances. As a very general rule, a distribution of pure, non-taxable, capital would be preferred, if possible, in which case section 13(5A) will not normally be in point. Subject to that, a distribution of income may well be preferable to one of capital gain.

7.4 Payment of Tax by the Company

It is also clear that if the company pays the tax due under the Provisions, the taxpayer obtains no relief from double taxation under the section. This is only fair, as the amount reimbursed is "not for the purposes of income tax, capital gains tax or corporation tax [to] be regarded as a payment to the person by whom the tax was originally payable."[37]

7.5 Tax "paid" or "payable"?

One key feature is that it is not enough for relief to be available that a gain has been attributed to a person under the Provisions: tax must actually have been paid and paid, if one construes the provisions literally, by him. The reliefs operate purely in terms of tax paid. Thus, if a gain is attributed to me and I do not pay tax on it because, for example, it is covered by my annual exemption or I have losses to offset it, the exemption or losses are in a sense wasted. The same considerations are in point where I do not pay tax on the imputed gain for some other reason, such as double taxation relief. *A fortiore*, where a gain is not even imputed to me, because I am not both domiciled and resident or ordinarily resident in the United Kingdom at the relevant time.

There is a technical problem in the way of obtaining relief where tax is payable but has not yet been paid. Fortunately, the Revenue are quite sensible on this point. They state, in the Capital Gains Tax Manual at 57362:

> "It is a condition of Section 13(5A) relief that the tax arising on the gain attributed under Section 13 must have been paid. In some cases the liability on the Section 13 gain and on the distribution will arise in the same year of assessment or accounting period, and in other cases the tax on the Section 13 gain will not have been paid.
>
> In practice relief may be given by set-off providing that the only reason

37 Section 13(11), as to which see 8 below.

> preventing relief being given is that tax on the Section 13 gain is unpaid."

7.6 Credit on Distribution

Under section 13(5A), tax paid under the Provisions can be offset against tax due on a distribution from the company. Such a distribution could be of an income nature, typically a dividend. It could also be of a capital nature, e.g. a repayment of capital or a distribution of surplus assets on a liquidation, in which case it could produce a liability to capital gains tax.[38]

It is stated in the Revenue Capital Gains Tax Manual at 57361:

> "Once capital gains tax has been paid under Section 13, then the whole of that tax is available for set-off against any tax liability on a subsequent distribution where the conditions for relief are met. Should only half of the gain be distributed this does not mean that only half of the Section 13 capital gains tax can be set off. The Section 13 tax represents a pool of tax credit to be used up against tax liability arising from appropriate distributions in respect of the same gain. Thus if only half of the gain is distributed but the tax liability on the distribution is at a higher rate than the tax on the Section 13 gain, the tax credit relief will be more than half of the Section 13 tax."

If read cursorily, the reference to a "pool" could mislead the reader. The amount distributed must, in the words of section 13(5A) be "in respect of the chargeable gain" of the company which has been imputed to the taxpayer under the Provisions. Hence, one still needs to identify the gain which caused the charge under the Provisions with the amount distributed. It is not the case that tax paid under the Provisions simply goes into a general pool and can then be offset against any tax liability of a type described in section 13(5A). There could be practical problems in identifying what is distributed with the gain which has been imputed to the taxpayer under the Provisions. A suitably worded resolution of the company in making the distribution could be appropriate.

7.7 Credit Non-Transferable

Suppose A pays tax on gains attributed to him under the Provisions and then disposes of the shares to B. Within two years of their being realised, the gains are distributed by way of dividend. Had A retained the shares, he would have been entitled to a section 13(5A) credit. Given the disposal, neither A nor B will obtain the credit,[39] although A

38 In accordance with Taxation of Chargeable Gains Act 1992 section 122.

39 This point, which is incontestable, is made very firmly in the Inland Revenue Capital Gains Tax Manual at 57354.

will in principle be able to claim a deduction in computing his capital gains tax on the disposal.

