THE LIECHTENSTEIN FOUNDATION AND UNITED KINGDOM TAX AVOIDANCE

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A Introduction

A wealthy individual might consider using a Liechtenstein Foundation instead of an offshore trust or company or some combination of the two. My conclusions are:

> A Foundation can have enormous capital gains tax advantages as compared with both a company and a trust. In particular, it enables one to avoid the Offshore Settlor Provisions. There is also a very good technical argument that the Offshore Beneficiary Provisions can never operate so as to impute to beneficiaries gains realised by a Foundation.
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> A Foundation is at least as efficient as a trust or a company in terms of income tax.
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> The Inheritance Tax treatment of a Foundation is the most difficult. At the worst, it could give rise to charges to tax both on the basis that it is a company and also on the basis that it is also a settlement.

In this article, I consider the United Kingdom taxation treatment of a Foundation and those associated with it. I do not consider the broader question of the desirability of using a Foundation or the type of factor which appears to have rendered Liechtenstein Foundations and other entities attractive to the late Robert Maxwell.

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B The Nature of a Foundation

A Liechtenstein Foundation is a somewhat curious creature. It is the creation of Liechtenstein Statute and has no exact equivalent in the law of England or, so far as I am aware, of any other common law country. The tax treatment of such a Foundation, its Founder and its beneficiaries must therefore be to some extent speculative and anyone who prefers to become Founder of a Foundation rather than settlor of a "common law" trust must appreciate that he is entering upon unchartered waters.

In some ways a Foundation resembles a trust. In other ways, however, it resembles an English-style corporation. Strictly speaking, it is neither one nor the other. It may, however, be treated in the same way as a trust or, alternatively, as a company for the purposes of the various United Kingdom taxes. Whether it will be so treated will depend upon the precise rules relating to each tax. It may be treated as both for the purposes of the same tax, at least in different contexts.

A Foundation resembles an English body corporate in that it has juridical personality and is run by a Council of directors. While it has no shareholders, that is true of an English company limited by guarantee. But then a company limited by guarantee does have members. Perhaps the nearest English analogy is a charitable chartered corporation, where the corporators perform the functions of directors and there are no members to whom they are answerable in general meeting.

A Foundation is established by a Founder who can reserve Founder's rights concerning the administration and control of the Foundation. It is a moot point whether he is a "member" of the Foundation. Perhaps the nearest English corporate analogy is the Visitor of a charitable chartered corporation. While the Foundation has beneficiaries, it is possible that these are merely persons for whose benefit the capital and/or income of the Foundation may or must be applied and it is far from clear that their interests are akin to the equitable interest of beneficiaries under an English trust. Indeed, it would appear that the assets of the Foundation are owned both legally and beneficially by the Foundation, that the beneficiaries have no proprietary interest in them and, very possibly, do not even have a personal right to have the statutes of the Foundation observed.[2] A loose analogy might be drawn with an English company established for charitable purposes only, the funds of which can only be applied for such purposes but which does not have beneficiaries in the normal sense of the word.

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[2] Sometimes the statutes of Foundations purport to exclude any direct legal claim by the beneficiaries against the Foundation. If this provision is valid as a matter of Liechtenstein law, then it would very much militate against the Foundation being regarded as in the nature of an English trust.

It is well established that in determining tax liabilities in relation to an entity governed by foreign law, the nature of the rights of the various parties must be determined under that law, but once such rights have been ascertained, United Kingdom taxability is to be determined in England by English law: see *Rae v. Lazard Investment Co Ltd*[3] and *Lord Inchyra v Jennings*.[4] It will therefore be necessary to discuss each relevant tax in turn.

C Taxation of Income

C.1 Corporation Tax on Income

In my view it is highly probable that a Foundation would be regarded as a "company" for the purposes of United Kingdom corporation tax. See Taxes Act 1988 section 832(1) which defines "company" to mean (subject to immaterial exceptions) "any body corporate or unincorporated association but does not include a partnership, a local authority or a local authority association".

If the Foundation is resident in the United Kingdom then it would be exposed to corporation tax on its income and gains worldwide. It will be resident in the United Kingdom if central management and control of it business resides here. That is a question of fact. Sometimes, the statutes of Foundations vest considerable powers in a Protector - powers which far exceed those normally conferred upon the protector of a "common law" trust. If the protector were resident in the United Kingdom, it might well be that the Foundation would be resident here too. Then again, if members of the Council in practice defer to the wishes of a person resident in the United Kingdom, for example the Founder, and act as mere rubber stamps, it is well settled that the Foundation would be resident in the United Kingdom, notwithstanding that such delegation of their functions by the Council members was unlawful: *Bullock v Unit Construction Co Ltd.*[5]

C.2 Income Tax Liability of the Foundation

If the Foundation is not resident (or ordinarily resident) in the United Kingdom, then it would, if a company for tax purposes, be subject to income tax at the basic rate only on its United Kingdom source income.

