CHANCERY BAR

Chancery Bar Association: Cayman 2016

UK Finance Bill 2016 and other implications for Cayman Trusts and Company Structures

Amanda Hardy QC and Stephen Arthur

OLD SQUARE TAX CHAMBERS

TEMPLE TAX CHAMBERS

Introduction

- We are covering:
  - Headline changes to (1) the UK taxation of foreign domiciliaries from 2017 (2) other changes
  - De-enveloping a Cayman company
  - Cayman trusts and the GAAR
  - Finance Bill 2016 clauses 150-154 – civil and criminal penalties in relation to offshore activities
  - Excluded property and Cayman Island companies

Changes to taxation of foreign domiciliaries

- From 6 April 2017 a UK resident foreign domiciliary who has been resident in the UK for 15 of the past 20 years will be deemed to be UK domiciled for all UK tax purposes
- They will therefore pay tax on the arising basis on their worldwide income
- Individuals who were born in the UK and who have a UK domicile of origin will revert to their UK domiciled status for tax purposes whilst resident in the UK

Changes to taxation of foreign domiciliaries

- Inheritance tax will be charged on all UK residential property indirectly held through an offshore structure from 6 April 2017
- Foreign domiciliaries who have a non UK resident trust set up before becoming deemed domiciled in the UK will not be taxed on income and gains retained in the trust
- Foreign domiciliaries who become deemed domiciled in April 2017 will be able to treat the cost base of their non UK based assets as being the market value of that asset at 6 April 2017

Changes to taxation of foreign domiciliaries

- Will rebasing be extended to offshore trusts and their underlying companies? – the present indication is not
- Individuals who expect to become deemed UK domiciled under the new 15 out of 20 year rule will be subject to transitional provisions with regard to offshore funds to provide certainty on how amounts remitted to the UK will be taxed

Other changes

- To the transactions in securities legislation, clause 33 to 35 – changes to current rules, procedure and distributions in a winding up.
- To certain property developers use offshore structures to avoid UK tax on their trading profits from developing property in the UK. Legislation will be introduced to Finance Bill 2016 at report stage to extend the corporation tax charge to any non-resident who trades in or develops UK land with a view to sale.

Other changes – offshore developers

- The charge will apply to existing developments in the course of construction and will tax the whole of the profit derived from the UK development activity to UK corporation tax.
- Also HMRC will create a new taskforce to ensure tax on these profits is effectively collected by identifying and investigating offshore businesses which try to avoid paying tax.
- Property traders and developers making use of offshore property holding structures will be effected
- New charge will apply to disposals that occur on or after the date that the legislation is introduced at report stage, expected to be June 2016. TAAR will come into effect from 3/16 to prevent arrangements avoiding charge.

De-enveloping – ATED and CGT – Background and intent

- Base level now £500k – ATED payment £3,500
- Rates carefully calibrated to match IHT charges in ‘relevant property’ trusts Foundations not within the ATED charge – IHT?
- Part of international drive against anonymous offshore companies? What will G20 do next? – but how will trusts be affected? CRS and UBO difficulties?
- Drive towards trusts at odds with disclosures required by UK SBEEA 2015 - ‘persons with significant interest
- FB 2016 provisions regarding property developer’s profits if not within ATED

De-enveloping – ATED and CGT

- 31 March the cut-off date in each year. No relief against 100% charge except by retrospective adjustment claim
- 5-year valuation periods – so purchases before April 2015 have another 2 years before revaluation
- If within ATED, then also within CGT charging provisions. Liquidation creates CGT disposal
- Two alternative calculations of liability – straight-line or elect for rebasing at 2013,2014 or 2015. Election can be made when disposal made
- Higher rate CGT for second or buy-to-let properties

De-enveloping – ATED and CGT and SDLT

- SDLT on £2mio+ buy to let now 9.25% on first £1.5mio, + 15% on excess
- Standard structure of trust/company – company debt financed
- Liquidation the preferred route in order to avoid a ‘sale’ for SDLT purposes
- Default SDLT rule – liquidation not chargeable – unless shareholder takes on company debt – eg assume liability for bank finance to company
- HMRC statement of practice - shareholder debt ignored for this purpose – otherwise GAAR concerns about shareholder debt release prior to liquidation. What about shareholder refinancing bank debt prior to liquidation?

De-enveloping – other considerations

- Liquidation may create trust gain on share disposal
- Distribute gain to non-UK resident? But no cash realised on liquidation.
- Trust liable to 45% income tax on UK source income, non-resident landlord scheme captures liability. Otherwise trustee self-assessment or money-laundering risk
- Can trustees use nominee company in order to avoid Land Registry administration on change of trustee?

Cayman Islands Trusts and the GAAR

Recap: GAAR Guidance: "It is recognised that under the UK's detailed tax rules taxpayers frequently have a choice as to the way in which transactions can be carried out, and that differing tax results arise depending on the choice that is made. The GAAR does not challenge such choices unless they are considered abusive. As a result in broad terms the GAAR only comes into operation when the course of action taken by the taxpayer aims to achieve a favourable tax result that Parliament did not anticipate when it introduced the tax rules in question and, critically, where that course of action cannot reasonably be regarded as reasonable."

Cayman Islands Trusts and the GAAR

2 examples involving offshore trusts:

> "A discretionary trust resident outside the UK was set up by a now deceased foreign domiciled settlor. The trust is worth £4m, has a pool of trust gains of £2.5m and no accumulated income or offshore income gains. There are no Sch 4C gains. There are four beneficiaries, two of whom are resident and domiciled in the UK and two of whom live permanently outside the UK. The trustees have made no capital distributions in recent years and it has been decided to end the trust."

