Chapter 4

WORK IS TAXABLE, WEALTH IS NOT

The Principle of Taxing Behavioural Outcomes

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Income can be defined as money that an individual or a business receives either by providing a service, goods or through investment. The concept of taxing income has its roots in ancient civilizations, with the earliest records concerning its collection dating back to Egypt in 1580 BC.[132] One of the first countries to adopt a law governing income tax was England in 1799, when imposing what was described as a temporary tax on income to help pay the costs of the Napoleonic Wars, a tax which was accepted as a vital price for winning the war against Napoleon. [133] This temporary tax was repealed in 1815 but would be adopted again in 1842. Income tax has remained since this time, but in the UK retains its 'temporary' nature in that it requires annual review by Parliament. Numerous other countries around the world adopted forms of income tax through the 19th and 20th centuries, examples being the United States in 1861, Italy in 1864, India in 1886, Spain in 1902 and Canada in 1917.[134]

In 1830, when Gibraltar became a Crown Colony, there was no local representation and the city's affairs, including the levying of import duties and rates,

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132 Charles R Metzger, 'Brief History of Income Taxation' [1927] 13(11) American Bar Association Journal [Online] 662-667 (Last accessed on 26th February 2024). Available from http://www.jstor.org/stable/25707292

133 Please see further: https://www.parliament.uk/about/living-heritage/transforming-society/private-lives/taxation/overview/incometax/ (Last accessed on 26th February 2024).

134 Charles R Metzger, 'Brief History of Income Taxation' [1927] 13(11) American Bar Association Journal [Online] 662-667. Available from http://www.jstor.org/stable/25707292 (Last accessed on 26th February 2024).

were handled by the Colonial Office in London. In the early twentieth century, the policy of the Colonial Office became one of gradually introducing a degree of self-government in all Crown territories. The first elections for a City Council in Gibraltar were held in 1921, but the gradual increase in local representation halted with the outbreak of the Second World War. Post-war, the pace of reform increased, thanks to the work of the Transport and General Workers' Union and the first members of the Association for the Advancement of Civil Rights, led by Sir Joshua Hassan.[135] The post war settlement which led to the creation of the welfare state across Europe meant that states everywhere were subject to greater demands than ever, a now more autonomous Gibraltarian state required greater funds and as a result an income tax was levied in Gibraltar for the first time by the 1952 Act.[136]

Wealth Based Taxes

In addition to taxes on income, states commonly levy taxes on wealth and capital. These include wealth tax, inheritance tax (or estate duties), gift tax and capital gains tax. In Gibraltar, estate duty was introduced under the Estate Duties Ordinance in 1934. During the Gibraltar 1996 general election campaign, the Gibraltar Social Democrats ('GSD') manifested a commitment to abolish estate duty between spouses and reduce the rate of estate duty between next of kin. The GSD's 1996 manifesto states:

> 'Taxes payable on death are usually paid only by those who have not made arrangements to avoid it. These are usually those who can least afford it. It is particularly harsh as a tax that applies between husband and wife. It is wrong that savings made by married people for the welfare of their spouses upon their death should be taxed. The GSD will in the first term of office abolish estate duty between spouses. We will also review estate duty levels and allowances with regard to inheritance between net of kin'.[137]

135 W.G.F Jackson,., F.J Cantos,. *From Fortress to Democracy: The Political Biography of Sir Joshua Hassan*. Gibraltar Books Ltd (1995).

136 Income Tax Act 1952

137 Gibraltar Social Democrats 1996 Manifesto, page 9

After being elected to Government, in 1997 the GSD upheld this commitment, but went a step further in abolishing estate duty in its entirety. The following reasons were submitted before the House of Assembly (which would subsequently become the Gibraltar Parliament in 2007):

The amount that would be collected (once the tax no longer applied between husbands and wives) would no longer be worth the administrative effort and resources needed to collect the tax effectively and efficiently;

The amounts collected in recent years showed that it was rare for estates to be subjected to the full rigour of the tax; and

It was unfair: a straightforward matter for wealthier individuals to plan their affairs around estate duty, whilst those bequeathed smaller estates, from people who had worked their whole lives, were more likely to be subjected to the tax.[138]

In fact, aside from the year 1993/1994, which was extraordinary due to the value of one particular estate, the figures of recent years before the abolition of the tax were low[139]:

Year	Collections
1991/2	£67,000
1992/3	£85,000
1993/4	£583,000
1994/5	£108,000
1995/6	£194,000
1996/7	£40,000

Estate duty was subsequently abolished, on the basis that the tax was not raising significant revenue for the Government, that it was individuals with more modest estates who were being most subjected to the tax, and at the time Gibraltar's anti-avoidance tax measures were unsophisticated. In the then House of Assembly it was specifically noted that the abolition of estate duty was justified due to the relatively small amounts collected. A comparison was made with the previous year, in which an increase in personal allowances had produced a loss of nearly £2