If, contrary to my view, a Foundation were to be held not to be a company for the purposes of the Taxes Act 1988, then it might be regarded as a trust. Provided

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[3] 41 TC 1.

[4] 42 TC 388.

[5] 38 TC 712.

none of the "trustees" of the trust were resident or ordinarily resident in the United Kingdom, then the trust would not be liable to United Kingdom income tax on its non-United Kingdom source income. Where some of the trustees are and some are not resident in the United Kingdom, the taxability of the trust will turn upon the domicile and residence status of the settlor at certain material times.[6]

Who would the trustees of the trust be? Prima facie, they would be the Council members. If the powers of the Protector were extensive, however, it is arguable that he might be held to be a trustee for this purpose. The same might be said of the Founder.

It is just possible that the Foundation would be regarded as a company which owned its assets not beneficially but upon trust. In such case, it would be taxed as a trust and the sole trustee would be the Foundation itself. In that case, the residence status of the trust would turn on the residence of the Foundation, applying the central management and control test.

If the Foundation is treated as a trust, an interesting question arises as to the rate at which it is liable to pay income tax. The problem is the same whether the Foundation is liable because it is resident in the United Kingdom (in which case it would be liable on all its income) or simply because it has United Kingdom source income. In particular, it is a moot point whether the Foundation would be liable simply to basic rate tax (currently 25%) or also at the additional rate tax (currently 10%), as a "discretionary or accumulation trust" within Taxes Act 1988 section 686. The answer might well turn on the statutes of the Foundation in question. In practice, I would guess that most Foundations would be exposed to the additional rate charge.

C.3 Income Tax Liability of the Founder and Beneficiaries

In my view, the Foundation is very likely to qualify as a "settlement" within the meaning of Taxes Act 1988 Part XV and in particular section 681(4), namely "any disposition, trust, covenant, agreement or arrangement". The Founder would clearly be a "settlor", namely "any person by whom the settlement was made". On that basis, all income arising to the Foundation would be deemed to be that of the Founder for United Kingdom income tax purposes unless (with very limited exceptions) the settlor and any spouse of his could in no circumstances whatsoever derive any benefit, directly or indirectly from the Foundation. The Founder could also be made liable to tax if the Foundation entered into any loan transaction with (a) the Founder or (b) any spouse of the Founder or (c) any company in which the Foundation was interested if that company also entered into a loan transaction with the Founder or the spouse of the Founder.

[6] See FA 1989 s.110.

Income of the Foundation could in the alternative be deemed to be that of the Founder by Taxes Act 1988 section 739. Section 739 can also catch income which arises to a company owned by the Foundation. Slightly different rules apply as to which income is caught by each set of provisions.

A gain realised by the Foundation in respect of a non-qualifying policy of insurance could also arguably in certain circumstances be visited on the settlor: see TA 1988 s.547(1)(a).

So long as the settlor is not domiciled in the United Kingdom as a matter of general law, income which does not have a United Kingdom source and is not remitted to the United Kingdom in any shape or form escapes Part XV and section 739. Thus, the Founder is no worse off so far as these provisions are concerned than if he had never created the Foundation.

Even if non-United Kingdom source income is retained outside the United Kingdom and not remitted to the United Kingdom in any shape or form, it is *arguable* that even the Founder would be liable to income tax pursuant to section 740 Taxes Act 1988[7] if he or his spouse received a benefit out of the assets of the Foundation which benefit was received or enjoyed in the United Kingdom.

If the Founder and any spouse of his are completely excluded from benefit under the "settlement" and no anti-avoidance provisions which would deem income arising under the "settlement" to be that of the Founder are in point, then no other beneficiary of the Foundation would be taxable simply because income had arisen to the Foundation. However, a beneficiary who was ordinarily resident in the United Kingdom and who received a benefit provided out of the assets of the Foundation could be subjected to a liability to income tax on the value of that benefit if and to the extent to which "relevant" income had arisen to the Foundation: Taxes Act 1988 section 740. In the context of a Foundation where any of the income could lawfully be paid or applied for the benefit of any beneficiary, all of the income will be "relevant income" in relation to each beneficiary.

Where the beneficiary is domiciled outside the United Kingdom then he would not be caught by section 740 provided *both*:

(a) the relevant income of the Foundation is non-United Kingdom source income which has not been remitted to the United Kingdom and

(b) the benefit is not received by the beneficiary in the United Kingdom.

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7 See the next paragraph.

As mentioned above, it is a moot point whether section 740 can apply to, say, a Founder who is not liable under Part XV or section 739 (because the only income of the Foundation has a non-United Kingdom source and is not remitted to the United Kingdom) if the Founder enjoys a benefit in the United Kingdom, for example a payment of pure capital.

