Analysis

Finance Bill 2016 changes to treatment of offshore developers and dealers in UK land

Speed read

The new legislation in Finance Bill 2016 governing sales of UK land is now public and effective. The new rules are much more voluminous than is necessary to achieve the key objective of preventing non-residents from shielding trading profits using a treaty. The usual problems arise of widely worded charging provisions hitting unintended targets, together with uncertainty as to what precisely the new measures actually mean. More unexpectedly, the crucial provision which switches off treaty protection only does so in limited circumstances; and it seems that some profits from disposals of UK land held as trading stock after 4 July 2016 will remain outside the scope of UK tax.

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Readers will recall that HMRC announced in Budget 2016 that new legislation would be introduced to ensure that profits from a trade which involves either dealing in or developing UK land are always chargeable to UK corporation tax or income tax. In particular, the key objective is to prevent non-resident companies from relying on the business profits article of a double tax treaty, so that profits from trading projects in UK land escape UK tax. (For more on the background, see my previous article 'Changes to treatment of offshore developers and dealers in UK land', *Tax Journal*, 22 April 2016.)

The legislation is now being enacted as part of the current Finance Bill having been introduced at Committee Stage. The basic position is that the new rules have effect in relation to disposals which take place on or after 5 July 2016. However, this is subject to anti-avoidance rules where on or after 16 March 2016 either a disposal has been made to an associated person; or essentially some kind of abusive arrangement has been entered into to circumvent the new rules. In addition, the changes to the treaties with Jersey, Guernsey and the Isle of Man (referred to together here as 'the Islands'), which form part of the same package of measures, take effect from 16 March 2016.

How the rules work

The new rules are essentially in five parts:

- the territorial scope of corporation tax is widened;
- an equivalent change is also made to income tax;
- the transactions in land rules are repealed and replaced with new revised versions for both corporation tax and income tax; and, finally
- the Islands treaties have been amended.

Two key issues are the extent to which the new rules negate treaty protection for traders in UK land; and essentially what other impact these changes, and especially the revised transactions in land rules, might have. These are considered in turn.

In order to assess the treaty override, it is necessary to understand the background. A non-resident company trading in UK land, even if outside the scope of corporation tax, was already chargeable to UK income tax on its profits. This is because under the source doctrine: 'the question is, where do the operations take place from which the profits in substance arise' (per Lord Atkin in *Smidth v Greenwood* 8 TC 193).

All that stopped the UK taxing profits from trading in UK land, prior to the introduction of new rules, was the ability of taxpayers to rely on the protection of a treaty pursuant to TIOPA 2010 s 6. It is this protection which needs to be switched off for the UK to tax. There are two ways in which that might be done: amend the treaty; or override it under domestic law. The new rules use both approaches, but neither is comprehensive.

> Existing arrangements established by Islands residents have been brought within the UK tax net by the recent treaty changes

The Islands treaties have been amended with effect from 16 March 2016. Most importantly, 'gains derived by an [Island's resident] from the alienation of UK immovable property' may be taxed in the UK. The same applies to gains from unquoted shares deriving more than 50% of their value from UK land. Income from UK immoveable property is also expressly taxable in the UK – although this is of limited relevance here, as it essentially means rents and not profits from sales of land.

The critical question in relation to the Islands is therefore whether the change which allows the UK to tax 'gains' on UK land enables it to tax trading profits. The short answer is that it probably does. A treaty must be interpreted in accordance with an ordinary international meaning and in light of the object and purpose of the relevant terms (see, for example, *Anson v HMRC* [2015] UKSC 44). Here, it is clear that the Islands treaties were amended to enable the UK to tax trading profits from the disposal of UK land. That does not leave taxpayers much scope to argue the contrary, notwithstanding that the capital gains article of a treaty does not normally deal with trading profits. In contrast, equivalent wording in older treaties is unlikely to be sufficient to give the UK taxing rights over trading profits, although there are counterarguments.

As regards the override, this is principally provided for as part of the measures which expand the territorial scope of corporation tax. A non-UK resident company is within the charge to corporation tax only if it carries on a trade of dealing or developing UK land. (This definition is discussed further below.) The override is in the new CTA 2009 s 5A, which provides that 'if a company has entered into an arrangement … one of the main purposes of which is to obtain a relevant tax advantage', this 'is to be counteracted by means of adjustments'. Critically, new s 5A(2) provides that a relevant tax advantage 'includes [doing so] by virtue of any provisions of double taxation arrangements, but only where the relevant tax advantage is contrary to the object and purpose of the provisions of the double taxation arrangements [and this has effect] regardless of [TIOPA 2010 s 6(1)]'.

