No compulsion

Alastair Wilson and Menna Bowen summarise the case of *Andreas Rialas* and the lessons that can be learned on the rules relating to the transfer of assets abroad.

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On 7 August 2019, the First-tier Tribunal issued judgment in favour of the taxpayer in *Andreas Rialas* (TC7316). The case concerned the transfer of assets abroad rules (TA 1988, s 739), and provides a judicial ruling on several important points concerning their application.

During 2005-06 and 2006-07, Mr Rialas – a national of Cyprus, holding a Cypriot passport – was resident and ordinarily resident, but not domiciled, in the UK. He was a 50% shareholder and director of a UK resident trading company (UKCO) which from 2001 had carried on business very successfully as a fund manager. The owner of the other 50% shareholding, and a co-director, was a Mr Cressman who was not otherwise connected with Mr Rialas. There was no provision in the memorandum and articles of association of UKCO providing for any compulsion to sell or transfer shares in the company. Nor was there any shareholders' agreement covering UKCO.

From the end of 2004, the two directors had started to disagree about the conduct and development of UKCO's business and, in spring 2005, Mr Rialas approached RAB Capital Ltd (RABCAP) about that company buying the issued shares of UKCO. There was an existing business connection in that RABCAP had invested in a fund that was managed by UKCO. Mr Cressman was involved in these discussions although, finally, RABCAP decided not to buy all the shares.

Key points

- The ruling in the *Rialas* case illustrates important points on the transfer of assets abroad rules.
- A dispute over the operation of a UK company led to a purchase of shares on which dividends were later paid.
- A non-UK family trust was established for the benefit of the taxpayer's family.
- HMRC argued that the taxpayer was liable to income tax under TA 1988, s 739(1).
- The tribunal agreed with the taxpayer that the transfer of assets abroad provisions did not apply because the conditions in ITA 2007, s 739 were not met.
- The tribunal also agreed with the taxpayer that the transfer of assets abroad rules must be disapplied, because they were penal and in conflict with the EU freedom of capital movement rules.

Mr Rialas asked Mr Cressman whether he would be prepared to sell his UKCO shares, and if so, what price he would find acceptable. Mr Cressman replied that he would sell for US $15m, which was about the price he had hoped to receive from RABCP.

Purchase arrangements

Mr Rialas instructed his lawyer in Cyprus to set up a non-UK company (NUKCO) owned by a Cypriot international trust, for the benefit of himself and his family, which would buy Mr Cressman's UKCO shares. Mr Rialas arranged a loan at interest to NUKCO for US $15m from a Greek company that had invested in funds managed by UKCO. Mr Cressman sold his UKCO share to NUKCO for a cash price of US $15m. Dividends on those shares were later paid by UKCO to NUKCO.

Mr Rialas did not take UK company law or tax advice on the family trust, NUKCO, or concerning the purchase of Mr Cressman's UKCO shares, but he was aware that a non-UK family trust was beneficial for him as a UK resident but non-domiciled individual.

HMRC's claim

HMRC issued a decision that Mr Rialas was liable to income tax under TA 1988, s 739(1) on the dividends paid by UKCO to NUKCO for the years ended 31 December 2005 and 2006. This was on the grounds that he was a 'transferor' and had power to enjoy the income of NUKCO as a beneficiary of the family trust that owned all the issued shares in NUKCO. HMRC asserted that Mr Rialas had 'procured' the transfer of shares made by Mr Cressman, by arranging the setting up of that family trust and NUKCO, and by discussing the loan made to NUKCO by the Greek lender, which enabled it to buy Mr Cressman's

UKCO shares. Alternatively, the £10 capital contributed by Mr Rialas to the non-UK trust was a transfer made by him, and the loan to NUKCO from the Greek lender was an associated operation procured by Mr Rialas.

Taxpayer's appeal

Mr Rialas appealed against the decision issued by HMRC on the following grounds.

First, he was not the transferor of the UKCO shares sold by Mr Cressman to NUKCO, and nor did he have or exercise control over Mr Cressman sufficient to 'procure' his sale of his shares, in the sense dictated by the case law (in particular *Vestey v CIRC* 54 TC 503; *Congreve v CIR* 30 TC 153; *Pratt v CIR* [1982] STC 756; and *Carvill v CIR* [2000] SSCD 143). The loan made by the Greek lender to NUKCO was not a transfer made by Mr Cressman since he did not control that lender, nor was it an 'associated operation'.

