# MR. LEE

## by Milton Grundy

His car was running smoothly, his driver was negotiating the traffic very expertly, the sun was shining over the Harbour and Kowloon, his son-in-law Charles was making agreeable conversation; Mr. Lee ought to have been contented. But he had been putting off this meeting with his solicitor for months – well, perhaps really for a few years. Peter had been his solicitor for a long time, and Mr. Lee had been to countless meetings – about his father's estate, about the take-over, about that unfortunate affair his daughter had got involved in. But this one was about – Mr. Lee spread out the fingers of his right hand – death. Most of his grandchildren lived in the United Kingdom. He liked to support them, at whatever stage they were at, making sure they had the best education he could buy, and making sure that they had a good start in life. He had been in the habit of making gifts to one or other of the grandchildren from time to time. There was no tax issue about that: he could draw down from his overseas investments and send them a cheque without any tax consequence – Hong Kong taxing on a territorial basis, and the United Kingdom (unlike some other places) not taxing donees. But how could this continue after he had passed away? Obviously, he must create a trust.

Charles had qualified as a solicitor in London, and while tax was not actually his special subject, he knew about what is now s.731 of the Income Tax Act 2007 and about s.87 of the Taxation of Chargeable Gains Act 1988

(as amended). Charles had given him copies of these statutory provisions; Mr. Lee had confessed that he didn't really understand them, and he was comforted to learn from Charles that not many people did. But the upshot, Charles said, was that if any of his children back in London got anything from a trust he created, they would probably have to pay income tax or capital gains tax on it, though happily not both.

Charles had taken the precaution before he left England of going to see counsel in that set of chambers which liked to think of itself as the thinking man's tax chambers. (Not that Mr. Lee approved of the soubriquet: he was brought up to believe that learning and modesty should go hand in hand.) Counsel had advised that the problem could be solved by having not one but two trusts. Perhaps Mr. Lee could create one and his wife the other. He had written an opinion and settled the requisite documents and Charles had e-mailed them all to Peter ten days ago.

Mr. Lee and Charles took the lift to the 17$^{th}$ floor.

"I have found a couple of trust companies. They are happy with counsel's draft, and so am I," said Peter. "What we don't have is a name for each of the trusts."

"We could call one the Village Trust and the other the Plum Tree Trust," Charles suggested. His son-in-law had been born and brought up in England. He could speak and understand Cantonese, but had never learned to write Chinese. Mr. Lee smiled: Charles must have

been taking lessons. Peter sensed that a joke was passing over his head, but continued.

"We need to divide your beneficiaries into two equal groups. One group will be entitled to the income of the Village Trust and the capital of the Plum Tree Trust and the other group the other way round. Counsel's advice is that all the income should be paid into a separate fund and accumulated, and what the beneficiaries get should come out of capital."

"The trick is," said Charles, just to show he knew, "that the trust income isn't 'relevant income' in relation to the beneficiaries who receive benefits from the trust."

"That can't go on forever," Mr. Lee observed.

"No." Peter agreed. "But if we distribute, say, four per cent to the beneficiaries each year, we can carry on for 25 years. And if we can make at least four per cent a year on our investments, the trust funds won't be any smaller than they are now."

"But any further distributions will cost tax," Charles added.

"I'd like," said Peter, "to leave your father with a power to revoke the settlements during his lifetime. All being well, he may, in – say – 10 years' time, revoke the settlements and make fresh ones. This will start the 25 years running again."

"Can I," Mr. Lee asked, "still control the way the money is invested?"

"The trusts provide for a person called the Protector," Peter replied. "He has a number of powers, one of which is to dismiss the trustee and appoint another in its place. This means in practice that your trustee is going to run things the way you want."

"And when I am gone?" Mr. Lee asked.

"You have power to appoint a successor, who can appoint a successor, and so on. This sort of arrangement is quite usual."

"And what about grandchildren not yet born? And their children too?"

"They become beneficiaries of one trust or the other, keeping the numbers equal."

Mr. Lee thought that was quite straightforward. Then he remembered that Charles had said something about a partnership. Peter explained that counsel wanted the two trustees to go into partnership and the partnership to run the portfolio as a business, dividing the profits between them equally.

"Including the capital gains?" asked Mr. Lee.

Peter hesitated. Charles saw another opportunity.

"There won't be any capital gains," he explained. "The partnership is to trade in securities, so that all the profits will be on trading account. Of course," he added, "we shall have to base these trusts abroad: a partnership trading in securities in Hong Kong is going to have to pay tax on its profits."

"Where do you think we should go?" Charles asked.

"You have options," said Peter. "The classic location for an activity of this kind would be one of the zero-tax jurisdictions – the Cayman Islands, say."

"The Cayman Islands?" Mr. Lee exclaimed. "Where are they?"

"I wasn't too sure myself," Peter said. "So I got an atlas out of the library."

He opened a large book. "If you look very carefully," Peter continued, "you will see three tiny specks between Cuba and Jamaica."

"That seems a very long way to go," said Charles.

"Yes," replied Peter. "But they have an excellent Trusts Law, and they have been doing zero-tax trust business for over 40 years. If you want somewhere closer to home, you might think of Labuan."

"Oh, in Malaysia?" Charles quickly interjected, afraid his father was going to ask where it was.

"Yes," said Peter. "Or you could go to Vanuatu. They are both relatively new to the business, but easier to get to from here than the Cayman Islands."

"I like that," said Mr. Lee. "I have a lawyer in Taipeh. I never have to go to his office. But he knows that I always might. And my papers never get stuck in his pending tray."

Peter smiled.

"They are not quite so handy as Taipeh" he said. "But I'll get one of my people to do you a little memo on both jurisdictions," he said. "Then you can decide."

**Note**

*Benefit received by capital beneficiary not caught by anti-avoidance provisions*

Income Tax Act 2007

s.732

(1) This section applies if--

(a) a relevant transfer occurs,

(b) an individual who is ordinarily UK resident receives a benefit,

(c) the benefit is provided out of assets which are available for the purpose as a result of-

(i) the transfer, or

(ii) one or more associated operations, ...

(2) Income is treated as arising to the individual for income tax purposes for any tax year for which section 733 provides that income arises.

(3) Also see that section for the amount of income treated as arising for any such tax year.

s.733

(1) To find the amount (if any) of the income treated as arising under section 732(2) for any tax year in respect of benefits provided as mentioned in section 732(1)(c) take the following steps.

...

*Step 3*

Identify the amount of any income which--

(a) arises in the tax year to a person abroad, and

(b) as a result of the relevant transfer or associated operations can be used

directly or indirectly for providing a benefit for the individual.

That amount is "the relevant income of the tax year" in relation to the individual and the tax year.

...