138 Gibraltar House of Assembly, Hansard 26th June 1997 (adj to 22nd July 1997), page 12

139 Ibid

million of revenue for the Government.[140]

Capital Gains Tax ('CGT') is a more recent form of taxation levied on gains realised on the disposal of assets. An early adopter of the tax was the United States. After the 16th Amendment to the Constitution was enacted in 1913, Congress was provided with 'the power to lay and collect taxes on incomes from whatever source derived, without appropriation'[141]. The US Revenue Act of 1913 followed by those of 1916, 1918 and 1921 defined and standardised the way taxes were levied on profits, with the 1921 Act making the distinction between income, gains from capital assets that were held for less than two years, and those held for more than two years.[142] This action was in response to concerns that the combination of capital gains and income tax were discouraging economic growth, particularly that the combination of the two taxes had peaked at 77% during World War One.[143]

In the UK, a comprehensive capital gains tax was first introduced in 1965 under Harold Wilson's Government, by the then Labour Chancellor James Callaghan who said '[t]here is little dispute nowadays that capital gains confer much the same kind of benefit on the recipient as taxed earnings more hardly won. Yet earnings pay tax in full while capital gains go free' [144]. There was a perception that the tax system was unfair because businesses and individuals could make significant profits from the sale of assets without being subject to the same level of taxation as those who earned a regular income. His conclusion was that a capital gains tax would remove the incentive of the 'skilful manipulator' to engage in avoidance by converting taxable income into capital.[145]

Gibraltar, on the other hand, for reasons examined below, has never taxed capital.

140 Ibid

141 The 16th Amendment, March 15, 1913; Ratified Amendments, 1795-1992; General Records of the United States Government; Record Group 11; National Archives

142 Anita Wells, 'Legislative History of Treatment of Capital Gains Under the Federal Income Tax, 1913-1948' [1949] National Tax Journal 2, no.1 <http://www.jstor.org/stable/41789799> (Last accessed on 26th February 2024)

143 Anita Wells, 'Legislative History of Treatment of Capital Gains Under the Federal Income Tax, 1913-1948' [1949] National Tax Journal 2, no.1 <http://www.jstor.org/stable/41789799> (Last accessed on 26th February 2024)

144 HC Deb 6 April 1965 Series 5 Vol. 710 C 245

145 Ibid

The Charge of Tax

Today in Gibraltar, ordinarily resident individuals are taxed on all income generated by a trade, business or vocation on a worldwide basis. In contrast, the Gibraltar corporate taxation system is a territorial taxation system, which charges tax in accordance with Section 11(1) of the Income Act 2010 ('ITA').

Section 11(1) states that:

> Tax shall, subject to the provisions of this Act and of the Rules, be payable at the rate or rates specified from time to time for each year of assessment or accounting period upon the income specified in tables A to C inclusive of Schedule 1 accruing in or derived from Gibraltar of any person.

Companies in Gibraltar are thus taxed on a territorial basis, meaning that they are only taxed on income which is accrued and derived in Gibraltar (subject to a few exceptions which lie beyond the scope of this Chapter). Gibraltar only taxes income; it has no CGT, inheritance tax, wealth tax, gift taxes, VAT or tax on bank interest.

It is not that capital gains taxes are 'exempt' from Gibraltar's tax base, but rather that the tax base, born from the Model Colonial Territories Income Tax Ordinance of 1922,[146] was never designed to accommodate CGT to begin with:

> 'All outgoings and expenses wholly and exclusively incurred in the production of income should be allowed as deductions in computing the amount of a person's "chargeable income". On the other hand, no deduction should be admitted for expenditure of a domestic or private character or for capital expenditure.' [147]

Gibraltar may seem to be the outlier now, at least in European terms, but it is the

146 Great Britain. Inter-Departmental Committee on Income Tax in the Colonies Not Possessing Responsible Government, 'Report of the Inter-Departmental Committee on Income Tax in the Colonies Not Possessing Responsible Government' (London: H.M Stationery Off., 1922)

147 ibid, p7

tax bases of other jurisdictions that have changed around it and provided for CGT, not Gibraltar that has deliberately 'diverged'. Unlike those jurisdictions that have deliberately designed their system to attract foreign inward investment Gibraltar has simply remained the same. Indeed, it is important to appreciate that there is a gap between what is 'exempted' from the tax base and what lies within its 'scope of taxation'.

In order to appreciate this gap, an understanding of a jurisdiction's broader sociocultural and economic context is crucial.[148] Tax bases are neither constructed nor operational in a vacuum, but are rather part of the complex web of social, cultural, economic and political strands of the jurisdiction in which they sit. We must understand the wider system in which they operate and in which tax structures evolve. Any assessment is always context driven: a tax system which worked well in one given time period may not be appropriate in another.[149] Equally, a tax system which can be hung comfortably upon one sociocultural and economic framework may not be hung comfortably upon another.

