THE STABLE DOOR AJAR II

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Planning

1. Individuals and Trustees

1.01 For individuals (or the trustees of a settlement) carrying on a trade, profession or vocation in the United Kingdom who are not resident in the United Kingdom or are intending to become non-resident prior to a disposal of the assets used in the trade, profession or vocation the following means (amongst others) of restricting or eliminating the charge to capital gains tax on the disposal of such assets are worth consideration.

Exchange trading assets for shares

1.02 Exchange the assets of the trade for shares in a company (s.123 CGTA). Thereafter the company will sell the asset in respect of which the gain accrued. Once it is accepted that the individuals or trustees are neither resident nor ordinarily resident in the United Kingdom the shares in the company may be sold or the company put into liquidation. This course is open whether or not the persons concerned are (at the outset) resident in the United Kingdom. But in practice its utility is circumscribed by *Furniss v Dawson*. The sale of the shares or liquidation cannot be part of the pre-ordained scheme. This basic scheme is still open to trustees following the 1991 Finance Act save that:

(a) the trustees must on abandoning their United Kingdom residence hold the land or other asset as a "chargeable asset" to be used in the carrying on of a United Kingdom trade through a branch or agency following migration (see s.83 FA 1991);

(b) due regard must be paid on any disposals of the shares following migration to the provisions of Sch 16 FA 1991 (settlor retaining an interest chargeable), and

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(c) on any disposal of the shares consideration should be given to the charge to tax on United Kingdom beneficiaries receiving capital payments (ss.80-85 FA 1981).

Roll over gain into non U.K. trading asset (not open to trustees)

1.03 Prior to emigration sell the asset used in the trade, profession or vocation in respect of which the gain has accrued. The chargeable gain is then rolled over into the acquisition of a new asset outside the United Kingdom for use in the same or a new trade. The new assets will be sold once it is established that the individual is neither resident nor ordinarily resident in the United Kingdom. Such arrangements will be of limited (or perhaps no) effect if the "old asset" in respect of which the gain has accrued has not been used for the purposes of the trade, profession or vocation throughout its period of ownership (s.115(4) CGTA) or where the persons concerned are already non-resident. The alternative to para 1.02 may be preferred in such cases.

Cessation of the trade prior to emigration (not open to trustees)

1.04 Prior to emigration the individual discontinues the trade, profession or vocation. He retains the assets in respect of which the gains have accrued until it is established that he is neither resident nor ordinarily resident in the United Kingdom.

1.05 By way of adaptation of para 1.04, prior to emigration the individual disposes of the trade to some other entity (e.g., a company or partnership) but retains the assets in respect of which the gain has accrued. Those assets are leased to that other entity. The assets concerned should be sold free of the lease once it is established that the individual is neither resident nor ordinarily resident in the United Kingdom.

Neither of the proposals in paras 1.04 or 1.05 are options open to non-residents or (since 13th March 1991) to trustees and in any event consideration would have to be given to the gains accruing on the assets which are acquired by the trading entity.

Rolling over gains into depreciating assets

1.06 Prior to emigration the trading individuals or trustees dispose of the old asset in respect of which the gain has accrued and roll over the gain by acquiring a new depreciating asset qualifying for roll-over relief under ss.115 to 118 CGTA but subject to the provisions of s.117(2). As an improvement on this proposal the individuals or trustees might cease to carry on the existing trade in which the "old asset" had been used and immediately commence the carrying on of a new trade for use in which the depreciating "new asset" would be acquired. The new depreciating asset can be sold or the trade discontinued once it is established that the owners are neither resident nor ordinarily resident in the United Kingdom. As the new depreciating asset is a chargeable asset within s.12 CGTA there may well be a charge limited to the actual gain accruing during the period of ownership of the new asset. This scheme is not open to those who are already non-resident.

Reduction in value of the asset

1.07 Before or after emigration effect a material reduction in the value of the asset used in the United Kingdom trade, profession or vocation (not itself being a disposal). Thereafter and following emigration the trade, profession or vocation will be discontinued or the trader will otherwise cease to use the asset in the trade, profession or vocation triggering a disposal under s.127(3) FA 1989 (in the case of trustees there would already have been a prior deemed disposal on emigration on the same basis as s.127(3) under s.83 FA 1991). This is a course of last resort. Reductions in the value of the asset will not infrequently involve part disposals of the asset concerned. The gain accruing will itself be a chargeable gain (either because the trader is resident or under s.12). Acceptance of the reduced market value on the disposal deemed to be made on the cessation of the trade (under s.127 FA 1989) is dependant on the weight attached to such arguments as are mentioned in para 2.07 in my article in the previous issue of the Review.

