NOT ALL BENEFITS ARE TAXABLE

by Michael Flesch, Q.C.

Mr. X, who is neither resident nor domiciled in the UK, establishes a non-resident discretionary trust for the benefit of his two adult children, both of whom are UK resident and domiciled. Mr. X transfers £1m. to the trustees, who invest the money outside the UK in income producing assets and accumulate the income. Six months later Mr. X transfers a further £1m. to the trustees, who immediately use the money to purchase a flat in London for the rent-free use of one of Mr. X's children, Ms. Y.[1]

Clearly Ms. Y receives a "benefit", as a result of living rent-free in the flat. But is the benefit liable to income tax? In particular, is Ms. Y taxable under section 731[2] et seq. by reference to the income accumulated in the trust?[3] Rather surprisingly, perhaps, the answer is: No.

And the reason, shortly stated, is as follows. The only "relevant transfer" is Mr. X's first settlement of £1m. It is *that transfer*, together with the "associated operations" relating to it, that results in income becoming payable to the non-resident trustees: see sections 716(1) and 719. But the benefit to Ms. Y is not "provided out of assets which are available for the purpose as a result of" that first transfer/associated operations: see section 732(1)(a)-(c). The benefit is provided out of Mr. X's second transfer of £1m. (plus the related associated operation) – and that second transfer/associated operation never generated any income. The key point to notice in this connection is that Mr. X's second transfer of £1m. is not an "associated operation" in relation to his first transfer of £1m.: see again the definition of "associated operations" in section 719.[4]

It should, however, be noted that if Mr. X's two transfers of £1m. had been made by a single disposition, or in circumstances where they constituted a single '*Ramsay*

transaction', then Ms. Y's "benefit" would be taxable under section 731 et seq. Similarly, Ms. Y would have a tax liability if any part of the £1m. first transferred by Mr. X was used to maintain or repair the flat.

But subject to these considerations the non-taxability of Ms. Y's benefit appears to be incontrovertible. The point is not a new one. It is referred to in a number of the text books. But it is surprising how often the point is overlooked: and it can often be relevant when considering the UK income tax implications of an offshore settlement to which there have been multiple transfers.[5]

Endnotes

1 Mr X is not troubled by the potential 10 year anniversary IHT charge. The flat will be sold before then.

2 All statutory references are to the Income Tax Act 2007 unless the contrary is indicated.

3 Readers can assume that the exemptions in sections 737 to 742A – no tax avoidance purpose etc. – will not apply.

4 The position might arguably be different if the wider IHT definition of "associated operations" had been used: see section 268(1)(b) of the IHT 1984.

5 If Mr X had sought advice from GITC prior to his second transfer of £1m. he would have been advised to make a new, separate settlement. But then this article would never have been written!