

[2019] AACR 3
(Green v Secretary of State for Work and Pensions and Adams (Diversion of Income))
[2018] UKUT 240 (AAC)

Judge Jacobs
18 July 2018

CCS/2563/2017

Child Support – 2012 Scheme – Diversion of Income – Regulation 71 of Child Support Maintenance Calculation Regulations 2012 – whether the transfer of an asset with potential income can amount to diversion

The NRP acquired a property from a trust fund (APF), but it was not let and he received no income from it. The NRP sold the property to a different trust fund (PT) of which he was not a trustee or a beneficiary. The property was subsequently let to a nursery on a 10 year lease at an annual rent of £50,000. The Secretary of State decided that the NRP child support liability was nil under the 2012 scheme. On an appeal to the First-tier Tribunal (Ft-T), the parent with care (PWC) argued that the diversion of the capital (the asset value of the property) led to a diversion of income and therefore she was entitled to a variation under regulation 71 of the Child Support Maintenance Calculation Regulations 2012. The First-tier Tribunal rejected the argument and found that as letting and rental occurred following the transfer from APF to PT, there was no diversion of income within the meaning of the law. The PWC appealed to the Upper Tribunal.

Held, dismissing the appeal, that:

1. regulation 71(1) contains two conditions: (a) the control condition; and (b) the diversion condition. For as long as the NRP was owner of the property, it was not let and he received no income from it. Regulation 71 did not apply because the NRP did not divert the income that might have been generated to another person or another purpose; (paragraphs 16 and 32)
2. once the property came into ownership of the PT, the NRP ceased to have any control over it. Accordingly, the control condition under regulation 71 was not satisfied, from which it follows that the diversion condition could not be satisfied either. (paragraph 33)

DECISION OF THE UPPER TRIBUNAL
(ADMINISTRATIVE APPEALS CHAMBER)

This decision is given under section 11 of the Tribunals, Courts and Enforcement Act 2007:

The decision of the First-tier Tribunal under reference SC312/16/00552 did not involve the making of an error on a point of law.

REASONS FOR DECISION

A. Introduction

1. This is one of nine appeals involving the same parties that are currently before me. The ultimate issue is the child support liability in respect of Nicholas. His father is Mr Adams and his mother is Ms Green. No anonymity order has been made in respect of the parents or of Nicholas. There was a discussion at the beginning of the oral hearing that I held in April about the position of Nicholas. Given that he is identifiable through his parents, I saw no point, given his age now, in prohibiting publication of his name.

2. Eight of the appeals are listed before me in August so that I can re-make the First-tier Tribunal's decisions. They concern the 2003 child support scheme. This case is distinct, as it arises under the 2012 scheme.

3. The appeal in this case was brought by Ms Green against the decision of the First-tier Tribunal, confirming the decision of the Secretary of State, that Mr Adams' child support liability for their son Nicholas was nil from and including 10 October 2015 under the most recent version of the child support scheme, introduced in 2012. The Secretary of State's decision was made on 21 January 2016. Ms Green's argument was that she was entitled to a variation on the ground that Mr Adams had diverted income that would otherwise be taken into account.

B. Diversion under the Child Support (Variations) Regulations 2000 (SI No 156 of 2001)

4. Before coming to the 2012 Regulations, it is helpful to look at how diversion was dealt with under the 2000 Regulations, which govern the 2003 scheme. The latter contained two provisions, one dealing with capital and the other with income. Regulation 18 dealt with assets in the form (broadly) of money, interests in land, shares and choses in action. It provided, subject to exceptions, for taking account of a notional income from a non-resident parent's assets worth more than £65,000 that the non-resident parent owned or controlled. Regulation 19 dealt with income not otherwise taken into account and diversion of income.

5. Broadly speaking, regulation 18 did not take account of assets used in the course of a trade or business (regulation 18(3)(d)), whilst regulation 19 applied (albeit not exclusively) to the control of income from a company or business, whether as an employee or a self-employed person.

