Section 739 And Foreign Domiciliaries: Some Reflections

Michael Flesch, Q.C.

The favourable – indeed bizarre – tax treatment of a UK resident who has the good fortune to be domiciled outside the UK (“a foreign domiciliary”) is very much in the news at present. This is therefore an opportune moment to reflect on one particular aspect of this tax treatment, namely the application of section 739 to a foreign domiciliary. (All statutory references are to ICTA 1988.)

Section 739 provides, in essence, that where a UK resident individual (who set up the structure) has “power to enjoy” the income of a non-resident entity, then that income is deemed to be the income of that individual for all income tax purposes. That is the basic rule. But as one might expect, a UK resident foreign domiciliary is accorded favourable treatment under section 739: just how favourable is, however, sometimes not fully appreciated.

Section 743(3) is the provision that confers a measure of protection on a foreign domiciliary. It provides that

“An individual who is domiciled outside the United Kingdom shall not be chargeable to tax in respect of any income deemed to be his by virtue of [section 739] if he would not, by reason of his being so domiciled, have been chargeable to tax in respect of it if it had in fact been his income.”
This is generally assumed to mean that, where the income in question has a non-UK source, a foreign domiciliary will only be taxable on it under section 739 insofar as the income is remitted to the UK. But I believe that the protection afforded to a foreign domiciliary by section 743(3) goes much further than that.

Let us take a simple example. Suppose our UK-resident foreign domiciliary, Mr. X, forms and subscribes for shares in a non-resident company.¹ If the company invests in, say, UK land Mr. X will, in principle, be liable to tax under section 739 in respect of the (net) rental income as it arises to the company. So much is clear.

But suppose the non-resident company invests in non-UK land. The rent paid to the company will certainly not be taxable on Mr. X under section 739 insofar as the company retains the rent outside the UK: see section 743(3). No-one would disagree with that. But in my opinion Mr. X will still not be liable under section 739 if, in the tax year following receipt of the rent, the company is liquidated, the land and the monies comprising the rental income are distributed to Mr. X in the liquidation and he then remits the monies in question to the UK.

The reason for Mr. X’s non-taxability is as follows:

¹ If Mr. X purchased the shares in the non-resident company he would not in any event be liable under section 739.
When considering the section 739 liability of a foreign domiciliary in respect of non-UK source income one must test the position either at the time of actual receipt of the income in question by the non-resident entity or, at latest, at the end of the year of assessment in which the income arises to the non-resident entity. There is in my view nothing in section 739 itself, or in section 743(3), that tells us that a subsequent remittance of that income can affect the situation.

The position in this respect can be contrasted with the provisions relating to settlor interested settlements, i.e. section 660A et seq. The settlement provisions afford – and have always afforded – some protection to a foreign domiciled settlor in respect of non-UK source settlement income. Indeed, until the ‘tidying-up’ of the settlement provisions in 1995 the position as I have described it in relation to section 739 applied equally to the settlement provisions. But in 1995 there was inserted – rather sneakily – a new concluding paragraph to section 660G(4), the subsection designed to protect foreign domiciliaries. The effect of this final paragraph is that a subsequent remittance of non-UK source settlement income will in principle trigger a liability to income tax. But – and this is the important point – there is no provision in section 739 et seq. which corresponds to the last paragraph in section 660G(4).
Thus, a foreign domiciliary will always (absent a section 741 defence) be liable to tax under section 739 in respect of UK source income. But he will not, in my view, be liable to tax under that section in respect of foreign source income even if that income is subsequently remitted to the UK, provided that the remittance takes place in a later year of assessment.

Five further points should be noted.

First, the above conclusion does not depend in any way on the source-ceasing rules – although these rules can, in an appropriate case, afford a further defence to a section 739 charge.²

Second, Mr. X in the above example could not be taxed under section 740 in respect of the money remitted to the UK. This is because inter alia the Revenue accept – rightly in my view – that a section 739 transferor who is not liable to tax under that section because of section 743(3) cannot be assessed instead under section 740: see Revenue Interpretation 201 (April 1999).

Thirdly, given the final paragraph of section 660G(4) the ‘loophole’ described above is likely to be relevant only when the section 739 non-

resident entity is an offshore company rather than the non-resident trustee of a settlement.

Fourthly, if in the above example the non-resident company had *dividended* its rental income to Mr. X he would, if he remitted the dividend to the UK, be taxed on that dividend income under Case V of Schedule D, unless he could take advantage of the source-ceasing rules.

Fifthly – and perhaps most importantly – the view advanced above as to the inter-action of section 739 and remittances is not one that I have seen expressed elsewhere. It is unlikely to be shared by the Inland Revenue. So readers should beware! But if there is a flaw in the argument then I would be grateful if someone could point it out to me.

************

Reference was made earlier to section 740. The keen-eyed reader will have noticed the words “*inter alia*” in the relevant paragraph. The point I have in mind can be illustrated as follows.

Suppose the company in the above example had been funded not by Mr. X but by Mr. X’s father, who subsequently gifted all the shares in the company to Mr. X. Since, on this assumption, Mr. X was not the ‘creator’ of the offshore structure he could not be liable to tax under section 739.
But there remains the possibility of a liability falling on Mr. X under section 740.

Section 740, in essence, imposes a charge to income tax on a UK resident who “receives a [capital] benefit” from an offshore structure where there is within the structure income which could have been used to benefit him. And again, as one would expect, there is a provision designed to protect a foreign domiciliary from a section 740 liability in certain circumstances. In particular, section 740(5) provides that insofar as the income within the structure is not UK source income, the foreign domiciliary will not be liable to income tax in respect of any “benefit not received in the United Kingdom”.

Reverting to the above example, Mr. X is in principle probably vulnerable under section 740 since, as owner of the shares in the offshore company (following his father’s gift), he could have received dividend income from the company. And on the winding up of the company Mr. X receives in capital form an amount (reflecting the rent) that he could have received as dividend income.³

Suppose, however, that on the winding up of the offshore company the money distributed to Mr. X is first paid into an offshore account in Mr.

³ It is arguable that this is not in fact a “benefit” within section 740 since Mr. X receives no more than the value of his shares: but let us leave this particular argument on one side.
X’s name. And then suppose that, say, 3 months later Mr. X transfers that money into his UK bank account.

In those circumstances is Mr. X caught by section 740? Or is he protected by section 740(5)? The answer depends on whether or not Mr. X’s capital benefit (i.e. the money distributed in the liquidation) was “received in the United Kingdom”.

In my opinion Mr. X is, in the above circumstances, protected by section 740(5). This is because the only benefit Mr. X received was received by him, from the company, outside the UK. When, three months later, Mr. X brought the money to the UK he was merely transferring money he already owned from one bank account to another. And that is not, in my view, the receipt of a benefit within section 740(5).  

Putting it another way, just as one cannot step into the same river twice, so too one cannot receive the same benefit more than once.

Again, I have not seen this argument advanced by other tax practitioners – although there are some Indian tax authorities that support my view. The Revenue are unlikely to agree with me. The result is

---

4 The ‘incorporation’ of section 65(6) to (9) into section 740 does not, in my view, affect the position in this respect.
certainly unintended. But again, if there is a flaw in the analysis would someone please put me right.