BAD timing: the need for clarity

Personal tax



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Keith Gordon looks at a case which considers the enti tlement of trustees to Business Asset Disposal Relief

Key Points

What is the issue?

In terms of business asset disposal relief, the rule for disposals by trusts does not focus on the shareholding of the trust itself but on the relationship between the company and an individual with an interest in possession (and not merely for a fixed period) in the trust – what the statute calls ‘a qualifying beneficiary’.

What does it mean for me?

In The Quentin Skinner Settlements, the Upper Tribunal considered that Parliament’s repeated use of ‘qualifying beneficiary’ rather than ‘individual’ was a hint that the individual was meant to be a qualifying beneficiary throughout the one-year (now, two-year) qualifying period.

What can I take away?

Trustees should consider taking the precaution of ensuring that disposals are not made until after the life tenants have had their interest in possession for a full two years (and perhaps until after they have held the shares for a similar period).

Business asset disposal relief (previously known as entrepreneurs’ relief) has many critics. However, its one saving grace is that the legislation is relatively clear, written in the style that was developed by the Tax Law Rewrite Project around the turn of the millennium. For example, rather than relying on a series of interconnected deeming provisions, the rules for the three separate strands of the relief are dealt with in separate sections, each setting out in clear terms when relief is available.

One of these strands concerns disposals by trusts. It must be stated that the rules are hard to justify from a policy sense, but at least the limited availability of the relief is clear from the statute. For example, it might be thought that a trust which

owned shares in a trading company for the requisite period (previously one year, now two years) should qualify for relief in the same way as an individual does (as set out in the Taxation of Chargeable Gains Act 1992 s 169I). However, the rule for trustees does not focus on the shareholding of the trust itself but on the relationship between the company and an individual with an interest in possession (and not merely for a fixed period) in the trust (s 169J) – what the statute calls

The facts of the case

The relevant facts are relatively straightforward. There were three settlements in which three individuals each had an interest possession since 30 July 2015; and each had owned sufficient shares in a trading company since 2011 so that the company was a personal company for each of the individuals at all relevant times. The individuals were also employees or officers of the company from 2011. Thus, had the individuals disposed of their shares, they ought to have qualified for entrepreneurs' relief on any gain made. Further shares were given to each of the trusts on 11 August 2015. The trust then disposed of its shares on 1 December 2015.

The trustees claimed what was then entrepreneurs' relief on the basis of what was said in s 169J(4), being that:

'throughout a period of one year ending not earlier than three years before the date of the disposal:

a) the company is the qualifying beneficiary's personal company and is either a trading company or the holding company of a trading group; and
b) the qualifying beneficiary is an officer or employee of the company or (if the company is a member of a group of companies) of one or more companies which are members of the trading group.'

The First-tier Tribunal went through the tests in s 169J(4) and concluded that each of the conditions was met throughout the year ending with the date of the disposal:

- For each individual, the company was a personal company.
- The company was a trading company.
- Each individual was an officer or employee of the company.

Accordingly, the First-tier Tribunal allowed the trusts' appeals. HMRC appealed against the decision to the Upper Tribunal.

The Upper Tribunal's decision

The case came before Mr Justice Michael Green and Upper Tribunal Judge Andrew Scott. They reminded themselves of the principles of statutory construction, which include looking not only at a provision in isolation but also in its proper legislative context. Another clue, to be used in cases where a real doubt exists about a statutory provision, is what was meant by a previous version of the legislation.

Although the judges considered thats 169J was a key provision, it was only, they said, 'part of the story'. Other parts of the story, the tribunal concluded, relate to the computation of the relief in each case, most notably the rules in s 169O ('Amount of relief: special provisions for certain trust disposals').

In the First-tier Tribunal, the relevance of s 169O had been doubted thus: 'In my experience of modern techniques of drafting of tax statutes, I would find it very strange indeed if the meaning of the primary qualifying conditions of a relief from tax were to be found obscurely by reference to an apportionment provision (which is all s 169O amounts to) and which, in any event, did not apply in this case (because … the qualifying beneficiary in respect of each … settlement in this appeal owned the entire trust property).'

However, the Upper Tribunal considered this to amount to an error of law. The Upper Tribunal considered that, when reading ss 169J and 169O together, the meaning should be consistent and coherent.

Focusing first on s 169J(4), the Upper Tribunal considered that Parliament's repeated use of 'qualifying beneficiary' rather than 'individual' was a hint that the individual was meant to be a qualifying beneficiary throughout the one-year (or two-year) qualifying period. Otherwise, s 169J(4) would simply have referred to 'the individual'.

Any lingering doubt, according to the Upper Tribunal, was dispelled by s 169O, which addresses the situation where there is more than one beneficiary with an interest in possession in the trust's assets 'at the material time'. The Upper Tribunal then considered the following question: 'What then is the material time? That concept is directly expressed by reference to the test in s 169J(4). It imports into s 169O the same one-year [now, two-year] period rule as is present in s.169J(4).'

The Upper Tribunal took further comfort from the equivalent provisions that governed the former retirement relief rules, on which entrepreneurs' relief was based.

For these reasons, the Upper Tribunal concluded that implicit within s 169J(4) is the requirement that the individual has an interest in possession throughout the one-year (now, two-year) period. Accordingly, HMRC's appeal was allowed.

Commentary

I fully accept that it is somewhat surprising that the one-year (now, two-year) test applies only to the relationship between the beneficiary and the company (and the nature of the company itself). After all, it might be expected that the trust should be required to own its own shares for the year (or two) before the disposal. However, as already noted, the entire policy underlying s 169J is hard to discern. Why should a life-interest trust which owns all the shares of a trading company be excluded from business asset disposal relief, but one with 95% or less of the company's shares qualify (provided that the life tenant owns at least 5%)?

