WHEN IS REMITTANCE NOT A REMITTANCE?

Robert Venables QC[1]

Conflict of Views

It is well know that foreign domiciliaries who are UK resident are liable to income tax under Schedule D Cases IV and V on most foreign-source income only to the extent to which it is "remitted" to the UK. There is much learning on what does and does not constitute a remittance for these purposes. Not surprisingly there is also much misunderstanding. I was surprised to hear the view expressed recently in a seminar that if one bought, say, a motor car abroad with one's foreign income and imported it into the UK, then there would be no remittance unless and until the car was sold. Consequently, if it was never sold in the UK but run into the ground or exported, no tax would be due. When asked for authority, the speaker referred to *Whiteman on Income Tax* (3rd Ed. 1988) at 22.13, under "What is a remittance?":

> "Income from a continuing source which is earned and invested abroad and brought to the United Kingdom in the form of such investment in a later year is taxable when the investment is sold here."

I could easily have written this passage myself, but certainly would not have understood it as supporting the proposition maintained by the speaker, especially in its context. The previous sentence in Professor Whiteman's work runs:

> "More difficulty has arisen in cases where the taxpayer has obtained the benefit in the United Kingdom of income from abroad without it being directly transferred to him."

Three cases are cited in the footnote. I shall consider each in turn.

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Scottish Provident Institution v Allan

The first is *Scottish Provident Institution v Allan* 4 TC 591, HL. It does not appear to be at all in point. The taxpayer company had mixed capital and interest in Australia in a common account. It remitted amounts to the UK to which it attached the label of capital. Its affairs were obviously very complex and the company had not sought to perform any tracing exercise. The amount of funds left over there was at no time less than that of the original capital. It was held that the funds remitted should be taken to be income. The moral, which is one which some accountants still find difficulty in drawing, is that liability to taxation depends on what has actually been done - more strictly, what can be proved by lawful evidence to have been done - and not what the accounts say has been done.

There were slightly different reasons given for the decision. In the Court of Session, the Lord President (with whom Lord Adam concurred) said, (at p 418):

> "The interest was not kept separate from the other funds of the Institution in Australia and so invested there as to preserve its identity as interest, and in the absence of evidence to the contrary, it appears to me that the drafts upon the bank account for the purpose of making new investments should be presumed to have been upon the capital of loans repaid, the interest in natural course being forwarded to this country."

He added:

> "When however the question is whether particular remittances, the real origin and character of which as capital or interest are not definitely established, should be regarded as consisting of capital or of interest, the fact that the amounts were entered into the accounts of the Institution, and treated as income in this country, may be admissible evidence upon that question. It further appears to me, that, under the circumstances, indefinite remittances to this country must be presumed to consist of interest, not of capital, so long as the amount of capital remitted to Australia for investment still remains invested there."

Lord McLaren said:

> "... I think everyone would agree that [the unappropriated remittances] must be dealt with according to the ordinary course of business, and those remittances must be presumed to be paid in the first place out of interest so far as they are income, and in the second place out of principal or capital. I think that rule results from the fact that no prudent man of business will encroach upon his capital for investment when he has income uninvested laying at his disposal."

This reasoning is singularly unconvincing. In what way does one "encroach" upon capital by investing it?

In the House of Lords, the Lord Chancellor seemed to rest his judgment entirely on the burden of proof being on the taxpayer - a burden which on the facts the taxpayer had not discharged. That was the short and simple answer to the appeal and was none the worse for its shortness and simplicity.

Lord Shand stated (at p 593) that the company still had the amount of capital which they sent out. "The monies that have come home were, therefore, in the nature of interest, and I do not think that the mere circumstances of there being such letters as are here founded upon, as making them out to be capital though they are really interest, can have that effect."

This might be thought to be question-begging on a vast scale. The whole point at issue was whether what remained in Australia was capital or income. Lord Shand is no doubt confusing two quite different meanings of the word "capital". What is for company law purposes "capital" may, as a matter of tracing, represent income rather than capital.