Acquisition of asset by non-trading non-resident

1.08 The soundest course for resident or non-resident individuals and trustees (or for those who are contemplating emigration) who can foresee that chargeable gains are likely to accrue in respect of United Kingdom trading assets used in carrying on a trade, profession or vocation in the United Kingdom is to secure that the assets are owned from the outset by persons (e.g., companies or trustees of settlements) who will at no time be resident or ordinarily resident in the United Kingdom. The asset will be leased to the person carrying on the United Kingdom trade, profession or vocation on a year to year basis so as to secure that the asset represented by the lease is of negligible value. Such arrangements are admirably suited to land and buildings - where large gains are most likely to accrue. They are less well suited to chattels because there is an attendant risk in such cases that the lessor will be treated as carrying on a trade of leasing chattels. Care would have to be taken to ensure that the lessor had no branch or agency in the United Kingdom. Such arrangements are ill suited to goodwill. But for so long as the person in whom the asset was vested is neither resident nor ordinarily resident in the United Kingdom gains accruing on the disposal of the asset will be free of capital gains tax or corporation tax in the hands of that person.

Emigration to treaty country

1.09 This is more likely to be of use to migrating companies or trustees. So it is considered further below.

2 Companies

2.01 Any attempt at minimising the impact of United Kingdom taxation on gains accruing on disposals of United Kingdom trading assets by a non-resident company is constrained by the following:

(a) the charge on emigration of the company (s.105 FA 1988); trustees are similarly affected (s.83 FA 1991);

(b) the inability of the company to roll over any gains by exchanging the trade for shares in a company;

(c) the charges on non-resident companies trading in the United Kingdom found in s.12 CGTA and ss.127-129 FA 1989; and

(d) the possibility of an apportionment of any gain not caught by s.12 or ss.127-129 to the United Kingdom shareholders under s.15 CGTA (or to non-resident trustees holding shares under s.15 and s.85 FA 1981). The limitations on s.15 (confined as it is to an apportionment to those "holding" shares in the company who would be entitled to more than

5 per cent of the net assets on a winding up) are outside the scope of these articles.

2.02 Long-term planning as described above in paragraph 1.08 also provides the key to the stable door for any company whether resident or non-resident which is contemplating the establishment of a trade in the United Kingdom - or which is carrying on a trade here. Ideally the United Kingdom asset (typically land or buildings) should from the moment of acquisition be beneficially owned by a non-resident company or trustees and leased to the company which is to carry on the United Kingdom trade.

These means offer no escape to companies which are resident in the United Kingdom or to companies which are not resident but carrying on a trade in the United Kingdom on the disposal of a trading asset in respect of which a gain has accrued.

Roll-over into depreciating asset

2.03 The trading company (being a United Kingdom resident) rolls-over the gain accruing by selling the asset in respect of which the gain has accrued under s.115 of the CGTA and acquiring a depreciating asset as described in s.117. Preferably the company would cease to carry on the trade in which the "old asset" was used and immediately thereafter commence the carrying on of a new trade in succession to the old. The depreciating "new asset" would then be acquired for use in that new trade. On the company subsequently ceasing to be resident in the United Kingdom there is no disposal of the new asset under s.105 FA 1988 because the new depreciating asset would be used in the United Kingdom trade. The chargeable gain on the disposal of the old asset would be deemed to accrue on the subsequent disposal of the depreciating asset or a cessation (s.117(2)). But it would not be charged to tax because the company would not then be resident in the United Kingdom. That event would also be the occasion for a disposal of the new asset under s.12 CGTA or s.127(3) FA 1989 but the gain accruing on that disposal would be limited to that accruing during the period of ownership. The success of this untried scheme depends on the correctness of the interpretation of these provisions in paras 2.13 and 2.14 of my earlier article. It will not work for companies which are already non-resident. For such companies the disposal of the old asset in respect of which the gain has accrued is caught by s.12 (which would not be the case if the company was resident in the United Kingdom). S.115 will prevent an immediate charge but the gain when it accrues under s.117(2) will be on a disposal which is caught by s.12 (since the company was non-resident at the time of disposal).

