The Offshore Tax Planning Review

THE OFFSHORE ENVELOPE TRICK: A PROBLEM CONSIDERED

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Robert Venables QC has identified a possible weakness in the strategy outlined in my article, concerning section 13(5)(a) of the 1992 Act, which disapplies section 13 in relation to "any amount in respect of the chargeable gain which is distributed" to shareholders or creditors within 2 years from the time when the chargeable gain accrued.

Take this case. An offshore company (OC1) owns an asset with a value of 100 and a base cost of 10. OC1 sells the asset to an offshore subsidiary (OC2) for 100, the price left outstanding (or OC1 transfers it to OC2 for new OC2 shares worth 100). Later OC2 sells the asset for 100. A chargeable gain of 90 thereupon accrues to OC2. Within 2 years, OC2 is liquidated and the 100 proceeds of sale (or assets representing them) are paid up to OC1.

Does the 100 paid up to OC2 qualify as "any amount in respect of the chargeable gain which is distributed" to creditors or shareholders (as the case may be) within section 13(5)(a)?

Mr Venables agrees that the 100 is "distributed", but argues that it is not distributed "in respect of" OC2's gain of 90, because "a wholly fictitious gain cannot be distributed".

In my view, this argument wrongly equates a *gain* with *an amount in respect of a gain*. It may be that a "fictitious gain" (by which is meant a statutory, taxable, gain which exceeds the commercial gain if any) cannot be distributed. But that is not the test. In my view, an amount "in respect of" a gain is distributed where all or part of the proceeds of sale (or assets representing them) by reference to which the gain is computed, are distributed.

Section 12 of the 1992 Act (foreign assets of person with foreign domicile) provides that tax shall be charged "on the amounts (if any) received in the United Kingdom *in respect of* those chargeable gains". Thus the test involves the same concept as for section 13(5)(a). Take the following case. A is UK resident and domiciled. His wife, B, is UK resident but non-domiciled. A owns a foreign asset with a value of 100 and a base cost of 10. He sells it to B for 100, the price to be left outstanding. Later, B sells it for 100 and so a chargeable gain of 90 accrues to her. She brings the proceeds to the UK, to pay A. Does section 12 apply? B's gain is a wholly fictitious gain, but does it follow that the 100 received here is not an amount received "in respect of" B's gain? It would be surprising, to say the least, if the charge on remittances only applies where the statutory gain is also a commercial gain.

One can think of many cases where the non-domiciliary (for section 12) or the subsidiary (for section 13) realises a statutory gain which is not a commercial gain. For example, the asset is a "new asset" for roll-over relief purposes; or is a shareholding acquired on a "reorganisation". In these cases, in my view, an amount is received or distributed in respect of the statutory gain if (*inter alia*) the proceeds of sale are received or distributed, irrespective of whether or not the statutory gain is to the same, or any, extent a commercial gain.

Mr Venables mentions the case of a gift by a non-domiciliary of a foreign asset to offshore trustees. The gift triggers a chargeable gain which is taxable, if at all, under section 12. But, says Mr Venables, "It appears to be universally accepted that as the gain is not a real gain, there is no question of it being remitted". For my part, I agree that there is no section 12 charge, in that case. Not because there is no real gain, but because there are no proceeds of sale which can be remitted. If, as I believe, the sections 12 and 13 test involves asking what happens (i.e., receipt in the UK, distribution to shareholders or creditors) to the proceeds or assets representing them, there is no inconsistency between that case and my strategy under section 13(5)(a).