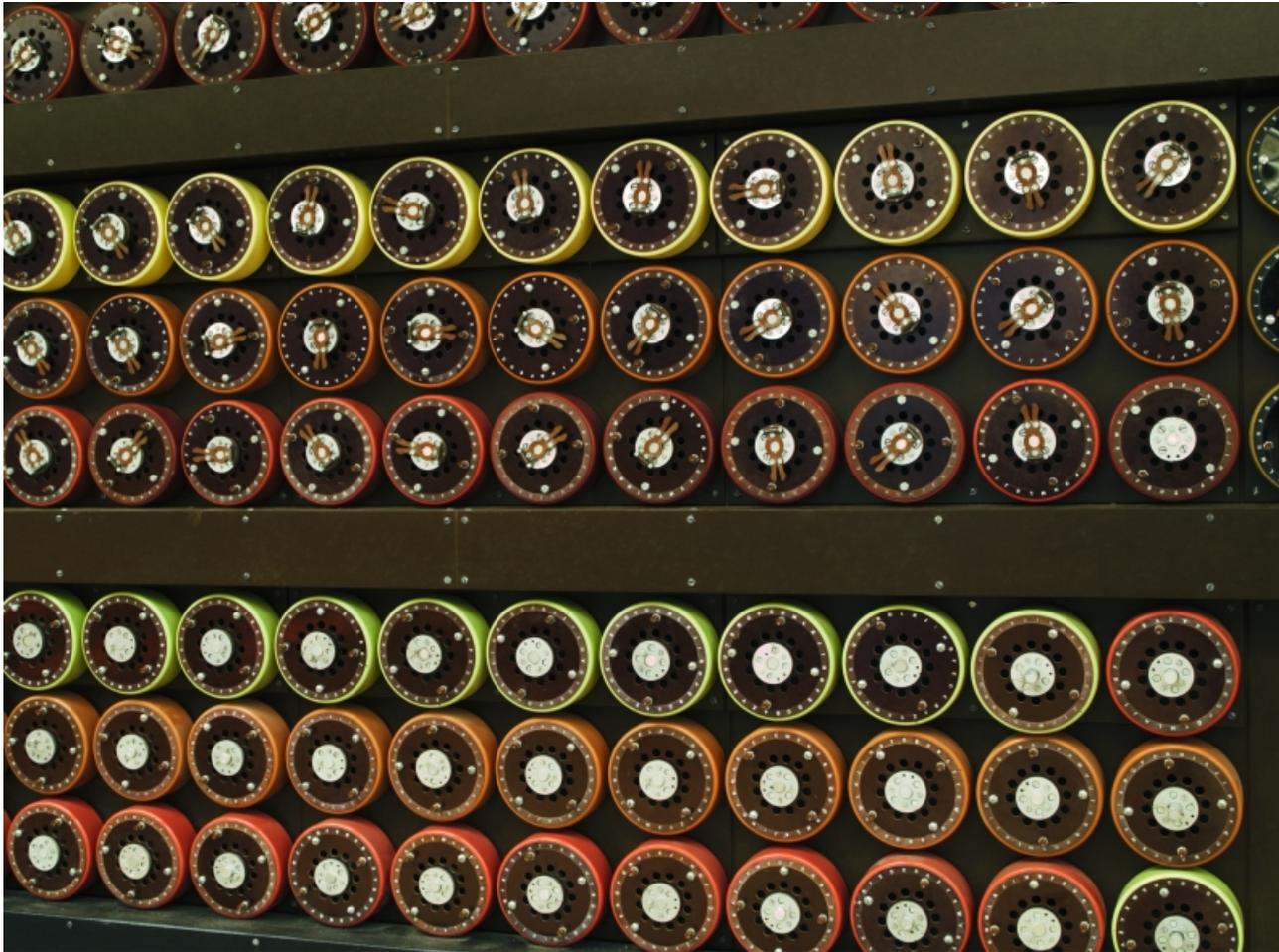


## The imitation game

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Keith Gordon reviews a case about the taxation of overseas dividends, while tackling the issue of the correct way to interpret rewritten tax legislation

### What is the issue?

The case of Shirley considers an argument that a rewritten piece of statute which affected overseas dividends received by UK residents had unintentionally changed following the Tax Law Rewrite

### What does it mean for me?

This case is another example of the tax code spiralling out of control and proving to be an enigma even to the experts

### What can I take away?

In the absence of any coherent set of principles, the tribunal felt bound to reach its decision on the basis of the natural reading of the words found in the current statute

The Tax Law Rewrite Project ran from 1996 until 2010. Its aim was to recast the tax statutes in a format that would be easier for readers to use. Increased usability depended upon two things: first, bringing together the provisions that were scattered throughout different statutes, but which dealt with the same subject matter; and, second and probably more importantly, the use of clearer language.

