The Offshore & International Taxation Review

ICTA SECTION 146 AND *ALLEN:* MUST THE CLIENT THROW IN THE TOWEL?

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1. Way back in the early 1980's, the Revenue took the point that a foreign domiciliary, owning shares in an offshore company which, in turn, purchased a United Kingdom residence and allowed him/her to live in it, was caught by ICTA 1988, sections 145 and 146. The argument was that the accommodation was provided for a person who was a "shadow director" (effectively, a person within section 168, subsection (8)) and thus a person in director's employment. This argument with its mis-match of deeming provisions led, over the years, to many foreign domiciliaries settling income tax bills, almost always concerning United Kingdom remittances, in sums higher than might otherwise have been the case. In the only case to go before the Commissioners, the Revenue's argument was thrown out.

2. Unfortunately, this highly technical point reached the Court of Appeal in an appeal against convictions for various tax offences, *R v Allen* [1999] STC 846, where the Court upheld all convictions. There is, at this stage, no point in setting out why the Court of Appeal was wrong. Nor am I concerned here with how to structure ownership of such residences so as to avoid an argument, which may be readily achieved with care, e.g., by retaining a leasehold interest in a settlement (with the freehold in a company), by option arrangements and by other careful structuring of the purchase. This article, however, is concerned with the client who already seems to be caught, because of *Allen*.

3. What should the advisor with a client in this position do? The current weight of published opinion (which might be described as the "headless

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chicken approach") seems to be that all that can be done is to throw oneself (i.e. one's client) on the tender mercies of the Inspector. This, however, takes the *dicta* in *Allen* too far: hope (of at least an arguable case) should not yet be abandoned.

4. What arguments, then, can be put to the Revenue where one's client is, *prima facie*, within the scope of the decision in *Allen,* so far as it interprets section 145? (Section 146 is not analysed in *Allen*).

5. Section 145

5.1 ICTA 1998 section 145 subsection (1) states:

> "Subject to the provisions of this section, where living accommodation is provided for a person in any period by reason of his employment ..., he is to be treated for the purposes of Schedule E as being in receipt of emoluments of an amount equal to the value to him of the accommodation for the period, less so much as is properly attributable to that provision of any sum made good by him to those at whose cost the accommodation is provided."

Thus, even if a person is within the ambit of section 145 subsection (1) in respect of the occupation of property owned by a company, one has to ask two questions, namely first, is there any sum "made good" to those at whose costs the accommodation is provided and, it necessarily follows, one must therefore pose the more fundamental question: at whose cost *was* the accommodation provided?

5.2 If the client has gifted all the necessary funds, for and since purchase, to the company, it is difficult to see how the company was the person "at whose cost" the accommodation was provided. In the vast majority of cases, however, the funds will have been lent to the foreign resident company, usually at no interest. What can be argued in this, more typical, case?

5.3 I believe that it can be argued that such provision of the funding, without any charge, represents a sum "made good" to the company (*assuming* it was the person at whose costs the accommodation was provided). (This "defence" however, will not draw the teeth from section 146, but it helps us to understand both sections 145 and 146.) This "making good" must be "properly attributable" to the rent-free provision, since it is the very provision of "free" funding *to* the company that allows it to provide rent

free accommodation to the foreign domiciliary. To argue the contrary is, it is highly arguable, to close one's eyes to reality.

5.4 "Making good" does not have to consist of simply paying a cash sum after the event: see *Mairs v Haughey* [1993] STC 569, and in the Court of Appeal ([1992] STC 495), the judgment of Nicholson J at page 543.

5.5 When, therefore, the Revenue Manuals, in the context of section 154, speak of "making good" involving the giving of money or something which can be converted into money, they are, it would seem, being rather narrow compared to the approach in *Mair*: see Sch E Manual, paragraph 3112.

5.6 The question of whether an interest-free loan might constitute "making good" was dealt with in *Stones v Hall* [1989] STC 138. There, the taxpayer (who represented himself) argued in the High Court that he could not be chargeable under what is now section 145 because, although he occupied accommodation owned by his employer, he had made interest free loans to that company.

5.7 There, as the Case Stated shows, that company purchased the accommodation (a farmhouse) in 1949: see page 141e. The taxpayer and his wife had been directors since 1972 and 1970, respectively. The Case Stated does not contain details of the interest-free loans, although it appears from page 140 that they were made between 1976 and 1985.

5.8 If the judgment of Warner J at page 149 is examined, it will be seen that he is *not* saying that interest-free loans cannot constitute "making good". In *Stones v Hall*, however, the taxpayer had not brought evidence to show that the loans were made in order to compensate the company: there was no evidence at all to link the two.

5.9 The position in *Stones v Hall* was, therefore, very different from the typical situation where a foreign domiciliary funds the purchase of a residence. There, a property had been owned by a company for nearly 30 years before the (actual) director made a loan to the company and there was no evidence linking the loan to the accommodation.