D Tax on Capital Gains

D.1 Corporation Tax on Capital Gains

If the Foundation is treated as a company, then it will be liable to United Kingdom corporation tax on capital gains realised by it at times that it is resident in the United Kingdom: TA 1988 s.6 and TCGA s.1(2). If the Foundation is treated as a company but is not resident in the United Kingdom, it could, exceptionally, be made liable to corporation tax on capital gains arising from the actual or deemed disposal of assets used in or for the purposes of a trade carried on in the United Kingdom through a branch or agency: see TA 1988 s.11 and TCGA 1992 s.10.[8]

D.2 Capital Gains Tax Liability of the Foundation

If the Foundation is treated as a company, it is arguable that it could be liable to capital gains tax if it had been or were to become resident in the United Kingdom during some part of the same year of assessment (i.e., a year ending on 5th April), notwithstanding that it was not so resident at the time of the disposal and thus escaped a charge to corporation tax.[9] (Although the Revenue do not normally seek to collect any CGT in respect of the non-resident period in the case of a migrating *individual*,[10] there appears to be no published concession in the case of a company.)

Similar considerations apply if the Foundation is treated as a trust, except that there is a statutory test of residence of trusts for capital gains tax purposes: TCGA s.69. A trust is normally[11] deemed to be resident in the United Kingdom unless the general administration of the trusts is ordinarily carried on outside the United

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8 See my *Capital Gains Tax Planning for Non-UK Residents* 3rd edition published by Key Haven summer 1994.

9 I am assuming that there would be no liability to corporation tax under Taxation of Chargeable Gains Tax Act section 10.

10 See ESC A11.

11 But see the exception relating to non-United Kingdom settlors and professional trustees, contained in s.69(2).

Kingdom and the trustees or a majority of them for the time being are not resident or not ordinarily resident in the United Kingdom.

In my view, if a Foundation were deemed to be a trust, then it would be a "settlement" for CGT purposes and the "trustees" would prima facie be the Council members. It is possible, however, that the powers of the Protector might be so extensive as to make him a "trustee" for these purposes. Where the Protector or the Founder is United Kingdom resident, one must bear in mind that it is irrelevant that all the trustees are neither resident nor ordinarily resident in the United Kingdom if in practice the real administration of the trusts is carried on in the United Kingdom by, say, the Protector or the Founder, the Council members merely acting as rubber stamps.

One must also remember, however, that as in the case of taxes on income, it is just possible that the Foundation would be regarded as a company which owned its assets not beneficially but upon trust. In such case, it would be taxed as a settlement and the sole trustee would be the Foundation itself. In that case, the residence status of the settlement would turn on the residence of the Foundation, applying the central management and control test.

D.3 Capital Gains Tax Liability of Founder and Beneficiaries

D.3.1 The Foundation as a Company

In my view, a Foundation would be regarded as a "company" for the purposes of the Taxation of Chargeable Gains Tax Act 1992. The term is defined by section 288(1) to include "any body corporate or an incorporated association but does not include a partnership ...". For present purposes, therefore, the definition does not differ materially from that contained in the Taxes Act 1988, which operates for the purposes of corporation tax and income tax. For the circumstances in which a Foundation would be directly exposed to capital gains tax, see section D.2.

Taxation of Chargeable Gains Tax Act 1992 section 13 apportions gains of a non-United Kingdom resident quasi-close company amongst its shareholders. "Close company" has the same meaning in the Taxation of Chargeable Gains Tax Act 1992 as that given to it by sections 414 and 415 of the Taxes Act 1988: section 155(1). The question of whether a Foundation is within the scope of section 13 is thus very similar to whether it is a close company for inheritance tax purposes: see the discussion of Inheritance Tax Act section 94 in E.1.

Even if a Foundation is a company within section 13(1), however, it is difficult to see how section 13 could in fact operate to visit gains of the Foundation on the beneficiaries. Section 13(2) provides:

> "Subject to this section, every person who at the time when the chargeable gain accrues to the company is resident or ordinarily resident in the United

> Kingdom who, if an individual, is domiciled in the United Kingdom and who holds shares in the company, shall be treated for the purposes of this Act as if part of the chargeable gain had accrued to him."

Section 13(3) further provides:

> "That part shall be equal to the proportion of the assets of the company to which that person would be entitled on liquidation of the company at the time when the chargeable gain accrues to the company."

The only general definition of "shares" for capital gains tax purposes is that contained in section 288(1) of the Capital Gains Tax Act namely, that "shares" includes stock. In my view, while "shares" might well cover rights in or over a company which are not so called, those rights must be *ejusdem generis* with shares and stock. The essence of shares and stock is that their holder is a member of the company, in direct privity with it, and has rights to share in the income and/or capital distributions of the company on a defined basis. That certainly cannot be said of the beneficiaries of a Foundation. Firstly, a person can be made a beneficiary without his knowledge and without any assent on his part. There need be no direct privity between himself and the Foundation. Secondly, the rights (if such they be) of the beneficiaries to participate in distributions of the company may not be on any fixed basis at all but may be discretionary and will but rarely rank *pari passu* with each other.

