Offshore Trusts for UK Expats post 2006 Budget: Why Labuan, Malaysia?

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The primary purpose of this paper is to deal with the usefulness of offshore trusts for UK expats while they are not resident in the UK, to provide flexibility for the future.

For UK expats living in South East Asia, the Federal Territory of Labuan, Malaysia may be of particular interest as it has a special regime for offshore trusts, providing significant asset protection, with little or no tax. The regime in Labuan for offshore trusts is dealt with in Appendix One hereto.

To understand the usefulness of an offshore trust for a UK expat, it is first necessary to understand the basis of the relevant UK taxation laws. As we are not UK tax practitioners[1], necessarily what we have to say should be checked with UK professionals before being relied upon.

The UK income tax is relevantly levied partly under the Income and Corporation Taxes Act 1988 ("ICTA") and partly under the Income Tax (Trading and Other Income) Act 2005 ("ITTOIA"), the capital gain tax is levied under the Taxation of Chargeable Gains Act 1992 ("TCGA"), and the inheritance tax ("IHT") is levied under the Inheritance Tax Act 1984 ("IHTA").

These heads of taxation have evolved over many years, not necessarily with reference to each other, so the logic of how they work is not necessarily consistent. The overwhelming conclusion that is quickly reached is that the provisions are enormously complex, which produces both opportunities and creates traps.

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[1] We have relied on the relevant statutes and texts such as "Revenue Law: Principles and Practice" Tottel 23rd ed (unless other editions noted – previously written by *Whitehouse*), Giles *Clarke* "Offshore Tax Planning" Lexis Nexus Tolly 12th ed, "Inheritance Tax 2006/07" Tottel, and the extensive material on HM Revenue and Customs website (www.hmrc.gov.uk)

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As the UK expat will invariably be a tax resident of the country in South East Asia where he is residing e.g. Malaysia, and as the tax system in that country will invariably be less stringent than that in the UK, the immediate income and capital gains tax issues on investment income are not usually pressing, as foreign sourced income of the individual will not be taxed in Malaysia even if remitted into Malaysia[2], and there is no general capital gains tax[3]. However, if and when the expat returns to the UK or goes to live in another high tax country, there will be a need, before leaving Malaysia, to consider how that income and those assets should be held with the move in mind.

However, there are two good reasons why this should not be left until then, but should be looked at as soon as the former UK tax resident takes up residence in Malaysia. As will be seen, the UK inheritance tax can be reduced by forming a non resident discretionary trust every seven (7) years, and living for seven (7) years after each is settled. In addition, the earlier it is formed, the less likely the anti avoidance provisions[4] of the income tax law could apply.

Whilst a resident discretionary trust might also be used to reduce UK inheritance tax, it will not avoid income and capital gains tax.

We deal with inheritance tax first, as this will be more relevant where large sums are settled by UK domiciles.

Inheritance Tax

Broadly, the UK levies inheritance tax on the estates (where ever situate) of persons domiciled in the UK at the time of death at the rate of 40%, subject to a threshold of £285,000 (as per the 2006 Budget, the "nil rate band"- £300,000 as per the 2007 Budget from 6 April, 2008), where the donee is not a domiciled spouse[5]. Non domiciles are only subject to IHT on death on their UK *situs* estates, subject to the same threshold. Chargeable life time transfers[6] exceeding £285,000 within any 7 year period, are taxed under the IHT at the rate of 20%. Once a gift to an individual is more than 7 years old, it can generally be ignored. Settlements on trusts are more complicated.

[2] c.f. s3 Income Tax Act 1967

[3] there is a CGT on Malaysian land and on shares in real property companies: Real Property Gains Tax Act 1976

[4] s739 ICTA; to the extent a purpose to avoid foreign tax , that will not offend the section

[5] on death the value of gifts made in the 7 years before death is taken added to the value of the assets held at the time of death, in applying the threshold

[6] the first £3,000 gifted in any tax year is exempt

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This paper is directed at typical UK domiciled clients i.e. born in the UK (with a UK born father), or not having been born in the UK, having adopted a domicile of choice in the UK, and intending to "end their days there"[7]. This is a different concept to tax residence (which may change from year to year), which is relevant to income tax and capital gains tax. UK expats may have been residing and working in South East Asia for a number of years, some more, some less, than 5 years. Therefore, they are invariably not tax residents of the UK. What they might most likely want to settle on an offshore trust is cash. There may also be some shares[8].

