

# The TAA Escape Clause



– any room for manoeuvre

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# What we will be covering

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- Outline of the Transfer of Assets Abroad rules
- The escape clause(s) (s 737 ITA 2007)
  - “purpose” (common approach)
  - “avoiding” (suggested approach)
  - *Andrew Davies & Others* [2018] UKFTT 559 (TC)
- Outline of the EU law defence

# A little bit about me...

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- Called in 2008
- Former HMRC litigator (Strategic Litigation)
  - avoidance litigation across most taxes
  - misc. TAARs, including TAA escape clause



## Outline of TAA

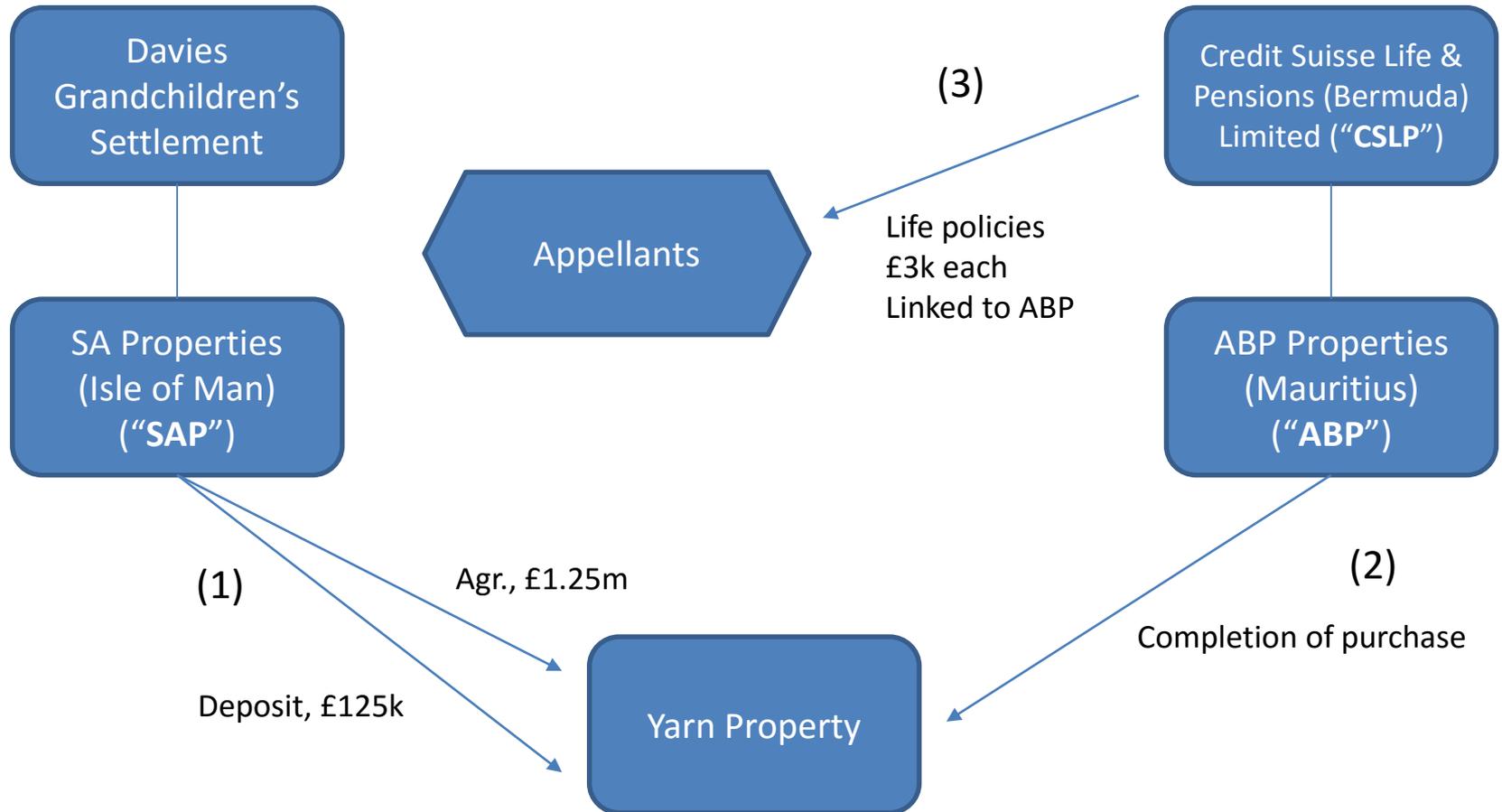
- HMRC cast a wide net (strictly three – ss. 720, 727 & 731)
- Unwanted fish are then thrown back into the sea (the ‘escape clause’ / ‘motive defense’ – s. 737)

