

Offshore trusts – anti-avoidance measures

(Lecture P1090 – 33.30 minutes)

Income and gains of the trustees of an offshore trust are, broadly speaking, taxable in the following four ways:

1. S86 TCGA 1992 treats gains accruing to the trustees of a settlor-interested offshore trust as being taxable on a UK-resident settlor who is domiciled or (from 6 April 2017) deemed domiciled in the UK.
2. If S86 TCGA 1992 does not apply, S87 TCGA 1992 attributes trust gains to beneficiaries to the extent that they receive one or more capital payments which can be matched with the gains.
3. Ss619 – 648 ITTOIA 2005 treat income arising to the trustees of a settlor-interested offshore trust as arising to the settlor (irrespective of whether he actually enjoys the income). Capital sums such as loans, which are paid to settlors in excess of the trustees' undistributed income, are also treated as income arising to the settlor. Where the settlor is subject to the remittance basis, any foreign source income is taxed in the year in which it is remitted.
4. Ss714 – 751 ITA 2007 apply where a person transfers assets as a result of which income becomes payable to a person abroad, e.g. the trustees of an offshore trust. This legislation deems income to arise to the transferor where that person is resident in the UK and:
 - has power to enjoy the income which belongs to the trustees; or
 - receives a capital sum from the person abroad; or
 - receives a benefit which is provided out of the transferred assets.

The rules prevent double taxation under both the transfer of assets abroad provisions and, for example, Ss619 – 648 ITTOIA 2005. Where the remittance basis is in point for the transferor, any foreign source income is taxed in the year in which it is remitted.

Income and gains which fall into any of the provisions referred to in (1) above may not be immediately liable to UK tax where the relevant person is not resident in the UK or alternatively is a UK-resident non-UK domiciliary who is a remittance basis user. The measures in S35 and Sch 10 FA 2018, which are described below and which have effect from 6 April 2018, seek to counteract the ability to wash out such income or gains by routing payments via:

- non-UK residents; or
- UK-resident remittance basis users.

TCGA 1992 changes

Para 1(1) Sch 10 FA 2018 inserts 12 new sections (Ss87D – 87P) into TCGA 1992. The following points should be noted.

S87D TCGA 1992 disapplies the attribution and matching rules contained in Ss87 and 87A TCGA 1992 where a capital payment is made to a person who is not resident in the UK.

S87E TCGA 1992 overrides S87D TCGA 1992 to the extent that a capital payment is made to a temporary non-UK resident. In this case, the payment is treated as having been received by the beneficiary in the period of his return to the UK.

S87F TCGA 1992 modifies S87D TCGA 1992 where:

- capital payments are received in the tax year when the offshore trust comes to an end;
- payments are made to two or more beneficiaries; and
- at least one of the recipients is a UK-resident beneficiary and at least one is not.

S87G TCGA 1992 applies if the beneficiary in receipt of the payment from the trustees is a close member of the settlor's family and the settlor is resident in the UK. Where this is the case, the capital payment rules are applied as if the payment were received by the settlor (rather than by the close family member). Where tax becomes chargeable on the settlor, the settlor can recover this sum from the beneficiary who received the capital payment. A 'close member of the settlor's family' is defined by S87H TCGA 1992 as:

- the settlor's spouse (or civil partner); or
- a minor child of the settlor, spouse or civil partner.

Two people living together as if they were spouses (or civil partners) will be treated as spouses (or civil partners). S87H TCGA 1992 makes it clear that these rules cease to be relevant in the event of the settlor's death.

S87I TCGA 1992 provides that Ss87J and 87K TCGA 1992 apply where:

- the trustees of an offshore trust make a capital payment ('the original payment') to a person ('the original recipient');
- there is an arrangement or intention for that payment (or anything which derives from, or represents, it) to be passed on within three years ('the onward payment') to a UK resident ('the subsequent recipient'); and
- in at least one of the tax years from the year of the original payment to the year of the onward payment the original recipient (or, where S87G TCGA 1992 applies, the settlor) is either a non-UK resident or a remittance basis user.

