SECTION 739: A CONVENTIONAL PROBLEM?

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A considerable amount has been written about TA 1988 s.739 in previous issues of this Review. This is hardly surprising because, in the context of offshore income tax planning, s.739 is arguably the most important provision in the tax code. This article is concerned with one fairly limited area, possibly of widespread practical significance, which is the position of a married couple who are both resident and ordinarily resident in the UK, but where one of the spouses is domiciled abroad. For ease of expression only it will be assumed that the UK domiciliary is the husband and the foreign domiciliary is the wife.

Such a couple would naturally wish to take advantage of the tax privileges available to the wife by virtue of her foreign domicile. The conventional advice is that the assets owned by the wife should, as far as possible, be situated abroad so that they would represent excluded property for inheritance tax purposes within the meaning of IHTA 1984 s.6. In addition, and possibly of more immediate importance, any income arising from the foreign assets would be subject to tax on the remittance basis by virtue of TA 1988 s.65(5). However, it may be that the wife has few assets of her own and the husband would like to enhance the tax saving opportunities by providing her with additional assets. He might therefore make an outright and absolute gift of cash of (say) £100,000 which she would deposit in the Channel Islands with a view to achieving the dual benefit of creating excluded property and income subject to the remittance basis.

The question arises whether these arrangements are vulnerable to attack by the Revenue under s.739. I put forward the following views with some diffidence, possibly in the secret hope that I will be contradicted because the conclusions seem to be rather alarming. As far as the wife is concerned there would seem to be no particular difficulty. Although she transferred the assets, the income arising thereon does not become payable to her by virtue or in consequence of the transfer; all income arising from those assets was payable to her before the transfer. A number of interesting arguments could be developed here but they seem not to be relevant to the main issue because, even if s.739 were to apply to the transfer by the wife, she would be fully protected by s.743(3) which provides a remittance basis as follows:

> "An individual who is domiciled outside the United Kingdom shall not be chargeable to tax in respect of any income deemed to be his by virtue of that section if he would not by reason of his being so

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> domiciled have been chargeable to tax in respect of it if it had in fact been his income."

But what of the husband? He made the initial transfer to his wife and it is the income derived from those assets which is payable to the wife. He may not in fact have "power to enjoy" the income within the meaning of s.742, but that seems not to matter because s.742(9)(a) deems the references in s.739 to an individual to include his wife.

Accordingly, as his wife has power to enjoy the income, he is deemed to have power to enjoy it as well, but unfortunately he is not deemed to have his wife's foreign domicile and cannot obtain the protection of s.743(3). On this reasoning the husband would be liable to tax on the whole of the income arising from the foreign deposit, despite the fact that he may be entirely unable to get his hands on any of the income to discharge the tax. This may not be thought to be excessively harsh because, after all, he did make the original transfer by way of gift. His idea was to transfer taxable income to the wife so that it would no longer be taxable and, if the device fails, he cannot really complain too loudly.

However, he would have more justification for complaint if his wife were to remit the income to the UK and be taxed on it on general remittance basis principles. Section 743(4) is designed to avoid a double tax charge in the following terms:

> "Where an individual has been charged to income tax on any income deemed to be his by virtue of section 739 and this income is subsequently received by him, it shall be deemed not to form part of his income again for the purposes of the Income Tax Acts."

This excludes the income from charge in the hands of the individual who has already been taxed on it by virtue of s.739, but that only applies to protect the husband; the wife will not have been taxed on the income and she will remain taxable. It is arguable whether s.742(9)(a) applies to the exclusion provided by s.743(4) but even if it does, the wording may not be wide enough to afford relief. To do so, the four references in s.743(4) to an individual (one in terms, once as "him" and twice as "his") would have to be interpreted as a reference to the husband on the first two occasions and to the wife on the third and fourth occasions. This seems a rather bizarre method of interpretation. It could perhaps be said that each occasion should refer to both spouses, but the word "again" seems to interfere significantly with this interpretation.

The problem really is the inadequate manner in which s.742(9)(a) meshes with the sections to which it is said to relate. If all references to an individual are to include his spouse, all kinds of absurdities arise. For example, does it mean in s.739(2) that both the spouses can be treated as the transferor, irrespective of which one actually made the transfer? If so, the Revenue have a choice to whom they can direct their assessment; this would seem to be contrary to *Vestey v CIR* [1980] AC 1148 both in terms and spirit. Furthermore, it could lead to the proposition that if a wife transfers her own funds to foreign trustees to be held on trust for her benefit, the husband could be taxed on the trustees' income even though he had no involvement, interest or even knowledge of any of the transactions.

If such absurdity is to be avoided, the meaning of s.742(9)(a) must be cut down to provide a sensible result - but how? It would seem to be logical for the spouse to be included when considering the definition of power to enjoy (this would be consistent with the normal settlement provisions) and excluded elsewhere. One could perhaps argue that where s.739 refers to "an individual", this is deemed to include the spouse, but references to "that individual" or "the individual" mean only the transferor and not the spouse. However, that interpretation comes to grief within the deeming provision itself because s.742(9)(a) states that a reference to "an individual" shall be deemed to include the wife or husband of "the individual".

Taking the matter further, let us assume that the husband married his foreign domiciled wife during a period when he was working abroad. Prior to their return to the UK, while they are both neither resident nor ordinary resident, the husband transfers assets to his wife to improve their overall tax position. This would be comparatively usual in many expatriate situations. On taking up residence (and ordinary residence) the wife leaves the income producing assets overseas so to keep the income and capital outside the scope of UK tax. Again there has been a transfer of assets by virtue or in consequence of which income has become payable to a foreign domiciled person and s.739 could apply to treat income to be that of the husband for the reason set out above.

There would seem to be two defences to a charge under s.739 in these circumstances: first that the transfer was not made from the UK and second that the transferor was not ordinarily resident in the UK at the time of the transfer. Both these questions have been the subject of learned examination in Vol 1 Issues 1 and 2 of this Review, and I do not propose to dwell on them further. The only other possibility would be to suggest that independent taxation of husbands and wives precludes such a result; however, this seems doomed to failure. TA 1988 s.685(4A) provides an exclusion from the settlement provisions in respect of outright gifts of capital, but that can hardly be expected to extend beyond its express scope - still less to a wholly different part of the Act.

If these conclusions are right, the position with s.739 is even more unsatisfactory than may have been generally supposed. It is hoped that there is a serious flaw in the analysis or that the Inland Revenue will not seek to construe the provisions strictly so as to produce an unreasonable result - but that takes us straight back to the point which their Lordships found so repugnant in *Vestey* and which many thought had been resolved.