As Murphy and Nagel argue, something can become so embedded in a social structure that we take it to be the 'norm' or even 'the natural order' of things', [150] but it does not follow that it is, particularly when we realise that we form a metric based on our own standpoint, the standpoint of the system of which we are a part. Necessarily, smaller jurisdictions may form different reference systems to their economically complex neighbours. Gibraltar, of course, is a small jurisdiction, beset with its own idiosyncrasies.

Whilst a full analysis of Gibraltar's socioeconomic history is beyond the scope of this Chapter, it is crucial to orientate the tax base within its broad context. With the closure of the land frontier with Spain in 1969, of which there had been signs for a number of years preceding the eventual closure, Gibraltar had to find ways to reinvent itself and remain sufficiently internationally competitive to attract the income which it could not self-produce. Whilst during the intervening period

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148 Grahame Jackson and Harriet Brown, 'The role of context in interpreting international tax instruments: a solution to the erosion of internal cohesion of domestic tax systems by international law? The EU Directive on Administrative Cooperation Version 6 (DAC6) – a case study' [2022] Bulletin for International Taxation

149 The Mirrlees Review, *Tax by Design* (OUP 2011)

150 Liam Murphy and Thomas Nagel., *The Myth of Ownership: Taxes and Justice*, (OUP 2002)

Gibraltar was highly dependent on the income received from the notable presence of Ministry of Defence forces on the Rock, it was in the 1990s that the territory rebuilt its identity as a financial centre. In order to attract the external investment, Gibraltar needed to ensure that there were tax incentives, or at least to minimise the disincentives. However, whilst such income is crucial to Gibraltar's economy, it should also be appreciated that Gibraltar enjoys a number of other significant income streams, most notably bunkering — the supply of fuel to ships — and tourism.

Even prior to this 'campaign' in the 1990s to revive Gibraltar's image and economy, Gibraltar had strived to be attractive, for tax purposes, to the external income it hoped to attract, and had operated a system of 'exempt companies'.[151] Gibraltar had modelled the concept on the IBC (International Business Companies) model of the Caribbean jurisdictions, which sprang up in the 1960s and 1970s.[152] This had resulted in a two-tier system of corporate taxation for companies in Gibraltar: a normal rate of 35% for regular Gibraltar companies, and a complete exemption for those companies awarded the required licence. Under the Companies (Taxation and Concessions) Act 1983, 'exempt' companies had to meet certain requirements including that it did not carry out any trade in Gibraltar, and that no Gibraltarian or Gibraltar resident held any interest in the company. As the century drew to a close, the exempt company regime came under pressure from the EU as it was at odds with their state aid rules and a Commission decision[153] resulted in the abolition of the last exempt company in 2010. Eventually, Gibraltar adjusted its tax system to move towards a lower rate of corporate tax. At the same time, as is discussed in later sections of this Chapter, further changes to the tax landscape were underway.

Gibraltar is not a fully sovereign state, though it may well meet some of the definitions of 'state' in use[154] and as such it lacks a number of categories of expense

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151 Companies (Taxation and Concessions) 1983

152 International Business Company: Offshore IBC What is it & Benefits (offshore-protection.com), accessed 26th July 2023

153 State Aid E 7/2002 (ex C53/2001 & NN52/2000) – United Kingdom Proposal for appropriate measures under Article 88(1) of the EC Treaty concerning Gibraltar exempt companies, accessed 26th July 2023

154 See Tse-shyang Chen, F. (2001). 'The Meaning of States in the Membership Provisions of the United Nations Charter', Indiana International and Comparative Law Review Vol 12, No1 2001

that are faced by larger, more sovereign states. For example, it does not maintain a navy, it has no nuclear power stations, nor an extensive pool of unemployed people, nor does it contribute to a space programme nor does it hold international summits. This gives rise to a reduced need for income, since the Gibraltarian state just does less than its larger neigbours, and as a consequence it can operate itself with a lower tax burden and a lower national debt. This means that it has not been necessary to scope out additional sources of revenue by levying more taxes and expanding the tax base. Even post-Pandemic, Gibraltar has maintained a healthy debt to GDP ratio. For 2021/2022, Gibraltar's estimated overall Government Revenue was £633 million, whilst estimated net public debt stood at over £558 million as of 31st March 2021, and its nominal GDP that year was estimated at £2.4 billion. That set Gibraltar's level of debt at approximately 25.6% of its estimated GDP in 2021/22.[155]

A comparison with the UK's figures serves to emphasise the different contexts in which the jurisdictions are situated. At the end of Quarter 1 of 2022 (January to March), the general government gross debt for the United Kingdom stood at an estimated £2,365.4 billion, 99.6% of its GDP.[156] A country with such debt will be driven to raise revenue, and a widened tax base is one obvious means to achieve this.