C. Diversion under the Child Support Maintenance Calculation Regulations 2012 (SI No 2677)

6. In order to understand how the legislation works, it is necessary to begin with gross income. This is calculated under Part 4 of the Regulations and covers income from employment, self-employment, social security benefits and pensions. An amount may be added to gross income under regulation 73 in order to give effect to a variation.

7. Coming to variations, regulation 71 deals with diversion of income:

71 Diversion of income

(1) A case is a case for a variation for the purposes of paragraph 4(1) of Schedule 4B to the 1991 Act where—

(a) the non-resident parent ("P") has the ability to control, whether directly or indirectly, the amount of income that—

(i) P receives, or

(ii) is taken into account as P's gross weekly income; and

(b) the Secretary of State is satisfied that P has unreasonably reduced the amount of P's income which would otherwise fall to be taken into account as gross weekly income or as unearned income under regulation 69 by diverting it to other persons or for purposes other than the provision of such income for P.

(2) Where a variation is agreed to under this regulation, the additional income to be taken into account is the whole of the amount by which the Secretary of State is satisfied that P has reduced the amount that would otherwise be taken into account as P's income.

8. Regulation 71 refers to regulation 69, which deals with what I call for convenience unearned income. The opening paragraphs provide:

69 Non-resident parent with unearned income

(1) A case is a case for a variation for the purposes of paragraph 4(1) of Schedule 4B to the 1991 Act where the non-resident parent has unearned income equal to or exceeding £2,500 per annum.

(2) For the purposes of this regulation unearned income is income of a kind that is chargeable to tax under—

- (a) Part 3 of ITTOIA (property income);
- (b) Part 4 of ITTOIA (savings and investment income); or
- (c) Part 5 of ITTOIA (miscellaneous income).

ITTOIA means the Income Tax (Trading and Other Income) Act 2005.

D. The First-tier Tribunal's findings and reasons

9. These were the tribunal's findings on the circumstances of the case. Their lack of clarity on some points reflects the complexity of Mr Adams' financial arrangement and, to an extent, an inability or unwillingness to explain them fully. The issue concerned a property at 1 Friern and two trusts, the APF and the PT. Mr Adams was a trustee of the APF, but was neither a trustee nor a beneficiary of the PT. He described the latter as an inheritance tax vehicle.

10. As best I can understand the tribunal's findings, the property was acquired by the APF. It came into Mr Adams' ownership through a route that is not entirely clear. The tribunal found that it did so as part of a withdrawal of a lump sum from the APF in the April 2011-2012 tax year. It represented £151,000 of the £450,000 lump sum. Mr Adams sold it to the PT on 11 March 2013 for £151,000. If this was a sale, Mr Adams must have received the purchase price, but the tribunal could not get to the bottom of what became of it. The reason for the low price was said to be its poor state of repair. It was subsequently let to a nursery school on a 10 year lease at an annual rent of £50,000.

11. The tribunal noted that the 2012 Regulations did not make any provision for a variation on the ground of assets. This was in contrast to regulation 18 of the 2000 Regulations, which provided for taking account of a notional income from assets worth more than £65,000 in which the non-resident parent had a beneficial interest or which were under his control.

12. This was the tribunal's reasoning on regulation 71:

“Mr Holden has argued on behalf of Ms Green that the diversion of capital led to a diversion of income. We can find no legal basis for accepting that this constitutes a variation case under the 2012 Regulations, given that the property was not let until after the PT acquired it from the APF. Had Mr Adams himself been in receipt of an income from the property, and had he then transferred the property to the PT it might have been arguable, but as a transfer of capital from the pension fund to the trust, followed by the letting and rental, we do not consider that this amounts to a diversion of income within the meaning of the law.”

13. I add that the terms of the PT prohibit any payment to Mr Adams.

E. Analysis

Arguments

14. I have considered Ms Green's argument and the response by Mr Adams. The Secretary of State opted not to make any submissions on this appeal. As I was finalising this decision, Mr Holden sent me a copy of the Government's response to the consultation on The Child Maintenance Compliance and Arrears Strategy, published on 12 July 2018, in which it announced its intention to add an asset ground for variation in the 2012 scheme. He asked for further time in which to make further submissions. I refuse that application. All parties have had ample time to make their submissions and there is nothing in the Government's response that could affect my interpretation of regulation 71 in the legislation as it was at the relevant time.