Where there is a series of payments via non-UK residents, the intermediate steps are ignored.

S87J TCGA 1992 is brought into play by S87I TCGA 1992. In the Tax Faculty's words, the section 'lays the groundwork for S87K TCGA 1992 by splitting the original . . . payment received by the original recipient into three slices'. The three slices are described as the:

- taxed amount (T);
- untaxed amount (U); and
- rest of the original payment (R).

In broad terms, T is the amount which is matched with the trust's stockpiled gains under S87 TCGA 1992 and taxed. U is the amount matched but which is untaxed due to being retained offshore on the remittance basis. R represents the balance of the capital payment once the above two amounts (T and U) have been calculated.

S87K TCGA 1992 is the operative section that attributes to the subsequent recipient an appropriate part of both the trust gains and the capital payment. How much is attributed to the subsequent recipient depends on the mix of T, U and R. S87K TCGA 1992 also introduces another component (G) which is the amount of the onward payment. The legislation in Ss87I – 87K TCGA 1992 is extremely complicated and S87K contains a number of formulae. A simple example is set out in below in the hope of making the position somewhat clearer.

Example

Assume that the trustees of an offshore trust make a capital payment to Alan of £200,000. Alan is a remittance basis user. This capital payment is matched with trust gains of £130,000, leaving £70,000 unmatched. Alan does not remit any part of his receipt. A few months later, Alan gifts £150,000 to Boris who is resident in the UK. The original payment is divided up as follows:

T = £0;

U = £130,000; and

R = £70,000.

When Alan makes his gift to Boris, G = £150,000. Applying the formulae in S87K(2) and (3) TCGA 1992, the legislation attributes to Boris:

£70,000 as a capital payment (this is R); and

£80,000 as trust gains (this is G – R).

Alan is left with gains of £50,000 which will be taxed if he makes a remittance to the UK.

S87L TCGA 1992 sets out the cases where the settlor is liable for tax on the onward payment, notwithstanding the fact that he is not the actual recipient.

The purpose of S87M TCGA 1992 is explained by the Tax Faculty as follows:

‘(This section) is designed to deal with scenarios whereby the recipient of the onward . . . payment is not the settlor, has (trust) gains or capital payments attributed under S87K TCGA 1992 and is a remittance basis user. In this case, parts of S87K TCGA 1992 are turned off and the capital payment is plugged back into S87I TCGA 1992. This is presumably to deal with chains of onward payments by UK-resident remittance basis users (as the chains dealt with by S87I(2) TCGA 1992 are only those chains involving non-UK residents).’

S87N TCGA 1992 applies if a capital payment is made to a beneficiary who was resident in the UK at the time when the payment was received, but the beneficiary then becomes non-UK resident before some, or all, of the payment is matched. The provision confirms that Ss87 and 87A TCGA 1992 are to be applied without taking into account the unmatched portion of the payment.

S87P modifies the application of S87N TCGA 1992 where a capital payment is made to a temporary non-UK resident beneficiary who returns to the UK. It confirms that Ss87 and 87A TCGA 1992 operate as if the payment was received during the beneficiary’s period of return.

Para 1(12) – (15) Sch 10 FA 2018 sets out the detailed commencement rules for all these new sections.

ITTOIA 2005 and ITA 2007 changes

For income tax purposes, there are similar adjustments to the:

- settlements anti-avoidance regime in Ss619 – 648 ITTOIA 2005; and
- transfer of assets abroad rules in Ss714 – 751 ITA 2007.

The key elements of the new legislation are Ss643A – 643N ITTOIA 2005 and Ss733B – 733E ITA 2007. The Government’s intention behind these income tax changes is to align the treatment of foreign source income with the rules that apply for CGT.

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