In his 2022 Budget Address,[157] the Chief Minister of Gibraltar maintained that increases in Government revenue during his Party's time in office (which commenced in 2011), have not been driven by taxation. This would lend weight to the fact that Gibraltar has no need to widen the tax base, such that if they did, they would be breaching the implicit principle of taxing only what is necessary. Indeed, it is a generally accepted principle of tax policy that a taxation should be limited in scope and remain free of excess and unnecessary taxes.[158]

Accordingly, from the perspective of a jurisdiction where the tax base includes

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155 Please see further: https://www.gibraltar.gov.gi/uploads/files/public-finances/SUMMARY%20OF%20PUBLIC%20FINANCES%20-%20web.pdf (Last accessed on 26th February 2024).

156 UK government debt and deficit - Office for National Statistics (ons.gov.uk)

157 Please see further: https://www.gibraltar.gov.gi/uploads/449-2022.pdf (Last accessed on 26th February 2024).

158 Robert F. van Brederode, *Political Philosophy and Taxation: A History from the Enlightenment to the Present*, (Springer 2022), p207

CGT[159], a limited tax base such as Gibraltar's may seem to be a 'deviation' from the norm. It is not, capital gains are entirely outside and have always been outside of the tax base, as is consumption of goods and services (there is no VAT); this is a difference, not a deviance.

The Meaning of 'Profits or Gains'

Having given some reasons for Gibraltar's tax base being as it is and setting it in its socio-economic context, we will now turn to a legal analysis of that tax base. As previously established, Gibraltar's corporate tax regime is governed by section 11 ITA 2010. This section directs us to Schedule 1 of the Act which contains the Heads of Charge. At Table A, we find the following language:

> 'the profits or gains of a company, a foundation or a trust from any trade, business, profession or vocation'

This explicitly ties the 'profits or gains' generated to the trade which generates them, and not to any source of a capital nature.

The Badges of Trade Test

When considering the taxation system applicable to companies, the basic position is that the primary head of charge is that of 'the profits or gains of a trade business profession or vocation'. [160] Given this the question 'how can it be determined whether a transaction gives rise to trading income or a capital receipt?' is central to the Gibraltar taxation system.

Given the limited number of Gibraltar tax related cases in the domestic system, we are obliged to look to the English courts for persuasive case law. The English courts have developed a series of tests, or so-called 'badges', to decide whether an

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159 Which as explained has been a relatively recent innovation in many developed economies

160 In the case of passive income this is extended to include intercompany interest, royalties and non-trade income from moveable property.

activity revolves around trade or around capital ventures.

It was the case of *Marson (H M Inspector of Taxes) v Morton and Others* [1986] STC 463 which set out the principles that have come to be used in assessing whether or not a transaction bears the 'badges of trade'. However, the Judge in this case was careful to emphasise that the test ought to be taken as a set of guiding principles, as opposed to a conclusive 'tick-box' test, and should be considered holistically, with no one badge being definitive of trade in isolation:

> 'I emphasise again that the matters I have mentioned are not a comprehensive list and no single item is in any way decisive. I believe that in order to reach a proper factual assessment in each case it is necessary to stand back, having looked at those matters, and look at the whole picture and ask the question - and for this purpose it is no bad thing to go back to the words of the statute - was this an adventure in the nature of trade? In some cases perhaps more homely language might be appropriate by asking the question, was the taxpayer investing the money or was he doing a deal?'[161]

The 'badges', which we shall explore in greater detail below, may be summarised as follows:

i. The presence or absence of a profit-seeking motive
ii. The number of transactions
iii. The nature of the asset
iv. The existence of similar trading transactions or interests
v. Changes to the asset
vi. The way the sale was carried out
vii. The source of finance
viii. The interval of time between purchase and sale
ix. The method of acquisition

i. The presence or absence of a profit-seeking motive

An intention to make a profit will generally support trading, but is not in itself conclusive, and as with the other badges needs to be considered in relation to the

161 *Marson (H M Inspector of Taxes) v Morton and Others* [1986] 1 WLR 1343 STC 463

other elements of the guiding principles. The taxpayer needs to prove the motive, rather than the existence of profit, to establish the carrying-on of a trade. If the acquisition of an investment was to realise a profit, or a commercial motive, it is likely to amount to trade. Speculation, however, does not amount to intention to make a profit, especially where the risk was recognised by the taxpayer and the investment or project nevertheless pursued.

