

OFFSHORE LONDON

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Those who live in the United Kingdom do not think of their capital city as an offshore centre. Quite the contrary. But those who do not live in the United Kingdom have found ways of doing business with a British face but without a British tax liability. This may facilitate doing business with customers whose local law prevents them from making payments to jurisdictions regarded as tax havens, or refuses to allow such payments to be deducted in computing their profits for tax purposes. And the image of the United Kingdom is undoubtedly that of a high-tax country: a tax inspector outside the United Kingdom, coming across a UK vehicle in a taxpayer's file, is not thereby stimulated to look for some tax avoidance scheme. On the other hand, the investment and professional services provided by the City make such an important contribution to the GDP, and one cannot avoid the impression that the tax system has been to some degree shaped so as to encourage foreigners to make use of those services without thereby exposing themselves to tax.

Let us take for our first example the UK partnership of which all the members are non-resident. The United Kingdom does not tax partnerships as such. The partners are taxed on their share of the partnership income. It follows that if the partner is non-resident and the source of the partnership income is outside the United Kingdom, he has no liability to UK tax. Let us call this the "Tax-favoured Partnership". Picture, then, a Tax-favoured Partnership carrying on a business of buying refrigerators in Nigeria and selling them in Greenland. If all its sales contracts are made outside the United Kingdom, the source of the profit will be outside the country and be

outside the tax charge. The best way of ensuring that the business is carried on abroad is by having an office abroad which makes the sales contracts, but it is sufficient if all offers for sale are – and can be shown to be – accepted abroad. It makes no difference if the partnership has a UK office or holds partners’ meetings in the UK. No tax consequence flows from the Partnership having a non-interest-bearing UK bank account. These rules apply, whether the partnership is a simple (or “open”) partnership, a limited partnership or a limited liability partnership. Partners in an open partnership are fully liable for partnership debts, and the partnership interests are UK assets for inheritance purposes. One solution to these problems is for the partners not to be individuals but offshore companies owned by individuals. This is a popular structure: it is easy for the client to understand, it is not prone to UK Inheritance tax and it of course frees the individuals from liability for partnership debts. There are two kinds of limited partnerships. There is the old kind, formed under the 1907 Act, and the newer kind – called a “limited liability partnership” – formed under an Act passed in 2000. The essential difference is that under the earlier Act a partner cannot have limited liability if he participates in the management of the firm, but under the later Act he can. Like the “open” partnerships already discussed, they give rise to tax liability only on income with a UK source, but they have the great advantage of having a registered number, which makes it easier for the partnership to open a bank account and do business in civil law countries.

Our second “British Face” is the UK-resident trust company which is trustee of a settlement made by a non-resident and non-domiciled settlor and has a non-resident co-trustee. The trust is treated as non-resident for income tax and capital gains tax purposes. Let us call this a “Tax-favoured Trust”. Picture, in this case, a UK-resident and – taxpaying company. It is called Brodsky & Grundy Refrigerators Ltd. It carries on abroad the

business of selling refrigerators, as before. It does so as trustee of a Tax-favoured Trust, but customers, or other outsiders, do not necessarily know that. This is not an unintended loophole but the opposite: Parliament has expressly provided a tax-free regime for the Tax-favoured Trust. The upshot is that the UK-resident trustee is fully taxable on profits and gains it makes for itself, but the trust is treated as a separate, and non-resident, person. As a result, capital gains and foreign income can accrue to the trust, without attracting any UK tax. Again, we have to remember that the United Kingdom has a far-reaching Inheritance Tax and partnership assets and bank deposits should be kept abroad. Can a Tax-favoured Trust get the benefit of tax treaties to which the United Kingdom is party? It seems, in a way, anomalous that it should, and the question in each case will be for the non-UK jurisdiction to decide. But our experience is that trustees generally get treaty relief without argument, whether the trust is Tax-favoured or not.

Older readers will remember the days when the zero-tax non-resident English company was a popular offshore vehicle. It was based upon the rule that a company is resident where its business is managed and controlled. It made no difference where it was incorporated, so it could still be tax-free even if it was incorporated in England & Wales – or, for that matter, in Scotland or Northern Ireland. These days came to an end on the 15th March 1988, since when a company incorporated in any part of the United Kingdom is resident there for tax purposes. But the old non-resident company was re-invented in 1994, in consequence – and it was probably an unintended consequence – of s.249 of that year’s Finance Act, by which a company incorporated in the United Kingdom, but qualifying as a resident of some other country for treaty purposes, is to be treated for domestic purposes as not resident in the United Kingdom. Section 249 is now gone but similar provision has been made in section 18 of the 2009 Corporation Tax Act.

Let us call a company which benefits from section 18 the “Tax-favoured Company”. At first blush, it does not look like a very interesting provision. Who would want to avoid tax in the United Kingdom in order to have the pleasure of paying tax in some other country? But that line of thought does not take into account the fact that some countries do not tax – or do not fully tax – all the income of all their residents, and the United Kingdom has treaties with several of them. Take Barbados, for example. A company resident there but incorporated elsewhere has a local tax regime which echoes the UK provisions applicable to individuals who are resident but not domiciled there. Accordingly, a company incorporated in the United Kingdom but resident in Barbados will pay local tax on its foreign income only to the extent – if at all – that such income is remitted to Barbados. The United Kingdom has many treaties with countries which tax on a territorial basis, and each of these may be considered for the residence of our third “British Face”, the Tax-favoured Company.

A website might also be a British face and the Revenue do not consider that a website alone amounts to a permanent establishment. Accordingly, the ability to run a business from abroad but with a UK face remains and, with all the changes that have come in the remarkable year of 2020, it is now much more than a theoretical possibility. It does not make sense to pay London rents (or rates) when business is conducted over video calls and the UK must consider its tax strategy carefully in the coming years now that a villa in the sun can exist with a British face. But for those who wish to “try” working abroad before returning in a few years, be careful: there are tax traps which tax those who dare to leave may encounter in their year of return.

A person may strive for a British face without a correlative tax liability. Rather less often does a person strive for a British tax liability without a British face. It may not surprise the

reader however than such occasions do now arise more frequently and indeed more dangerously. The clearest example of this phenomenon is the taxation of UK property. It used to be thought that we wanted foreign investment in our property market because more property was good and brought prices down. Now it is bad (or at least, less good) because the wealthy buy property and keep it empty and so we should tax foreign owners of UK property.

On 1 April 2013 capital gains tax became payable on gains made on the disposals of dwellings subject to the annual tax on enveloped dwellings, irrespective of the residence status of the person making the gain. In 2015 certain non-residents were brought within the charge to capital gains tax when disposing of UK residential property. In 2016 non-resident persons carrying on a trade of dealing in or developing UK land became subject to income tax or corporation tax. And now non-residents are liable on the disposal of interests in UK land whether residential or not. There are similar provisions in other parts of the tax code and those with offshore structures with links to UK property should consider the implications carefully.

This is not so much a slippery slope as a cliff jump and not so much a tax creep as a sprint. The sprint will pick up speed if the Government begins to tax capital gains at the same rate as income. Have these changes increased the tax take? The amount of tax revenue actually raised is beside the point when it is a vote winner, and raising tax from those who do not vote often seems like a very good idea to those who do.