INTERNATIONAL FOCUS

Planning points for offshore companies resulting from recent UK tax developments

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Not so long ago offshore companies could own UK assets without significant UK tax consequences, assuming these were not assets of a UK permanent establishment or of a UK trade carried on through the permanent establishment. Subject to that, it was always clear that if the offshore company was non-UK resident, there was no question of any form of UK capital gains taxation. Moreover, regardless of the nature of the UK asset, complete protection from UK inheritance taxation would also ensue for non-UK domiciled shareholders.

However, since 2012, a great deal of UK legislation has been passed to make the advantages of using offshore companies less clear-cut in the context of UK tax planning. A prime example of this new approach is the so-called ATED regime, which is a deterrence to offshore corporate ownership of UK residential property. ATED imposes a penal rate of Stamp Duty Land Tax (SDLT) of 15% on offshore corporate acquisition of UK residential property worth more than £500,000, as well as an annual banded tax on the ownership (or "enveloping") of the UK residential property, and an ATED-related CGT regime. ATED was the first real inroad into a general and long-standing principle of UK tax law that non-UK residents were not liable to UK capital gains tax on UK investment assets.

However, ATED can be seen as an essentially voluntary tax regime, in the sense that its charges are completely mitigated provided that the offshore company's board of directors resolve to let the residential property on commercial terms; or conduct a property trading or development business. These are statutory reliefs, but they also require the beneficial owner or owners of the offshore company – and those connected with them - to desist from occupation of the residential property.

NRCGT

More recently, the UK has added another capital gains tax regime applicable to non-residents of the UK who own UK residential property, called Non-Residents Capital Gains Tax or NRCGT. The broad policy behind NRCGT is to create a level playing field between UK residents and all non-UK residents in the capital gains taxation of UK residential property. NRCGT applies to offshore companies that are relieved from paying ATED-related CGT (e.g. because of the conduct of a qualifying property rental business). NRCGT is a much less aggressive tax than ATED-related CGT, because the rate of tax is much lower

(20% for non-UK resident companies, compared with 28% for ATED-related CGT), and also because NRCGT is subject to indexation relief in its application to non-UK resident companies.

Neither NRCGT nor ATED-related CGT are retroactive in effect. Therefore, gains accruing to an offshore company from ownership of residential property before the enactment of these taxes are not chargeable. NRCGT was introduced on 6 April 2015, and ATED-related CGT on 6 April 2013.

NRCGT is not confined to companies owning UK residential property, but also applies to non-UK resident individuals and trusts (whereas ATED-related CGT is essentially confined to companies, or partnerships with corporate partners or members). The rate of NRCGT for trusts is 28%, and for individuals is likely to be 28%, depending on the individual's marginal rate of income tax.

NRCGT and ATED-related CGT sit alongside each other but they cannot result in double taxation. Furthermore, NRCGT does not automatically apply to a non-UK-resident company if it is a "diversely-held "company. Diversely held companies can claim exemption from NRCGT, as can certain other types of legal structure including widely-marketed schemes whose investors include offshore funds, open-ended investment companies (OEICs), or authorised unit trusts.

Planning points

In relation to existing corporate envelopes of residential property, planning should focus either on coming within a statutory relief to "switch off" the annual tax and the related CGT regime, e.g. by letting the residential property on commercial terms; or "de-enveloping". De-enveloping can prove to be a tax-efficient way of collapsing offshore companies that cannot escape the penalties of ATED. De-enveloping normally involves a liquidation of the offshore company (often a BVI company) and should probably be considered if:

a) the beneficial owner is non-UK resident (or anticipates becoming so and remaining non-UK resident for at least five full UK tax years); and
b) there is no mortgage or debt attached to the property, or any such liability is not substantial.

For NRCGT the main planning opportunity arises for non-UK resident companies that are not close or closely held (referred to as "diversely held" in the NRCGT legislation), or from the use of investment structures comprising offshore funds and OEICs. These entities are all able to claim relief from NRCGT, although there is a general anti-avoidance rule which applies if the main purpose or one of the main purposes of such arrangements is the avoidance of CGT.

How can Jordans help?

- We can assist offshore companies wishing to retain UK residential property subject to a statutory relief, by administering their ATED filings and claims for relief as the UK tax agent.
- We can assist with ATED-related CGT filings where offshore companies within the ATED regime sell the property, assisting the company to claim all appropriate CGT reliefs, and refunds of ATED (as ATED is paid on a full year "up front" basis).
- We can assist offshore companies wishing to de-envelope via liquidation, or members voluntary winding up. This is a statutory process involving the appointment of a liquidator, and is SDLT-efficient. Jordans can provide a liquidation package that is cost-effective and user-friendly.
- We can assist clients who wish to acquire UK residential property through diversely held companies, and investment structures involving offshore funds, OEICs and authorised unit trusts. Such vehicles are able to claim relief from NRCGT in appropriate circumstances. Our Luxembourg office (Vistra Luxembourg) is able to advise and assist in this niche area.