By the time the project came to an end, most of the primary income tax and corporation tax legislation had been

rewritten, together with some secondary legislation. The project had been unable to turn to other taxes, such as capital gains tax and inheritance tax; nor were the administrative provisions, found mainly in Taxes Management Act 1970, rewritten (although many of these have since been superseded by new 'harmonised' legislation following the merger of the former Inland Revenue and HM Customs & Excise).

The principal purpose of the rewritten legislation was to recreate the effect of the previous statute. However, what made the Tax Law Rewrite Project different from the occasional 'consolidation exercises', such as amalgamating the provisions of preceding Finance Acts, was that the project was permitted to make minor changes to the law. These changes were subject to particular parliamentary scrutiny, and were effected by a customised process involving a joint committee of MPs and peers.

At first, the project was very conservative about the changes being made. Its concern was that it would be constitutionally problematic if the project were to increase (actually or potentially) a person's tax liability. However, the joint committee encouraged the project to be bolder in its approach. Later rewritten acts contained a range of changes, many of which were potentially adverse to taxpayers.

The changes (even those that were 'pro taxpayer') were minor in nature, seeking only to remove anomalies that had crept into the tax code. They had all been subject to detailed consultation before the respective Bills were introduced to parliament. They were also the focus of commentary in the explanatory notes that were provided to MPs and peers when the proposed legislation was debated.

Inevitably, when any document is being rewritten using different words from the original, there is the potential to argue that the meaning has changed in the process. Such a change would be an unintentional consequence of the rewrite, as opposed to the intentional changes already discussed. The case of *Shirley v HMRC* [2014] UKUT 1023 (TC) considers such an argument.

## Facts of the case

The case concerns the tax years 2005/06, 2007/08 and 2008/09. (The missing year was due to an oversight by HMRC.)

In those years, Mr Shirley was a UK resident, although he was not domiciled in any part of the UK. He was the life tenant of two overseas trusts that were effectively established by his parents when they were based in Ireland. The trusts owned shares in overseas companies and Mr Shirley (as life tenant) received dividend income paid by the various companies. The dividends were paid directly into the UK by the overseas companies.

As the income was remitted to the UK, the income was undoubtedly assessable on Mr Shirley by virtue of ITTOIA 2005. The question for the tribunal was whether the income was assessable under s 399 of that act or elsewhere.

## The relevant statute

Section 397 provides the normal rule for the taxation of dividends. A dividend is treated as being paid net of a tax credit worth one-ninth of the amount received. Therefore, the recipient of a dividend of £90 will be treated as having received taxable income of £100, but will have a non-repayable £10 credit to set against any tax liability arising in relation to the dividend income. As the dividend ordinary rate is 10%, this credit extinguishes the tax liability for most recipients of dividends.

For the years with which the case is concerned, higher rate taxpayers were subject to the dividend upper rate of 32.5% (or 22.5% after the deduction of the s 397 credit). These rates are, of course, misleading because they apply to an artificially enhanced income figure; effective tax rates are more meaningful. Basic rate taxpayers and non-taxpayers effectively received dividends tax free, whereas higher rate taxpayers were liable for tax of 25% of the actual dividend

received. For example, a higher rate taxpayer receiving a £90 dividend would be treated as having received taxable income of £100, on which tax of £32.50 would be payable, less the £10 credit, leaving a net liability of £22.50 (being one quarter of the dividend received).

Section 399 operates differently. Under s 399, a dividend received is not grossed up; instead, the taxpayer is taxed on the amount of the actual dividend itself. Nevertheless, the taxpayer is still treated as having a 10% credit on that amount. Therefore, as with s 397, basic rate taxpayers' tax liabilities are extinguished by virtue of the tax credit. Similarly, higher rate taxpayers are liable for a net tax liability of 22.5% of the taxable income. However, unlike s 397, as the dividend income has not been grossed up, this is a pure 22.5% liability on the actual dividend received, as opposed to an effective 25% rate.