ii. The number of transactions

If a transaction is carried out on a single occasion, it is unlikely that it will be treated as indicative of carrying on a trade. On the other hand, if the transactions are systematically repeated, particularly at a high frequency, this will support 'trade' (*Pickford v Quirke CA 1927, 13 TC 251*). However, cases will be taken on their own merits. In the case of *Salt v Chamberlain* [1979] 53 TC143, a number of Stock Exchange transactions (200 sales and purchases over a three-year period) was not sufficient to establish that the taxpayer was trading due to the nature of the transaction. On the other hand, a single transaction undertaken, such as a purchase of a commodity at a volume which surpasses that required for personal use, and a subsequent resale of this large quantity of commodity, as in the case of CIR v Fraser [1942] 24TC498), may be deemed to amount to trade. In this case, Mr Fraser, a woodcutter, had bought a consignment of whisky in bond and sold it through an agent at a profit. In concluding that the purchase amounted to trade, the court considered two factors. Firstly, that it was of a quantity far in excess of what an individual could be expected to consume. Secondly, and related to the above, it was deemed to offer no 'pride of possession'[162], i.e. there was no obvious enjoyment that was likely to be experienced as a result of the individual's purchase, unlike, for example, a work of art, or a quantity of whisky more commensurate with personal consumption.

iii. The nature of the asset

Is the asset of such a type or quantity that it can only be turned to advantage by a sale? Or did it yield an income or give 'pride of possession'? An example of the latter would be a piece of art for personal enjoyment.

162 Pride of possession is a phrase which is used to delineate the pleasure to be had simply from owning an asset. Such as the joy one has from a new car rather than an old one.

However, problems may arise when assets are combined such as:

- Investments with the ability to generate income;
- Personal assets; or
- Some assets used by a trade, such as plant and machinery.

In *Marson v Morton* [1986] 1 WLR 1343, land was purchased with the intention to hold it as an investment. The land did not have planning permission, and no income was generated by the land. The land was later sold following an unsolicited offer. The transaction was far-removed from the taxpayer's usual trade as a potato merchant, thus was treated as an investment, rather than trading profit.

iv. The existence of similar trading transaction or interests

Transactions that are similar to those of an existing trade may themselves qualify as trading. Further, it should be considered whether the particular transaction is similar to the ordinary business of the taxpayer in question. For example, a one-off sale of a tractor by a farmer is more likely to be considered to be a trade transaction than such a sale by an accountant.

The case of *CIR v Fraser* [1942] 24TC498, as discussed above, best illustrates this badge:

> 'The purchaser of a large quantity of a quantity of a commodity like whisky, greatly in excess of what could be used by himself, his family and friends, a commodity which yields no pride of possession, which cannot be turned to account except by a process of realisation, I can scarcely consider to be other than an adventurer in a transaction in the nature of a trade… Most important of all, the actual dealings of the respondent with the whisky were exactly of the kind that take place in ordinary trade.'[163]

v. Changes to the asset

If you buy a product with the intention to modify it to make it more attractive for sale, it is possible that this may be found to amount to trading. Moreover, the court may look at whether the item purchased was resold in one lot as it was bought, or whether it was broken down into saleable lots. If it was broken down, this is again

163 *CIR v Fraser* [1942] 24TC498

some indication that it was a trading transaction, the purchase being with a view to resell at profit by carrying out a modification in relation to the object bought.

Cape Brandy Syndicate v CIR [1921] 2KB 403 was concerned with members of a wine syndicate who joined in a separate syndicate to purchase brandy from South Africa. Some of the brandy was shipped to the East, with the remainder sent to London to be blended with French brandy, re-casked and sold at a profit. The taxpayer sought to make the case that the transaction was of a capital nature arising from the sale of an investment. However, it was ultimately held that a trade was being carried out and so the income was assessable as trading profit.

vi. The way the sale was carried out

Was the asset sold in a way that was typical of trading organisations? Alternatively, did it have to be sold to raise cash for an emergency?

According to the HMRC guidance, it is always a positive indicator of this badge if a transaction follows that of an 'undisputed trade'. In *CIR v Livingston* and others [1926] 11TC538, three unconnected individuals bought a cargo vessel together. The vessel was converted into a steam-drifter and sold for profit. The purchase was the first vessel which the individuals had bought. An assessment was raised on the profit which was upheld as a trading profit. The judge stated that:

> 'I think the test, which must be used to determine whether a venture such as we are now considering is, or is not, in the nature of "trade", is whether the operations involved in it are of the same kind, and carried on in the same way, as those which are characteristic of ordinary trading in the line of business in which the venture was made.'[164]

vii. The source of finance

The court will consider whether money was borrowed to buy the asset, and whether the funds could only be repaid by selling the asset.

