

NON-UK UNIT TRUSTS: INHERITANCE TAX IMPLICATIONS FOR NON-UK DOMICILIARIES

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Introduction

We consider, in this article, the situs of units held in a non-UK resident unit trust in the context of UK IHT.

Non-UK situate assets beneficially held by an individual not domiciled in the UK constitute excluded property (IHTA 1984 s.6(1)). Thus, transfers of such assets by non-UK domiciled individuals cannot be transfers of value (s.3(1),(2)). It follows that non-UK domiciliaries may, if the situs of the units in the type of trust we consider is non-UK, freely transfer such units (either gratuitously or at an undervalue) without a charge to IHT in the UK. UK domiciled individuals are, of course, subject to IHT in respect of transfers of value of any assets, wherever situate.

Unit trusts are trusts in the strict legal sense of the word, and operate in accordance with the terms of a trust deed, usually governed by the law of a jurisdiction outside the UK. Thus a "non-UK resident unit trust" is simply a unit trust where the trustee or majority of trustees are non-UK resident. The trustee is usually an insurance company or a bank. The trustee will commonly hold the trust

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assets through an intermediary holding company. Management of the trust is usually undertaken by a separate entity; this "management trustee" is often a separate management company. Unit holders are simply beneficiaries under the trust deed whose rights are regulated by the trust deed. Unit holders may dispose (the trust deed will determine whether the consent of the trustees is required) of their units either in an available market or by selling them to the management trustee; in the latter case, the sale will often be at a discount to market value. After any sale to a management trustee, units may be held for a sale to another investor (whether new or existing) or simply cancelled.

The trust deed often provides that a unit holder may require his units to be redeemed in consideration for an amount calculated in accordance with a specified formula. Equally, it is common for the trustees to be able to require compulsory redemption of the units.

As far as one can generalise about non-UK unit trusts, the trust fund is usually held as a single common fund. The fund may well include shares and securities of UK companies. The units do not confer any interest or share in any particular asset or part of the trust fund and if the trust is terminated, the unit holders are entitled to a distribution of the net cash proceeds once the assets held by the trust have been realised. There is no absolute reason, of course, why the trustees may not determine that the assets in question should be distributed to the unit holders in lieu of a cash distribution. Usually this determination is at the option of the trustee.

We assume for the purpose of this article that the units are registered and the register is kept outside the UK. We also assume that the trust holds the assets held as part of the common fund through an intermediate holding company. We make the further assumption that this intermediate company is UK incorporated and UK resident. If this was not the case and the share register was kept outside the UK, the shares in the intermediate company would be non-UK situs property since registered or inscribed securities are located in the country in which the register ought to be kept.

The type of the unit trust we describe above gives rise to neither successive nor contingent interests within the terms of IHTA 1984 s.43(1)(a) and does not fall within s.43(1)(b) or (c). Therefore the unit trust will not be a "settlement" for UK IHT purposes and thus no UK IHT charge should arise on the scheme itself.

Non-UK Domiciled Unit Holder - IHT Liability

Whether or not the units in a non-UK resident unit trust held by a non-UK domiciled unit holder have any UK IHT liability in respect of a transfer of value of those units (e.g., a sale to the management trustee at an undervalue) depends

on determining the nature of the property represented by the unit, which in turn will govern the situs of that property.

Units Analogous to Shares

On the basis that the units are transferable, confer income rights when the scheme is ongoing and rights to money payments on redemption of the units or termination of the scheme and that the transfer of the assets held by the unit trust (via the intermediate company) in specie is usually at the discretion of the trustees and not a right of a unit holder, we conclude that the unit falls within the definition of "security" outlined by Ungood-Thomas J in *IRC v Parker* (1964) 46 TC 396 at 408B: "security by a document establishing personal liability and without a charge on property is recognised as a form of security."

The question then arises as to what is the situs of the unit. On the basis that it is registered and transferable via the register, the situs of the register, in our view, determines the situs of the unit (*A V B Higgins* (1857) 2 H & M 339 and *Eire Beech Company Ltd v AG Ontario* [1925] AC 161 *Standard Chartered Bank Ltd v IRC* [1978] 1 WLR 1160). Assuming the register is kept offshore, the situs of the units follow the non-UK situs of the register.