A quick comparison

15. There are a number of differences between the approach to variations under the 2000 Regulations and the 2012 Regulations. It is certainly the case that, taken overall, the latter are more restrictive than the former. However, it is not simply a case that there is no longer any provision for attributing an income to assets. Regulation 69, read with regulation 73, provides for unearned income to be added to gross income; and regulation 71 provides for the possibility that a non-resident parent has diverted what would otherwise be unearned income to some other person or purpose.

The two conditions

16. In order to decide this case, I have to analyse regulation 71. Regulation 71(1) contains two conditions: (a) the control condition; and (b) the diversion condition. I will take them in turn.

17. Although the regulation does not spell it out, there is an inherent link between the two conditions. The reduction and diversion must be possible and arranged by virtue of the parent's ability to control the amount of their income. And that control must be applied to the same source of income that was considered under the diversion condition.

The control condition

18. The control condition distinguishes between income that the non-resident parent receives and income that is taken into account as their gross weekly income. The best sense I can make of that distinction is that (i) refers to income under Part 4 (employment, self-employment, social security benefits and pensions) and (ii) refers to income added by way of variation under regulation 73. This condition is defined in general terms, but in practice the focus will always be on a particular source of income that the non-resident parent is able to control. The condition is worded in the present tense, reflecting the focus on the time in respect of which the decision is made.

The diversion condition

19. The diversion condition does not follow the structure of the control condition. It does not draw a distinction between income under Part 4 and income that would be taken into account under regulation 73. Instead, it treats both as income 'to be taken into account'. It

seems to me that the only way to make coherent sense of this regulation as a whole is to treat the two conditions as referring to the same types of income, despite the different wording.

20. The diversion condition involves two elements: reduction and diversion. Reduction refers to the result: the non-resident parent has less income to be included in the maintenance calculation than would otherwise be the case. Diversion refers to the means by which that result is achieved: the non-resident parent must have diverted the income either to someone else or for some other purpose than their own income.

21. Although the diversion condition refers only to reduction, it must surely apply both to cases where the non-resident parent receives a lower income that would otherwise be the case and to cases where the non-resident parent receives no income when something would otherwise have been payable. Any other interpretation would produce the anomalous position of favouring a non-resident parent who has eliminated a source of income entirely compared to one who has retained a purely nominal amount.

22. A person who wants a variation has to show that both elements of the diversion condition are satisfied. It is not sufficient to show that the non-resident parent has reduced income; there must also be a diversion and that diversion must be possible and be achieved through the exercise of the non-resident parent's control.

23. It is important to know what is being diverted. Paragraph (b) says that the non-resident parent must have diverted 'it'. That can only refer to income that would otherwise have been received. This can have significant consequences. Assume that a non-resident parent who runs a business draws only the minimum wage but pays the equivalent of what he would otherwise have earned as salary to his part-time secretary who happens to be his wife. In this case, income has been reduced and diverted to another person. Or assume that a non-resident parent draws only the minimum wage from her company and arranges for the remainder of what she would otherwise have been paid to be retained in the company so that it will build up capital that can be used for future expansion. This would be a reduction and diversion of income for another purpose.

24. But assume now that the non-resident parent simply decides to work only part-time or not at all. The parent is free to work as much or as little as they want and, thereby, to control the amount they receive as income. They have reduced the income they would otherwise receive, but there has been no diversion, because the money they would have earned has not been paid to someone else or for another purpose. It has just not been earned. To take a case closer to this one, assume the parent has acquired a house, which can be held without generating income, and simply retains it for any one of a number of reasons:

- so that it is available should they wish to move into it as their home;
- because they can't be bothered with the hassle of letting it; or
- just to spite the parent with care and keep their child support liability to a minimum.

The income that would otherwise have been produced has been reduced (eliminated) but it has not been diverted to another person; it has simply not been generated. Nor has the income been diverted for any other purpose; again, there has been no income. What has been retained is the asset. But the diversion condition is not concerned directly with the source of potential income; it is only concerned with income that would otherwise have been available to the non-resident parent from that source. In other words, regulation 71 does not apply just because a non-resident parent has failed to take advantage of an opportunity to generate income.