2.04 For companies incorporated in the United Kingdom and which cannot therefore lose their United Kingdom residential status (s.66 FA 1988) the course suggested in paragraph (2) is not enough by itself. The trade and the assets employed therein would have first to be transferred to a company incorporated outside the United Kingdom but resident within the United Kingdom by virtue of the situation of central management and control. The shares in this second company would be beneficially owned by the first company. The companies will constitute a "group" for the purposes of s.272 ICTA 1970 and the transfer of the assets to the second company will be on a no-gain, no-loss basis under s.273. The snag with this arrangement is that the transferee company would leave the s.272 group when it became non-resident. If this event took place within 6 years of the end of the accounting period in which the transfer took place s.278 of the ICTA 1970 would trigger a disposal at market value of the new depreciating asset and result in an immediate accruer of the chargeable gain realised on the earlier disposal of the old asset under s.117(2).

Sale of shares in the company

2.05 If the shareholders in the company are prepared to part with control over the trade and to accept also a discount which reflects the potential charge to tax on the gain when it accrues to the company they can of course sell the shares in the company. If the shareholders are United Kingdom residents and are prepared to emigrate they can (subject to obtaining clearance under s.88 CGTA) effectively realise free of United Kingdom capital gains tax the major part of the gain in the underlying value of the trading assets by exchanging their shares for shares or securities in the purchaser company and selling or otherwise disposing (e.g., on redemption or liquidation) of the shares acquired in exchange after becoming non-resident. The drawback with this course is that the company will be liable for tax when it comes to dispose of the assets in respect of which the gain accrues. So in many cases the discount on the share price in respect of such potential charge makes this option unattractive.

Depreciating the value of the trading asset

2.06 The company could depreciate the value of the asset for the purposes of reducing its market value on the disposal deemed to take place when the company abandons its United Kingdom residence (s.105 FA 1988) or when the company subsequently ceases its United Kingdom trade (s.127(3) FA 1989). The same comments apply here as applied above in para 1.07.

Emigration to a treaty country

2.07 The company (not being incorporated in the United Kingdom - s.66 FA 1988) ceases to be resident in the United Kingdom and acquires a residence in a country having a double tax agreement with the United Kingdom under the terms of which the profits of the United Kingdom branch or agency are exempt from United Kingdom income tax. The gains subsequently accruing on the disposal of assets employed in that branch or agency are excepted from the provisions of s.12 CGTA 1979 as applied by s.11 ICTA 1988 (see s.12(2)) and accordingly from the provisions of s.127 FA 1989. The exception from the deemed disposal of the assets of a migrating company imposed by s.105 FA 1988 is for assets which are employed in the United Kingdom trade of the company then or subsequently carried on through a branch or agency. The exception is not dependant for its operation on a requirement that gains which would accrue on the assets if they were actually disposed of immediately after emigration would be caught by s.12 CGTA (see s.105(4)). The problem is to find a treaty country which exempts the profits of the United Kingdom branch or agency from income (or corporation) tax. For most treaties allow for the taxation in the United Kingdom of a trade carried on through a "permanent establishment" here. A "permanent establishment" is defined in terms which almost invariably embrace a "branch" - although (see e.g., the treaty with the United States) not always in terms adequate to include an agency as defined for the purposes of s.12 CGTA. Nonetheless this does, in the writer's view, represent a promising escape route for gains accruing to a emigrating company on the disposal of assets used in the trade.

3 Conclusions

3.01 The provisions of the Finance Acts 1988, 1989 and 1991 underline the need to consider the impact of United Kingdom taxation on those contemplating emigration from the United Kingdom or on non-residents carrying on or intending to carry on a trade, profession or vocation in the United Kingdom. For individuals (whether or not carrying on business in partnership) the new provisions present no great obstacle to those who wish to avoid the charge imposed by s.12 which cannot be overcome by careful tax planning. For gains accruing to individuals in respect of United Kingdom trading assets the stable door remains very much ajar. For settlement trustees there remains the possibility of rolling over gains on trading assets into shares under s.123 CGTA. For companies the position is different. Finance Acts 1988 and 1989 have barred the stable door to all but the adventurous, the evader or the long-term planner.