Second, and in the alternative, if Mr Rialas was found to be the transferor or to have 'procured' the transfer of Mr Cressman's UKCO shares, he was entitled to the exclusion in TA 1988, s 741 because his motive was to take advantage of the excluded property inheritance tax rules in IHTA 1984, s 48(3). Section 741 was rewritten as ITA 2007, s 739, which states that, for pre-5 December 2005 transaction, the transfer of assets abroad provisions do not apply if conditions A or B are met.

- Condition A is that the purpose of avoiding liability to taxation was not the purpose, or one of the purposes, for which the relevant transactions or any of them were effected.
- Condition B is that the transfer and any associated operations:

a) were genuine commercial transactions; and
b) were not designed for the purpose of avoiding liability to taxation.

Mr Rialas argued that his actions involved tax mitigation rather than tax avoidance (*CIR v Willoughby* 70 TC 57).

Third, and again alternatively, if Mr Rialas was found to be the transferor or to have 'procured' the transfer of Mr Cressman's UKCO shares, the application of the transfer of assets abroad rules would infringe his entitlement to freedom of capital movement under the Treaty Establishing the European Union 2002, Art 56. The UK tax rules must be interpreted to conform to EU rules, or the application of UK tax rules was precluded so far as they conflicted with EU rules. This argument was supported by the decisions in *État Belge* EU Case C-311/08; *Staatsecretaris van Financiën v Verkooijen* EU Case C-35/98; *Cadbury Schweppes Overseas Ltd and Cadbury Schweppes plc* EU Case C-196/04; and *Fisher* (TC3921).

Decision of the First-tier Tribunal

On his first argument, the tribunal agreed that Mr Rialas was not the transferor of Mr Cressman's UKCO shares, nor did he have or exercise sufficient control over him to show that he had 'procured' the transfer of his shares. On its own, this would be enough for the tribunal to allow the appeal. However, it went on to consider the other arguments.

Planning point

The tribunal held that TA 1988, s 739(1) was not compatible with the EU principle of free movement of capital because it was penal in its effect.

On the second point, Mr Rialas was not entitled to the exclusion in TA 1988, s 741 because he did have an understanding of the UK tax benefits of a non-UK trust, so the decision in *Burns v CIR* [2009] SSCD 165 applied, and the decision in *Beneficiary v CIR* [1999] SSCD 134 did not. In *Burns*, on becoming entitled to assets at 18, the taxpayers transferred UK property that would have been subject to UK tax to an offshore company controlled by their parents. In the *Beneficiary* case, the transfer of non-UK assets would not, by itself, have changed the UK tax liability.

On the final point, the application of TA 1988, s 739(1) was penal and did involve a breach of the freedom of capital movement rights under EU law, but an interpretation of UK tax rules to conform with EU rules was not feasible, even taking account of the wider definition of tax avoidance in EU law established by the decision in *X Gmbh v Finanzamt Stuttgart – Korperschaften* EU Case C-135/17. Therefore, the provisions of s 739(1) were not compatible with the EU principle of free movement of capital because they were penal in their effect and the only effective remedy in these circumstances was to disapply s 739(1).

Conclusions

We can draw several conclusions from the tribunal's decision.

First, an individual (Mr Rialas in this case) can procure a transfer of assets abroad made by another individual (here, Mr Cressman) if it is shown that the first individual had and exercised sufficient control or influence over the other individual – the approach in *Carvill v CIR* [2000] SSCD 143 was followed. The wide scope of 'associated operations' was insufficient to cover the loan at interest by the Greek lender to NUKCO.

Second, the exclusion in TA 1988, s 741 (for pre-5 December 2005 transactions) can apply only if no UK tax benefit is in the mind of the relevant individual. Here, the approach in *Burns v CIR* was followed so, broadly, the exclusion will not apply if the transfer of UK situs assets producing income is involved.

Finally, the transfer of assets abroad rules are penal and incompatible with the freedom of capital movement rules under EU law, so UK tax rules must be disapplied to avoid infringing EU rules. This is an important restriction on the application of the transfer of assets abroad rules.

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