It is first necessary to understand how the IHT works for gifts to individuals, to see the difference with settlements on trusts. The IHT liability on a gift during life to an individual (other than a domiciled spouse), is not immediately charged (and is within the definition of a "potentially exempt transfer" – "PET"), and will depend on whether the donor lives for at least 7 years after gifting the property. There is no liability if he lives for 7 or more years. If he dies between 3-7 years from gifting property (other than to a domiciled spouse), the IHT will be triggered retrospectively, but fades out the longer he lived after gifting the property. It is the value of the amount gifted at the time of gift that becomes liable, not what it has grown into. However, the liability to IHT if the settlor lives for less than 7 years (subject to taper relief for death between 3-7 years of the transfer), is calculated at the death rate (40%), not the life time transfer rate (half that on death): 20%.

Lifetime transfers between UK domiciled spouses are not subject to inheritance tax, as the transferee's estate will remain subject to UK inheritance tax.

Lifetime transfers by a UK domiciled spouse to a non-UK domiciled spouse are PETs, so there is no IHT liability if the donor lives for at least 7 years after the gift. If the donor does not live for at least 7 years, there is still an exemption of £55,000.

Until the 2006 Budget, for a settlement on a trust in excess of the £285,000 "nil rate band", unless the settlor (a person who directly or indirectly provides funds or property[9]) retained an "interest in possession" in the trust, there would be an immediate charge to inheritance tax, as a chargeable lifetime transfer. "Interest in possession" in this context means a vested interest in the income of the settlement. If the settlor lived for at least 7 years after the date of the settling of the property[10], there was no charge to IHT. A

[7] see generally: *Clarke* Ch 40

[8] cash is ideal, as shares which have appreciated in value may have CGT implications if settled within 5 years of ceasing to be a resident

[9] see s44 IHTA

[10] see s54A(1) IHTA

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settlement where the settlor retained an "interest in possession" was within the definition of a PET[11].

The 2006 Budget did away with this concession[12]. However, it is still possible to settle a discretionary trust (and now there is no direct benefit in retaining an “interest in possession” for the settlor – which was in any event an income tax disadvantage). While the settlement is limited to £285,000 “nil rate band” (assuming there have been no other gifts in the preceding 7 years), it is possible to repeat the exercise each 7 years (at the level of whatever the “nil rate band” then is), without incurring any IHT at each settlement. A downside of discretionary trusts, which was avoided with the “interest in possession” trust formed before the 2006 Budget, is that the discretionary trust is subject to a 6% IHT charge every 10th anniversary from initial settlement of the trust[13].

As noted above, the advantage of formation of a non-resident discretionary trust, is that it won’t be subject to income and capital gains tax in the UK if it doesn’t hold UK assets, whereas a resident discretionary trust will be subject to income and capital gains tax in the UK even if it holds foreign assets.

Whereas persons domiciled in the UK do not have a liability to UK CGT on settlement of CGT subject property into a foreign settlement if they are not resident or ordinarily resident, the IHT works on a basis of domicile or *situs* of assets (including cash). It has nothing to do with residence. A person not domiciled in the UK can have an IHT liability (on death) on UK *situs* assets[14], excluding some bank deposits and government securities.

The "gift with reservation" (GWR) rules[15] disregard certain transfers of assets where the settlor retains the use of the asset although it is now held by the donee[16].

If a settlement is of cash or shares, the GWR rules aren't relevant, as the only use of the property as far as the settlor is concerned, will be to be entitled to the income from the property of the trust. The GWR rules could only apply to property which the settlor can use e.g. realty[17].