My view that the gains of a Foundation cannot then be visited on the beneficiaries is further reinforced by section 13(3). For even if the beneficiaries could be said to hold shares in the Foundation it may well not be the case that it could be predicated of each one that he would be entitled to a particular proportion of the assets of the Foundation were it to be liquidated immediately.

Of course, there might be cases, no doubt quite exceptional, where the rights of the beneficiaries were of such a nature that it could be plausibly asserted that they held shares in the Foundation. For example, if there were a finite number of beneficiaries each of whom was entitled to share equally in all distributions, whether of capital or of income and whether on a going concern basis or on a liquidation.

Founders sometimes reserve rights in respect of the Foundations they have created. It is possible that if a Founder were to reserve unwisely wide powers and rights to benefit personally from the Foundation, then those rights might be held to be in the nature of "shares". I imagine, however, that such a case would be very rare indeed.

I therefore conclude that in the normal case section 13 of the Capital Gains Tax Act would have no practical application in relation to a Foundation.

D.3.2 The Foundation as a Settlement

D.3.2.1 General Definition

While the term "settlement" is not defined by the Taxation of Chargeable Gains Tax Act, "settled property" is defined to mean any property held in trust, subject to certain exceptions: see section 68. There is nothing in the Act itself corresponding to section 43(2) of the Inheritance Tax Act,[12] so that the general capital gains tax definition of "settlement" is potentially much narrower than the inheritance tax definition. A settlement for general capital gains tax purposes must be a "trust". It is not enough that some arrangement under foreign law has the equivalent effect to a trust.

On this basis, therefore, in my view the Foundation would not be a trust for general capital gains tax purposes. It would in fact be a company.

D.3.2.2 The United Kingdom Settlor Provisions

Thus a Foundation is not in my view a "settlement" for the purposes of the UK Settlor Provisions, which can operate to deem gains of a UK resident trust to be those of the settlor.[13]

D.3.2.3 The Offshore Settlor Provisions

Nor, in my view, is a Foundation a "settlement" for the purposes of the Offshore Settlor Provisions, which can operate to deem gains of a non-UK resident trust to be those of the settlor.[14]

D.3.2.4 The Offshore Beneficiary Provisions

In the case of the Offshore Beneficiary Provisions,[15] there is a special definition of "settlement"[16] which provides:

> ""settlement" and "settlor" have the meaning given by sections 681(4) of the Taxes Act...; and

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12 Discussed at E.2.

13 Taxation of Chargeable Gains Tax Act 1992 ss.77 - 79.

14 Taxation of Chargeable Gains Tax Act 1992 s.86 and Sch 5.

15 Taxation of Chargeable Gains Tax Act 1992 ss.87 - 98.

16 Contained in s.97(7).

> "settled property" shall be construed accordingly."

Taxes Act 1988 section 681(4) is contained in Part XV (Settlements). It provides:

> ""settlement" includes any disposition, trust, covenant, agreement or arrangement, and
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> "settlor", in relation to a settlement, means any person by whom the settlement was made;
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> and a person shall be deemed for the purposes of this Chapter to have made a settlement if he has made or entered into the settlement directly or indirectly, and, in particular, but without prejudice to the generality of the preceding words, if he has provided or undertaken to provide funds directly or indirectly for the purposes of the settlement, or has made with any other person a reciprocal arrangement for that other person to make or enter into the settlement."

There is a substantial body of case law on section 681(4) and its predecessors. In my view, where a Founder establishes a Foundation and transfers assets to it for the purpose of making provision for third parties and not simply for commercial reasons, then he has indeed made a "settlement".

There are some potential difficulties in adapting the Taxes Act 1988 definition to the Offshore Beneficiary Provisions. For the purposes of the Taxes Act 1988, one is concerned simply to identify income arising under a settlement and the settlor in relation to that income. For the purposes of the Offshore Beneficiary Provisions, however, one is concerned also to identify "the trustees" and "the beneficiaries". This may not always be easy as the Taxes Act 1988 contains no definition of these terms: it does not need to.

In the present context, there is in my view a likelihood that an English Court would hold that the Foundation itself - not the members of the Council - was "the trustees". The "beneficiaries" would clearly be the beneficiaries of the Foundation. The "settlor" would normally be the Founder but any person who had funded the Foundation could also be a settlor.