Units Analogous to Partnership Share

In the absence of a separate personality on the part of the unit trust, the rights of the investors in respect of their units may give rise to the argument that the unit holder's rights are more analogous to that of a partner's share in a partnership rather than that of a shareholder in a company. We are not attracted by this argument. The title to the underlying assets is, in the type of unit trust we examine, in the name of the trustee. Management of the underlying assets is in the hands of the management trustee. The relationship amongst the unit holder, the trustee and management trustee is not one of carrying on business in common with a view to making a profit, (see s.1(i) of the Partnership Act (1890) since the unit holder is merely a passive investor. Thus the relationship is not, in UK terms, properly viewed as one of partnership.

In any event, for present purposes the distinction between the unit as security and the unit as partnership share is largely academic. A partnership share is a separate item of property which gives income and capital rights but no interest in the specific underlying assets in English law. The location of a partnership share is the territory in which that partnership business is carried on, (in the *Goods of Ewing* (1881) 6 PD 23; *Laidkey v Lord Advocate* [1890] 15 AC 468; *Beaver v Master in Equity of Victoria* [1895] AC 251(PC); *Commissioner of Stamp Duties v Salting* [1907] AC 449(PC)) which would in the circumstances we consider, be the territory where the trustee and management trustee carry on business.

Rights in Units Similar to Beneficiaries' Rights in Trust Fund - Right Analogous to Creditors' Right

What if one were to "look through" the units? Our conclusion as to situs does not change. To our mind, the only alternative analysis to that given above, whereby we reached the conclusion that the property comprised in the estate of the unit holder for IHT purposes was the units rather than any proprietary interest in the trust fund, is that the unit holder has a beneficiary's interest in the common fund. Certainly the beneficiary has an "in personam right to compel the trustees to perform the trust" but equitable rights in rem against third parties "as a result of equitable tracing rights" (see *Heyton & Marshall*, Cases and Commentary on the Law of Trusts p 11).

What is the nature of this interest? Assuming that the investor-beneficiaries' rights are analogous to those of beneficiaries in English law (and this would be a question of interpreting the domestic law which was the proper law governing the unit trust) the units would give personal rights enforceable against the trustees by reference to the proper law governing the common fund. On this basis, bearing in mind that the proper law of the trust is non UK, the in personam right against the trustees does not have a UK situs. So far as any rights in rem are concerned, these are clearly determined by the trust deed. We have already noted above that generally the trust deeds governing non-UK unit trusts provide for a single common fund in which the unit confers no interest or any share in any particular part of the assets comprising that common fund. It follows that the unit holder can have no more than a monetary right to an undivided share in the fund, irrespective of whether this right is proprietary in nature or not. There is no right in rem vis a vis the trustees in respect of the underlying assets.

Thus we see that the ongoing right of a unit holder under the type of scheme considered here is (during the life of the scheme) only to cash and not to specific assets or any part of the fund. This arrangement is analogous to a debt whose situs is where it can be enforced, which would be where the trustees are resident (see *English, Scottish and Australia Bank Ltd v IRC* [1932] AC 238 and *New York Life Insurance v Public Trustee* [1924] 2 Ch 101). It follows that, on the view that the units in the type of non-UK resident unit trust we consider give rights analogous to the share of a beneficiary in a non-interest-in-possession trust, the rights in respect of such units are effectively creditors' rights. It further follows that on this view there is no UK situs asset for the individual who holds units in a non-UK unit trust and has no UK domicile.

It is true to say that the unit holders, in their entirety acting together, may perhaps in terms of the proper law governing a particular unit trust, terminate the scheme on a *Saunders v Vautier* basis, thus giving these unit holders an equitable proprietary right in the fund, rather than merely to cash, and the fund may, as we have observed, include shares in UK resident companies. However, an individual unit holder (whose rights are determined by the proper law of the

settlement: *Duke of Marlborough v AG* [1945] Ch 78) quite simply does not have such a right. The position is no different in respect of individual beneficiaries of a discretionary trust. The right to terminate a trust by acting together with all of the other interested parties does not confer a UK situs on the rights held by an individual beneficiary simply by reason of the trust fund containing UK situate assets.

Furthermore, the very fact that whether or not all of the investors could terminate the arrangement is a matter of the proper law governing the trust again suggests a non-UK situs in respect of the rights held by each individual unit holder.

Conclusion

Our conclusion is that, on any view, units in a non-UK resident unit trust held by a non-UK domiciliary ought not to give rise to a charge to UK IHT should the latter make a transfer of value in respect of them. However, the proper law governing the scheme must be considered in detail to ascertain precisely what rights each individual unit holder has.