7.8 Gains Imputed to Trustees

The gains of an offshore quasi-close company can be attributed to non-UK resident trustees for the purposes of the Offshore Settlor Provisions and the Offshore Beneficiary Provisions. This can result in the gain being further attributed to the settlor or a beneficiary. The double taxation relief provisions are difficult to apply in such a situation. There are many possible permutations of problem situations. The following is but one example.

Suppose the trustees of a settlement to which the Offshore Settlor Provisions do not apply have a 100% holding in an offshore company which realises a gain. The gain is attributed to them for the purposes of the Offshore Beneficiary Provisions. It is then attributed to beneficiary A, who receives a capital payment from the trustees and he is liable to tax.[40]

Suppose that the company then distributes the gain by way of dividend or other distribution which is of an income nature for income tax purposes. If the dividend belongs to A as the person entitled for an interest in possession, he will be taxable on it. In my view, A would be entitled to the credit. Capital gains tax was paid by him "in pursuance of" section 13(2), notwithstanding that it was also paid in pursuance of section 87 ... and section 2(1) ... and section 1. While it is true that the gain is imputed to the trustees by virtue of section 13(10), it is section 13(2) which is then brought into play. Although section 13(10) itself provides that the persons to whom a part of a chargeable gain accruing to a company may be attributed shall include non-UK resident trustees, which in part performs the same function as section 13(2), the provisions as to the manner of apportionment, which are clearly brought into play by section 13(10), themselves refer back to section 13(2).

If the trust is a discretionary one and the trustees in their discretion distribute the dividend to A as income, the position is more complex. On my view, the position is no different than if A had been entitled to the dividend. The Revenue view is that his source is not the dividend but the trust.[41] Even if the Revenue view is correct, A's liability to income tax on the income received from the trustees may still fairly be said to be a "liability of [A] to income tax in respect of the distribution" by the company to

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40 Where the gain simply goes to swell the pool of trust gains, some of which are apportioned to beneficiaries other than A, an apportionment is presumably required.

41 Or the trustees, or their discretion - it is not entirely clear which. See my *Comments on The Inland Revenue Consultative Document on Trusts*, published by Key Haven Publications PLC.

the trustees, in that the liability would not have been incurred but for that distribution. Where the dividend is accumulated and received by A as trust capital which is deemed to be income by virtue of, say, Taxes Act 1988 section 740, the position is more problematic. The same argument could in principle be used, but the practical difficulty may be in identifying the capital payment received by A with the dividend paid by the company to the trustees if there was other "relevant income" in relation to A.

If the person to whom the dividend belongs being as the person entitled for an interest in possession is B, he is apparently not entitled to any credit as he has not paid any tax. This technical point appears to be one which the Revenue are keen to make: see the Capital Gains Tax Manual at 57354, where the words "same person" are emboldened.

Suppose that the company does not declare a dividend, but the trustees subsequently liquidate the company and realise a further capital gain, which is also a trust gain for the purposes of the Offshore Beneficiary Provisions. Is it reduced by virtue of the prior attribution to the trustees? Clearly not. If this further trust gain is imputed to beneficiary A, can he claim a credit for the tax already paid by him on the previous occasion? Let us assume that A can overcome the hurdle of showing that it was indeed the further trust gain which was imputed to him, which may not always be easy, given that the Provisions involve a pool of gains and attribution on an accounting rather than a tracing basis. Can A claim a credit for the amount of tax paid by him in respect of the earlier imputed gain? In my view he may be able to. A's liability is still "in respect of the distribution", if he would not have incurred the liability but for the distribution. This is a question of fact in each case.

If the trust gain is imputed to beneficiary B can he claim a credit for the tax paid by beneficiary A? The Revenue view is again firmly that he cannot, and this is indeed the technical position in law.

