

THE MUSIC BETWEEN THE NOTES

A review of “*More Essays in International Tax Planning*” by Milton Grundy¹

By Conrad McDonnell

Legend has it that in 1969, in order to obtain a copy of the first edition of *Tax Havens* by Milton Grundy, you had to make your way to a certain office in a certain side street in Vaduz in Liechtenstein: the book was not available for sale in the United Kingdom and the secrets contained within its pages it were considered far too daring for ordinary consumption. In these enlightened times the latest version of that book, as *Offshore Business Centres: A World Survey* (seventh edition) is of course readily available, in all good bookshops as the saying goes.

To an extent, where *Offshore Business Centres* leaves off, *More Essays in International Tax Planning* commences. The former provides a pragmatic review of general business conditions and the companies and other legal vehicles available in each jurisdiction, as well as a brief summary of key treaty elements, but essentially leaves it as an exercise for the reader what to do with all of this information. As *Essays* did before it, now *More Essays in International Tax Planning* takes these ingredients and refines and blends them so that we see what delights may emerge. *More Essays* is not a didactic textbook, nor a work of reference: it is assumed that the reader already has a good working knowledge of the

United Kingdom tax system and the international tax arena. On the contrary, the purpose of *More Essays* is to present inspirational ideas, to show the reader what may be possible, and to provoke discussion. The essays take a conceptual approach rather than setting out the detailed implementation of any of the schemes discussed. In that way, it is like a book which is about food, rather than an actual recipe book. That is perhaps an important point: unlike most professional works, this is a book which is designed to be read from beginning to end in the conventional manner and enjoyed in that way.

It should be said that *More Essays* does not of course present a solution for every situation, instead it presents a variety of approaches based on common themes. To continue the food analogy, it is a book organised around selected ingredients, rather than a presentation of a complete repertoire. Some of the approaches have doubtless been implemented many times on behalf of selected clients, and the author speaks from much experience of refining these schemes over the years — other approaches are frankly acknowledged to be untested for want of a client who is in precisely the right position to implement them.

Chapter 1 (London as an Offshore Centre) examines the use, by overseas residents, of the United Kingdom as a low tax jurisdiction. These are familiar concepts, but it is useful to the reader to have them collected together in this way. Limited partnerships and limited liability partnerships are discussed, before a more detailed treatment of the UK settlement established by a

non-resident and non-domiciled settlor, the use of a UK company as an agent, and the use of a UK company as a holding company. A particular focus (and a recurring theme throughout *More Essays*) is the extent to which these vehicles may benefit from the international double taxation treaty network.

The Finance Act 2006 changes for UK trustees of non-resident trusts are mentioned, but the brief and efficient way in which that is done reveals much about the overall approach of this work. The Finance Act 2006 is just another development in a long line of legislative tinkering, and it is a detail which should not distract us from the broad concepts at play. Where other books might keep their feet on the ground and plough through the legislative changes, this work instead chooses to soar above all of that in order to reveal the elements which are really of interest. As the title page says, the music is not in the notes, but in the space between the notes (a quotation attributed to Debussy).

Another theme which is repeated throughout *More Essays* is the tax efficient treatment of royalties. Royalties are of particular interest to the international tax planner since of course in practice an asset which generates royalties is likely to be simultaneously exploited in many different high-tax jurisdictions. In this context, Chapter 1 examines the use of the UK company as a stepping-stone for royalties in relation to several different source jurisdictions, as well as the use of UK trusts. An Appendix sets out a worked example in

relation to a Hong Kong pop singer: worked examples are otherwise not used in *More Essays*.

As is appropriate in these days of globalisation, there is significant focus on cross-border issues for companies, in particular the apparently simple (but common in practice) problem of how to derive dividends or business profits from activities in another jurisdiction while minimising local tax costs. But where other works or professional conferences may set out to address all of the complexities involved, in some cases adding layers of mystique which are perhaps uncalled for, the approach here is beguilingly simple. Issues such as transfer pricing are essentially disregarded as mere details of implementation: what is of interest here is the overall structure and the broad concepts in play.

Chapter 2 (The Uncertainty Principle) is a short but extremely thought-provoking essay analysing the implications of *Franklin v CIR* (1930) 15 TC 464. The case is a mere footnote in most textbooks and not very well known. The premise here is that a receipt which is unascertainable in amount is not a taxable receipt until such time as the amount of it can be ascertained. The consequences of this are explored, and in particular a scheme is presented for the almost indefinite deferral of tax on royalty income from a copyright work.