Cayman Island trusts and the GAAR

The trustees have three options:

- End the trust in Year 1 paying £1m to each beneficiary. UK res beneficiaries each pay UK tax on 1/4 of the trust gains i.e. £625,000 as gains are allocated pro rata to the beneficiaries. Non-res beneficiaries will pay no UK tax although 1/2 the trust gains are allocated to them.
- Pay the UK resident beneficiaries £2m in Year 1 and the non resident beneficiaries £2m in Year 2. The UK resident beneficiaries will each pay UK tax on £1m of gains since all the gains are allocated to them on a LIFO basis. The non-UK resident beneficiaries pay no UK tax and no gains are allocated to them.

Cayman Island trusts and the GAAR

- Pay the non-UK res beneficiaries £2m in Year 1 and the UK res beneficiaries £2m in Year 2. The non-UK res beneficiaries pay no UK tax but the pool of trust gains that can be allocated to payments in the following year is reduced to £500,000. £2m of gains have been "washed out". The UK resident beneficiaries each pay capital gains tax on £250,000.
- The trustees choose Option 3 (the least tax is payable).

Cayman Island trusts and the GAAR

"The substantive results of the transactions are consistent with the principles on which the relevant provisions are based. The trustees have three different ways of achieving the same result viz to end the trust and distribute property equally to the beneficiaries. They are not compelled to choose the one that raises the most tax or the "middle" option. Provided the payments to the non resident beneficiaries in Year 1 are genuinely intended to benefit them (and the cash will not simply be passed back to the UK residents later) HMRC would not seek to invoke the GAAR".

Cayman Island trusts and the GAAR

- Second example.
- Mrs X is non-UK res and dom. Her son Y is UK resident but foreign dom and occupies a house owned by a non-UK resident company that is held within a Cayman Island trust.
- The trustees own no other assets. The property is worth £10m. Gains that have accrued post April 2008 are £4m (£2m on property and £2m on company). The property has not increased in value since April 2013. The trustees do not want to pay the annual tax on enveloped dwellings and decide to end the trust by liquidating the company. The intention of the trustees and family is that the son should own the property. There is no accumulated income or offshore income gains.

Cayman Island trusts and the GAAR

- Option 1 - Trustees pay the property to the son. He receives a capital payment of £10m in the UK to which gains of £4m are attributed. He pays tax on all the trust gains at 28%. The remittance basis does not apply. Small IHT exit charge.
- Option 2 – The settlor adds £4m cash to the trust in year 1. In the same year the trust liquidates the company and holds the property direct thus realising the £4m gain. It then pays the £4m cash back to the settlor in the same year.

Cayman Island trusts and the GAAR

- Year 2 - the property is distributed to the son with a small amount of inheritance tax. The £4m cash payment made in Year 1 washes out the trust gains and so on the distribution of the property to the son there is no capital gains tax.
- The trustees therefore choose option 2.

Cayman Island trusts and the GAAR

- "option 2 is not consistent with the principles on which the relevant tax provisions are based. LIFO was intended to operate on distributions of capital to beneficiaries by matching gains in a certain order. In this case the settlor has added the cash to the trust as part of a pre-arranged scheme to wash out the gains that she knows will be realised and on the basis that she will receive the cash back again. HMRC would seek to invoke the GAAR. The legislation was not intended to allow settlors to add cash to trusts on a short term basis only to receive it back again shortly thereafter and simply as an exercise to wash out gains."

Excluded property and Cayman Island companies

- As noted IHT will be charged on all UK residential property indirectly held through an offshore structure from 6 April 2017
- Wait and see on precise structure of rules
- Non UK situate property can still have excluded property status, subject to the new 15 year rule

Finance Bill 2016 – facilitating offshore tax evasion- 1

- New strict liability offence of facilitatingoffshore tax evasion. No requirement on the part of the prosecution to prove dishonesty.
- New corporate offence (also strict liability) of failing to prevent the facilitation of tax evasion (whether offshore or domestic).
- Applicable to companies registered in UK or with trading presence in UK
- Applies equally to non-UK tax evasion if dual criminality

Finance Bill 2016 – facilitating offshore tax evasion- 2

- Offences are :cheating the public revenue (or any other tax offence which could be construed as such); being knowingly concerned in the fraudulent evasion of tax.
- A facilitates such an offence by
  - (a) assisting in or encouraging its commission by B; or
  - (b) by aiding and abetting, <u>counselling</u> or procuring its commission by B or
  - (c) by being <u>knowingly involved</u> (or taking steps towards) the fraudulent evasion of the tax by B.

Finance Bill 2016 – facilitating offshore tax evasion- 3

- Company X can be guilty of the offence is A & B are employees and if both have acted dishonestly

Excluded property and Cayman Island companies - 2

- How will secured loans be treated? A present HMRC takes the view that secured loans are UK assets – no current problem if held through an offshore company.

- GAAR rules may be relevant if loans are re-structured to try to reduce IHT exposure

Thank you for listening… and disclaimer

DISCLAIMER: Neither these notes nor the talks based on them nor anything said in the discussion session(s) constitute legal advice. They are simply an expression of the speakers views, put forward for consideration and discussion. No action should be taken or refrained from in reliance on them but independent professional advice should be taken in every case. Neither any speaker nor the ChBA accepts any legal responsibility for them.