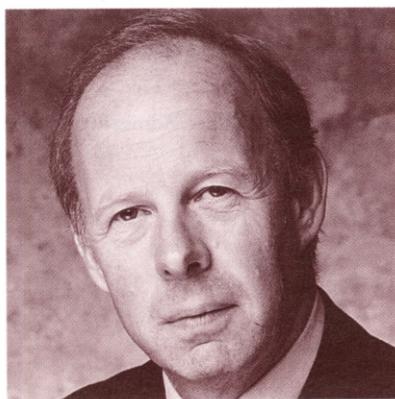


Taxation

The implications of the Court of Appeal decision R v Dimsey

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Dimsey was an accountant resident in Jersey. He helped an avionics engineer called Chipping supply equipment to South Africa in breach of sanctions. Dimsey, Chipping, Chipping's solicitor Da Costa and a business associate called Allen were all convicted of cheating the public revenue and sent to prison. Dimsey's and Allen's sentences were for 18 months and 7 years respectively. Allen was also ordered to pay £3m, with a consecutive 7 years' imprisonment in default.

Dimsey and Allen appealed against their convictions. These appeals were heard in the Criminal Division of the Court of Appeal, where the appellants were represented by well-known tax barristers, including Robert Venables QC and James Kessler. Their technical tax arguments did not carry much weight with the criminal judges. By directing their attack through the criminal courts, the Revenue almost certainly obtained rulings on several issues which were more favourable to them than might have been expected had the points been argued elsewhere.

The Revenue will not be slow to exploit this in a number of areas where there has for some time been a stalemate on the technical arguments.

This short article summarises the important issues decided in the judgment of 7 July 1999 (*R v Dimsey (Dermont Jeremy)* CA [1999] STC 846).

DECEPTION

The court found that both appellants had positively misled the Revenue

investigators. This is what led to the criminal charges.

Some of the untruths related to sums of money which were not disclosed; some related to the way in which the business had been started and had no impact on tax liability as such. For example, it was claimed that Dimsey contacted Chipping, rather than the other way round. In particular the Revenue were able to show that Chipping had withheld information even when giving a certificate of full disclosure. These deceptions gave the Revenue the opportunity to press criminal charges.

COMPANY CONTROL

Dimsey administered 13 companies for Allen in Jersey. These held a portfolio of properties. The question was whether the companies were centrally managed and controlled by Dimsey in Jersey or Allen in the UK. The text of the judgment speaks for itself on this issue and should be read in full, but the following extracts are significant:

'The companies were administered by Dimsey for Allen in accordance with Allen's instructions. Dimsey and his office undertook administrative work relating to the offshore companies and Allen's personal assets. It was the prosecution case that Allen himself managed and controlled the companies in the UK.'

Numerous draft letters were recovered showing that Allen was giving instructions to Dimsey to send letters on behalf of the offshore companies.

When Allen's home was searched there were found numerous detailed cash statements ... cheque books in respect of the companies where blank cheques had been signed by the authorised signatories, and bank statements of the companies annotated by Allen.

The house in which the Allen family lived was held in the name of Peche d'Or. Allen and members of his family had credit cards in the name of Meldrette and Peche d'Or which were used to pay household and personal bills and for holidays and education. School fees for four of Allen's children were paid by Peche d'Or.'

Against this damning evidence Allen did not appeal the question of control.

Dimsey, however, submitted that the trial judge had misdirected the jury on the test for determining whether some of Chipping's companies were UK resident.

The Appeal Court agreed that some aspects of the summing up could have been misleading but took the view that the overall result was correct.

'The factual issues in the case centred on the question whether it was Mr Dimsey who managed and controlled the companies, with Mr Chipping merely acting as a consultant who undertook work in England on behalf of the companies. ... So long as the prosecution could satisfy the jury so that it was sure that Mr Chipping was not a consultant but in fact not only undertook the day-to-day running of the business but made all the decisions whilst Mr Dimsey carried out the functions of administration in Jersey, no sophisticated or difficult questions of central management and control arose.'

The Appeal Court approved the following passage from the trial judge:

'The prosecution case is that Mr Chipping was really the linchpin of the whole business, that he had both the technical expertise and the business and financial knowledge to negotiate and carry out these contracts. They say that effectively he simply used Thomlyn and Glenville to do his business for him, that those companies were just convenient facades or fronts set up for the purpose. The defence case is that those companies were or at least may have been genuine trading companies controlled at least in Jersey and that Mr Chipping was merely a consultant.'

The court went on to refer to the way in which the business had been done:

'It emerged that Mr Dimsey signed the contracts, arranged for Mr Allen's commission to be collected from the bank, chased late payments and dealt with invoices.'

... The question of control by shareholders of a company was never argued before the jury. It was never mentioned by the judge. Accordingly we do not think that it would ever have occurred to the jury to conclude that because Mr Chipping was the beneficial owner of the shares in the company those companies were resident in the UK ...'