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[11] see s3A(4) IHTA

[12] there were no further changes in the 2007 Budget

[13] see *Clarke* 3.14; *Inheritance Tax 2006/07* 8.45ff

[14] see s6(1) TCGA

[15] ss102-104 Finance Act 1986

[16] see generally: *Clarke* Ch 45 and *Inheritance Tax 2006/07* Ch5

[17] The Finance Act 2004 Sch 15 introduced new provisions to subject to income tax the benefit of the use of the property previously owned by the donor (the so-called “pre-owned asset rules”) e.g. a house to live in,

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There is no additional IHT problem with the settlor also being a discretionary object of the trust capital[18]. However, for there to be a valid trust, it is the trustee who must control the trust, but of course the trustee would take into account the wishes of the relevant beneficiaries. The commercial reality of the trust business, is that if a professional trust company does not carry out its duties professionally, it is likely to be subject to supervision of the regulatory authority, and is unlikely to be in business very long if it ignores (for no good reason) the wishes of the relevant person. This would be true of onshore and offshore professional trustees. For a case where the trustee ignored its duties so the trust was held to be a sham, so that the property was held for the estate of the settlor, which would bring it back into the IHT net, see the *Abdel Raham* case[19].

Even if a person changes their domicile to outside the UK, if they die within 3 years of changing their domicile they are still liable to IHT or if he was a resident for income tax purposes in the UK and in not less than 17 of 20 income tax years ending with the income tax year in which he made the relevant transfer. This catches the person who lived in the UK for a long time even though he never became domiciled in the UK under the general law, i.e. a deemed domicile[20].

HMRC has shown resistance to claims of loss of UK domicile of origin: see *Anderson v IRC* [1998] STC (SCD) 43; *F v IRC* [2000] STC (SCD) 1; *Civil Engineer v IRC* [2002] STC (SCD) 72; *Moore's exec v IRC* [2002] STC (SCD) 463; *Surveyor v IRC* [2002] STC 501; *Gaines-Cooper v Revenue & Customs* [2006] UKSPC SPC00568 (31 October 2006).

UK Tax Residence

The tests of residence and ordinary residence for UK domestic purposes are a mixture of statute and case law[21]. One statutory test is that an individual is resident in the UK if he spends more than 6 months there in any one tax year: s336 ICTA.

A person who has left the UK for permanent residence abroad is regarded as continuing to be resident in the UK if his visits to the UK average 91 days or more per tax year. In addition, a regular visitor to the UK becomes resident after 4 years if his visits during those years average at least 91 days per year. In cases where it is clear that the taxpayer intends to make such visits he is treated as a resident either from the date of his first visit or from the date where he forms that intention (if later).

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if the GWR rules don't apply: see *Clarke* para 62.16; *Inheritance Tax 2006/07* 15.21

[18] see s43(1) IHTA

[19] 1991 JLR 511; see generally: *Clarke* Ch 24

[20] s267 ICTA

[21] see generally, *Clarke* Ch 37; also see Ch 32 re migration

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A person is ordinarily resident in the UK if they reside in the UK habitually (*Lysaght*'s case[22]), so whilst a person who has lived in the UK for many years and is therefore ordinarily resident, goes to live outside the UK, the Inland Revenue will only treat them as losing their ordinary resident status if they have not resided in the UK in the last three income years[23]. The 2005 Budget contained as measure to counter the use of convenient double tax treaties e.g. the UK/Belgium treaty, which had allowed ordinary residence to be shed immediately that the former UK taxpayer had become a Belgium tax resident, with a rule that ordinary residence can't be lost under such a treaty unless the former UK resident has been out of the UK for 18 months.

