STEP JERSEY

TRUSTEE LOANS – AVOIDING UK TAX PITFALLS

18 JANUARY 2018
VISCOUNT TRUST (Jersey)

Non-UK cash and investments

Settlor
UK resident, non-domiciled

Beneficiary
UK resident, non-domiciled

Loan

Loan
Loans on arm’s length terms

Settlor’s UK taxation

• Income tax
  ➢ No actual income benefit has been received by the settlor
  ➢ Anti-avoidance rules treat a loan to the settlor as a payment of income to the settlor to the extent that the trust has income, not including income not already attributed a settlor/beneficiary
  ➢ Income of the trust may be attributed to him under UK income tax rules
  ➢ So, there is a mechanism that can treat the loan as a payment subject to income tax but it does not actually give rise to income tax

• Capital gains tax - no benefit so no tax on loan itself
Loans on arm’s length terms (2)

- If the settlor is a remittance basis taxpayer – beware!
  - He may have settled the trust with unremitted income and gains
  - If that income/gains forms part of the loan monies and the loan is used in the UK, the income/gains are remitted – he pays UK tax on them
  - The loan to the beneficiary may also result in the remittance of income/gains if s/he is a relevant person in relation to the settlor

- The loan will not be deductible for inheritance tax as it derives from property provided by the settlor
Loans on arm’s length terms (3)

Beneficiary’s UK taxation
• Income tax – no benefit so no income tax on loan itself
• Capital gains tax - no benefit so no income tax on loan itself
• The loan will be deductible for inheritance tax

Trustee’s UK taxation
• Income tax – the interest paid by the settlor and beneficiary will probably be treated as having a UK source. The settlor and beneficiary will have to deduct and account for UK income tax at source at 20%
• Capital gains tax – none
• Inheritance tax – the trust now owns UK assets (the debts), which are inheritance taxable
Other issues

• The UK trusts register
  ➢ Applies to non-resident trustees who have a UK tax liability
  ➢ An arm’s length loan with interest to a UK resident will result in a requirement to register

• Loans/interest left outstanding
  ➢ If interest is rolled up, HMRC may claim that the borrower has received a benefit equal to the interest
  ➢ If there is no realistic possibility of repayment, HMRC may argue that loan should be treated as a distribution
  ➢ Ensure that any roll-up arrangements/repayment arrangements are commercial, e.g. by taking security for both the capital lent and interest and regular review of the lending arrangements
Loans **NOT** on arm’s length terms

Settlor’s UK taxation

- **Income tax**
  - The settlor is in receipt of an income benefit equal to the interest foregone
  - Again, beware a remittance of income originally settled into trust

- **Capital gains tax**
  - Settlor is treated as having made capital gains to the extent that the value of the benefit can be matched to the trust gains (s.87 TCGA)
  - Settlor pays tax on the gains attributed if the loan is remitted to the UK
  - Again, beware a remittance of capital gains originally settled
Loans **NOT** on arm’s length terms (2)

Beneficiary’s UK taxation

- **Income tax**
  - The beneficiary is receiving a benefit equal to the interest foregone at the official rate
  - The beneficiary is treated as having received income to the extent that the value of the benefit can be matched to the relevant income of the trust
  - The beneficiary pays tax on the deemed income if the loan is remitted to the UK
  - Again, beware a remittance of income attributed to/originally settled by the settlor
Loans **NOT** on arm’s length terms (3)

**Beneficiary’s UK taxation**

- **Capital gains tax**
  - None, if the benefit is taxed to income tax
  - If there was no relevant income, it can be matched against trust gains (s.87 TCGA 1992)
  - The beneficiary is treated as having made capital gains to the extent that the value of the benefit can be matched to trust gains
  - The beneficiary pays tax on the gains attributed if the loan is remitted to the UK
  - Again, beware a remittance of capital gains originally settled

- **Finance Bill 2018**
  - Will treat the UK res settlor as the recipient of the benefit for CGT purposes if the loan is made to a ‘close family member’ of his (spouse/civil partner/partner/minor child)
  - Such loans will need review before 6 April 2018
Loans not on arm’s length terms (4)

Trustee’s UK taxation

- Income tax – none, if there is no interest
- Capital gains tax – none
- Inheritance tax – the trust now owns UK assets (the debts), which are inheritance taxable
- The trustees must register the trust if loans to trusts are outstanding at a 10 year anniversary
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(Jersey)

BOURBON LIMITED
(BVI)

Loan

Non-UK cash and investments

Settlor
UK resident, deemed UK domiciled

Beneficiary
UK resident, non UK - domiciled
Loans **NOT** on arm’s length terms – is there any change if the loan is from the company?

