KPMG

Tax Newsletter: KPMG Isle of Man

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We hope you will enjoy this issue of our Tax Newsletter. Our purpose is to try to keep you abreast of topical UK tax issues which may affect you, your business, and/or your clients.

In this issue:

IHT and excluded property added to and transferred between trusts

On 11 July, the UK Government published draft clauses for the next Finance Bill here which confirm that property added to a settlement or transferred between settlements after the settlor has become UK domiciled or deemed domiciled cannot generally be excluded property for UK inheritance tax purposes.

These changes will primarily affect affect UK domiciled or deemed domiciled individuals who have created an offshore trust when they were previously non-UK domiciled and have subsequently made additions of assets to that trust.

The Chartered Institute of Taxation and the Society for Trust and Estate Practitioners have made representations on these changes to inheritance tax and excluded property added to and transferred between trusts which can be found here.

Isle of Man aircraft and yachts VAT review

On 16 October 2019 HM Treasury published their long-awaited report into the importation practices operated by Isle of Man Customs & Excise in respect of yachts and aircraft. The report found that the Isle of Man Customs & Excise had performed importations in compliance with the appropriate VAT and Customs regulations. The report made recommendations that more frequent post-VAT registration check are carried which has been addressed by Isle of Man Customs & Excise implementing an assurance visiting programme.

The report can be accessed here.

Transfer of Assets Abroad: Unexpected First Tier Tribunal decision

The outcome of a recent First Tier Tribunal (FTT) case highlights some interesting points on the application of the Transfer of Assets Abroad (TOAA) rules. We await to see if HMRC will appeal the FTT decision.

The Rialas case considered the section 739 ICTA 1988 (now section 720 ITA 2007) Transfer of Assets Abroad rules (TOAA) in relation to dividends paid between 2005 and 2007.

The Tribunal considered three questions:

1. whether taxpayer was a transferor for s739 – held not;
2. whether motive defence was available – held not;
3. whether a right to free movement of capital was infringed - held yes.

The taxpayer, Mr Rialas (R), a UK resident who was ordinarily resident and a non-dom, owned 50% of Argo, a successful UK company. R wished to buy out his former business partner C to facilitate a future sale of Argo. Therefore, R set up a structure, contributing £10 to a settlor interested non-UK resident (Cyprus) discretionary trust which acquired an off the shelf non-UK resident company 'F'. Financed by a third-party loan, which was provided on favourable terms by a business friend of R, F acquired the remaining 50% of Argo from R's former business partner C at a market value price. Over the next few years (2005 – 2007) Argo paid substantial dividends to F on which HMRC sought to tax R under s739. Argo was subsequently sold to a third party. The dividends and sale proceeds were used to repay the loan.

There are a number of interesting points arising from the decision:

1) Taxpayer transferor

The FTT concluded R was not the transferor for the purpose of s739 because he did not possess the necessary influence to dictate whether or not C should sell his shares or to whom he should sell them. As such R could not be considered to be the quasi transferor of C's shares.

In addition, the FTT considered the associated operations rules did not apply. In particular, the HMRC argument that formation of a subsidiary company, F, the borrowing of $15m by that company, followed by the acquisition of the shares in Argo, were "associated operations" "in relation to" the £10 initially contributed to the trust, the FTT concluded, seemed to be stretching the words beyond breaking point.

The judgement continues:

'71. If this argument were correct then it would mean that the establishment of any non-resident trust by a UK resident individual, with however small an initial contribution, could lead to that individual being taxable on the income from any investments which such a trust might acquire, directly or indirectly, from anywhere in the world, even though the whole of the funds required in order to acquire those investments had been borrowed. We do not believe that this is a consequence which could have been in the mind of Parliament or indeed the draftsman of this legislation. This is simply going too far.'

KPMG Comment

The Tribunal focused on the shares in Argo as the asset which is being transferred. An alternative analysis might focus on the cash, funded by the loan to F, which was used to purchase the shares in Argo. The Tribunal accepted that R orchestrated the purchase side of the transaction. This alternative perspective might make R a quasi-transferor.

If the FTT's view of associated operations and in particular para 71 are correct, then it would appear to open wide the TOAA legislation to enable certain offshore structures to escape its provisions.