Malaysian Tax Residence

The question of Malaysian residence for an individual is dealt with by Peter K Searle in a paper entitled "Malaysian Tax Residence for Individuals" which is available at http://www.ectrustco.com/documents/contents/whitepapers/MalaysianTaxResidence.htm

For present purposes it should be noted that s7 of the Income Tax Act 1967 (Malaysia) provides:

"(1) For the purposes of this Act, an individual is resident in Malaysia for the basis year[24] for a particular year of assessment if-

(a) he is in Malaysia in that basis year for a period or periods amounting in all to one hundred and eighty-two days or more;

(b) he is in Malaysia in that basis year for a period of less than one hundred and eighty-two days and that period is linked by or to another period of one hundred and eighty-two or more consecutive days (hereinafter referred to in this paragraph as such period) throughout which he is in Malaysia in the basis year for the year of assessment immediately preceding that particular year of assessment or in that basis year for the year of assessment immediately following that particular year of assessment:

Provided that any temporary absence from Malaysia -

(i) connected with his service in Malaysia and owing to service matters or attending conferences or seminars or study abroad;

(ii) owing to ill-health involving himself or a member of his immediate family; and

[22] (1928) 13 TC 511

[23] unless the individual has take up full time employment outside the UK for a complete tax year: IR20 para 2.9; also see *Clarke* para 37.16

[24] defined in s20 to be the calendar year

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(iii) in respect of social visits not exceeding fourteen days in the aggregate,

shall be taken to form part of such period or that period, as the case may be, if he is in Malaysia immediately prior to and after that temporary absence;

(c) he is in Malaysia in that basis year for a period or periods amounting in all to ninety days or more, having been with respect to each of any three of the basis years for the four years of assessment immediately preceding that particular year of assessment either-

(i) resident in Malaysia within the meaning of this Act for the basis year in question; or

(ii) in Malaysia for a period or periods amounting in all to ninety days or more in the basis year in question; or

(d) he is resident in Malaysia within the meaning of this Act for the basis year for the year of assessment following that particular year of assessment, having been so resident for each of the basis years for the three years of assessment immediately preceding that particular year of assessment.

(1A) For the purposes of subsection (1), an individual shall be deemed to be in Malaysia for a day if he is present in Malaysia for part or parts of that day and in ascertaining the period for which he is in Malaysia during any year, any day (within subsection (1)(a) and (c)) for which he is in Malaysia shall be taken into account whether or not that day forms part of a continuous period of days during which he is in Malaysia."

Article 4 Malaysia/United Kingdom DTA

The Malaysia/UK DTA contains "tie breaker" provisions in Article 4 where a person (including a company) would otherwise be a dual resident:

"1. For the purposes of this Agreement, the term "resident of a Contracting State" means:

(a) in the case of Malaysia, a person who is resident in Malaysia for the purposes of Malaysian tax; and

(b) in the case of the United Kingdom a person who is resident in the United Kingdom for the purposes of United Kingdom tax.

2. Where by reason of the provisions of paragraph 1 of this Article an individual is a resident of both Contracting States, then his status shall be determined in accordance with the following rules:

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(a) he shall be deemed to be a resident of the Contracting State in which he has a permanent home available to him; if he has a permanent home available to him in both Contracting States, he shall be deemed to be a resident of the Contracting State with which his personal and economic relations are closer (centre of vital interest);

(b) if the Contracting State in which he has his centre of vital interests cannot be determined, or if he has no permanent home available to him in either Contracting State, he shall be deemed to be a resident of the Contracting State in which he has an habitual abode;

(c) if he has an habitual abode in both Contracting States or in neither of them, he shall be deemed to be a resident of the Contracting State of which he is a national;

(d) if he is a national of both Contracting States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement."

Income Tax

For all trusts, resident and non resident, the settlement code[25] now in Pt 5 Ch 5 of ITTOIA can tax settlors on the trust income, *where they retain an interest in the trust* (s624).

A person who is neither resident nor ordinarily resident in the UK cannot be assessed to UK income tax on income which arises from a source outside the UK. Accordingly, an individual resident of the UK could have sought to avoid UK income tax by transferring income producing assets to a non UK resident who is not subject to UK income tax.

To prevent such arrangements, s739 of the ICTA provides that if an individual transfers assets so that as a result of that transfer, or of associated operations, income becomes payable to any person resident or domiciled outside the UK and the transferor (or his spouse) has either power to enjoy that income[26], or receives a capital sum[27], the income of the non UK resident is taxed as that of the transferor. Since 1996, s739 applies irrespective of the residence of the transferor at the time of the transfer.