Suppose that the trustees neither receive a dividend from the company nor liquidate it but sell the shares. Does section 13(7A) come into play? Capital gains tax paid by A cannot be deducted in computing the gain of the trustees as it is their gain and they have not paid the tax. Suppose that a further capital payment is made to A on which A is liable to capital gains tax under the Offshore Beneficiary Provisions. Suppose further that that charge to tax would not have occurred but for the trustees having realised a gain on the sale of the shares. A is in my view a person who has paid capital gains tax "in pursuance of" section 13(2), in so far as the tax paid on the earlier capital payment to him was attributable to the gain attributed to the trustees under the Provisions. Can he, however, obtain a deduction "in the computation ... of a gain accruing on the disposal by him of any asset representing his interest as a participator in the company"? As a matter of law, this is extremely difficult. He has not in fact disposed of any asset; the gain is attributed to him in gross under the Offshore Beneficiary Provisions.

7.9 Ordering Rules

Section 13(7A) contains what the Revenue Manual refers to as "tax relief ordering rules". It provides:

> "(7A) In ascertaining for the purposes of subsection (5A) or (7) above the amount of capital gains tax or income tax chargeable on any person for any year on or in respect of any chargeable gain or distribution—
>
> (a) any such distribution as is mentioned in subsection (5A)(b) above and falls to be treated as income of that person for that year shall be regarded as forming the highest part of the income on which he is chargeable to tax for the year;
>
> (b) any gain accruing in that year on the disposal by that person of any asset representing his interest as a participator in the company shall be regarded as forming the highest part of the gains on which he is chargeable to tax for that year;
>
> (c) where any such distribution as is mentioned in subsection (5A)(b) above falls to be treated as a disposal on which a gain accrues on which that person is so chargeable, that gain shall be regarded as forming the next highest part of the gains on which he is so chargeable, after any gains falling within paragraph (b) above; and
>
> (d) any gain treated as accruing to that person in that year by virtue of subsection (2) above shall be regarded as the next highest part of the gains on which he is so chargeable, after any gains falling within paragraph (c) above."

The explanation of this subsection given in the Revenue Capital Gains Tax Manual, at 57375, is:

> "Where the events which can give rise to relief under Section 13(5A) and (7) occur within a single tax year, there can, in certain circumstances, be computational problems. To prevent this subsection (7A) sets out the order of priority to be given to each tax charge. In ascertaining for the purposes of subsections (5A) and (7) the amount of Capital Gains Tax or Income Tax which is chargeable on a person for a year, the order is:
>
> (a) any distribution which is chargeable as income is treated as the top slice of income for that year

(b) any gain accruing on the disposal of any asset representing the participator's interest in the non-resident company is treated as the top slice of gains for that year

(c) any gain accruing on a capital distribution is treated as the second slice of gains for that year

(d) the gain attributed to the participator under Section 13 is treated as the third slice of gains for that year."

8 Payment of Tax by the Company

Section 13(11) provides:

> "(11) If any tax payable by any person by virtue of subsection (2) above is paid by the company to which the chargeable gain accrues, or in a case under subsection (9) above is paid by any such other company, the amount so paid shall not for the purposes of income tax, capital gains tax or corporation tax be regarded as a payment to the person by whom the tax was originally payable."

This may be an attractive option, given the limitation on the relief from double UK taxation afforded by the Provisions. It may be difficult to achieve in practice, except in the case of a wholly-owned company established under a jurisdiction with a particularly flexible company law. In other cases, the main problem may well be in persuading the directors and/or other participators that the payment should be made. Another problem is the taxation of the payment in other jurisdictions, such as that where the company is incorporated or resides or where it earns it profits. Likewise any payments made to compensate other participators who are not caught by section 13, or not caught to the same extent.

Another possible problem is an uncertainty as to what counts as a payment of tax by the company. Suppose I own equally with a US resident the share capital of a US investment company. The company realises a chargeable gain caught by the Provisions, half of which is imputed to me. The US shareholder will not agree to the company simply paying my tax and/or that is not permitted as a matter of the law of the state of incorporation. Instead a dividend is declared, the net amount of which, after allowing for US withholding tax, is, in my case, equal to the capital gains tax payable by me as the result of the operation of the Provisions in relation to the company's gain. One would hope that in these days of purposive construction the Revenue would not object that the company did not pay the tax but merely put me in funds to make the payment (or reimbursed me after making the payment). The reference to income tax and corporation tax is helpful in this regard. In the case of non-UK resident companies, there is next to nothing corresponding to the very extended definition of "distribution" for Schedule F purposes. If the company simply paid a capital gains tax liability imposed on me in respect of the company's gain, it is arguable that I would not have received any income for the purposes of Schedule D Case IV or V.