# The main charging provision

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- The s. 720 charge requires (broadly):
  - a UK resident individual
  - the “power to enjoy” income of a “person abroad”
  - as a result of a “relevant transfer” or “associated operations” (or both)
  - The UK resident individual would have been taxed on the income, had it arisen directly to him.

# An example – Andrew Davies & Others



# The escape clause – condition A

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- Either condition A or B must apply
- Old and new conditions (pre/post 5 December 2005)
- The new condition A
  - “... it would not be reasonable to draw the conclusion, from all the circumstances of the case, that the purpose of avoiding liability to taxation was the purpose, or one of the purposes, for which the relevant transactions or any of them were effected”

# The escape clause – condition B

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- The new condition B:
  - “(a) all the relevant transactions were genuine commercial transactions (see section 738), and
  - (b) it would not be reasonable to draw the conclusion, from all the circumstance of the case, that any one or more of those transactions was more than incidentally designed for the purpose of avoiding liability to taxation”
- S 738 (meaning of “commercial transaction”)
  - effected in the course of trade or business
  - ‘arm’s length’ terms
  - making and managing investments not a business unless between unconnected persons.

# “Purpose” – common approach

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- Common approach:
  - “... our client’s intentions were pure...”
  
- HMRC’s approach:
  - Don’t be silly
  - result (tax savings) = purpose (tax avoidance)

# “Avoidance” – *IRC v Willoughby* [1997] 4 All ER 65 (HL)

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- What is “avoidance”? (at 73ef)

“Tax avoidance was to be distinguished from tax mitigation. The hallmark of tax avoidance is that the taxpayer reduces his liability to tax without incurring the economic consequences that Parliament intended to be suffered by any taxpayer qualifying for such reduction in his tax liability.

The hallmark of tax mitigation, on the other hand, is that the taxpayer takes advantage of a fiscally attractive option afforded to him by the tax legislation, and genuinely suffers the economic consequences that Parliament intended to be suffered by those taking advantage of the option.”

# *Willoughby* – facts

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- Professor Willoughby purchased offshore personal portfolio bonds through Royal Life
- Tax exemption for offshore life policies
- Ability to manage the investments through a unit system
- Willoughby would have been liable to tax if he had bought investments directly
- Revenue’s argument:
  - “Parliament cannot sensibly have intended the statutory taxation regime for offshore life policies to apply in such circumstances, so the purpose of an investor in such bonds cannot be characterised as mere tax mitigation” (at 74cd)

## *IRC v Willoughby cont.*

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- Lord Nolan (at 74d):

“My Lords, there is a basic fallacy in this argument. It lies in the proposition that the 'underlying reality' is that the holder of the bond continues to manage and benefit from 'his own portfolio of investments’.

... so far from the underlying investments being owned by the bondholder, he has no legal or equitable interest in them whatever. As cl 12 of the policy makes clear, the allocation of investment units ... is purely notional.

The reality in truth is that the bondholder has a contractual right to the benefits promised by the policy, no more and no less. It is therefore quite wrong to describe the bondholder as having ... 'in substance all the advantages of direct personal ownership without the tax disadvantages’.

The significance of this misdescription would become all too apparent if ... Royal Life were to become insolvent and unable to meet its obligations to the bondholders.”