Lord Davey said, impeccably (at p 594):

> "I agree that the mere calling it capital for the purpose of Inland Revenue Department will not make into capital that which is essentially and in truth profit, a profit made by the interest received on the securities."

Lord Robertson said (at p 595):

> "As the whole money remitted came out of a bank account it is impossible to identify the money and the facts of the case must furnish the inference. ... The inference from these facts is that monies remitted were in fact profits, and, in the absence of anything to the contrary, profits of the year in which they were remitted."

The moral of the case is that the prudent taxpayer will ensure that capital and income are kept firmly separated from each other; for example, in different bank accounts.

Scottish Provident Institution v Farmer

Scottish Provident Institution v Farmer (1912) 6 TC 12 was a Court of Session case. A life assurance society invested interest arising from foreign and colonial securities in America in foreign bearer bonds. The bonds were sent to the UK for safe custody.

In the next financial year they were sold and the proceeds of sale were received by the Institution in the UK. It was held that the proceeds of sale of the Bonds were chargeable under Sch D Case IV in the year in which the bonds were realised. It was conceded that the important point had already been decided in *Scottish Widows' Fund v Surveyor of Taxes* 5 TC 502. The only argument for the taxpayer was that the interest was earned not in the year of assessment but in an earlier year. Not surprisingly, that argument was dismissed. It was also admitted that the proceeds of sale of the bonds were received in Edinburgh.

Scottish Widows' Fund v Surveyor of Taxes

Scottish Widows' Fund v Surveyor of Taxes was also decided in the Court of Session. The Lord President delivered a judgment in which Lord Kinnear and Lord Pearson concurred. He cited *Gresham Life Assurance Company v Bishop* 4 TC 464, a decision of the House of Lords. The company in that case included foreign interest in its accounts and balance sheets in order to ascertain its profits and pay its dividends. It was held by the House of Lords that the money had not for that reason been received in the United Kingdom, although it had been brought into account here. The Lord President also quoted Lord Halsbury, saying: "In no way that I can give any reasonable interpretation to has the money reached this country or been received in this country."

The Lord President continued:

> "Now, actual receipt of money, it seems to me, can only be effected in one of two ways. Either the money itself must be brought over *in specie* or the money must be sent in the form which, according to the ordinary usages of commerce, is one of the known forms of remittance."

He rejected, quite correctly, an argument that the case was different as the bonds were negotiable instruments and had been received in the UK.

He said:

> "Now, how can this money be said to have been received in this country? As far as the bond itself is concerned, it is, of course, a piece of paper but it represents a debt. But the debt is a debt which is not presently payable, but which, taking the bond we have taken as an illustration, is the debt which is not payable until the year 1935, and then is not payable in this country but in New York. In the same way the interest is not payable here; it is only payable, taking the specimen coupons, on the first day of October, 1907, at the agency in the City of New York ... What I have been absolutely unable to understand is the answer to the question I put, and put in vain so far as any answer was given, - how money could be in two places at once."

The Crown relied upon the Probate cases relating to the situs of assets. The Lord President accepted that "Probate Duty is payable in respect of bonds of Foreign Governments, of which a testator domiciled in this country was the holder at the time of his death, and which had come to the hands of his executor in this country, such bonds being marketable securities within this kingdom saleable and transferable by delivery only, it not being necessary to do any act out of this kingdom in order to render the transfer of them valid."

The Lord President continued (at p.510):

> "As Lord Halsbury said in the *Gresham* case, we have got to do with the words of the Income Tax, not with other Acts, and more than that I can see, if one comes to principle, a perfectly good reason which makes such things liable to Probate Duty and would not apply to the case of Income Tax ... What you have to do with in Probate Duty is a question of giving someone an active title. A man dies and leaves behind him every class of investment, and, among other things, he leaves in his safe a set of Bearer bonds. Who has got the right to touch them? Anyone, as soon as he obtains the key of the safe, but he has no legal right to intromit with them. The only person who has a right to take these things the dead man left behind him and turn them into money is the executor after he has got Probate. One can quite understand, therefore, the principle on which it was quite right that the executor should, so to speak, pay for what he gets."

