BRIEFING NOTE

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ROOKS RIDER SOLICITORS

Issues for Offshore Trusts – Action Required Now!

Following the uncertainty which prevailed about the changes to the taxation of non-UK domiciled individuals we finally have further detail and clarity in the Finance (No.2) Act 2017 which was enacted on 16 November 2017. The measures take effect from 6 April 2017.

Other provisions are now included in the Finance (No.2) Bill published on 1 December 2017 and are expected to come into effect on 6 April 2018. We highlight some of the principal provisions affecting Offshore Trusts as below.

1. Does your Offshore Trust structure provide a benefit in the form of a Loan to any Beneficiaries?

   From 6 April 2017, the recipient of a loan is treated as receiving a benefit for every year the loan is outstanding equal to HMRC's Official Rate of Interest (currently 2.5%), less the amount of any interest actually paid by the Beneficiary to the Trustees in the relevant tax year.

   This means that if interest is rolled up and left unpaid, the Beneficiary will still be treated as receiving a taxable benefit each year. This new fixed valuation procedure will apply to all Beneficiaries receiving benefits from non-resident trusts, whatever their tax status and whether or not the Settlor is deemed domiciled.

   All loan arrangements should be reviewed to evaluate these new measures.

2. Does your Offshore Trust provide a non-monetary benefit relating to the use of art or chattels to any Beneficiaries?

   In addition to the above and also with effect from 6 April 2017, the benefit of the use by a Beneficiary of assets such as works of art, yachts and aircraft owned by the Trust will be charged to tax.

   The amount of the benefit is reduced by anything paid by the Beneficiary to the Trustees for the use of the asset and also by any amount paid by the Beneficiary in respect of the repair, insurance, maintenance or storage of the asset.

3. Does the Offshore Trust have a foreign Domiciled Settlor under general principles?

   For tax year 2018/19 both Income Tax anti-avoidance regimes and the CGT offshore trust anti-avoidance provisions will contain further provisions to tax a UK resident Settlor on a benefit received by a close family member (essentially a spouse/civil partner (or unmarried

equivalent) or a minor child) who is either non-UK resident or is a non-domiciled remittance basis taxpayer and who therefore does not pay tax on the benefit. These measures are intended to take effect from 6 April 2018, although it is worth noting that for the 2017/2018 tax year a new Income Tax Charge is already imposed by a modification to the transfer of assets abroad legislation in such circumstances. Broadly speaking this means that unless the motive defence applies whereby it can be shown that neither the original transfer of assets to the Trust nor any subsequent associated operations were motivated by the avoidance of UK tax, an Income Tax Charge already applies.

In these circumstances, the benefit is treated as if it had been received by the UK resident Settlor who will be subject to income or capital gains tax on the amount of the benefit (unless the Settlor is subject to the remittance basis). This is known as the close family member rule.

If the Settlor is himself a remittance basis taxpayer, he will only be taxed if the benefit is received in or remitted to the UK.

There are other issues linking the close family member rule and the anti-conduit rule which are set out in paragraph 5 below.

4. Does your Offshore Trust provide benefits to Beneficiaries resident outside the UK?

Historically, CGT could in some cases be avoided by making distributions to non-resident Beneficiaries to “wash out” the gains on the stockpiled gains pool before making a distribution to a UK Beneficiary in a subsequent year.

From 6 April 2018, benefits conferred on non-UK residents will not reduce or “wash out” gains in this way and so the pool of trust gains which can be taxed when benefits are received by UK resident Beneficiaries is simply ignored.

On the basis, this provision will only take effect from 6 April 2018, consideration should be given to making any payments to non-UK residents before that date, although care should be taken in this respect since the new rules also apply to capital payments made prior to 6 April 2018 that have not been matched to gains.

5. Has the Offshore Trust made a distribution to any Beneficiary which may be gifted on to another who would have been subject to UK tax if he had received the payment from the Trust directly?