# Proposed escape clause methodology

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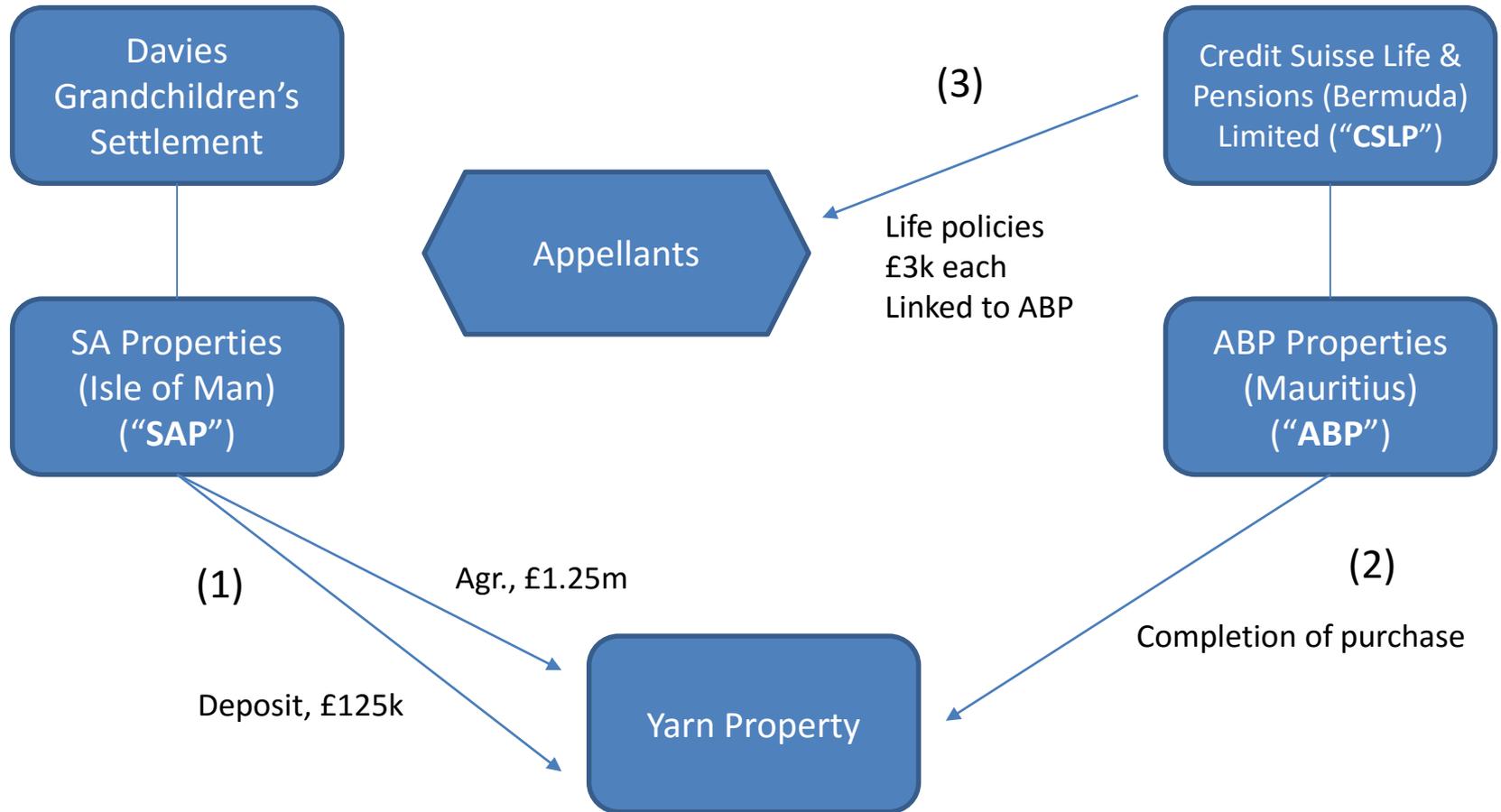
- Step 1: was there a tax advantage?
- Step 2: if there was, was it 'mitigation' or 'avoidance'?
  - What was the fiscally attractive option?
  - What were the economic consequences Parliament intended?
  - Did the taxpayer genuinely suffer those economic consequences, having regard *inter alia* to the taxpayer's legal and equitable rights, the risks involved and the consequences of insolvency?

