The Offshore & International Taxation Review

United Kingdom Mini-Budget Anti-Avoidance Measures

Robert Venables QC[1]

1 The Measure

The United Kingdom Chancellor of the Exchequer in his "mini-Budget" speech in November announced an important anti-avoidance move: "holdover" relief from capital gains tax on gifts of shares and securities to United Kingdom resident companies was to be abolished forthwith. Such gifts were often used in offshore tax planning. In this article, I consider to what extent the move has pre-empted some hitherto viable strategies.

2 Offshore Bonds

Non-qualifying insurance policies with offshore insurers held by non-UK resident companies offer significant opportunities for deferral, and in some cases even avoidance of tax liabilities. The opportunities are increased if the bond is held through a non-UK resident company, with the share in that company being held directly by an individual (even one domiciled and resident in the United Kingdom) or through an offshore trust. [2] They can in principle be "personalised" policies to which, and to which only, a "private" life fund of the company is linked.[3] A taxpayer who had left his tax planning very late and who was ready to sell shares or securities in a trading company with a large inherent capital gain could take out such

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2 See my article *Insurance Policies Held by Trusts, Companies Or Foreign Institutions* in *The Personal Tax Planning Review*, Volume 7, Issue 1 p. 55.

3 While it is true that the Personal Portfolio Bonds (Tax) Regulations (made under the authority of the Finance Act 1998) attempt to discourage such bonds by imposing a penal charge based on the premiums paid, the Regulations in their current form are relatively easy to avoid.

a policy with a relatively small single premium, ask the insurance company to invest part of his linked fund in acquiring a £100 United Kingdom resident holding company and then gift the shares or securities in the trading company to that holding company, making an election for holdover relief pursuant to Taxation of Chargeable Gains Act 1992 section 165. The insurance company could then sell the shares in the holding company to a purchaser. There would ,up to and including this stage, be no charge to tax.

The scheme is now scuppered as regards shares and securities, as holdover relief is no longer available. The scheme is still viable as regards gifts of land qualifying for agricultural relief from inheritance tax.[4]

3 The Envelope Trick

This was in some ways similar to the offshore bond route, except that the United Kingdom resident holding company was owned by an offshore trust. Restrictions on holdover relief introduced by Finance Act 1989 ensured that in general the trustees could have no more than a 49% stake in the holding company. The capital gains tax Offshore Settlor Provisions introduced by Finance Act 1991 and extended by Finance Act 1998 to trusts which were already non-UK resident before the 1991 Budget Speech negatived the planning if they applied.

This scheme, too, is still viable as regards gifts of land qualifying for agricultural relief.

4 Sale of Interest under Trust - Holdover Relief Strategy

The sale of an interest under a trust is normally exempt from capital gains tax. Where assets were already owned by a trust, the trustees could, if they had the necessary powers as a matter of trust law, reorganise the beneficial interests so that they could be sold to a purchaser who would thereby become absolutely entitled to the settled property. On that occasion, the trustees would prima facie be deemed to dispose of the settled property for a market value consideration. If the trustees were United Kingdom resident or ordinarily resident in the year in question, they would be liable to capital gains tax, nowadays at a rate of 34%. If they were not so resident, then the trust gain could be taken into account for the purposes of the Offshore Settlor Provisions or the Offshore Beneficiary Provisions. Provided the purchaser was United Kingdom resident or ordinarily resident, however, a joint election for holdover relief could be made by the trustees and the purchaser, thereby

4 See my *Inheritance Tax Planning* 3rd edition, Chapter C.6. Published by Key Haven PLC

eliminating the gain. There were many complications and traps to be avoided, which it is not necessary to rehearse.

Where no trust already existed, but assets were owned absolutely by an individual who was United Kingdom resident, he might create the trust for the purposes of the strategy. In such a case, careful attention needed to be given to the possible application of the *Ramsay* doctrine.

If, as would usually be the case, the purchaser is a company, the strategy is no longer viable where the settled property consists of shares and securities in a company. It is still viable if the purchaser is a United Kingdom resident individual or trustees, or a partnership consisting of such persons. It is also viable as regards land qualifying for agricultural relief.

5 Sale of Interest under Trust - Strategy with no Holdover Relief

Another, similar, strategy which is apparently not caught by the restriction of holdover relief is appropriate where the assets are owned by an existing non-UK resident trust, One or more beneficiaries sell their interest under the trust to a non-UK resident, which becomes absolutely entitled to the settled property. The application of the Offshore Settlor Provisions can be avoided by ensuring that the settlor and all "defined persons" in relation to him are excluded from benefit after the sale and that the purchaser does not become absolutely entitled until the next year of assessment. The application of the Offshore Beneficiary Provisions should in principle be of no consequence, as trust gains will be imputed to a non-taxable non-UK resident, although care must be taken to ensure that the gains imputed to the non-UK resident cannot be further imputed to United Kingdom residents e.g. its shareholders.

The main problem with this strategy is that the disposal of an interest in a non-UK resident trust is not exempt from capital gains tax. Since the 1998 Budget Speech, the exemption has also been removed in the case of a trust which has at any time been United Kingdom resident, so that the strategy of importing a non-UK resident into the United Kingdom cannot be relied on. There are, however, ways of ensuring that the sale of the beneficial interest does not give rise to any appreciable chargeable gain.

The sale of an interest in an offshore trust can also be a very useful means of avoiding the application of Taxes Act 1988 section 740, as is confirmed by the Revenue Interpretation of April 1999: see my article *Tax Avoidance by Transfers of Assets Abroad: the Revenue View,* Volume 9 Issue 1 page 45 of this *Review*.

6 Temporarily Non-UK Resident Individuals[5]

Finance Act 1998 introduced into the Taxation of Chargeable Gains Act 1992 a new section 10A which, broadly speaking, charges to UK tax capital gains of individuals who cease to be either resident or ordinarily resident in the United Kingdom for less than five years of assessment. It does so by deeming such gains to be gains of the year of return. There is an exemption in the case of assets acquired by the taxpayer in a year later than the year of departure. (This cannot apply to assets which the taxpayer never owned, such as those of an offshore company or trust the gains on the disposal of which are imputed to him under the Offshore Settlor Provisions or the Offshore Beneficiary Provisions.) If an individual owning, say, shares in a United Kingdom trading company, were to become "temporarily" neither resident nor ordinarily resident in the United Kingdom, he could form a new United Kingdom holding company to which he would gift the shares in the trading company, making an election for holdover relief. He could then sell the shares in the holding company and would not be caught by the provisions.

This strategy is now clearly preempted, except as regards land qualifying for agricultural relief from inheritance tax.

Other strategies remain unaffected, such as the individual taking up residence in a jurisdiction which has a double taxation convention with the United Kingdom which confers on him exemption from United Kingdom capital gains tax. Another strategy, particularly useful in the case of shares in United Kingdom companies, is for the individual to arrange to take his profit in an income rather than a capital form.

5 See my *Non-Resident Trusts* 7th edition, Published by Key Haven Publications PLC especially at 11.7, 13.3.5.1A and 14.11A.