The Provisions apply only for a year of assessment (to 5th April) during which the trustees are at no time resident or ordinarily resident in the United Kingdom: see s.87(1). In my view, when one is applying the extended definition of "settlement" in section 97(3) one does not necessarily adopt the test of residence laid down for "settlements" in the narrower sense by Taxation of Chargeable Gains Tax Act 1992 section 69. In the case of a Foundation, if my view that it is a company is correct, it is relatively easy to determine its residence for capital gains tax purposes: see C.1.

The question arises whether gains realised by a Foundation could both escape a direct charge to corporation tax on the basis that the Foundation was not resident in the United Kingdom for the *accounting period* in which the gain was realised and yet also escape Taxation of Chargeable Gains Tax Act section 87 on the basis that the Foundation was resident or ordinarily resident in the United Kingdom *at some time during the year of assessment* in which the gain was realised, albeit not at the time the gain was realised. For example, the Foundation realises all its assets and distributes the proceeds in May and becomes United Kingdom resident in June.

While in my view they could, there is a risk that the Foundation itself would be chargeable to capital gains tax. For Taxation of Chargeable Gains Tax Act section 2(1) provides simply that a "person" shall be chargeable to capital gains tax in respect of chargeable gains accruing to him in a year of assessment during any part of which he is resident in the United Kingdom, or during which he is ordinarily resident in the United Kingdom. In a taxing statute, "person" is apt to include a company. While Taxes Act 1988 section 6(3) does prevent a company from in general being chargeable to capital gains tax, it applies only to gains in respect of which a company is chargeable to corporation tax and, in the circumstances envisaged, the Foundation will not be chargeable to corporation tax in respect of the gain. Could one perhaps argue that Taxation of Chargeable Gains Tax Act section 1(2) prevents a company from ever being liable to capital gains tax. That would involve reading in the italicised words:

> "Companies shall be chargeable to corporation tax in respect of chargeable gains accruing to them in accordance with section 6 of the Taxes Act and the other provisions of the Corporation Tax Acts *and shall consequently not be liable to capital gains tax.*"

Some support for this construction can be found in section 1(3):

> "Without prejudice to subsection (2), capital gains tax shall be charged for all years of assessment in accordance with the following provisions of his Act."

This is, frankly, not an argument on which I would advise any client of mine to rely in 1994.

If the Foundation is liable to capital gains tax in respect of gains realised in the part of the year when it is not resident or ordinarily resident in the United Kingdom, the question arises as to the *rate* at which it is taxable. As no express provision is made for this special case, the rate is simply equal to the basic rate of income tax: see Taxation of Chargeable Gains Tax Act s.4(1). Hence, a Foundation might in any event be a suitable vehicle for saving capital gains tax at the higher rate.

Another condition precedent of the application of section 80 is that the settlor or one of the settlors is at any time during the relevant year of assessment, or was when he made the settlement, domiciled and either resident or ordinarily resident in the United Kingdom. The test of domicile is the common law test. Thus, so long as the Founder does not acquire a United Kingdom domicile of choice and so long as the existing law is not changed the Foundation would in any event not be caught by section 87. If section 87 does apply for a year of assessment, one computes the "trust gains" and visits them on beneficiaries who have received "capital payments" from the trustees. If there is an excess of trust gains over capital payments, one carries trust gains forward to future years until they are fully utilised. Similarly, if there is an excess of capital payments over trust gains.

If a trust gain is attributed to a beneficiary, it is deemed to be a chargeable gain realised by the beneficiary in the year of attribution. Thus, if the beneficiary is not resident or ordinarily resident in the United Kingdom in any part of that year, he will escape capital gains tax on it. Moreover, under existing law a beneficiary who is not domiciled in the United Kingdom at any time in the relevant year of assessment also escapes tax on the imputed gain: section 87(7). This exception from charge is already particularly generous as compared, say, with a gain actually realised by a beneficiary resident but not domiciled in the United Kingdom. For the beneficiary would escape capital gains tax on such a gain only if both it were from the disposal of an asset situate outside the United Kingdom and it were not remitted to the United Kingdom.

The identification of "trust gains" in the case of a Foundation is not altogether straightforward. One computes in respect of every year of assessment for which section 87 applies "the amount on which the trustees would have been chargeable to tax under section 2(2) if they had been resident or ordinarily resident in the United Kingdom in the year". Section 2(2) simply provides:

> "Capital gains tax shall be charged on the total amount of chargeable gains accruing to a person chargeable in the year of assessment, after deducting..."

If a Foundation had been resident in the United Kingdom it would not, if my view that it is a company is correct, be chargeable to capital gains tax at all. See Taxes Act 1988 section 6(3). Hence the trust gains would appear to be nil so that section 87 loses its bite in the case of a Foundation! This is such a startling result that the Revenue could be expected to contest the point vigorously and the Courts to strain to find any half-plausible ground on which to reject it. Nevertheless, it is one which I believe to be sound as a matter of technical law. The Revenue's difficulty stems from the fact that Finance Act 1981, the predecessor of Taxation of Chargeable Gains Tax Act 1992 s.87, had no special definition of "settlement" as originally enacted. That was added, as an afterthought and with no serious consideration of the consequences, only by Finance Act 1984.