9 Losses

The OCC Provisions work unfairly in relation to losses. Consequently, the timing of disposals can be very important. Section 13(8) provides only limited relief. It provides:

> "(8) So far as it would go to reduce or extinguish chargeable gains accruing by virtue of this section to a person in a year of assessment this section shall apply in relation to a loss accruing to the company on the disposal of an asset in that year of assessment as it would apply if a gain instead of a loss had accrued to the company on the disposal, but shall only so apply in relation to that person; and subject to the preceding provisions of this subsection this section shall not apply in relation to a loss accruing to the company."

Hence, losses are attributed to persons. The attribution will occur only if the person satisfies the relevant domicile and residence requirement at the time the loss is realised. If, say, a UK domiciliary is resident or ordinarily resident in the United Kingdom for only part of a year, losses sustained on the direct disposal of an asset by him at any time in that year are allowable losses. No loss will be attributed to him for the purposes of the OCC Provisions, however, at a time when he is neither resident nor ordinarily resident in the United Kingdom.[42]

A loss attributed to a person under section 13(8) can thus be used only to offset a gain imputed to him under the OCC Provisions for the same year of assessment. Any other loss so imputed is in effect "stranded". Where a person has interests in two or more companies to which the Provisions apply, there is nothing to stop him offsetting attributed losses referable to one company against attributed gains referable to another.[43]

10 Taper Relief and Indexation Relief

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42 See the discussion at 4.1 above for the position regarding gains. There is no question of allowable losses being denied by Extra-Statutory Concession. *Sed quaere* whether, if a migrant individual wished to take advantage of ESC D2 to avoid capital gains tax on gains realised by him during a non-resident part of the year, he would be allowed by the Revenue at the same time to set losses realised during such period against gains realised during a resident period.

43 The Revenue agree with this view. See Inland Revenue Capital Gains Tax Manual at 57295.

Finance Act 1998 has abolished capital gains tax indexation relief in respect of periods after April 1998. Taper relief has been introduced in its place. The changes do not apply to corporation tax on chargeable gains. In the case of the OCC Provisions, gains will be computed on corporation tax principles: section 13(11A). The corollary is that no taper relief will be available so as to reduce the gain of the company, whether before or after being imputed to a participator: section 13(10A).

11 Indirect Interests

Gains can in principle be apportioned through a chain of non-UK resident quasi-close companies to the participators in the top company. Section 13(9) provides:

> "(9) If a person who is a participator in the company at the time when the chargeable gain accrues to the company is itself a company which is not resident in the United Kingdom but which would be a close company if it were resident in the United Kingdom, an amount equal to the amount apportioned under subsection (3) above out of the chargeable gain to the participating company's interest as a participator in the company to which the gain accrues shall be further apportioned among the participators in the participating company according to the extent of their respective interests as participators, and subsection (2) above shall apply to them accordingly in relation to the amounts further apportioned, and so on through any number of companies."

The provisions relating to credits and deductions are correspondingly more complex when there is more than one company in the chain.

For a discussion of the "sub-subsidiary trick", see my *Non-Resident Trusts* 7th edition at 9.4.4. For indirect interests in the context of the Offshore Settlor Provisions, see *ibidem* 13.7.4.5.

12 Double Taxation Relief

The Revenue appear to be of the view that if the gain of the company is relieved from capital gains tax/corporation tax by a double taxation convention, then section 13 cannot apply to it. CCAB TR 500, of 10th March 1983 (Guidance note on taxation: points of practical interest) includes a statement, at paragraph 14, of the then Revenue view:

> "14 [TCGA 1992 s.13] can impose a charge on a UK parent company on capital gains arising from disposals by its overseas subsidiary if the latter would be a close company if it were resident in the UK. The Inland Revenue have confirmed that, where the overseas subsidiary is resident in a territory with

> which the UK has a double taxation agreement and there is an article exempting residents of that territory from a charge to UK capital gains, then such an article *may* prevent the imposition of a charge under s 13."