5.10 In a typical case, however, the loan and the accommodation could hardly be more linked since, without the loan, the property would not have been purchased. The purchase is usually made in the knowledge that the foreign domiciliary would provide the funding. The loan, and its terms, are such that, if there *is* any cost to the company, this more than "makes good" such

cost, so that the net "cost" is nil.

At whose "cost" is the accommodation provided?

The answer to section 145.

5.11 Considering *this* point brings us to the more fundamental issue implicit in section 145 subsection (1). There must be a person "at whose cost" the accommodation is provided and we need to know who that is. It must be arguable that the provision of the accommodation costs the company nothing, since it was provided with interest free funding by the foreign domiciliary for the very purpose. This argument is fundamental to both sections 145 and 146.

5.12 It is useful to note the decision of the House of Lords in *Wicks v Firth* [1983] STC 25. There, the first point considered, concerning the scholarships provided to the children of employees of ICI by a trust, was whether the person "at whose cost" the scholarships were provided was the trust, or ICI. Their Lordships were unanimous on this point, which was dealt with in detail by Lord Templeman. He stated, at page 31g:

> "In my opinion the scholarships were provided at the cost of ICI and not at the cost of the trustees because the trustees with moneys supplied by ICI were only performing fiduciary duties ... The capital moneys necessary for the performance by the trustees of the functions were provided by ICI ... The income of the trust fund was sacrificed by ICI to the same purpose ..."

5.13 Thus Lord Templeman is looking at who actually put the trustees in the position where they could award scholarships: without ICI they would have had no funds to do so (except, perhaps, by borrowing in the market, which is an unrealistic assumption). In reality, the funding comes from ICI and it was ICI "at whose cost" the scholarships were awarded by the trustees.

5.14 From there, it is a small step to argue that the only person, in reality, who bears the cost of the provision of the accommodation is the foreign domiciliary. Without his or her funding, the property could not have been purchased (in reality) and the accommodation would not have been available to him or her. Since the cost of the funding and the provision of the accommodation is wholly borne by the foreign domiciliary, how can he or she be within section 145 in the first place? On that basis, we should not need to ask whether he or she "made good" that cost, since that cost has

only ever been borne by him or her.

R v Allen

5.15 The typical position is not identical to the facts in *R v Allen* [1999] STC 846). There, the Jersey and Liberian companies, in fact run by Mr Allen in the United Kingdom, made substantial profits out of UK property transactions. They used those funds, amongst other things, to buy the property in which Mr Allen lived. While that case mainly concerned the evasion of corporation tax (by these companies) Mr Allen was of course convicted of evading tax on the many benefits he obtained. Amongst these was the benefit of free accommodation and the Court of Appeal held that section 145 was satisfied.

5.16 There, however, it was *not* the case that the company was simply funded by Mr Allen, what happened was that the companies were making (non-disclosed) profits on the United Kingdom property deals and the profits were then syphoned off into various benefits for Mr Allen. It could not therefore be argued first, that Mr Allen had "made good" the company's costs in providing him with his benefits and, indeed, it could not be said that he was the person "at whose cost" these benefits were provided.

5.17 It can therefore be argued that section 145 is not capable of applying to the typical case since, at first glance, the foreign domiciliary may well have made good any cost of providing accommodation, if the cost *was* borne by anybody else but more fundamentally, because the only person "at whose cost" the accommodation is provided will normally have been the foreign domiciliary.

6. Section 146

6.1 This brings me to section 146, which applies where:

"(1) ...

(a) Living accommodation is provided for a person in any period, by reason of his employment;

(b) By virtue of section 145 he is treated for the purposes of Schedule E as being in receipt of emoluments of an amount calculated by reference to the value to him of that

accommodation or would be so treated if there were disregarded any sum made good by him to those at whose cost the accommodation is provided; and

(c) The cost of providing the accommodation exceeds £75,000."

The answer to Section 146

6.2 The first question to ask is whether, within section 146 subsection (1)(b) section 145 applies. The fact that an employee has "made good" the cost of providing the accommodation does not prevent section 146 having application, but if it is not, in fact, the employer "at whose cost" the accommodation is provided, but the (alleged) "employee", section 146 cannot apply. Thus, if the argument set out above in relation to section 145 applies, section 146 does not bite either.

Another answer to section 146

6.3 There is, however, an additional argument why section 146 does not bite. It must first be asked whether, with both section 145 and section 146, if there is a "shadow director", he or she can be said to be "in employment" simply by virtue of being such "shadow director" within the meaning of section 168 subsection (8). (Let us assume, for the sake of argument, that our client may be a "shadow director".)