25. The word 'otherwise' in the diversion condition can cause difficulties. History may show what income would otherwise have been payable. So, a non-resident parent who

transfers a fund from a form of investment that generates income to one that favours capital growth has reduced income that would have been available if no change had been made. In other words, there has been a change to the status quo. Other cases will involve more speculation that the decision-maker or tribunal can only resolve by taking account of any explanation given by the non-resident parent, exercising judgment and considering the inherent probabilities in the circumstances of the case.

26. There is also the ‘unreasonable’ test that the Secretary of State (or the tribunal on appeal) has to apply as part of the diversion condition. I do not need to consider that, as it does not arise in this case.

Irrevocable disposal of a source of income

27. How does regulation 71 apply if a non-resident parent transfers a source of income beyond their control? I will approach this in stages.

28. First: what is the position if the parent transfers an asset that is generating income but retains the ability to control it? Suppose that the parent has an asset that is generating income. That income is taken into account in calculating child support liability. If the parent transfers the asset to someone else but retains control, there has been a diversion and the income still falls to be taken into account.

29. Second: what is the position if the parent transfers an asset that is not generating income but retains the ability to control it? Suppose that the parent has an asset that could generate income, but is not exploiting its potential. I have already explained why there is no diversion. Suppose now that the parent transfers the asset to their spouse, but is still able to control it. By transferring the asset, the parent has transferred its potential to generate income. When the spouse exploits that potential, the effect of the transfer is that the income that arises would otherwise have fallen to be taken into account as the parent’s income. It is now taken into account under regulation 71.

30. Third: what is the position if the parent transfers an asset and puts it beyond their control? It does not matter whether the asset is being exploited to produce income or not. Once the parent transfers the asset to someone else in circumstances that involve relinquishing legal and practical control over it, any income that the other person generates would not have arisen had it not been for the transfer. It looks like a diversion but regulation 71 does not apply, because the control condition is not satisfied. That condition is worded in the present tense, and from the moment of transfer the parent no longer has the ability to control income from that asset. This conclusion is supported by considering the problems that would arise under regulations 71(2) and 73 if the position were otherwise. For how long would income be attributed to the parent? How would it be calculated? How could allowance be made for the fact that the person has been able to exploit the asset more effectively than the parent could have managed? And so on. It may be that there has been a diversion at the moment of transfer, but that is only for an instant, as the parent immediately ceases to have the ability to control the amount of income they receive.

F. Applying this analysis

31. The First-tier Tribunal was only concerned with the position at the time of the decision under appeal: section 20(7)(b) of the Child Support Act 1991. That means the period between the effective date of the decision (10 October 2015) and the date when the decision was made (21 January 2016). By that time, the property at 1 Friern had been owned by the PT for over 2½ years.

32. For so long as Mr Adams was the owner of the property, it was not let and he received no income from it. It could have produced income if he had rented it out, but he did not do so. Regulation 71 did not apply because Mr Adams did not divert the income that might have been generated to another person or to another purpose. Looking at the position under the Child Support (Variations) Regulations 2000, regulation 19 did not apply for the same reason. Regulation 18 might have applied.

33. Once the property came into the ownership of the PT, Mr Adams ceased to have any control over it. He was neither a trustee nor a beneficiary of that trust. Indeed, he was prohibited from receiving any benefit from it. The tribunal did not find that he had the ability to control it. Given the tribunal's acceptance of the nature of the trust, it would be counterproductive for Mr Adams to have retained any control. Accordingly, the control condition under regulation 71 was not satisfied, from which it follows that the diversion condition could not be satisfied either. For that reason, the tribunal came to the right decision in law.

34. In his argument on behalf of Ms Green, Mr Holden argued that there had been diversion in respect of other properties. The First-tier Tribunal's decision did not deal with those properties. As I have found no error of law in the tribunal's decision, it is not permissible to raise issues in respect of those properties.