Where a short-term loan has been taken out to fund the asset, HMRC are likely to find that the asset was specifically purchased with a view to selling it. In *Wisdom v Chamberlain* [1968] 45TC92, silver bullion was purchased on a short-term loan. Mr Wisdom could not service the interest payments from his existing money, but as soon as he sold the bullion and repaid the loan, he found he had

164 *CIR v Livingstone* [1926] 11TC538

made a substantial profit. The profit was found to be taxable as trading income.

viii. The interval of time between purchase and sale

Assets that are the subject of trade will normally, albeit not in all cases, be sold quickly. On the other hand, if you have owned an asset for a long time, it is easier to argue that it was purchased for 'pride of possession' and personal consumption. It follows that an intention to resell an asset shortly after purchase will support the distinction of trading. On the other hand, an asset which is to be held indefinitely is much less likely to be a subject of trade.

ix. The method of acquisition

Finally, we must turn to the way in which the asset has been acquired. An asset that is inherited, or acquired as a gift, is unlikely to be the subject of trade, although of course, there could always be exceptions.

In the case of *Taylor v Good* [1974] 1 All ER 1137, a taxpayer purchased a house with the intention of using it as his family home. However, when his partner did not approve of the house and refused to move in, he was forced to immediately sell the house. The taxpayer had a genuine intention of using the property for the long-term purpose of a family home, and not simply buying it for a profit-making motive, such that the transaction was not deemed to be one of trade. However, the Judge was careful, again, to highlight the nuances of the Badges of Trade, acknowledging that there could be occasions where a profit-making motive is formed later:

> 'Even if the house was purchased with no thought of trading, I do not see why an intention to trade could not be formed later. What is bought or otherwise acquired (for example, under a will) with no thought of trading cannot thereby acquire an immunity so that, however filled with the desire and intention of trading the owner may later become, it can never be said that any transaction by him with the property constitutes trading. For the taxpayer a non-trading inception may be a valuable asset: but it is no palladium. The proposition that an initial intention not to trade may be displaced by a subsequent intention, in the course of the ownership of the property in question, is, I think, sufficiently established...'[165]

165 *Taylor v Good* [1974] All ER 1137

The Non-allowance of Capital Deductions

It would seem entirely logical that in an income-only tax system capital expenditure is not permissible as an expense or deduction against income profits. However, Gibraltar does have a limited capital allowances regime which allows capital expenditure on certain classes of assets to a limited degree and in a regulated fashion. This is a reflection of the fact that some capital expenditure is a necessary prerequisite for the generation of any income. The regime is very limited in its nature compared to other jurisdictions.

In Gibraltar, the following capital allowances are currently available at the date of writing (June 2023):

- A 'first year allowance' for the first £30,000 of qualifying expenditure on plant and machinery (including fixtures and fittings), and the first £50,000 of qualifying expenditure on computer equipment;
- Thereafter, qualifying assets are pooled and subject to an annual capital, or wear and tear, allowance. Allowances of 15% are available for plant and machinery, computer equipment and motor vehicles, calculated on a reducing-balance basis;
- Capital allowance for industrial buildings is deductible at the rate of 4% per annum on a straight line basis.

Essentially, capital allowances are tax-deductible expenses which are available in respect of qualifying capital expenditure. Capital expenditure are funds used by the company to acquire, upgrade, and maintain physical assets, such as the purchase of property or plant and equipment. Capital expenditure typically amounts to a one-off large purchase of fixed assets that will be used to support generating income over a longer period.

To assist in conceiving of the difference between capital expenditure and income expense, we may draw on an often-used analogy between a tree and its fruit.

A capital item may be likened to a tree: the one-off fixed asset. On the other hand, income expenditure is typically an ongoing operating expense, in the form of short-term expenses that are used in running the daily operations of the business. This expenditure is the fruit borne by the tree. Without the tree, fruit could not grow.[166] Ultimately, capital expenditure is required for the production of income, so that the trade can operate. Effectively, capital allowances enable cost recovery, allowing businesses to recover the costs of their investments, and to facilitate their business activity (the growth of the fruit). Nevertheless, the capital investment has a value in itself: a capital value.

The principle of income tax, as we have seen, is that there is only deduction permitted for expenditure incurred wholly and exclusively in the generation of the income in question. Thus, a capital allowance regime would allow a deduction of capital expenses, with their capital value, where there is no corresponding inclusion in the form of CGT.

Tax is double-ended. There ought only to be deductions where there is a corresponding inclusion, in order to avoid creating a situation similar to what is technically known as 'hybrid mismatch', as further detailed in Chapter 6. Were Gibraltar to have a broad capital allowances regime in the absence of CGT, such a mismatch would result due to the existence of an allowance for capital expenditure without the matching deduction of CGT. However, in order to stimulate economic growth, some capital allowances need to be granted, but only to such an extent that the income-only tax-base is not violated. Thus, having a very limited capital allowances regime provides that necessary stimulus, whilst preserving the integrity of the income-only tax system.[167]

No Wealth Tax

Wealth tax is a broad-based tax on the ownership of net wealth. It is a tax levied on all (or most) of the assets owned by an individual. Net wealth is a person's assets minus their debts.[168] A primary aim of jurisdictions which have imposed wealth

166 However, the tree-fruit analogy has its limits, as was identified in the South African case *Visser v CIR* SATC 271: 'for what is in principle or tree in the hands of one man may be interest or fruit in the hands of another. Law books in the hands of a lawyer are a capital asset; in the hands of a bookseller they are a trade asset'.