An individual will avoid liability under these sections if they otherwise would apply, if he can prove either that the transfer or associated operation was not made for the purpose of

[25] formerly Part XV of ICTA see s660A

[26] s739(2) ICTA

[27] s739(3) ICTA; and the repayment to the settlor of loans made by his to the trust (on non commercial terms?) is so regarded

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avoiding any tax[28] or that it was a *bona fide* arrangement the purpose of which was not to avoid tax[29]. *Whitehouse* comments, there is no clear procedure and the onus of proof is on the taxpayer. In IRC v. Willoughby (1997) 70 TC 57 the court accepted that if the overall objective was not tax avoidance the motive defence could apply even if the object was achieved in a tax efficient manner.

Whilst s739 can apply to transfers to a non resident individual, company or trust, the overlapping provisions of the settlement code in Pt 5 Ch 5, in the foreign context, only apply to foreign settlements where the settlor retains an interest in the trust.

It is worthy of note that the UK CFC provisions only apply to attribution of controlled entities income back to UK corporate entities[30]. This is unusual in the sphere of CFCs, and has been criticized by Prof. Brian Arnold[31]. In the *Tax Bulletin* for April 1999 the Inland Revenue Dept[32] made it clear that a taxpayer needed to disclose reliance on the section 741 defence in their self assessment return, in order that the exemption not be reconsidered in later years.

It is most important to note that s739 (and s624) only have practical application where the person who made the transfer is in the UK year of income ordinarily resident in the UK. Accordingly, if the transfer takes place at the time the individual is not ordinarily resident in the UK, s739 (& s624) can only have application for a year of income in which the individual resumes ordinary residence in the UK[33].

It would seem that where a trust is formed and property settled on the trust by a transferor who is at that time not ordinarily resident in the UK, the taxpayer's motive may well not be to avoid UK taxes on his return to the UK if it can be established that the purpose for the creation of the fund was for some other purpose eg asset protection or a fund set up for a particular purpose, such as succession planning or to avoid foreign taxation[34]. The trouble before the 2006 Budget was that in order to avoid a lifetime transfer charge under

[28] s741(a) ICTA; see generally, *Clarke* Ch 50

[29] s741(b) ICTA

[30] see generally, *Clarke* Ch 59

[31] see discussion on CFCs in Appendix Two

[32] as it was then known

[33] this is so for Pt 5 Ch 5 ITTOIA due to s648(2)-(5) formerly Part XV due to s660G(4): see *Clarke* para 51.25

[34] the avoidance of the UK IHT is an avoidance of "taxation" for the purposes of s739: *Clarke* para 50.5

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IHT, it was necessary that the settlor retain a life interest in the income of the settlement, which meant that if and when the settlor became resident and ordinarily resident in the UK again, they would be subject to tax on the income of the foreign settlement.

As a result of the 2006 Budget, it is not necessary for IHT purposes that the settlor have an "interest in possession" and so s739 is more easily avoided, but a decision to exclude the settlor and his spouse absolutely from having the power to receive income from, or to receive a capital benefit from the trust, assumes they have family or others they wish to benefit.

If they are not prepared to forgo the possibility of benefiting from the trust themselves, so s739 applies, they will need to satisfy the motive defense in s741.

Whitehouse confirms that the UK domiciliary may employ an offshore trust to obtain income tax advantages for his family[35]. He says the following factors should be borne in mind:

1. The trust must be in discretionary …form; all trustees must be non resident and the income must be foreign source;

2. the settlor and his spouse must be excluded from all benefit and must not receive any actual benefit;

3. UK tax is avoided provided that the income is accumulated; any distribution should be to a non resident.

The accumulation of income in a discretionary trust in which the settlor and his spouse[36] are excluded as beneficiaries means that the transferor does not have "power to enjoy that income" if it is the trustee who decides to whom the income goes[37]. Before the 2006 Budget, the income tax deferral would however come at the expense of the trust not being capable of being a PET for IHT purposes. For settlements after the 2006 Budget, the settlement can't be a PET if the amount settled (and gifts made in the prior 7 years) exceeds £285,000.