Nevertheless, when it comes to interpreting a statute, it should not be a case of trying to discern the policy but should be a case of interpreting the words used by Parliament. As was stated by Lord Nicholls in R v Secretary of State for the Environment, Transport and the Regions and Another, ex parte Spath Holme Ltd in 2000:

'Statutory interpretation is an exercise which requires the court to identify the meaning borne by the words in question in the particular context. The task of the court is often said to be to ascertain the intention of Parliament expressed in the language under consideration. This is correct and may be helpful, so long as it is remembered that the "intention of Parliament" is an objective concept, not subjective.

'The phrase is a shorthand reference to the intention which the court reasonably imputes to Parliament in respect of the language used. It is not the subjective intention of the minister or other persons who promoted the legislation. Nor is it the subjective intention of the draftsman, or of individual members or even of a majority of individual members of either House. These individuals will often have widely varying intentions. Their understanding of the legislation and the words used may be impressively complete or woefully inadequate. Thus, when courts say that such-and-

such a meaning “cannot be what Parliament intended”, they are saying only that the words under consideration cannot reasonably be taken as used by Parliament with that meaning.’

Indeed, even more recently, the Upper Tribunal made the following observation: ‘The oddity point pre-judges the question of statutory construction … While from a policy viewpoint we can see the desirability of the [position being advanced by the taxpayer], we must be guided by the words of the statute.’ (Hoey v HMRC [2021] UKUT 82 (TCC))

Thus, of course, it is appropriate, indeed obligatory, to consider the statutory words in their context. In fact, one can say that the Upper Tribunal identified all the relevant tools of statutory interpretation when reaching its decision. However, it is my respectful view that their approach was akin to missing the wood for the trees. In particular, the Upper Tribunal failed to give credit to the drafting style which (perhaps dull) sets out in logical steps what the statutory conditions are, precisely with a view to making the art of statutory interpretation that much easier.

I respectfully disagree therefore with the Upper Tribunal’s decision to try to discern a meaning of s 169J by reference to the phraseology adopted in s 169O.

The whole point of the Tax Law Rewrite Project (and the drafting style it employed) was to avoid statutory interpretation requiring one to view the words from an obscure angle whilst squinting (unlike, for example, the skull in Holbein’s ‘The Ambassadors’). Indeed, one of the advantages of the rewrite style is that the meaning of the statutory words should be easier to discern and, therefore, if there are apparent anomalies in the statute they would be more obvious. Consequently, if those apparent anomalies make it to the final version of the legislation, it must be more readily inferred that they do indeed reflect the true intentions of those promoting the statute. Accordingly, if Parliament had really intended the beneficiaries to have had an interest in possession for the full qualifying period, it would be reasonable to assume that Parliament would have said so directly.

Furthermore, any exercise in trying to interpret the legislation by reference to what a court or tribunal thinks that the policy should dictate might, in the present case, also require the trust to have owned the relevant shares for the full year (or, now, two years) prior to the disposal. But that is precisely what a court or tribunal should not do as that is straying into the realm of legislating rather than interpreting.

However, I fear that that is precisely what the Upper Tribunal has done in the present case.

What's more, if one is to try to fit the legislation with the presumed policy, the Upper Tribunal should then have considered the Explanatory Notes which accompanied the 2008 Finance Bill. That made it very clear that the test in s 169J was to apply to the beneficiary the same tests that would have applied to an individual who was making an equivalent disposal. There is nothing in those notes that suggests that the individual had to have an interest in possession as well throughout the qualifying period.

As for the Upper Tribunal's expressed reasons for disagreeing with the First-tier Tribunal, I agree that the overall scheme should be coherent. However, it is still important, I say, to recognise that s 169J addresses the question as to when relief might be available, with s 169O addressing only the quantification of such relief in certain specific cases. Thus, to expect a reader to understand s 169J only by drawing an inference from the wording of s 169O strikes me as the antithesis to the clear drafting techniques that the drafter of the entrepreneurs' relief rules was adopting.

Indeed, it is quite clear to me why s 169J(4) refers to 'the qualifying beneficiary' and not 'the individual'. First, the term is already defined and therefore it makes sense to use it. Secondly, to use 'the individual' would have been stylistically unclear in the context of s 169J(4) and the most concise alternative would have been 'the individual referred to in sub-section (3)'. However, that concept is even more clearly expressed by using the already defined term 'the qualifying beneficiary'.

Furthermore, I do not even see that s 169O justifies any conclusion that the beneficiary has to have an interest in possession throughout the qualifying period. Section 169O expressly refers to 'the material time' which it then defines in sub-section (6) to be the end of the relevant one or two-year qualifying period. Again, a statutory label is used because it provides a useful shorthand for the precise meaning of a concept which takes 90 words to define. As the taxpayers' counsel submitted, the statute provides for a snapshot approach. The policy might be questioned. However, the snapshot approach is in fact the consistent theme of the rules (for example, an asset disposed of shortly before the cessation of trade would not qualify for the relief).

As for the Upper Tribunal's reliance on the retirement relief rules, I just do not see their relevance. Yes, the entrepreneurs' relief rules were based on them. However, to the extent that the wording is similar, that does not resolve any ambiguities, but replicates them. And, to the extent that the wording is different, that should be a clue that the provisions are to be interpreted differently. In my view, the Upper Tribunal has made a wrong decision in this case and the First-tier Tribunal's decision should be preferred.

What to do next

I therefore hope that the case will be looked at again by the Court of Appeal. In the meantime, trustees effecting similar disposals should consider taking the precaution of ensuring that disposals are not made until after the life tenants have had their interest in possession for a full two years (and, perhaps to avoid further disputes, until after they have held the shares for a similar period).