DUTY TO DISCLOSE

The Taxes Management Act 1970 requires a company which is chargeable to corporation tax to give notice to the Revenue that it is so chargeable. Of course none of the Chipping or Allen offshore companies had done so, it being assumed there was no liability in the first place. This obligation falls on the 'proper officer', usually the company secretary or the person acting as company secretary.

It was submitted that as neither Chipping nor Allen was an officer of their respective companies they could not be fixed with any criminal or other liability for the failure to comply with this statutory obligation. This was dismissed:

'In our judgment this has no merits. It is obvious that any failure by the proper officer to perform his ... duty cannot relieve the company of its obligation to corporation tax. ... If an individual having total de facto control of a company, arranges its affairs so that the company (a) makes profits but (b) does not declare them to the Revenue, he is obviously cheating the Revenue ...'

'... the offence of cheating is perfectly simple: it is constituted by any form of fraudulent conduct having the purpose and effect of depriving the Revenue of money due to it. In any event it is simply artificial, on the facts we have recounted, to suggest these were cases of mere omission. These were deliberate plots, involving overt acts in the way of correspondence and so forth, to bring about a state of affairs in which the Revenue was to be defrauded.'

SECTION 739

The argument was advanced on behalf of the appellants that, as the offshore income of the companies was potentially liable to tax in the hands of the UK-resident individuals who had 'power to enjoy' it under the *Income and Corporation Taxes Act 1988 s. 739(2)*, it should not also be liable to corporation tax. If so then neither Dimsey nor Allen could be convicted of any corporation tax offences.

Robert Venables QC made the point that if the income is deemed to be that of one taxpayer (the individual), it is only logical to assume it cannot at the same time be that of another (the company). This ingenious line of argument was dismissed by the Court of Appeal on the narrow ground that s. 739 deems offshore income in such a case to be the income of the individual taxpayer 'for all the purposes of the Income Tax Acts' and does

not therefore extend to corporation tax.

It was also pointed out on behalf of the Crown that Venables' argument on this point might enable corporation tax owed by a profitable company to be avoided by fixing it on an impecunious individual.

The court realised it might be leading towards a conclusion which would allow the same income to be taxed twice and made the following useful comments:

'... There is a theoretical liability to double taxation. We were told the practice is not to exact tax twice. We wholly accept that the subject is not to be taxed by discretion. Were a situation to arise in which, contrary to their plain statement to this court, the Revenue sought in a s. 739 case to exact tax both from the transferor (or other person with 'power to enjoy') and the offshore transferee, the High Court might be invited to prohibit it as an abuse of power.'

SHADOW DIRECTORS

Allen and members of his family occupied properties owned by some of the offshore companies and the Revenue raised additional assessments against him on the ground that he was in effect a director of these companies and therefore taxable on the use of the properties as a benefit in kind.

The tax at stake here can be significant. It is based on a simple calculation of the cost of the property to the company over £75,000, multiplied by an interest factor (currently 6.25 per cent). So where, for example, a company has spent £2,075,000 on the acquisition and improvement of the property the additional income will be £125,000, taxable at 40 per cent, giving rise to tax of £50,000 p.a..

This is the intended result of provisions introduced to tax a UK director provided with the use of expensive accommodation at the cost of his employer. The Revenue have attempted for some years to apply this legislation to offshore property-owning companies, but until now there has been great uncertainty as to whether the legislation supported this where the taxpayer concerned was not actually appointed a director or other officer of the offshore company.

In order to recover tax in such situations the Revenue have alleged that a person who has no formal position in the

company may nonetheless be chargeable if he comes within the definition of a shadow director – i.e. 'someone in accordance with whose instructions the company is accustomed to act'. Until the Dimsey/Allen appeal, the balance of the argument was running against the Revenue. In a case before the Special Commissioners the point was decided against the Revenue on the question, whether the taxpayer concerned could be regarded as a shadow director, but the court went on to say it had no confidence in the argument. The Appeal Court's decision in Dimsey has changed the position dramatically in the Revenue's favour. This will lead to considerable problems for foreign families who have traditionally owned UK property through offshore companies. Each case will have to be reviewed on its own facts, but a number of general points can be made:

- (1) It may be more difficult for the Revenue to apply their provisions where no member of the family with any real influence over the property is currently UK resident.
- (2) There should be no problem where the only UK resident members of the family in occupation of the property are not directors and do not act as if they are directors. This means making sure that other people not resident in the UK positively do act as directors and it can be shown that they make all the important decisions outside the UK.
- (3) Care should be taken not to convert a situation in which the reality is that the company has been controlled by individuals resident in the UK to one where it is not. This is because the actions of a 'shadow director' may have resulted in the company becoming treated as UK resident. The Dimsey tests on this should be borne in mind. If there is a risk of this then there are two more complications to consider:
 - (a) It is a criminal offence for a UK resident company to be taken non-UK resident without Treasury consent. This is a hangover from exchange control, which was withdrawn in 1979. But the section requiring Treasury consent remains in force. It now serves an information-gathering role for the government.

