

Budget 2005: Matters with an Offshore Element

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In this Budget, the Chancellor focused on certain aspects of capital gains tax as they apply to individuals or persons with an overseas element. A broad outline of these proposed changes is set out in the Budget Notes. The full impact of the proposed changes will not, however, be clear until the Finance Bill is published.

Two of the proposed changes are aimed at neutralising any advantage that may be gained by seeking the protection of double taxation agreements (“DTA”). The third seeks to bring within the scope of the charge to capital gains tax gains that would arise on the disposal of certain assets if the disponors were UK resident, ordinarily resident and domiciled. These three proposed changes are discussed below.

Trustees’ Change of Residence

This change is aimed at preventing the advantageous use by non resident trustees of a suitably worded DTA. This provision affects the wandering trustee trick.

This involves a trust which starts off being non-UK resident, say Jersey-resident. The trust is pregnant with gains. The trust migrates to another territory and becomes resident there. The trustees of the trust now dispose of the assets and realise a gain. The idea is that the trustees are chargeable under the laws of the new territory because the disposal has taken place while the trust is resident there. The gains are thought to be protected by the relevant DTA. The trust becomes UK resident after the gains arise.

The proposed change will remove the protection hitherto thought to be given by DTAs. The Finance Bill will provide that nothing in the terms of the relevant DTA will prevent the UK tax authorities from taxing gains arising to trustees in any case where the disposal giving rise to the gains is made in a year in which the trustees are at some time resident or ordinarily resident in the UK and not at the same time treated as resident in another territory by the provisions of a DTA.

Relief from double taxation will be available where, as a result of the proposed changes, the trustees are also liable to tax in the non-UK territory in which they realised the gains.

It must be noted that the proposed changes will not affect trustees who have not been resident or ordinarily resident in the UK at any time in the tax year in which the gains arise.

Temporary Non-Residents

The general rule is that non-residents are not chargeable to capital gains tax on gains they realise, regardless of the situs of the assets.

Section 10A TCGA 1992 was introduced in order to deal with individuals who chose to avoid capital gains tax by the simple expedient of becoming non-resident for a complete tax year.

Section 10A TCGA 1992 applies where, broadly, the emigrant has been non-UK resident for less than five complete tax years after his emigration and the emigrant had been resident in the UK for some part of

at least four out of the seven tax years preceding the year of this emigration.

Where s10A TCGA 1992 applies, any gains (subject to an exception relating to gains arising on the disposal of assets acquired during the period of non-UK residence) realised by the individual during his period of absence from the UK are treated as accruing to him in the year of his return to the UK and are liable to capital gains tax in his hands.

However, s10A(10) TCGA 1992 provides an important limitation to the application of s10A TCGA 1992. It provides that the charge under s10A TCGA 1992 is without prejudice to DTAs.

Most DTAs follow the OECD model. They usually give the territory of residence of the donor exclusive taxing rights over capital gains (subject, usually, to an exception relating to assets and land used in a permanent establishment in the other territory).

As a result, it is possible for an individual to become resident in a territory with which the UK has concluded an appropriate DTA, realise the gains once he is resident for DTA purposes in that other territory and, thereby, avoid any UK capital gains tax.

The Chancellor has announced that it will now no longer be possible to rely on DTAs to avoid the application of s10A TCGA 1992. The proposed change will ensure that nothing in the provisions of any DTA will prevent s10A TCGA 1992 applying to an individual who has realised

gains during a period of non-residence of less than five complete tax years.

Another proposed change will ensure that an individual will be treated as non-resident for the purposes of s10A TCGA 1992 where, although UK resident and ordinarily resident in a tax year, he is also treated as resident in another territory under the terms of a DTA.

This change aims to counter the ploy whereby an individual could avoid a charge under s10A TCGA 1992 by ensuring that he did not cease to be UK resident and ordinarily resident even though he was treated for DTA purposes as resident in another territory.

Location of Assets

Individuals who are non-UK domiciled, but are resident and ordinarily resident are chargeable on the remittance basis in respect of gains they realise from non-UK situs assets.

Section 275 TCGA 1992 provides a non-exhaustive guide to the situs of particular assets. Where a particular asset is not covered by the specific rules in s275 TCGA 1992, its situs is determined using common law principles.

The proposed change is aimed at ensuring that where an asset derives most or all of its value from the UK, that asset will be treated as situated in the UK.

The proposed change will affect the following assets as set out below:

1. all shares, whether registered or not, in a company incorporated in the UK will be treated as UK situate. This is subject to a proviso relating to government and municipal shares or securities;
2. all debentures, whether registered or not, of a company incorporated in the UK will be treated as UK situate. This is subject to a proviso relating to government and municipal shares or securities;
3. the existing rules in s275 TCGA 1992 which deal with securities will apply in relation to debentures. As a result, registered debentures of a company incorporated outside the UK will be treated as being situated where they are registered or, where there is more than one register, where the principal register is situated;
4. the situs of membership rights in companies without share capital, e.g. guarantee companies, will be determined in the same way as the situs of shares or debentures of companies with share capital;
5. for the purposes of TCGA 1992, the situs of assets that are rights under the law of a non-UK territory and which correspond to patents, trade marks, registered designs,

copyright, design rights or franchises, or licences or other rights in respect of such corresponding rights will be determined in the same way as that question would be determined for the purposes of patents, trade marks, registered designs, copyright, design rights and franchises;

6. any intangible asset (broadly, a thing in action or other intangible or incorporeal property) whose location is not otherwise determined under TCGA 1992 will be treated as UK situate at all times for the purposes of TCGA 1992 if it is subject to UK law when it is created. An asset is “subject to UK law” at any time when any right or interest which comprises the asset, or forms part of it, is subject to, or enforceable under, the law of any part of the UK;
7. any options or futures which are intangible assets (as described above) and which are not subject to UK law when they are created will be treated as UK situate at all times if they can be satisfied, whether wholly or in part, by delivery of a UK situate asset or if any part of the underlying subject matter is unissued shares in, or debentures of, a UK incorporated company. It must be noted that these rules will not apply to cash settled options or futures;
8. where TCGA 1992 determines the situs of an asset and that asset is co-owned by two or more persons, the situs of the interest in that asset for TCGA 1992 purposes is the same as

the situs of the asset would be if it were wholly owned by that person.

As can be seen, these changes are relatively far reaching. For instance, bearer shares in UK incorporated companies will be treated as UK situs assets regardless of where they are physically present. Further, non-UK options or futures may be UK situs if they can be satisfied by a UK situs asset.

Comments

The Budget Notes set out the aims that the proposed changes seek to achieve. These proposed changes could affect several tax planning measures currently in place. As practitioners are aware, however, the full extent of what is caught by the proposed changes will not be clear until such time as the draft legislation is published.