D.4 Funding of Foundation

When a Founder funds a Foundation otherwise than in sterling cash he is deemed to receive market value consideration for the assets transferred: Taxation of Chargeable Gains Tax Act 1992 section 17(1). If the settlor is not domiciled in the United Kingdom at the time the transfer is made and the transfer is of assets situate outside the United Kingdom,[17] then the Founder is, if resident or ordinarily resident in the United Kingdom at a relevant time, chargeable to capital gains tax only on the amounts, if any, received in the United Kingdom in respect of the chargeable gain which he is deemed to realise: section 12. If the Founder receives no consideration for the transfer, so that the gain is purely a deemed one, there can be no question of his remitting it to the United Kingdom so that the transfer will escape capital gains tax altogether.

On the basis that the Foundation is neither resident nor ordinarily resident in the United Kingdom at the time a transfer is made to it, there can be no question of any election for hold-over relief being available. If the Foundation were resident in the United Kingdom at the time the transfer were made an election for hold-over relief could be made under Taxation of Chargeable Gains Tax Act 1992 s.165 and Schedule 7 in the case of qualifying business assets, shares and agricultural property, provided the Foundation were regarded as an entity for capital gains tax purposes. An election could be made pursuant to s.260 of the Act[18] only if the Foundation constituted a "settlement" for capital gains tax purposes. The relevant definition of "settlement" is the more limited one which applies for capital gains tax purposes generally: see D.3.2.1. In my view, a Foundation is not such a "settlement" and thus, even if it is resident in the United Kingdom, there is no possibility of hold-over relief being available.

E Inheritance Tax

E.1 The Foundation as a Close Company

E.1.1 Taxation of Close Companies and their Participators

If the Foundation is treated as a company for inheritance tax purposes, then it will *as such* have no direct inheritance tax liability. In particular, chargeable transfers of value are transfers of value made only by individuals, not by companies: see Inheritance Tax Act 1984 section 2(1). There is nothing in the inheritance tax

17 The relevant situs rules being those contained in Taxation of Chargeable Gains Tax Act s.275 insofar as they conflict with the general rules of law which are applied, for example, for inheritance tax purposes.

18 Disposals which constitute chargeable transfers of value for Inheritance Tax purposes.

legislation affecting companies which corresponds to the charges levied on settlements by Part III.[19]

Where, however, a close company makes a transfer of value, that transfer of value is visited on individual participators in the company: Inheritance Tax Act section 94(1).

E.1.2 Is a Foundation a Close Company?

"Close company" is defined by Inheritance Tax Act s.102(1) to mean a company within the meaning of the Corporation Tax Acts which is, or would be if resident in the United Kingdom, a close company for the purposes of those Acts.[20] Taxes Act 1988 section 414 defines a "close company" to mean, firstly, a company which is under the control of five or fewer participators.

A person has "control" of a company if, *inter alia*, he possesses or is entitled to acquire such rights as would, in the event of the winding-up of the company or any other circumstances, entitle him to receive the greater part of the assets of the company which would then be available for distribution among the participators: Taxes Act 1988 section 416(2). Where two or more persons together satisfy any of the conditions of subsection (2), then they are taken to have control of the company: section 416(3).

The term "participator" is defined to include "a person having a share or interest in the capital or income of the company": Taxes Act 1988 section 417. It is possible that beneficiaries of a Foundation are "participators" in it. Even if the beneficiaries are participators, however, if there are at least 11 of them who are not connected with each other and if the Council has complete discretion as to which, if any, of them it should pay income and/or capital, then it would appear to be impossible to point to any five of them which did have "control" of the Foundation.

Even if the beneficiaries do not have "control" of the Foundation, the Foundation could be a close company on the alternative basis that it was under the control of participators who were "directors". Whether this would be the case would to some extent depend upon the constitution of the Foundation. "Director" is defined, by section 417(5), to include "any person occupying the position of director by whatever name called" and "any person in accordance with whose directions or instructions the directors are accustomed to act". Thus, the following might be the directors:

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[19] See E.2.

[20] See Taxes Act 1988 Part XI Chapter 1.

(a) the members of the Council, or

(b) the members of the Council and the Protector, or

(c) the members of the Council and the Founder, or

(d) the members of the Council, the Protector and the Founder, or

(e) the Founder alone, or

(f) the Protector alone, or

(g) the Founder and the Protector.