167 It is worthy of note that there is a claw-back provision contained in Schedule 3 Part 2 Chapter III para 4 of the ITA 2010 that goes someway to resolving this issue.

168 Advani, Chamberlain and Summers, Wealth Tax Commission, 'A Wealth Tax For the

taxes is to shift the burden of tax towards more affluent households.[169] Gibraltar does not levy wealth tax. Wealth tax is not generally part of the UK's tradition either, however, the UK has debated its implementation on numerous occasions, notably in times of public finance crisis. It is worth analysing the reasons why it was considered and ultimately rejected, so that we can draw a comparison with the position in Gibraltar.

After the Second World War, it was Cambridge-educated economist, Nicholas Kaldor, who first recommended the implementation of a wealth tax in the UK. [170] It was not until the 1974 general election that Harold Wilson's Labour Party made a manifesto commitment to implement such a tax. Before the election, the Labour Party had consented to implement a series of measures aimed at fundamentally redistributing income and wealth, to secure trade union agreement for wage restraint during a period of unsustainable inflation.[171]

The Labour Party Manifesto stated:

> 'Redistribute income and wealth. We shall introduce an annual Wealth Tax on the rich; bring in a new tax on major transfers of personal wealth; heavily tax speculation in property – including a new tax on property companies.'[172]

Despite election victory and the passing of a Green Paper, Labour eventually decided to abandon their pursuit of a wealth tax in 1976, in the face of scrutiny and disapproval, particularly from the recently established Institute for Fiscal Studies, Treasury officials and external groups.[173]

Included among the objections for raising a wealth tax were the following:

UK' 2020 p. 7

169 Scheuer, Florian, and Joel Slemrod. 'Taxing Our Wealth.' The Journal of Economic Perspectives, vol. 35, no. 1, 2021, pp. 207–30. JSTOR, https://www.jstor.org/stable/27008021. (Last accessed on 26th February 2024).

170 Glennerster, Howard (2012) 'Why was a wealth tax for the UK abandoned? Lessons for the policy process and tackling of wealth inequality.' Journal of Social Policy, 41 (2) pp.233-249. DOI: 10.1017/S0047279411000602

171 Ibid

172 United Kingdom Labour Party Manifesto 1974

173 Arun Advani., Helen Miller, and Andy Summers ('Taxes on wealth: Time for another look?' [2021], Fiscal Studies, 42, pp. 389–395.

a. That although the tax would remove major concentrations of wealth, it would produce much less revenue, as people instead give away wealth to family members and charities;
b. Opposition from external interests, such as bodies representing the owners of country houses, small businesses and the Bank of England; and
c. Concerns about the tax leading to capital flight, with businesses moving out of the UK and people seeking non-resident status.[174]

It is worth noting that despite these objections, the Meade Report, published by the Institute for Fiscal Studies in 1978 recommended an annual tax on the stock of wealth to supplement a system of taxes on consumption,[175] yet once again the prospect was not further pursued. In 2011, the Mirrlees Review re-examined and ultimately rejected the possibility of an annual wealth tax in the UK, concluding, with reference to experiences of implementing the tax in other jurisdictions, that it would be inefficient, unfair and costly to administer.[176]

The objections outlined above are similar to those raised in support of the GSD's abolition of estate duty in Gibraltar in 1996 (as discussed above). Moreover since 1996, Gibraltar's tax base has grown significantly.

For taxation to occur in Gibraltar, an activity must have taken place. A taxable event can occur from income generated by one of the heads of charge as set out in tables A-C of schedule 1 of the ITA 2010. These are wide-ranging, from the profits or gains of an individual from self-employed work to royalties received by a company. Gibraltar also levies stamp duty, triggered by the transfer or sale of any Gibraltar property, shares in a company owning Gibraltar real estate and on mortgages secured on Gibraltar property.[177] It is also worth mentioning that import duty is applicable to goods entering Gibraltar at varying rates. In all of the above examples, an event has to occur for the taxes to be triggered. In Gibraltar, tax

174 Howard Glennerster 'Why was a wealth tax for the UK abandoned?: lessons for the policy process and tackling of wealth inequality', [2012] 41(2) Journal of Social Policy, pp. 233-249

175 The Meade Committee, Report of the Committee on the Working of the Monetary System, Cmnd 6753 (HMSO 1978).

176 Arun Advani., Helen Miller, and Andy Summers, 'Taxes on wealth: Time for another look?' [2021], Fiscal Studies, 42, pp. 389–395.