# Mitigation/avoidance a wider doctrine?

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- GAAR Study Group (p 32f)
  - “...recognise that tax rules may give taxpayers a number of reasonable choices as to the sort of transactions which they may carry out and, depending on the choice, the tax results which could be achieved”
  - “... reasonable responses to choices afforded by the legislation”
- GAAR Guidance (C5.7.2 – 3)
  - “... by referring to the ‘principles on which the provisions are based’ and the ‘policy objectives’ of those provisions, the GAAR requires consideration not only of the express terms of the legislation but also any underlying assumptions or broader policy objectives relating to the particular rules ... such as Parliamentary debates and press releases...”

# Andrew Davies & Others – Facts



# Andrew Davies – Reasoning

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- *Andrew Davies and others*
  - “[87] The Appellants argued that the present case should follow *Willoughby* on the basis that they did not avoid tax because their life policies were subject to UK tax under the particular regime in sections 461 to 463 ITTOIA 2005. Further, the purposes of the arrangements were to get SAP out of the property purchase without forfeiting the deposit and to make pension arrangements
  - The taking out of life policies per se does not constitute tax avoidance. However, unlike in *Willoughby*, that is not the only transaction in this case. The creation of a special purpose vehicle was primarily for the purpose of creating an entity to complete the purchase in SAP's place. The selection of Mauritius as the jurisdiction for this vehicle, however, was specifically for tax reasons: to avoid paying tax in the UK under the terms of the Treaty. In addition, the purpose of creating a vehicle to replace SAP was to avoid SAP becoming liable to UK tax on income from the property development as well as to avoid losing its deposit.
  - It cannot therefore be said that “avoiding liability to taxation was not...one of the purposes for which the transfer .... [was] effected”

# Did the FTT apply the wrong test?

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- What should have been considered?
  - What was the fiscally attractive option?
    - Articles 7 and 22 of UK/Mauritius treaty
  - What were the economic consequences Parliament intended?
    - Indication that Mauritian nexus required?
    - Indication that treaty shopping not intended?
  - Did the taxpayer genuinely suffer those economic consequences, having regard to the taxpayer's legal and equitable rights, the risks involved and the consequences of insolvency?
    - Were ABP and CSLP genuinely independent? (para [78])
    - What if the directors went rogue?
    - “went on to make further property investments...” (para [77])
    - Did risks otherwise differ from SAP/UK comparator? (para [42])

# Outline of the EU defences

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- Statutory defence (from Apr 2012 (s 742A))
- Condition A:
  - (a) were, viewed objectively, the transaction to be considered to be a genuine transaction having regard to any arrangements under which it is effected and any other relevant circumstances, and
  - (b) were the individual to be liable to tax under this Chapter by reference to the transaction,  
the individual's liability to tax would, in contravention of a relevant treaty provision, constitute an unjustified and disproportionate restriction on a freedom protected under that relevant treaty provision.
- Condition B:

“the individual satisfies an officer of Revenue and Customs that, viewed objectively, the transaction must be considered to be a genuine transaction having regard to any arrangements under which it is effected and any other relevant circumstances.”

# EU defences cont.

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- “genuine transaction”
  - arm’s length requirement, or
  - non-arm’s length requirement, and
  - ‘economically significant transaction’ requirement (“...provision by the person of goods or services ... on a commercial basis and involve (a) the use of staff in numbers, and with competence and authority, (b) the use of premises and equipment, and (c) the addition of economic value ... [to customers], commensurate with the size of nature of those activities”)
- Is the EU law defence EU law compliant? Is there a ‘residual’ EU law defence?
- Kessler’s alternative (*Taxation of Non-Residents ... 2018/19*, p 1768):

“This chapter shall not apply in relation to income arising from economically significant activities carried on by the person abroad”

# EU law defences cont.

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- The case law EU law defence

“**[679]** The appellants ... would recast the motive defence so as to construe tax avoidance in the more restricted European law sense of artificiality so that the provision did not operate so as to catch exercises of freedom of establishment and movement of capital protected by the Treaty.

**[680]** The motive defence must, they argue, be interpreted in a manner which complies with EU law, ... i.e. that disregards only activities which are wholly artificial.

**[681]** We think a conforming interpretation along the lines the appellants suggest is possible... [with the caveat that the] more restrictive definition of 'avoidance' ... need only be applied to those situations where the individual subject to the charge is exercising Treaty freedoms.”

# Office and contact details

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