2) Motive defence

Although not strictly needed given the conclusion in 1), the Tribunal also concluded that the taxpayer could not take advantage of the TOAA motive defence. In their view, the only apparent explanation for the interposition of a non-resident trust between the taxpayer and the shares in Argo, was the reduction of the taxpayer's exposure to UK Inheritance Tax, thereby demonstrating a tax avoidance motive.

KPMG Comment

Arguably the taxpayer was a little unlucky on this point as the facts showed that that he had not received any specific UK tax advice on this structure but was only aware that an offshore trust was a 'good thing' from a UK Inheritance Tax perspective.

3) Free movement of capital

Although not strictly needed given the conclusion in 1), the Tribunal also concluded that the TOAA legislation was not compatible with the EU principle of free movement because it was penal in nature and that the only effective remedy was to disapply s739.

The analysis was based on a comparison with F and a hypothetical UK holding company receiving dividends from Argo with clear discrimination shown between the two scenarios. Therefore there is a clear infringement of the principle of free movement of capital.

Three defences were available to HMRC:

(1) Is the integrity of the UK tax system at stake, as per Bachmann v Belgian State C-204/90?

(2) Is the measure necessary for some broad economic purpose such as retention of capital in a Member State, or for a balanced application of taxing rights?

(3) Is the measure aimed at tax avoidance and, if so, is it justified and proportionate in its pursuit of this objective?

HMRC only chose to argue the third defence.

The historic case law on this considered that the relevant EU definition of tax avoidance was based on the Cadbury Schweppes case, i.e. that of something which is totally artificial. The FTT considered that under this approach s739 would not be considered justified as the structure was not totally artificial.

However, a recent case *X GmbH v Finanzamt Suttgart – Korperschaften* has changed this approach 'in the context of the free movement of capital, the concept of 'wholly artificial arrangements' cannot necessarily be limited to merely the indications referred to in paragraphs 67 and 68 of the judgment [in Cadbury Schweppes].' In particular 'that concept is also capable of covering, in the context of the free movement of capital, any scheme which has as its primary objective or one of its primary objectives the artificial transfer of profits made by way of activities carried out in the territory of a Member State to third countries with a low tax rate.'

The FTT considered that the provisions of s739 were justified based on this CJEU case.

However, FTT considered that the provisions of s739 were not proportionate because the effect of s739 was penal because it put R in a worse situation then he would have been if F had been UK tax resident – R was taxable directly on the income and no deduction is available for the interest paid by F.

As the provisions of s739 were not compatible with the EU principle of free movement of capital because they were penal in their effect, the only effective remedy in these circumstances was to disapply s739.

KPMG Comment

This case shows the complexities involved in arguing a free movement of capital defence. Whilst the TOAA legislation was changed in 2012 with the purpose of bringing it line with EU jurisprudence, this decision would suggest that the impact of TOAA is still potentially penal in nature, depending on the relevant facts, and therefore potentially remains not compatible with the free movement of capital.

Deed of appointment rescinded after mistake as to IHT consequences

The case of *Payne and another v Tyler and another [2019]* is another case in which the High Court has allowed the rescission of a voluntary disposition on the grounds of mistake. The Court found it was analogous to the position in *Pitt v Holt* as it involved an unexceptional step of tax mitigation, with no element of artificiality or abuse of statutory relief.

The background facts of the case have been summarised below:

- Mr Mallett died in 2010 and, under the terms of his will, left half of his estate to his wife, Mrs Alston.
- Mrs Alston created a discretionary settlement (the Settlement) by deed of variation so that instead of inheriting her half-share in her late husband's residuary estate outright, it would be transferred to the Settlement thus removing it from her estate for UK inheritance tax (IHT) purposes.
- Upon advice from a tax specialist, the trustees exercised their powers of appointment to grant Mrs Alston an irrevocable life interest in the Settlement so that she had an automatic right to the income of the Settlement. The trustees however failed to appreciate that by making such an appointment within 2 years of Mr Mallett's death would create an immediate post-death interest (IPDI) and thus the trust fund would form part of Mrs Alston's estate upon her death (exactly what she was trying to avoid!).
- Mrs Alston's died in 2016 at which point it became apparent that the tax advice provided to the trustees had been wrong. The trustees therefore applied to the court to set aside the deed of appointment on the ground of mistake.