177 Stamp Duties Act 2005,Schedule 1

is not triggered by passive occurrences or events, for example an annual charge on an individual's net wealth or an inheritance that they have received. In other words Gibraltar taxes the outcomes of behaviours, not wealth in itself. In this it mirrors the British tradition.

Although wealth tax is not currently part of Gibraltar's tax system, could it be? In modern times, a move away from wealth tax has been prevalent. In the 1990s, for example, twelve OECD member countries levied an annual wealth tax. Now however, all but three of those countries (Norway, Spain and Switzerland) have repealed this tax.[178] Decisions for repeal have centred around efficiency and administrative concerns, low revenue collection and the conclusion that net wealth taxes have frequently failed to meet their redistributive goals.[179]

Furthermore, in July 2020, Rishi Sunak, then Chancellor of the Exchequer, was quoted as stating that he believed that there would never be a right time for a wealth tax.[180] Despite this recent move away from wealth taxes, however, the Covid-19 Pandemic and its resulting strain on public finances, has caused a number of jurisdictions to look for ways to recover funds and to consider whether a wealth tax should be introduced.

One example of this is Argentina, which in December 2020 passed a new one-off levy on citizens with assets over $2.5 million, to pay for resources to assist with the covid-19 Pandemic.[181] In the UK, a group of academics known as the Wealth Tax Commission delivered a final report on whether a wealth tax should be introduced. The Commission endorsed a one-off wealth tax instead of an annual levy, which they projected could raise at least 260 billion pounds if it consisted of a flat rate of 5% on assets over £500,000.

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178 Arun Advani, Helen Miller and Andy Summers, 'Taxes on wealth: Time for another look?' [2021], Fiscal Studies, 42, pp. 389–395.

179 'The Role and Design of Net Wealth Taxes in the OECD' – (12 th April 2018), – available online on: https://www.oecd-ilibrary.org/taxation/the-role-and-design-of-net-wealth-taxes-in-the-oecd_9789264290303-en?itemId=/content/publication/9789264290303-en&_csp_=b746b256f23e109b9244f92078eb7093&itemIGO=oecd&itemContentType=book (Last accessed on 26th February 2024).

180 Arun Advani, Emma Chamberlain and Andy Summers, 'A Wealth Tax For the UK', (Wealth Tax Commission, 2020), pp. 5

181 Arun Advani, Helen Miller and Andy Summers, 'Taxes on wealth: Time for another look?' [2021], Fiscal Studies, 42, pp. 389–395.

At the time of writing, the EU Tax Observatory had just published a proposal for a Global Minimum Wealth Tax for those ultra-high net worth individuals worth in excess of £1,000,000,000. However, it has not yet gained significant support.[182]

Conclusion

If Gibraltar introduced a capital gains tax or a wealth passive it would be a major departure from the design of the Gibraltar taxation system as it exists at the time of writing, both practically and conceptually. Ultimately, tax systems are not operative in a vacuum, but evolve within a complex web of sociocultural, economic and political factors.

Gibraltar's situation is unique: as a very small territory it must remain sufficiently internationally competitive to attract the income which it cannot self-produce. Propelled by the hardship experienced from the closed frontier with Spain in the latter half of the 20th century, Gibraltar improved its self-sufficiency by developing as a finance centre and attracting external investment. The introduction of the Category 2 status for individuals with a net-worth of over £2 million (discussed further in Chapter 3) was aimed at injecting private capital into the jurisdiction. Furthermore, with a small population and therefore limited workforce, the introduction of the HEPSS status (High Executive Possessing Specialist Skills) aims to encourage individuals possessing specialist skills to relocate to Gibraltar and fill in talent-gaps where such talent is not locally available.

Finally, it is an implicit principle of tax morality that a jurisdiction should not tax more than is necessary. With relatively low demands on its exchequer and as a result a low national debt to GDP ratio, Gibraltar has not needed to expand its tax base to include CGT or wealth taxes in the way that many other jurisdictions have, and so long as this remains the case, it should not.

The intellectually coherent taxation system which was instituted for the requirements of a growing trading colony in the 1950s remains intact and fit for purpose. It has produced sufficient revenue in all but the most exceptional circumstances. It is our opinion that Gibraltar has the taxation system it needs. In respect of companies, it taxes trading activity and a number of forms of passive

182 Global Tax Evasion Report 2024, EU Tax Observatory (2023)

income. The exempt company and the anomalies that regime created have been abolished. The Gibraltar system remains that the outcome of trade and other active behaviours are taxable, wealth itself is not.