The word "may", which I have italicised, is crucial. The Inland Revenue Capital Gains Tax Manual at 57380 (Double taxation agreements), as revised to July 1996, states:

> "You should always check whether there is a double taxation agreement between the UK and the country in which the company making the gain is resident. ... But, if the agreement provides that gains of the type realised by the non-resident company are only taxable in that company's country of residence Section 13 TCGA 1992 cannot apply. For example, Article 15(4) of the Kenya/UK Double Taxation Agreement would prevent Section 13 TCGA 1992 applying to the disposal of stocks and shares by a company resident in Kenya. Agreements will often treat gains on the disposal of particular types of asset differently."

Why did the Revenue say "may" in 1983, whereas in 1996 it stated categorically that Section 13 TCGA 1992 cannot apply? There is in my view no inconsistency. Double taxation conventions exempt either a person or a profit from UK tax. If they exempt only the person, then prima facie no other person can claim the exemption. If they exempt the gain, there is no reason why the exemption should not apply to a gain of the relieved description which is attributed to a person who did not in fact realise it. In the 1983 statement, the Revenue referred to double taxation conventions in general. Hence, their statement was necessarily qualified. In the Manual, however, they refer specifically to a provision of a convention which exempts the gains. Article 15(4) of the Kenya/UK Double Taxation Agreement is in standard OECD Model form. It reads: "Capital gains from the alienation of any property other than those mentioned in paragraphs (1), (2) and (3) of this Article shall be taxable only in the Contracting State of which the alienator is a resident." It thus exempts from UK tax the gain itself rather than the resident of Kenya who realises the gain.

The Revenue certainly do not accept as a general proposition that a double taxation convention will necessarily afford relief to a UK resident who is charged to tax on an amount computed by reference to a profit or gain which, in the hands of the person to whom it arises, is exempted from UK tax by the terms of the convention.[44]

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44 See generally my articles 'Double Taxation Treaties: the Antidote to Anti-Avoidance Provisions'? *Bricom Holdings Ltd v IRC* in Volume 6, Issue 3, of *The Offshore Taxation Review* at page 161 and 'Treaty Override: *Bricom Holdings Ltd v IRC* in the Court of Appeal' in Volume 7, Issue 3, of *The Offshore Taxation Review,* at page 151.

13 Relief for Foreign Tax

If the company has suffered foreign tax on the gain, it would be unjust if some credit or relief were not given under section 13, especially if it would have been available if the UK resident to whom the gain has been imputed had himself realised the gain and suffered the tax.

The Revenue are prepared to allow a credit for the foreign tax paid. They state, in their Capital Gains Tax Manual, at 57382 (Tax credit relief):

> "Section 277 TCGA 1992
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> "The UK resident can claim tax credit relief under Section 277 TCGA 1992. Relief is given on a proportion of the foreign tax equal to the proportion of the total gain attributable to the UK resident. This amount is set-off against the charge to Capital Gains Tax or Corporation Tax on the relevant chargeable gains. ... If tax credit relief is allowed no deduction under Section 278 TCGA 1992 can be allowed in computing the chargeable gain."

While a credit will usually be preferable to a deduction in computing the gain on a disposal of the participator's interest, the latter may be more advantageous in certain circumstances, in which case the Revenue are prepared to allow it. They state, in their Capital Gains Tax Manual, at 57383 (Tax deducted in computing gain):

> "Section 278 TCGA 1992
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> "If the UK resident does not want to claim tax credit relief, the tax can be deducted in computing the gain, Section 278 TCGA 1992. The foreign tax paid does not qualify for indexation allowance. ... In all other respects you compute and apportion the gain in the usual way allowing the foreign tax paid as a deduction. ..."[45]

45 The Manual contains worked examples.