- The settlor and beneficiary are still taxed in a similar way as to a trust loan but
  - The trust does not have a UK situs asset, so no inheritance tax issues
  - The trust will therefore not face registration purely as a result of the loan
  - If the loan is made without realistic prospect of success or interest is rolled up, HMRC may treat it as a distribution from the company, which would be taxed at dividend rates (subject to the remittance basis)
Loans **NOT** on arm’s length terms – is there any change if the settlor is deemed domiciled in the UK?

- It will not change the actual mechanism (i.e. the sections of law) that apply

- The settlor will be subject to UK CGT on the loan under s.87, whether or not the loan is remitted
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UK residential property only
Lending and UK residential property

• Pre-6 April 2017, there was no IHT charge on the property

• Post-6 April 2017 (Finance (No2 Act 2017)):
  ➢ The company shares are UK situs assets
  ➢ But the loan is a UK situs asset in the hands of the trustees
  ➢ The whole value of property can fall into IHT
  ➢ When the property is sold, the value of the loan and company fall outside UK IHT
  ➢ If the company was sold with a loan (and UK property) in place, the situation would be different – non-excluded property for 2 years
Settlor
UK resident, non-domiciled

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Non-UK cash and investments

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Intra company loans

• Do not trigger UK tax issues in themselves
• But risks/consequences should not be overlooked

• Loss of the motive defence
  ➢ The transfer of assets rules attribute income of a company to the settlor/beneficiaries
  ➢ If UK tax avoidance was not a motive for the original transfers of assets, the rules are disapplied
  ➢ The loan is a new transfer of the lending company’s assets
  ➢ Income arising in respect of the assets lent may no longer qualify for the defence

• ‘Tainting’ the borrowing company
  – If the borrowing company was acquired with its assets, the income falls outside the transfer of assets rules
  – Income from assets acquired with borrowing from a company covered by the transfer of assets rules will be taxable under those rules
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Non-UK cash and investments

Loan

Settlor
UK resident, deemed domiciled from 6 April 2017
Trustee borrowing – deemed domicile

• Post 5 April 2017, foreign income and gains of a trust are not taxed on the settlor if they meet certain conditions (the ‘protected foreign source income’ rules)
• One condition is that neither:
  ➢ the settlor
  ➢ Another trust of which he is settlor OR beneficiary provide property or income to the trust while the settlor is UK domiciled
• A loan can be treated as the provision of property that will ‘taint’ the trust unless it is on arm’s length terms
Ensuring exemption of existing loans predating deemed domicile on 6 April 2017

• Before 6 April 2018, existing loans
  ➢ Must be repaid or
  ➢ Varied so that they are on arm’s length terms and interest is paid from 6 April 2017 - beware accidental waiver and reissue of loans

• After 6 April 2017, do not
  ➢ capitalise interest
  ➢ fail to pay interest/breach the terms of the loan
Trustee borrowing – collateral

• Under the transfer of assets rules, income of the trust is attributed to the settlor

• If:
  ➢ The trustees borrow and secure the borrowing on the trust fund/assets including trust income and
  ➢ The trustees use the borrowing in the UK

• The settlor could be liable to UK tax on the income and gains as they have been remitted to the UK – they have been used by a relevant person (the trustees) in respect of a relevant debt (the borrowing used in the UK)
Finance Bill 2018 – Onward gifts

• From 6 April 2018, where:
  ➢ A capital payment is made to a beneficiary
  ➢ At the time there is an intention to pass all or part of the payment to another person who is resident in the UK
  ➢ The beneficiary makes a gift of the payment/property derived from it to the other person
  ➢ The beneficiary is a remittance basis taxpayer or non-resident at some point between the capital payment and his gift

The part of the payment that is not treated as taxable on the beneficiary is treated as received by other person

• Re loans, a beneficial loan to X (a non-resident), which he gives to Y (a UK resident) would therefore give rise to an annual UK CGT liability on Y, subject to the remittance basis, under s.87 TCGA
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