In some cases, distributions from trusts have been made historically to non-UK resident Beneficiaries (who are not taxable) who then have subsequently made onward gifts to UK resident individuals (who would have paid UK tax had they received a direct distribution from

the trust). New rules are being introduced both for Income Tax and CGT purposes which have the effect of treating the UK resident in these circumstances as having received a direct distribution from the Trust. The result of this is that the UK Beneficiary may be subject to Income Tax or CGT on the amount of the gift or the benefit which they receive although the benefit of the remittance basis is available if the UK Beneficiary is a non-UK domiciled remittance basis payer. Generally, the provisions are intended to be triggered in the following circumstances:

- a capital distribution is made by an offshore trust to an individual (the "**original beneficiary**") who is not subject to UK tax on it (either as a result of being non-resident or because the Beneficiary is a UK resident remittance basis user who will not remit the payment); and

- there is an arrangement or an intention for the capital distribution or anything derived from it to be passed on (the "**onward payment**") in the year of distribution or during the following three tax years either directly or after a series of transfers to an individual, a "**gift recipient**", (whether a trust beneficiary or not) who would have been taxable (by virtue of being UK resident at the time he receives at least part of the onward payment) on the capital distribution if it had been made directly to him by the trustees.

The provisions will also apply to onward payments made over a longer period if it is reasonable to assume that the onward payment was part of an arrangement. The anti-conduit measures apply to onward payments made after 5 April 2018 and will do so even if the capital payment was made before 6 April 2018.

For UK tax purposes the gift recipient will be treated as if the part of the benefit or capital payment transferred to him is matched to income or attributed to gains of the trust. If only part of the benefit or capital payment is passed on the amount that can be taxed is capped at the value received.

The anti-conduit rule can also work in conjunction with the close family member rule as indicated in paragraph 3 above. So, for instance, if trustees make a distribution to a non-resident Beneficiary who then makes an onward gift to a UK resident individual who is a close family member of the Settlor of the Trust and is not otherwise taxable, it will be the Settlor (if he is resident) who will be taxable on any income or gains rather than the close family member.

Where the Settlor is taxed as a result of any of these provisions he has a right to recover the tax from the relevant close family member.

6. Do the Trustees rely on funding from the Settlor if the Trust is asset rich but cash poor?

The new measures applicable to Deemed Domiciled Settlors (under the new Fifteen Year Rule – for details see separate Briefing Note entitled "Deemed Domiciled Changes – Action Required Now!") incorporate some protection for Income and Capital Gains with effect from 6 April 2017 to protect Deemed Domiciled Settlors from an immediate tax charge on income and gains of a trust established before becoming deemed domiciled but this protection is lost if property is added to the Trust.

Given the disastrous consequences of even a tiny addition to a trust in that the Trust protections are lost in their entirety great care needs to be taken to avoid any unintended addition to the Trust.

Trustees will need to continue to review the funding of the Trust.

What constitutes an addition is widely defined and includes the following:

- adding value to property held by the Trustees; and
- a loan from the Settlor to the Trustees unless the Trustees actually pay interest on the loan at least annually and the interest rate is not less than HMRC's official rate (currently 2.5%). It is not enough that the loan agreement specifies that interest must be paid annually; the interest must actually be paid. The terms of the loan must be complied with and the interest must not be capitalised.

There are however some helpful exceptions in the legislation so, for instance, except in the case of a loan, an unintended addition will not taint the Trust if there was no intention to confer a gratuitous benefit. Moreover, there is a 12 month grace period for those Settlors who became Deemed Domiciled on 6 April 2017 during which loans which would have been made to a Trust and are not commercial and therefore which would otherwise cause the Trust to be tainted can be remedied.

Summary and Next Steps

It is very important that any such arrangements are reviewed as a matter of urgency. The significance of the changes has been highlighted above and Settlors, Beneficiaries, Offshore Trustees and/or any other persons affected should take specialist advice at the earliest opportunity to deal with the measures already in force (from 6 April 2017) or to plan ahead in terms of those changes which are expected to take effect from 6 April 2018.

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