Chapter 3 (The Zero-Tax Trust) leaves the shores of the UK to explore the benefits which might flow from the use of a trust in a tax haven jurisdiction, rather than the more standard offshore company. As many readers will be aware, “tax haven” jurisdiction in relation to a

trust can include, among others, Australia, New Zealand, Israel, South Africa, and the United Kingdom, since all have a tax system such that a resident trustee of a trust established by a non-resident is not taxable on trust income arising outside the jurisdiction. The main point of interest is the extent to which such a trustee can benefit from various tax treaties.

The second half of this chapter includes a longer treatment of the use of the two types of international trust which are available in Barbados. These are of particular interest in relation to income sourced in the United Kingdom, Canada and the USA, since Barbados has relevant treaties with all three jurisdictions. There is a detailed analysis here of certain provisions of the treaties and the related Barbadian legislation: this type of analysis is otherwise rare in *More Essays* but it is certainly useful here. For example, we learn of the use of a "shield trust" in order to preserve treaty benefits.

Chapter 3 culminates with a specific discussion of the use of Cyprus trusts and Cyprus low tax companies, and in particular the extent to which they may enjoy the benefits of Cyprus' extensive treaty network with other European countries. The discussion is topical and up to date (including, for example, a general discussion of the recent treaty amendments and the current status of Cyprus' double taxation treaties with the former Soviet Union and with the former Yugoslavia). This is the type of information and analysis which it must surely be difficult to find elsewhere.

Chapter 4 (The Offshore World and the UK Taxpayer) should cause the reader to stop and re-assess the current prevailing view that there is now no advantage available to a UK resident and domiciled individual through using an offshore company or trust to hold certain assets. The real issue here is how to circumvent s.739 ICTA 1988 and/or s.13 TCGA 1992 (in conjunction with s.77 TCGA 1992, in the case of trusts). Those sections of course have the effect of attributing respectively the income and the gains of any offshore vehicle to the UK resident individual who established the structure. But perhaps it is possible to sidestep them?

One way to get around s.13 TCGA 1992 is to establish a company such that each individual investor in question has less than a 10% stake in the company. (In essence the purpose of this legislation is not to penalise genuine equity investments in overseas companies, but only to tax the holders of “personal” or “family” companies, although the 10% test is something of a blunt tool to achieve that objective.) The use of a stake below the threshold is a well known approach which is often discussed but rarely implemented in practice. *More Essays* examines some of the practical implications of this type of structure, since it could potentially be used as a collective investment vehicle which is worthy of considerably more interest from offshore financial institutions.

A more advanced way to avoid s.13 is through the use of a Thin Trust combined with an offshore company,

in the reverse sense from how that might usually be done. This is an extremely interesting idea but I will say nothing more about it here: full details are in Chapter 4 of *More Essays*.

In relation to income tax, two alternative mechanisms are proposed to allow a UK resident and domiciled investor to invest in an offshore portfolio of investments, without triggering a charge to tax under s.739 ICTA 1988. *More Essays* frankly accepts that these mechanisms may be difficult to implement in practice. Like several of the schemes which are presented here for consideration by individuals, these mechanisms do depend on locating an existing offshore investor who is willing to sell an existing substantial offshore structure, for a suitable price. Of course in practice such persons do exist, in particular if the price is right, but locating them and bringing the parties together to a satisfactory conclusion calls for an intimate knowledge of the offshore world which few possess. As the author says, "I have only seen a few examples of these kinds of structures over the last forty years, and if they had ever become really popular, they would surely have been stopped already."

All of this is merely leading up to the pièce de résistance, a vehicle which, if the various practical obstacles can be overcome, has the potential to avoid (or defer indefinitely) both UK income tax and UK capital gains tax, and also to escape source country taxation (if there happens to be an appropriate double taxation treaty: Spain is the example discussed) — and all of this,

even though the ultimate beneficial owner remains UK resident and domiciled.

Offshore limited partnerships (for example under the Jersey Limited Partnerships Act) are discussed, for example as a means to change the source of business income where the business is conducted by a UK-resident non-domiciliary. To extend these same benefits potentially to UK domiciled individuals, the contingency principle from Chapter 2 is reintroduced, here in relation to a UK-offshore partnership, and a novel vehicle termed the “offshore discretionary company”.

Finally in Chapter 4, there is a discussion of the UK capital gains tax “market value” rule (s.17 TCGA 1992) and how this may, in certain circumstances, result in either a chargeable gain which is significantly less than the actual profit arising on disposal, or a base cost which is close to current market value. The reduction in the disposal consideration requires a combination of circumstances which would not unusually arise naturally (although it sometimes may), and the suggestion is that to create those circumstances artificially would amount to *Ramsay*-type avoidance. The method leading to an uplift in base cost has no such drawbacks, other than that it needs to be implemented before the investment is first made, that is to say probably many years before disposal. One is reminded of the question: “When is the best time to plant a forest?”, the answer of course being “20 years ago.”