UK commercial property

UK commercial property is not subject to ATED or NRCGT. Neither is it subject to the new IHT rules that from April 2017 will render offshore company shares transparent for UK IHT purposes where the value of the shares is directly or indirectly represented by UK residential property. What this means is that provided UK commercial property is being acquired by a non-UK resident offshore company for investment purposes (and not short-term profit), then the long-standing rules of UK CGT applicable to non-UK residents is in point, i.e. if the offshore company that owns UK commercial investment property is non-UK resident (e.g. registered, and managed and controlled in Jersey), then any resulting capital gain from disposal of the commercial property is free from UK taxation. This is not UK tax avoidance, but tax mitigation, because such offshore arrangements are not in conflict with Parliamentary policy. If this were not so, then Parliament would enact legislation to tax such investment gains when realised by offshore companies.

An offshore company used to invest in UK commercial property is straightforward where the participators are non-UK resident. But where the participators are UK resident the capital gains of the company arising from realisation of the investment can be apportioned to UK resident participators on a "just and reasonable" basis. Moreover, this apportionment will not be subject to the remittance basis, as the gains will have been realised from a UK-situated asset. However, s13 apportionment charges are now precluded provided the participation of any UK resident in the offshore company is 25% or less taking into account the participations of connected persons. Even where such participations exceed 25%, a motive defence can prevent a s13 apportionment charge. If the de minimis and motive exemptions are for some reason unavailable, an offshore trust will, with planning, preclude s13 apportionment charges for UK resident settlors who are non-UK domiciled. Rental income from UK commercial

property received by an offshore company will be liable to UK basic rate income tax (20%), but if the offshore company has any UK resident participators, income tax anti-avoidance legislation can apportion income arising to the offshore company to such participators or other UK residents with "power to enjoy" the income (s720 ITA 2007) who have transferred assets to or created rights in the offshore company. Appropriate planning with offshore trusts can mitigate income tax apportionment charges under 720, and against the "settlor" provisions in s 624 ITTOIA 2005.

Even if there is no need to consider ss 720 and 624 (e.g. because all participators in the offshore company, and all transferors and settlors are non-UK resident or excluded from benefit) it will be essential that the offshore company appoints a competent UK tax agent to report its UK source income correctly and accurately for UK income tax purposes. Errors in tax returns (whether careless or deliberate) are now very expensive where offshore companies are involved (a summary of the new legislation affecting the UK tax penalty regime as it applies to offshore matters will follow in the next Focus in March).

How can Jordans help?

- We can incorporate and administer offshore companies to acquire UK commercial investment property on behalf of non-UK residents.
- Where UK residents participate in the offshore company, we can provide preliminary advice and guidance, and also refer clients to independent tax advisers.
- We can provide management services for the offshore company in prime financial centres such as Jersey or the BVI.
- We can provide UK tax services to the offshore company by acting as the offshore company's UK tax agent.

UK tax mitigation in general and the use of excluded property trusts

When considering UK investment strategy generally for non-UK domiciled individuals, offshore companies should always be considered for reasons of UK IHT protection. Direct personal ownership of UK investments typically results in UK IHT exposure, whereas indirect investment through an offshore company means that the taxpayer owns non-UK assets (offshore company shares) and the general rule is still that offshore company shares remain "excluded property" for UK IHT purposes. However, the general immunity from IHT conferred by offshore company shares for non-domiciled shareholders will not apply in relation to UK residential property owned directly or indirectly by offshore companies from 6 April 2017.

There are nevertheless still very good reasons for using offshore companies, often owned by offshore trusts, when devising UK investment strategies for non-UK domiciled investors:

1. The use of an offshore trust prevents any UK resident non-domiciled individual from being a shareholder of the offshore company - and therefore reduces the risk of the offshore company being held to be UK resident under management and control principles.

2. Capital Gains realised by the offshore company cannot be apportioned under s13 TCGA 1992 to a UK resident but non-UK domiciled settlor of a trust that owns the offshore company (whereas if the same settlor were to own the shares personally, he would be subject to s13 apportionment charges on the company's gains if he was unable to come within one of the s13 exemptions).

3. The offshore trust will continue to protect the settlor's non-UK assets (e.g. the offshore company's shares and such of the shares' value as is unconnected with UK residential property) from UK IHT even if the settlor subsequently acquires a deemed or actual UK domicile. New rules will for the first time create deemed domicile status not just for IHT, but also for income tax and capital gains tax, if the taxpayer has been resident in the UK for 15 or more of the preceding 20 UK tax years on 6 April 2017. But the creation of an offshore trust now in which to place non-UK assets prior to 6 April 2017 (in anticipation of deemed domicile on that date) will provide ongoing IHT, income tax and capital gains tax protection for such assets as long as they are held in the trust. Such trusts are known as "excluded property" trusts. Needless to say, the new rules relating to "deemed domicile" represents a new and very complex area of UK taxation law, where independent UK tax advice will need to be taken on a timely basis.

How can Jordans help?

- We can incorporate and administer offshore companies for UK resident "non-doms" and UK non-residents as part of legitimate UK tax mitigation strategies.
- We can establish offshore discretionary trusts as a part of these legitimate tax strategies.
- We can introduce our clients to reliable sources of independent tax advice which is now essential in UK tax planning involving offshore companies.

In the next issue of the Focus, we will consider the advantages of well-informed offshore jurisdiction selection, which is now a much more important component of UK tax planning than it once was, as a result of recent legislation.

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