It is probable that the members of the Council would in virtually all cases be participators in that they would possess voting rights in the company: Taxes Act 1988 section 417(1)(a). The Protector might also be a participator for the same reason. If the Founder has reserved Founder's rights which include voting rights (even if limited to certain matters) he too would be a participator for the same reason. A Founder (or, for that matter, Protector) who is a beneficiary *could* alternatively or additionally rank as a participator by virtue of section 417(c) - "any person who possesses, or is entitled to acquire, a right to receive or participate in "distributions" of the company..." or (d) - "any person who is entitled to secure that income or assets (whether present or future) of the company will be applied directly or indirectly for his benefit".

E.1.3 Manner of Apportionment

Thus, if the Foundation is a close company, whenever it made a transfer of value, in particular whenever the company paid out capital or income to a beneficiary, that transfer of value would be apportioned among the participators "according to their respective rights and interests in the company immediately before the transfer": Inheritance Tax Act section 94(2). While the test is comparatively easy to operate in the context of a company limited by shares, it must be a matter of speculation as to how it would be applied by the Court in the case of a Foundation. The danger is that the Court would follow by analogy the decision of the House of Lords in *Leedale v Lewis* [1982] STC 835 (apportionment (under legislation repealed in 1981) of capital gains of non-resident discretionary trust amongst beneficiaries) and apportion the transfer of value amongst those beneficiaries who could be said, in a loose sense, to be those for whose benefit the assets of the Foundation were in reality being held.

E.1.4 Non-United Kingdom Domiciliaries

If the transfer of value is attributable to the value of any property situate outside the United Kingdom, then no apportionment is to be made to an individual who is domiciled (for inheritance tax purposes) outside the United Kingdom.[21] Thus, whether a distribution out of the assets of the Foundation will give rise to a charge to tax would depend upon the current domicile status of the beneficiaries or other persons amongst whom the transfer of value was apportioned. It would not depend upon the domicile status of the Founder at the time he created the Foundation. In this respect, therefore, a Foundation could have a marked inheritance tax disadvantage as compared with a conventional trust established by a non-UK domiciled settlor which has or will have UK domiciled beneficiaries.

Foreign domiciliaries who wish to own property situate in the United Kingdom are often advised to hold it through the medium of an offshore company. Simply holding United Kingdom situate assets through a Foundation may not be a complete solution, even on the basis that it is a company and that rights in or over it are situate outside the United Kingdom. For if the Foundation makes a transfer of value involving United Kingdom situate property, say, by transferring a London house to a beneficiary for no consideration, the participators will be deemed to make a transfer of value of non-excluded property. Nor will the simple use of an offshore corporate subsidiary of the Foundation be a complete solution, given that transfers of value made by it can be apportioned to the Foundation and then sub-apportioned to the participators. Instead, a more sophisticated solution is required.

E.2 The Foundation as a Settlement

E.2.1 Is a Foundation a "Settlement"?

Whether or not it is a company and caught by the close company apportionment provisions, a Foundation could also be a settlement for inheritance tax purposes. "Settlement" is defined by Inheritance Tax Act 1984 section 43(2) to mean:

> "any disposition or dispositions of property, whether effected by instrument, by parol or by operation of law, or partly in one way and partly in another, whereby the property is for the time being -
>
> (a) held in trust for persons in succession or for any person subject to a contingency, or
>
> (b) held by trustees on trust to accumulate the whole or part of any income of the property or with power to make payments out of

[21] Inheritance Tax Act s.94(4)(b).

that income at the discretion of the trustees or some other person, with or without power to accumulate surplus income, or

(c) charged or burdened (otherwise than for full consideration in money or money's worth paid for his own use or benefit to the person making the disposition) with the payment of any annuity or other periodical payment payable for a life or other limited or terminable period,

or would be so held or charged or burdened if the disposition or dispositions were regulated by the law of any part of the United Kingdom; or whereby, under the law of any other country, the administration of the property is for the time being governed by provisions equivalent in effect to those which would apply if the property were so held, charged or burdened."

One could certainly advance a fair argument that the assets of a Foundation are not held "in trust" or "on trust". More difficult, however, is the question whether the property would be so held if the disposition or dispositions were regulated by the law of any part of the United Kingdom. In my view, one has to ask what disposition one could make under the law of part of the United Kingdom which would have the same effect as transferring property to the Foundation in question. On any view, there must be a real risk that the answer would be "a trust governed by English law", in which case the Foundation would clearly constitute a settlement for inheritance tax purposes. This argument is even stronger if the beneficiaries under a Foundation in fact have the legal right to complain of breach of duty on the part of the Council Members.

An alternative answer is "a body corporate". Yet such body corporate could not be one limited by shares, otherwise the shareholders would be free to change the constitution of the company and to deprive the beneficiaries of any further benefit. The difficulty with the alternative of a company limited by guarantee is that every provision in the memorandum or articles or any resolution of the company purporting to give any person a right to participate in the divisible profits of the company otherwise than as a member is void: Companies Act 1985 section 15(1).