6.4 The distinguished Deputy Special Commissioner Dr John Avery Jones in *Re Taxpayer FI*, decided that these sections did not apply to a shadow director because there was no "employment". The point was, however, the basis of one of the charges in *R v Allen*. The Court of Appeal very briefly discussed this point. The Court had already decided, in respect of section 154, that a shadow director was "in an employment", reading in section 168 subsections (2) (definition of employment) and (8) (definition of director). In discussing section 145, Laws L J said, at pages 870/871:

> "The counts in the indictment cover both benefits to which s.154 applies and benefits consisting of the provision of living accommodation under s.145(1). Since the counts cover both, it is strictly unnecessary further to analyse the provisions of s.145 since the convictions would be safe even if the provision of living accommodation to the appellant did not fall within s.145(1). But for the sake of completeness we should add that, in our judgment,

> the provision of living accommodation to this appellant as shadow director does fall within s.145. By virtue of s.145(8)(b), the definition of employment in s.168(2) and the extended meaning of director in s.168(8) are carried through to the meaning of employment in s.145. S.145 applies where a person is provided with living accommodation by reason of the fact that he holds an office. For the reasons we have already given the combined operation of s.168(2) and (8) have the effect that the holder of an office includes one who falls within the extended definition of director. For those reasons, therefore, we conclude that the appellant was in receipt of living accommodation chargeable to tax under s.145(1) because he was a shadow director."

6.5 The first thing to note is that these remarks are strictly *obiter*, since the Court says that it is "strictly unnecessary" to consider section 145 as the conviction would stand even if the benefits were not within that section. The judgment, therefore, on this point, is strictly not binding, but, in the real world, Commissioners will need to be shown why the *dicta* is distinguishable.

6.6 The Court draws the analogy with section 154 and holds that the effect of section 168 subsections (2) and (8) is that if a shadow director holds an office (it must, I concede, be implied), he or she is therefore in an "employment". This result is "surprising" but, while it is *obiter* and in the criminal context, it is still from the Court of Appeal and therefore we must give it appropriate weight.

6.7 It is, the Court says, the case that section 168 subsections (2) and (8) apply because of section 145 subsection (8) (b) which specifically incorporates the definitions of "employment" and "director" into section 145, where those terms are both used.

6.8 Turning to section 146, however, there are three requirements before it applies. Assuming the property costs more than £75,000, we are only concerned with paragraphs (a) and (b). If we accept (for the sake of argument for the moment) that section 145 applies, satisfying paragraph (b) (of section 146 subsection (1)), the question is whether "accommodation is provided for a person in any period" by reason of his employment (paragraph (a)). These words are *exactly the same* ones as are used in section 145 subsection (1), and section 145 subsection (1) must apply or section 146 subsection (1) (b) would not be satisfied. What, then, is section 146 subsection (1) (a) for? It can only have any point if the meaning of

"provided ... by reason of his employment" in subsection (1) (a) is different to (and narrower than) the meaning of those words in section 145 itself.

6.9 According to *Allen*, the meaning of these words when used in section 145 is wide enough to catch a shadow director because we must read in the meaning of "employment" and "director" in section 168 subsections (2) and (8), as section 145 subsection (8) tells us to. (It, of course, does nothing of the sort!) Assuming, however that it *does*, we need to know how section 146 deals with the meaning.

6.10 This takes us to section 146(10) which says:

"For the purposes of this section, living accommodation shall be treated as provided for a person by reason of his employment if it is so treated for the purposes of section 145; 'employment' has the same meaning in this section as in that".

6.11 Here, the draftsman has specifically provided that, in looking at the meaning of the words in section 145, the term "employment" is to have the same meaning. Thus, section 146 subsection (10) incorporates the meaning of "employment" in section 145 subsection (8), and therefore section 168 subsection (2). There is, however, no extended definition of "director" in section 146. The extraordinary "reading through" practised by the Court of Appeal in respect of section 145 should not, it seems, apply to section 146. We read in the meaning of "employment" but we are not told to read in the meaning of "shadow director" set out in section 168 subsection (8). Thus, with section 146, there must be an *actual* employment, as director or employee. Viewing section 146 thus, section 146 subsection (1) (a) makes sense, since the meaning of "by reason of his employment" is narrower in section 146. (I add that it is not apparent how section 146 subsection (1) (a) could possibly have a purpose if the interpretation were otherwise.) This is a bold and highly nit-picking approach, brought on by the Court of Appeal's bold and highly nit-picking approach.

6.12 As far as section 146 goes, the decision of the Special Commissioner has relevance. Since a shadow director is not "in employment" (unless there is an *actual* employment) it necessarily follows that in interpreting section 146 subsection (1) (a) he or she cannot have had accommodation provided "by reason of employment". Accordingly, for this further reason, it is arguable that section 146 has no application even where a foreign domiciliary occupying property owned by a foreign company, funded by him or her, *is* a shadow director. While the analysis may appear unduly

technical, a Court *not* trammelled by the necessity to leave the Crown Court Judge's summing-up alone at all costs, but trying simply to reach a just decision in a straightforward tax case, may well go along with it.

Conclusion

6.13 Additionally, in the typical case, as I have noted, it is highly arguable that there is no "expenditure incurred" by the foreign company. Bearing in mind the "purposive" approach to statutory interpretation so prevalent now, it cannot be ignored that the purpose of the section is obviously to charge tax where employers provide tax free benefits to employees, instead of salary (as indeed was the case with Mr Allen). It is not there to stop a person wholly funding a purchase himself or herself and then finding themselves taxed on the "benefit" resulting from having provided that funding.