TAX ALERT

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REGAINING ITS TEETH

A recent Court of Appeal decision revitalises a key HMRC anti-avoidance provision.

Taxpayers considering moving assets or businesses offshore, or incorporating a non-UK resident company, will need to consider their income tax position carefully in the light of the Court of Appeal's recent decision in Fisher and others v HMRC (2021) STC 2072.

The decision results in income of a Gibraltar trading company being taxed on shareholders personally. HMRC will be encouraged by this ruling, and UK resident individuals should now review their offshore structures.

The facts of the Fisher case can be simply stated and serve to emphasise the need to consider the impact of the income tax anti-avoidance legislation contained in section 720 ITA 2007 when considering any use of offshore jurisdictions.

The Fishers ran a very successful betting business in the UK, but the future of the business was thrown into doubt by the fact that their competitors were avoiding gambling duty by trading via offshore companies. The Fisher family therefore incorporated a company in Gibraltar and in 2000 transferred the trade of their UK company to the new offshore vehicle.

HMRC accepted that the transfer of the business offshore was a "commercial transaction" but nevertheless sought to tax the Fisher family on the trading profits of the Gibraltar company as they arose. In essence, HMRC looked to pierce the corporate veil so the Fisher family paid income tax on the profits arising in Gibraltar. This was a very different outcome to that expected by the Fishers when they set out to save the family business.

In what HMRC will regard as a very significant decision, the Court of Appeal has agreed with HMRC that income tax was payable. This reverses the decision of the Upper Tribunal, which had blunted the impact of section 720. The decision is significant for a number of reasons.

The Width of Section 720

In music to HMRC's ears, the Court of Appeal re-emphasised the fact that section 720 is a broad spectrum anti-avoidance provision, which should not be narrowly or technically construed. Section 720 has (in various guises) been one of HMRC's main 'weapons' since the 1930s and the Fisher decision emphasises the need for it to be considered whenever there is an offshore element involved in a transaction.

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The Court agreed with HMRC that the provision can bite even if, as a result of the transactions, income tax has not been avoided. Section 720 is aimed at preventing avoidance – but income tax need not actually be avoided. Moreover, the section can bite if the purpose of the operation is to avoid another UK tax – here the Fishers' only focus was betting duty.

Who In Reality Made The Transfer?

The decision emphasises that the potential impact of section 720 should be considered, even where the proposed actions may not immediately bring income tax issues to mind. In Fisher, the business was moved offshore by a transfer between the existing UK company and the newly incorporated offshore company.

The Court of Appeal was, however, prepared to accept that section 720 would apply where the shareholders in the UK company had "procured" the transfer. The idea that a shareholder in a company could fall within the ambit of section 720, where he or she had "procured" the transfer, had been established in the case of IRC v Pratt (1982) STC 756, but had not found favour with the Upper Tribunal in the Fisher case. However, the Court of Appeal concluded that the view that section 720 can apply if the execution of the transfer was procured by the individual, even though it was not actually executed by him or his agent, "chimes with the nature and purpose" of the anti-avoidance provision.

HMRC will be much encouraged by this conclusion as it means that they can seek to invoke section 720, even where the transfer offshore is made via a company, provided they can establish that the individual shareholders were the 'transferors' in reality (which the Court termed "quasi-transferors"). Moreover, the Court was of the view that this approach can apply where there are "multiple (quasi-) transferors" because a number of shareholders were involved in the decision. The Court noted that "machinery now exists (now in section 743 ITA 2007) under which no more than a proportion of income need be attributed to either a transferor or a quasi-transferor".

The Court noted that if "a group of shareholders decided on a transfer and brought it about, they could all be considered quasi-transferors". The Court recognised that there must be some limitation on who can be counted as a quasi-transferor (and hence within the scope of the anti-avoidance legislation). Thus, an individual is unlikely to be within section 720 if he were a director of the company (and acted exclusively in that capacity and in the company's interests) but not a shareholder. The Court also felt that section 720 is not applicable to someone who simply does nothing: the fact that he might have been in a position to prevent a transfer (say, as a controlling shareholder) will not mean that he "procured it". It appears therefore that "procure" means "doing something positive to bring something about". In Fisher, a shareholder who was "happy to go along with (their) decisions" was held not to be within the ambit of section 720.

The line will obviously be a difficult one to draw and one can see that HMRC will look closely at the facts where an individual claims to be too remote from a decision to qualify as a transferor. What of the case, for example, of the individual whose only direct involvement was as a director but he held shares via a family trust? The decision emphasises the need to look at the real decision makers and the relative influence of the directors and shareholders.

The 'Motive' Defence

Clearly not every transaction will be within section 720 and reliance is often placed on the 'motive' defence (whereby the section does not apply if either (a) the purpose of avoiding liability to taxation was not the purpose or one of the purposes for which the transfer was effected or (b) the transfer was for bona fide commercial reasons (and in Fisher all parties accepted that they were) and were not designed for the purpose of avoiding liability to taxation). These are the section 741 defences, named after their derivation in the predecessor legislation, ICTA 1988.

The Court of Appeal's decision has emphasised the narrow width of the defences and taxpayers should be aware that HMRC are very reluctant to accept the availability of the defences. The following extract from the Court of Appeal's judgment serves to illustrate the difficulty taxpayers face:

> "The avoidance of betting duty and saving of the business were inseparable. The main purpose of the transfer of the business was to avoid betting duty and thereby to save the business: the two were perceived as going together. Put slightly differently, there can be no question of section 741 applying because a transferor hopes that an intended avoidance of liability to taxation will achieve some further end. It will rarely, if ever, be the case that a transferor wishes to avoid liability to tax for the sake of it; in normal circumstances, a transferor will be intending to use the avoidance of

tax to attain another object. That being so, were someone able to escape 720 by looking beyond the tax avoidance to its consequences, the motive in defence would be generally available. That will not have been Parliament's intention."

This passage has been quoted at length because it is often easy to think that because a transaction 'feels commercial' then the section 741 defences will apply. The Court of Appeal's decision emphasises how hard it can be to reach the safe harbour – as mentioned above, everyone (including HMRC) accepted that the Fishers had taken their business offshore to ensure its survival – but the fact that their transfer would not have been effected at all but for the desire to avoid betting duty was enough to deny the safe harbour. It should also be noted that the Court was willing to accept that tax mitigation (as opposed to avoidance) was sufficient to negate the availability of the defence – another of the increasing occasions when the lines between avoidance and mitigation are being blurred.

The European Defence

The Court of Appeal was also asked to consider if section 720 was compatible with European Union law. It concluded that section 720 did not infringe the taxpayers' freedom of establishment in any relevant way and that EU Law could not be invoked to defeat the assessments to tax. The empathic nature of the judgment on this point will be welcomed by HMRC.

Conclusion

The decision of the Upper Tribunal in Fisher held out the hope for taxpayers that section 720 was less restrictive in its consequences than HMRC believed. That hope has now been extinguished. The section has its teeth back. The Court of Appeal's decision has re-emphasised that section 720 is a "broad spectrum anti-avoidance provision". A leading QC once said to the author that "if you think about tax, the defence will not be available". That may not be an absolute truth, but it does emphasise the need to consider section 720 very carefully and to be aware that escaping its clutches may require a very special and specific set of facts.

It remains to be seen if this is the last word on the Fisher case, or if the case will go to appeal at the Supreme Court (for example on the EU aspects). If the final words do lie with the Court of Appeal, HMRC can be expected to repeat those words frequently to taxpayers.

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