CAPITAL GAINS TAX AVOIDANCE COURTESY OF THE INLAND REVENUE

Robert Venables QC[1]

1 Scope of Article

Ever since the introduction of United Kingdom capital gains tax in 1965, taxpayers and their advisers have been trying to avoid the tax by the use of offshore structures. In that period, a complicated edifice of anti-avoidance legislation has come into being, aimed largely at offshore trusts, companies and institutions. In *Jerome v Kelly*, decided 20th December 2002, the English Court of Appeal has effectively endorsed a far simpler strategy. It has done so, ironically enough, by giving effect to the contentions of the Inland Revenue in that case and despite the fact that the tax planning consequences of their decision were plainly pointed out to them.

As I am, together with Mrs Amanda Hardy, counsel for the taxpayer and the House of Lords has been petitioned for leave to appeal, it would not be appropriate for me to comment on the soundness of the decision. In this article, I shall point out the new opportunity for tax avoidance which will be available unless the House of Lords agrees to hear an appeal and in fact allows it.

2 The Decision

Jonathan Parker LJ, delivering the judgment of the Court of Appeal, stated the issue:

> "3. The appeal raises a short but important question as to the true construction of s.27(1) of the Capital Gains Tax Act 1979 ("the 1979 Act"), a provision which is now to be found in s.28(1) of the Taxation of Chargeable Gains Act 1992 ("the 1992 Act"). S.27 of the 1979 Act is directed at situations in which an asset is disposed of under a pre-existing contract. It provides as follows (so far as material):
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> > "27. Time of disposal and acquisition where asset disposed of under contract

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> (1) Where an asset is disposed of and acquired under a contract the time at which the disposal and acquisition is made is the time the contract is made (and not, if different, the time at which the asset is conveyed or transferred).
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> This subsection has effect subject to .... subsection (2) below.
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> (2) If the contract is conditional .... the time at which the disposal and acquisition is made is the time at which the condition is satisfied."

4. The question which arises is succinctly expressed in the Revenue's skeleton argument as follows:

> "If A enters into an unconditional contract to sell land to B, and in the interval between contract and completion transfers his residual beneficial interest in the land, subject to and with the benefit of the contract, to C (e.g. by means of a declaration of trust), who is treated as disposing of the land for CGT purposes when the contract is completed in accordance with its original terms by a conveyance from A to B? Is it A, as the Revenue contends and the Special Commissioner held? Or is it C, as the taxpayer contends and Park J has now held?"

The Court preferred the Revenue's contention and reversed the decision of Park J, the most experienced and knowledgeable of the judges in Revenue matters. Jonathan Parker LJ said:

> "76. For the reasons I have given, the true position, in my judgment, is that s.27(1) has a much simpler and more limited effect than that which the judge ascribed to it. Its effect, in my judgment, is that where the owner of an asset contracts to convey or transfer it, and the contract is subsequently completed, the disposal of the asset for capital gains tax purposes takes place when the contractual obligation is created and not when it is performed."

3 The New Tax Avoidance Strategy

We had submitted, on behalf of the taxpayer:

> "If the Revenue is right, the following would result:
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> A is United Kingdom resident and domiciled. B is neither resident nor ordinarily resident in the United Kingdom. B contracts to sell specific non-quoted securities to C (another non-UK resident) say, completion to be five years ahead and for a consideration equal to market value at completion. B sells the securities to A subject to and with the benefit of the contract with C. In due course the contract is completed. The securities are in fact disposed of by A who receives the consideration and realises the gain. Yet if the Revenue is right,

> the gain is deemed to be realised by B, who is outside the charge to capital gains tax."

In other words, in a start-up situation, a little simple, forward planning can avoid the charge to capital gains tax. The taxpayer does not need any trust, company or foreign institution in which he or his beneficiaries have interest. Instead, B and C can be tax haven companies wholly owned by professional advisers. The contract can be made very flexible as to time of completion: e.g. twenty years ahead or on B (or his assignee) giving notice to C. The only limitation is that the contract must be specifically enforceable. Normally, a contract of sale will be specifically enforceable provided it is not for assets which are readily available in the marketplace, such as quoted shares or Brent crude.

The Court's reaction to this was interesting. Jonathan Parker LJ said:

> "77. As to Mr Venables' submission that this construction of s.27(1) facilitates tax avoidance, it seems to me that if his construction was adopted, there would be far greater opportunities for tax avoidance. In this respect, the very complicated device which he proposed in argument is to be contrasted with the very simple device involved in the instant case, were his submissions to be accepted."

I leave it to the reader to judge just how complicated is the device the Court of Appeal has endorsed. I also leave him to judge whether any taxpayer would be prepared to get involved in such complications just to save millions of pounds in tax.

4 The Alternative Device

The reader might well wonder what was "the very simple device involved in the instant case". Could it be that the Revenue is in a no-win situation so that if the Court of Appeal decision is reversed on appeal to the House of Lords, another strategy will be open to taxpayers? The answer in my view, is "no".

In April 1987, the land was contracted to be sold. Completion would take place only if planning permission was obtained. No deposit was paid and the purchaser was free to rescind if planning permission was not obtained. In December 1989, the taxpayer gifted undivided shares in the land, subject to the contract of sale, to Bermudian trustees. The only advantage to be expected was the same as if the undivided shares had been gifted to the trustees before the date of the contract. That advantage was that, while the inherent gain to the date of the gift would be brought into charge to capital gains tax on the settlor at the date of the gift, the future gain on a disposal by or on behalf of the trustees would not. Yet that was in those days a feature of offshore trusts in general. By delaying the gift until after the date of the contract, Mr Jerome had in fact increased his own tax bill on the gift, because the market value of what had been gifted had risen.

The obnoxiousness, if any, of the device lay not in the gift being made after the contract of sale but in its being made at all, to an offshore trust. Since 1989, the law has moved on. If a taxpayer were to make a similar gift today on similar trusts (and to make it before any contract of sale of the asset had been entered into by anyone), he would be taxable, under Taxation of Chargeable Gains Act 1992, section 86, on the gain realised by the offshore trustees. Even if the trusts were very different, so that for some reason section 86 did not apply, United Kingdom domiciled and resident beneficiaries who received capital payments from the trustees could be taxable at an effective rate of up to 64%, as compared with a maximum rate of 40% which would have been charged if the settlor had not made the gift or the gift had been made directly to the beneficiaries absolutely.

Conclusion

Taxpayers and their advisers will no doubt wait with bated breath to see whether this will be a case like *Dr Barnardo's Homes v Special Commissioners*,[2] where the Revenue, in successfully attacking a respectable charity, scored an own goal in favour of surtax payers (exposed in *Corbett v IRC*[3]) or whether the House of Lords will, as they did in *Unit Construction v Bullock*,[4] tell the Revenue that it is going to lose the appeal for its own good.

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2 7 TC 646.

3 21 TC 449.

4 38 TC 712.