In such a trust to avoid the income tax, the settlor should only have power to change the trustee, and perhaps have a veto over changes to the trust deed, with the exception that the settlor and his spouse should not be able to be added as beneficiaries.

If and when a UK resident beneficiary has a vested interest in the income, if that is not the year in which the income was earned by the trust, there is an additional tax of the

[35] para 13.127 ; also see p260 numbered para (5)

[36] s742(9)(e) ICTA

[37] s742(2)(e) ICTA

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nature of interest on the tax which would have been paid had it been vested in the year the trust earned it.

Capital Gains Tax

A resident individual is subject to capital gains tax on his world-wide assets.

A non resident individual (excluding the "temporary non resident") escapes capital gains tax even on disposals of assets situated in the UK except where he carries on a trade or professional vocation in the UK through a branch or agency[38].

A "temporary non resident" is in the current context, a former long term resident of the UK who has been a non resident for less than five years[39]. An individual who is "temporarily non resident" is taxed on certain gains realized while non resident, on his return to the UK.

As a general rule, a non resident company is excluded from liability to CGT (except where it trades in the UK through a branch or agency), this could have given risen to avoidance which is dealt with in s13 (TCGA). Where the non resident company would be a "close company" if it was resident in the UK, the gain of the company is attributed to the "participator's interest in the company" on a "just and reasonable basis". In any event, s13 would only have any impact on participators[40] who are themselves UK resident[41].

Section 13 is only presently relevant if the non resident trust in consideration owns the shares in a company which makes the capital gain, either in the UK or outside the UK.

A trust is not UK resident if a majority of the trustees are non resident and the trust is administered outside the UK.

Gains can be taxed to the settlor of a foreign settlement if the settlement is a "qualifying settlement", but the taxation of the settlor on gains made by the foreign settlement can only apply in years where the settlor is both domiciled and either resident or ordinarily resident in the UK. Gains realized in other years are not taxed as the settlor's, nor are gains realized in the year when the settlor dies.

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[38] s10(1) TCGA

[39] s10A TCGA

[40] which has its s417 ICTA definition

[41] It is not clear how a settlor and his spouse who have no interest in the non resident settlement could be attributed with the capital gain of a company owned by the non resident settlement, but see s13(14) TCGA & s839(3) & (3A) ICTA

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A qualifying settlement is one in which "defined persons" are identified. "Defined Persons" are the settlor, the settlor's spouse, children of the settlor or of the settlor's spouse (with no age limit), the spouse of any such children, company controlled by a person or persons referred to above, a company associated with a company falling within the definition, any grandchild of the settlor or of his spouse the spouse of any such grandchild, and companies controlled by such persons and companies associated with such persons. In order for the settlor charge to apply, it is necessary that the "defined persons" benefits or will or may become entitled to benefit in either the income or the capital of the settlement.

It should be noted that the settlor charge under s86 (TCGA) can apply regardless of the motive of the settlor[42].

It would seem therefore that if the UK expat settles the foreign trust while non resident, then any capital gains made by the trust which are accumulated will not be subject to UK tax (whether the *situs* of the assets is UK or foreign), while the settlor remains a non resident of the UK. Clearly such a trust should realize all capital gains immediately before the settlor resumes residence in the UK.

In relation to capital gains tax, the fact that the settlor and his spouse might be excluded (so as to avoid an income tax liability) will not prevent the trust from being a qualifying settlement for CGT purposes as invariably lineal descendants of the settlor and/or spouse will be named beneficiaries[43].

A UK domiciled and resident beneficiary may be taxed in the UK on a capital gain made by a foreign trust if it isn't taxed to the settlor. However, this will only be if that person benefits from the capital gain.

If a UK domiciled and resident beneficiary of a foreign trust receives a capital payment made out of capital gains, there is an interest charge in addition to the tax liability to reflect the delayed payment of the capital gains tax, although it is limited to a 6 year period[44].