Corresponding changes are made both for the income tax and for the transactions in land rules for both taxes. Importantly, an arrangement entered into before 16 March 2016 is not a relevant arrangement for these purposes. Accordingly, existing structures are likely to be unaffected by this change.

Taxpayers who are potentially within s 5A have a defence that the claimed treaty protection is not contrary to the object and purpose of the relevant treaty. There is clearly room for dispute over this and a full discussion is outside the scope of this article. Treaty interpretation is a difficult area. However, this is not a straightforward test for HMRC to win on. Given that a treaty is a contract between sovereigns, which is to be interpreted in accordance with its purpose, that would seem to leave little scope for a purpose-based override. On the other hand, HMRC may argue that the purpose of the treaty is not to permit double non-taxation, if that is indeed the result (see, for example, *R (oao Huitson) v HMRC* [2011] STC 1860, CA). There is obviously scope for argument as to whether double non-taxation is contrary to the object of the particular treaty or simply an unintended consequence of the relief which the treaty grants. (Saying that facilitating something is not the purpose of the treaty does not necessarily mean that by happening it contravenes the purpose of the treaty.) A related issue is the relevant time for determining the treaty's purpose; and there is a question as to how the burden of proof falls (it is the taxpayer's appeal but HMRC will be alleging the purpose test is contravened). On a practical note, as this only affects new structures any taxpayer who wants to claim relief should choose a jurisdiction which does tax the profits, so as to counter HMRC's likely best argument. All of this, of course, assumes that treaty relief is available. If double non-taxation is the result, HMRC may also seek to deny the relief and so the taxpayer will need to win on both issues.

The impact

Where does all this leave non-residents who may want to claim treaty protection for trading projects involving UK land in practice? Individual taxpayers will, as ever, need to take their own advice, but the position may be along the following lines.

Existing arrangements established by Islands residents have been brought within the UK tax net by the recent treaty changes. However, the same is not true for those with arrangements established elsewhere prior to 16 March 2016, as neither the treaty changes nor the override affect them. That is not to say that relevant profits will escape UK tax, as HMRC may seek to deny treaty protection, run an implementation attack based on residence or challenge using diverted profits tax.

For new projects, the obvious course is to use a UK company, especially with the UK corporation tax rates falling. However, in the right circumstances, treaty protection is at least in theory available – but setting out to get it is not for the faint-hearted. The supporting documents indicate HMRC has a £2.6m enforcement budget to use in this area, so taxpayers should beware.

The other key issue with the new rules is the extent, if any, to which the distinction between trading and investment might be overridden. HMRC has said that the aim is not to catch investors and this is supported by a statement in *Hansard*. However, the legislation gives serious cause for concern. Trading in land is defined to include 'developing UK land for the purpose of disposing of it'. This might be read as being synonymous with trading, but it is also capable of being read more widely. The new transactions in land rules apply where 'one of the main purposes' of acquiring the land is to realise a profit or gain from its disposal. In contrast, the old wording applied where this was the sole or main object.

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The true concern here is that whilst HMRC can say that it will only apply this kind of charge to traders who are seeking to avoid tax, where it forms that view and a dispute arises then, if these provisions are sought to be applied, the taxpayer will have an additional obstacle to overcome, although purposive interpretation might achieve that. This may be particularly acute if HMRC takes the view that projects are now being artificially labelled as investment. Those who wish to claim investment status would be well advised to ensure that they have strong evidence that this is indeed the case.

As regards the new transactions in land rules, space precludes a full discussion here. Essentially, these follow the format of the old rules but the wording is widened. Sales of interests in landowning vehicles are caught but only if there is dealing in or development of the underlying land. The statutory clearance procedure has gone. The most significant change here might be psychological, in that it was extremely rare for HMRC to challenge using the old rules, whereas it may be more confident using the new version (even if the technical result is no different).

Final thoughts

Despite the amount of new legislation, there is significant uncertainty about how it applies. This is partly because the legislation is full of widely worded anti-avoidance rules, but there is also a lack of clarity which the Explanatory Notes do not help. There is a stand-alone clause dealing with pre-trading expenses which appears to reset the timing rule in CTA 2009 s 61; but otherwise there is a lack of rules for companies transitioning into corporation tax, especially as these may already have been subject to income tax. Overall, there is plenty that is unsatisfactory with these changes, both for taxpayers and probably also HMRC. Guidance and clarification may smooth out some of the difficulties but there remain significant issues which may well turn into disputes. Taxpayers should prepare accordingly. ■

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- *Anson*: entity classification revisited (Charles Yorke, 8.7.15)
- BEPS: Preventing treaty abuse (Michael McGowan, Andrew Thomson & Emma Hardwick, 29.10.15)