- (b) The change from UK to non-UK resident status results in a deemed CGT disposal by the company of all its assets, against which it will not be possible to claim principal private residence (PPR) relief.
- (4) It should be considered in each case whether the property really was owned by the company beneficially or whether the company was just a nominee for the real owner. There should be no attempt to rewrite history here, but frequently the company has acted as no more than a nominee and the value of the property has never been treated in its accounts or otherwise as an asset of the company. If this treatment is applied it should be appreciated that the company will not have provided any protection for a non-domiciled owner, or trust made by such a person, from UK Inheritance Tax.

THE SHAM TRUST POINT

Allen left out of statements to the Revenue about the extent of his assets all those held by two offshore discretionary trusts. His argument was that he had no need to disclose these assets because they belonged to the trusts, not to him.

The Crown Court judge had directed the jury in the following terms:

'But here the question is, was Mr Allen the beneficial owner, the true owner of the shares, the properties and the bank balances in question? If he was then clearly the schedule of assets which he provided to the Revenue in answer to their enquiries was entirely wrong. If he appreciated that he should have declared them to the Revenue, then he was cheating the Revenue by failing to do so ...'

'... the assets belonged to the trusts unless you are satisfied that the various very lengthy trust deeds you have seen are a sham, that is to say, documents which purport to show a legal situation which is other than the real one; intending to give the appearance of creating legal rights different from the actual legal rights. If these trust deeds are a sham then it is open to you to find that the defendant was the beneficial owner of the various assets, knew that he was, and was cheating the Revenue in not disclosing ...'

'... it is said to you that the various deeds are perfectly standard discretionary trusts. Yes and no. No doubt they are in a form very frequently used, but you have seen that the only named

beneficiaries are the Red Cross and Oxfam. You have seen that the trustees of each trust have power to appoint additional beneficiaries ... you may think it extremely unusual for a person who is really wanting to put money into a trust not to specify at least the classes of people whom it is intended to benefit ...'

'... if you were to conclude ... that in practice Mr Allen used any monies or assets belonging to any of the various companies as if they were his own then ... that would be an indication that the various trusts do not set out the true position. An owner of things is the person generally who has the say so about what happens to them. You are entitled to say whether you keep your motor car or you sell it for instance ... if you concluded that Mr Allen actually did whatever he liked with any of the assets or monies of any of these companies that would be powerful evidence that these documents, lengthy as they are, are ... simply pieces of paper.'

The Court of Appeal agreed that the judge should not have suggested there was anything sinister in the drafting of the documents or the existence of bearer shares, but concluded that in the context of the whole situation the right directions had been given to the jury:

'The plain fact is that if the jury found that Allen was the beneficial owner of the assets in question, they must inevitably have convicted him ...'

'... there was, in fact, overwhelming evidence that the assets were Allen's to dispose of as he would, that he treated them as such, and that there was no question of the trustees possessing any real power or discretion in the matter.'

Allen's Counsel had one last try. He submitted that if the arrangements were sham then the existence of the companies (and thus all the corporation tax penalties) could be ignored on the basis that the assets should only be taxed as Allen's personal property. This was dismissed by the Appeal Court, which held that the sham led to Allen being treated as owning the companies, not their underlying assets. There would seem to be some inconsistency between this and the trial judge's views quoted above about Allen treating the company assets as his own. Also there is nothing in the judgment to indicate Allen was given the slightest benefit of the doubt that he was relying on advice, however misguided, to the effect that these arrangements might work.

CONCLUSION

The Revenue have collected more ammunition in the course of this one series of cases than could ever have been envisaged when their investigators first began questioning Chipping.

It is also interesting to note that the investigation was started as a result of information passed to the UK Inland Revenue by the German authorities. Exchange of information on tax-sensitive matters has been commonplace within Europe for many years, but the pace at which this happens will undoubtedly increase as the G7 and OECD focus more on tax avoidance and evasion.

The use of the criminal courts led to a robust no-nonsense approach to abstruse technical tax questions. Points raised by the tax barristers would have been given more consideration in the Chancery Division, where the argument would have taken place had the Revenue not had such clear evidence of deceit. Points scored in this context will however now be brought to bear in situations where there is not the slightest trace of criminal behaviour.

The result is that more care than ever needs to be taken by those who use offshore trust and company vehicles to ensure they are real. This means:

- using reputable, independent trustees and taking the risk that they may not always do what is expected of them;
- appointing real people, with knowledge and business skills, to be directors;
- making sure decisions are taken outside the UK when that is relevant;
- avoiding drafting up minutes in the UK for use overseas;
- maintaining careful records of the decision-making process overseas;
- avoiding the use of 'black hole' trusts, nominee directors and such devices;
- recognising that a purposeful omission to act may be held against you; and
- responding truthfully to enquiries.

Some people may see all this as the bureaucrats moving the goal posts without warning. Let no one say after reading this that they haven't been warned. Perhaps it is no coincidence that my spellchecker wants to change Dimsey to DISMAY!

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Macfarlanes