This is a salutary reminder of how little the situs rules have to do with the question of remittance and the source of income for income tax purposes. The situs rules were important for probate duty, estate duty and capital transfer tax and are still important for inheritance tax and capital gains tax. Yet even some writers of "essential reading" on remittances have confused the two sets of rules. And there are still practitioners who think that to make interest on a debt have a non-UK source for Sch D purposes, it is enough to evidence the debt by a specialty which is kept abroad!

The *ratio decidendi* is thus that in applying the remittance rules, one ignores the situs of a bearer bond (or similar instrument) and looks to where the debt is payable. It is scant authority to enable a taxpayer to buy a car abroad, to bring it to England and to run it into the ground without there being any remittance. There is a passage in the judgment (at p 510) which might give colour to such an argument, if it did it not prove too much:

> "... Probate Duty in one sense is a return for giving somebody an active title he would not otherwise get. That is quite a different state of things from what you have to do with in the case of Income Tax. Although the bearer bonds are marketable securities, that is, of course, surely neither here nor there, because in one sense everything is a marketable security at a price. The fact that a bearer bond is a marketable security and easily marketable, and therefore a negotiable instrument, does not seem to me to touch for one moment the question of whether it is an ordinary form of remittance. Nobody ever heard of remitting money by means of a bearer bond, for this very good reason: you could not possibly remit money by it and know exactly what you are doing, because the price of bearer bonds fluctuates in the market every day, and a bond might start from New York at one price and arrive in London at a perfectly different one. It therefore is not at all in the same category with that way in which modern arrangements have perfected, by which we may send money from one country to another in the form of hard cash consigned in a package or box, or by means of a bank draft, which is, of course, simply a transaction of debtor and creditor between different persons on different sides of the Atlantic."

Is it not equally true that non-sterling cash, such as US dollars, can vary in price while crossing the Atlantic? This argument proves too much. If it were sound, no remittance could ever be made otherwise than of sterling, either in cash or through the banking system.

Walsh v Randall

In *Walsh v Randall* (1940) 23 TC 55, the taxpayer instructed his overseas agents to sell foreign investments representing foreign unremitted income and to send to him in the UK a "demand draft on London" in favour of a hospital. He handed over the draft to the hospital in the UK. Wrottesley J decided firstly that the income had retained its character as income even though in the meantime it had been invested in foreign investments. One cannot quarrel with that conclusion. He secondly decided that the taxpayer had not alienated the income *before* it came into the UK. This part of the judgment is somewhat unsatisfactory as he does not answer the point that the taxpayer could not lawfully have demanded to be paid on the draft. If he could, *Scottish Provident* and *Scottish Widows* are obviously distinguishable in that payment could have been obtained in the UK so that the "investment" which the draft represented was clearly in the UK.

Conclusion

I thus conclude that while none of the cases cited by Professor Whiteman is directly in point, *Scottish Provident v Farmer* is indirectly in point as having impliedly approved *Scottish Widows*. These cases are authority, however, only for the proposition that a foreign investment is not remitted to the UK merely because the paper which evidences or confers title is physically imported into the UK. The cases are in my respectful opinion no authority for anything further. If a car in which foreign income has been invested is brought to the UK, that is in my opinion plainly a remittance of that income as the income does not need to be remitted in the same shape or form as that in which it arose. *Walsh v Randall* is incidentally indirect authority for this view. Wrottesley J held that the foreign income did not lose its

character by being invested in foreign investments which were then sold, the proceeds being invested in a UK draft which was itself remitted to the UK. He would surely have held that the physical importation of a tangible "investment" of foreign income, such as a car, would have constituted a remittance.