Chapter 5 (International Tax Planning through Life Assurance) concerns the use of life assurance bonds as a

“wrapper” for investments. This is a well-established concept in tax planning, for example there is a well-known structure called a “personal portfolio bond” (Milton Grundy reminds us that it was he who invented that structure, and indeed that name for it, in the 1970s). There are of course two key elements to any use of life assurance as a wrapper. First, the policyholder does not own the investments directly, nor does he have any beneficial interest in them: instead he has the insurance company’s contractual obligation to him which is designed to be of equal value (so long as the insurance company remains solvent, which insurance companies tend to do with certain spectacular exceptions). Second, the person who is beneficially entitled to the investments is an insurance company which may benefit from tax-free investment income and gains.

It is the second benefit which is explored in Chapter 5, in an international tax planning context. In particular the chapter concerns the use of an insurance company which is tax resident in a “high-tax” jurisdiction like the United Kingdom (there is also discussion of Ireland and Luxembourg), issuing a policy to a resident of a different jurisdiction. Such an insurance company may be in a position to claim treaty relief from source country taxation: in particular there is a detailed discussion of the US-UK treaty, since that 2001 treaty has “anti-treaty shopping” provisions which are normally notoriously effective.

Assuming that the underlying investment needing a tax shelter consists of, not a standard portfolio of quoted

securities, but shares in a private company or a more exotic (from the perspective of an insurance company) investment such as a copyright, there are of course obstacles to setting up an insurance company which will be able to hold that investment. The UK and many other jurisdictions have strong regulations for the insurance industry which govern, in particular, the type of assets in which insurance companies may invest so as to secure their liabilities. It is suggested that Ireland and Luxembourg may have a less restricted approach, so long as the liability precisely matches the value of the asset in question: that would be similar to the approach of a traditional offshore insure. Even so, it is probably difficult finding an insurance company in Ireland or Luxembourg which is open to this type of business: some names are suggested in Chapter 5. An alternative structure, making use of a company which is tax resident in the UK but doing no insurance business in the UK, is also proposed.

As can be seen, much of the scope of Chapter 5 is not really tax planning, it is more planning one's way around insurance regulations. Other than the treaty aspects, the tax planning itself is fairly straightforward and follows automatically if the appropriate insurance structure can be set up. Planning around insurance regulations is a newer field of endeavour than tax planning, and consequently less mature; there are also fewer individuals with any experience of it although in a slightly different context my own brother (currently at Royal & Sun Alliance) happens to be one of them, as a consequence of which I am aware that while

developments in this area are fast-paced, there are opportunities which arise from time to time.

The final chapter, Chapter 6 (A Place in the Sun) is all about retirement, and in particular retirement to a different jurisdiction accompanied by an effective change of domicile for inheritance tax purposes. This is an idea familiar to any UK tax practitioner, and we have all said to the client with an inheritance tax problem, "Of course, you could just emigrate". Most clients demur: they expect any decent tax adviser to find a way to reduce the inheritance tax bill while they continue to live at home in the UK. Chapter 6 will provide the answers if your client instead happens to say, "Well yes, that is an attractive idea and it would certainly be sunnier too, but where exactly do you suggest we emigrate to?". The chapter covers France, Italy, Spain, Portugal, Greece, Cyprus, Malta, Gibraltar, Guernsey, Monaco, Switzerland and also (less known for their sunny climate, but at least they are close to home) Ireland and the Isle of Man.

The facts set out in Chapter 6 have been verified by members of the International Tax Planning Association (ITPA) practising in the relevant jurisdiction, which of course makes it a hugely valuable resource. Given that, a surprising aspect is that for at least two of the jurisdictions discussed, it is reported that there is a culture of systematic under-declaration of investment income by retirees, to which the authorities may even turn a blind eye: this seems thoroughly alien to any UK tax practitioner.

Would I recommend this book? I certainly would recommend it to anyone offering tax planning advice to private individuals, both because it is inherently an interesting read, and because some of the ideas in it may thus find application. It is also surely required reading for anyone seeking to design innovative offshore products or services for high net worth individuals. I was reminded of Pirandello's play "Six Characters in Search of an Author". There are at least six good tax-planning ideas here in search of a client and they deserve to be more widely known.

¹ Published in January by Key Haven Publications.