The residual position is that a disposition constituting a transfer of funds to a Foundation could not be governed by the law of any part of the United Kingdom and there are no provisions of any such law equivalent in effect to such a transfer.

E.2.2 Taxation of Foundation as a Settlement

If a Foundation were to be treated as a settlement, it is a moot point whether it would be its Council Members or the Foundation itself which would be treated as the trustees. It might well not matter in the normal case. The liability of the trustees to inheritance tax would depend upon a large number of factors, not all of which can be mentioned here. Broadly speaking, however, if at any time the Foundation was made and funded the Founder (including any other person funding the Foundation) were neither domiciled nor deemed to be domiciled in the United Kingdom for inheritance tax purposes, and provided neither the Founder nor the spouse of the Founder had the equivalent of an initial interest in possession, then so long as the assets of the Foundation were situate outside the United Kingdom they would constitute excluded property and thus be free from any inheritance tax charge under the settlement provisions.

To this rule, there is one possible exception. If the Founder has "reserved a benefit" which does not cease more than seven years before the Founder's death, then the assets of the Foundation could be brought into charge on his death by virtue of Finance Act 1986 section 102. Whether they would in fact come into charge is a controversial point. At the moment, the Capital Taxes Office appears to be of the view that they would not.

It must be stressed that whether a Foundation qualifies as a company and whether a Foundation qualifies as a settlement for inheritance tax purposes are completely separate questions. It is logically possible that it qualifies as both and would thus be potentially exposed to both sets of charges!

E.2.3 Foundations Funded by Non-United Kingdom Domiciliaries

The conventional advice which is given to a potential donor who is neither domiciled nor deemed to be domiciled in the United Kingdom for inheritance tax purposes who wishes to gift his property for the benefit of his family, is to create a non-United Kingdom resident trust.

Where is desired that a settlement created by a non-United Kingdom domiciled settlor should contain assets situate in the United Kingdom, matters are so arranged that the assets are held directly by a company incorporated under some foreign law (the shares in which cannot be dealt with in the United Kingdom) and the trustees own the share capital in the company. If my view that a Foundation is a "settlement" for inheritance tax purposes is correct, then assets held directly by the Foundation which are situate in the United Kingdom will not be excluded property. For as the charge would be on the assets of the Foundation, it is immaterial where the Foundation is incorporated.

If, therefore, it is thought that this strategy is appropriate, it would be necessary for the Foundation to own the assets through a subsidiary. It should be remembered that the mere use of a subsidiary will not of itself ensure that there is no charge on the basis that the Foundation is a close company. See E.1.4.

E.3 The Funding of a Foundation

The funding of a Foundation by the Founder would normally constitute a transfer of value on his part. He would make no transfer of value if he were neither domiciled nor deemed for inheritance tax purposes to be domiciled in the United Kingdom and he funded the Foundation with money or property situate outside the United Kingdom, so that the transfer was one of excluded property. Similarly, he would make no transfer of value in the unlikely event of his being entitled to an initial interest in possession.

If the transfer were not of excluded property, then one would need to determine whether the transfer of value made by the Founder were chargeable, exempt, or potentially exempt. The normal expenditure out of income exemption might conceivably be in point.[22] In the unlikely event of the Founder's spouse being entitled to an initial interest in possession, that would normally give rise to an exempt transfer.

The transfer of value would not be potentially exempt on the basis that it constituted a gift to another "individual", namely the Foundation, within the meaning of Inheritance Tax Act section 3A(1)(c). For "individual" in this context does not include a company. The transfer of value might be potentially exempt on the basis that the Foundation constituted a settlement and that the trusts of the settlement were either interest in possession trusts or accumulation and maintenance trusts at the time of the gift. This would clearly depend upon the constitution of the Foundation and in particular on the rights conferred on beneficiaries and the powers to change the constitution.

F Conclusion

The Liechtenstein Foundation offers potentially important United Kingdom tax advantages. It also carries with it certain risks. Potential Founders will no doubt make their own minds up as to whether Liechtenstein is the sort of place to which they wish to transfer control of their assets.

The intelligent reader of this article will be aware that a clued-up tax haven jurisdiction could make a killing by enacting legislation providing for the creation of entities which would have all the advantages and none of the drawbacks of a Liechtenstein Foundation. Fortunately for Her Majesty's Exchequer, most tax havens seem too parsimonious or myopic to invest in the infrastructure of high-class tax *avoidance*.

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[22] Inheritance Tax Act s.21.

The highly intelligent reader may also have appreciated that it is possible, using the Liechtenstein Foundation as a model both of what to imitate and of what to avoid, to create super-efficient tax structures based on the *existing* legislation of certain tax havens. Such tax planning is very much of the "bespoke" variety, for high net worth individuals. The last thing such individuals want is to see their strategies exposed in a published article. Hence, this will an appropriate point for me to conclude mine.