The Court applied the principles set out in Lord Walker's judgment in the Supreme Court case of *Pitt v Holt* and acknowledged that the discretionary trust existed solely to ensure that the funds inherited by Mrs Alston from Mr Mallett fell outside her estate for inheritance tax purposes and had the trustees received correct tax advice, they would not have executed a deed of appointment within two years of Mr Mallett's death. The Court concluded that the necessary

conditions were met in order to set aside the relevant transactions.

Residential property CGT 30-day reporting: HMRC test new CGT reporting form

From April 2020 UK residents disposing of UK residential properties will be required to report the gain and pay any CGT liabilities arising within 30 days from the date of disposal.

We understand that HMRC is developing a new service to be used for reporting such gains and the new CGT reporting form is currently being tested.

The new reporting form will also replace existing forms used by non-UK residents to report gains crystallising on disposal of UK land and property.

It will be important to ensure that you and/or your clients who might be impacted are aware of this new rule and the need to ensure they have identified all relevant information and calculated the expected gain prior to completing such a disposal.

Entrepreneurs' Relief: qualifying beneficiary at time of disposal by trustees

In the case of *Quentin Skinner Settlements v The Commissioners of HMRC [2019]* the First-tier Tribunal (FTT) concluded that an individual only needs to be a qualifying beneficiary at the time of the disposal of qualifying assets by a settlement for trustees to potentially qualify for Entrepreneurs' Relief (ER).

This decision is contrary to current HMRC guidance in CG63985 here which sets out that for trustees to qualify for ER, the beneficiary must have held an interest in possession throughout the relevant 24 months prior to the date of disposal (12 months for disposals pre 6 April 2019). The FTT's finding highlights the importance of identifying and addressing tax issues both before and during the two years leading up to the sale of a business, including the possibility of protecting family wealth while benefitting from the reduced ER rates of capital gains tax.

HMRC writes to tenants of corporate non-resident landlords

HMRC have started issuing letters to the tenants of corporate Non-Resident Landlords (NRLs) and appear to be attempting to identify companies not registered under non-resident landlord scheme (NRLS). The letter is addressed to the tenants advising that tax may need to be deducted from their payments, unless rental payments are made through an estate agent.

An ICAEW article, which can be found here states that Tax Faculty is seeking further clarity from HMRC. The example letter seen by ICAEW (click here) was issued on 2 August 2019 and had a 6 September 2019 response deadline.

'From April 2020, non-resident companies with income from UK property will stop being charged UK income tax and will instead be subject to the UK's corporation tax regime. HMRC is expected to publish further guidance in due course; in the meantime details of the policy change can be found in an HMRC policy paper.

The companies affected are likely to need to re-register with HMRC for corporation tax. Some, but not all, will already be known to HMRC through their registration under the non-resident landlord scheme.

It appears that HMRC is seeking to identify non-resident companies where they are not registered under the non-resident landlord scheme. The Tax Faculty has seen a copy of a letter which the HMRC wealthy and mid-sized business compliance unit is sending to the tenants of non-resident companies that are not registered under the non-resident landlord scheme… Unless the tenant is connected to the non-resident company named they are likely to be very confused by this lengthy letter and may not have access to a tax adviser. There is no requirement to operate the scheme where the landlord has registered for gross payment or the payment is made to a letting agent.

The Tax Faculty is seeking further clarification from HMRC.'

Jersey consults on taxing enveloped property

The Government of Jersey is consulting on proposals to introduce a charge equivalent to stamp duty (SD) on transfers of Jersey real estate held within corporate bodies.

The "New Law" will seek to impose a tax charge on certain transactions involving the transfer of Jersey real estate which are currently outside the scope of both the SD Law and the Jersey Land Transactions Tax (LTT) Law.

In order to do this, the "New Law" will bring into scope transactions which confer to a person a "significant benefit" in Jersey real estate, such as the transfer of shares in a company which owns "enveloped property".

The definition of "significant benefit" would only include transactions where a person acquires, either directly or indirectly, more than 50% of the entity in which the Jersey real estate is held. Where less than 100% of the entity is acquired, the tax charged on the "significant benefit" would be a proportion of the tax due in respect of 100% ownership.

The "New Law" will apply whether or not any of the parties to the transaction are present or resident in Jersey, or whether or not any legal person being the owner of the property is registered or has a presence in Jersey.

For the Jersey Government announcement click here.
The consultation closed on 14 October 2019