Proposal

Bringing together the inheritance tax, income tax and capital gains tax regimes into something using a trust that produces a result which makes some sense, might involve the following:

[42] contrast ss739-740 of the ICTA which are subject to a "motive defense" in s741

[43] however, *Clarke* at para 3.6.2 (11th ed) suggests trusts in which no lineal descendant will be named may sometimes be viable depending on personal circumstances

[44] *Whitehouse* (21st ed) page 410 numbered para "3"

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To potentially reduce the onerous inheritance tax consequences of a UK domicile leaving a significant estate, subject as it is to a 40% charge over the threshold of £285,000, and assuming the client expects to live for seven more years, the client while non resident, could settle £285,000[45] into a non resident settlement each 7 years (assuming no other gifts have taken place in the 7 years preceding each settlement). If both spouses are domiciled, then they can both make settlements, thereby doubling the amount potentially protected from IHT. If one spouse doesn't have the funds, as a gift from one domiciled spouse to another doesn't attract IHT, the financial spouse can first make a gift to the non-financial spouse.

The non resident settlement could then form a non resident company which could then subscribe the cash for shares in the company, or lend the funds to the company. The company would then invest the cash so as to produce foreign source income and gains[46], which it would accumulate. Appendix Two deals with why Labuan, Malaysia is often a suitable jurisdiction in which to form such a company.

If the settlor lives for 7 years after settling the cash, what it has grown into will not from part of his estate for UK inheritance tax purposes, whether he dies in the UK or elsewhere. However, for settlements made after the 2006 Budget, the 6% IHT liability on the value of the settlement on each 10 year anniversary of the settlement cannot be avoided.

Whilst the settlor is not resident in the UK, he will not be liable to UK income tax or capital gains tax on the income of the company.

In preparation to return to the UK, the company should realise all its non cash assets, to avoid an attribution of capital gains to the settlor on his return. The company would then only earn income and not make capital gains e.g. place the cash on deposit at interest.

As the non resident trust itself makes no income, on his resuming residence in the UK, there is no trust income in which he may have retained an "interest", as for income tax purposes, the income of the company is not deemed to be that of the trust[47].

If the settlor or his spouse have totally excluded themselves from the possibility of benefiting directly or indirectly from the settlement in the relevant ways, then the anti-avoidance provision of s739 cannot apply.

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[45] to keep the example simple. The amount in 7 years time would be the then "nil rate band" amount

[46] If the income and gains were from the UK, different considerations would arise

[47] see Pt 5 Ch 5 ITTOIA formerly Part XV ICTA, unlike the attribution of capital gains of the company to the trust by s13 TCGA: refer *Whitehouse* para 11.107 and *Clarke* para 51.24

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If the beneficiaries who ultimately take on a vesting of the trust (e.g. the settlor's children or grandchildren) reside outside the UK at the time they take, no UK tax should be payable.

If the client waited until immediately before his return to the UK to create the non resident trust, then he will have potentially wasted years of the 7 year period to avoid the inheritance tax net[48].

If the settlor and his spouse are not totally excluded from the possibility of benefiting from the settlement in the relevant ways, so that s739 applies, the motive defense in s741 may apply if his main purpose was to come within a suitable asset protection regime e.g. Labuan, Malaysia, to provide for succession, and/or to avoid foreign taxes. However, it would be safer to avoid the need to rely on s741.

<u>In the End</u>

Once the settlor has passed away, the income tax and capital gains provisions obviously can have no implications for the settlor (or his estate), so the utility of non resident trusts is actually even greater after that time[49] while income and gains are accumulated.

<u>Disclaimer</u>

This paper does not constitute advice. It should not be relied on as such. Persons wishing to explore the opportunities to use offshore trusts should seek professional advice.

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[48] *Inheritance Tax 2006/07* 12.21- As a result of the 2006 Budget it is said "the message to wealthy estate owners will therefore be to 'get on with it'"

[49] *Clarke* para 3.6.1

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