So far as UK residents are concerned, s 397 applies in relation to a 'qualifying distribution made by a UK resident company'. Section 399 applies 'if a person is not entitled to a tax credit for a qualifying distribution'.

## The respective arguments

Mr Shirley argued that the wording of the legislation is clear. He claimed that, as his dividends were received from non-UK companies, this meant that s 397 could not apply in relation to his income, and so s 399 would apply instead.

HMRC, on the other hand, pointed to the 'overall purpose and rationale' of the relevant chapter in ITTOIA 2005. They argued that s 399 was limited in its application to distributions from UK companies. Furthermore, citing the legislative predecessor to ICTA 1988 ss 397 and 399, HMRC argued that what is now s 399 would not have applied to the overseas dividend income.

Therefore, in the absence of a deliberate change being effected through the Rewrite Project, HMRC argued that the preceding legislation should be taken into account when interpreting the rewritten provisions.

For completeness, it should be noted that Mr Shirley considered that the meaning of the legislation did not change as a result of the Rewrite Project.

## The tribunal's decision

The tribunal (judge Nicholas Aleksander, sitting with Mr Michael Sharp) set out and followed the previous authorities on the use of antecedent legislation when interpreting later versions. In particular, it noted that one should refer to earlier legislation only in limited circumstances; for example, if the new legislation was unclear when considered on its own.

Adopting this approach, the tribunal held that it did not need to consider the earlier legislation, because it held that the ITTOIA 2005 legislation was sufficiently clear as to its meaning.

Even if there had been an unintentional change in the legislation as a result of the rewrite process, that was a price paid for the overall simplification of the statutory code.

Thus, the tribunal gave no decision on the meaning of the previous legislation, but had to consider the effect of the provisions since 2005. On this point, the tribunal's decision was, in accordance with the arguments put forward by Mr Shirley, that s 399 did in fact apply, meaning that the effective tax rate was reduced to 22.5%. In particular, even though ss 397 and 399 come within a chapter primarily devoted to the taxation of dividends from UK resident companies (s 382(1)), there was a clear statutory pointer in s 382(2) to the effect that ss 397 to 401 apply more broadly.

## Commentary

As the tribunal did not need to express any opinion on the correct interpretation of the provisions in ICTA 1988, the

decision does not tell us whether UK resident recipients of overseas dividends had been overtaxed in the years leading up to the rewrite in April 2005. Nevertheless, the case certainly suggests that possibility and the apparent certainty that some taxpayers have since been overcharged.

As with my article in last month's Tax Adviser ('[La peine quotidienne](#) [1]'), the rate of tax applicable to a particular type of income should be a relatively simple part of the tax code and ought not to give rise to the kind of dispute as seen in the present case. Indeed, when non-tax specialists suggest to me that the country's tax rules would be so much simpler if there were a flat rate, my normal response is to point out that the rules concerning the rates of tax are not the source of the complexity. It is the rules that have to be followed to calculate the taxable income in the first place that cause the difficulties to arise. Nevertheless, as a result of this case, I am going to have to modify my response.

The complexities arising in this case were the result of a series of changes to the taxation of dividend income over the past 40 years (particularly in the period before 2005).

As the tribunal noted:

'The difficulty that ... HMRC face is that it is not possible to ascertain a consistent and logical basis in the legislation for the taxation of dividends. Whilst there might have been some sort of logical underpinning to the basis of taxation of dividends in the early 1970s, when the partial imputation system was introduced (with ACT and tax credits) – any such logic had long disappeared as a result of the many amendments to dividend taxation in the period leading to the enactment of ITTOIA. Parliament has chosen to legislate for a system of great complexity, involving different tax rates, tax credits, deemed payments of tax, grossing up and various other matters. There are no logically consistent principles (as it were) underpinning the taxation of dividends, against which the result of a literal interpretation can be compared – in order to reach a judgment that a literal interpretation results in an anomaly or absurdity.'

In the absence of any coherent set of principles which could suggest that the result contended for by Mr Shirley was anomalous, the tribunal felt bound to reach its decision on the basis of the natural reading of the words found in the current statute.

This case is a further example of where the tax code is spiralling out of control and proving to be an enigma even to the experts.

When will the politicians finally take note?

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