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UK Taxation Possibilities of Jersey Foundations

It may be the case that UK residents (whether or not domiciled in the UK) will wish to incorporate Jersey Foundations in preference to either Jersey trusts, or Jersey companies.

This note assesses the possible tax planning points arising from incorporating a Foundation on behalf of a UK resident Founder and/or UK resident beneficiaries.

The conclusions below are based on John Dewhurst's presentation and the subsequent open discussion session held at Savoy Place on 30 July 2009. A very informative presentation followed on the nature of Jersey Foundations given by Christopher Scholefield.

Characterisations of the Foundation under UK law

- The Jersey Foundation is a body corporate and will therefore be a "company" for UK income tax and capital gains tax purposes.
- Although the Foundation does not have shareholders or members, it is considered unlikely that HMRC could classify it per se as a trust.

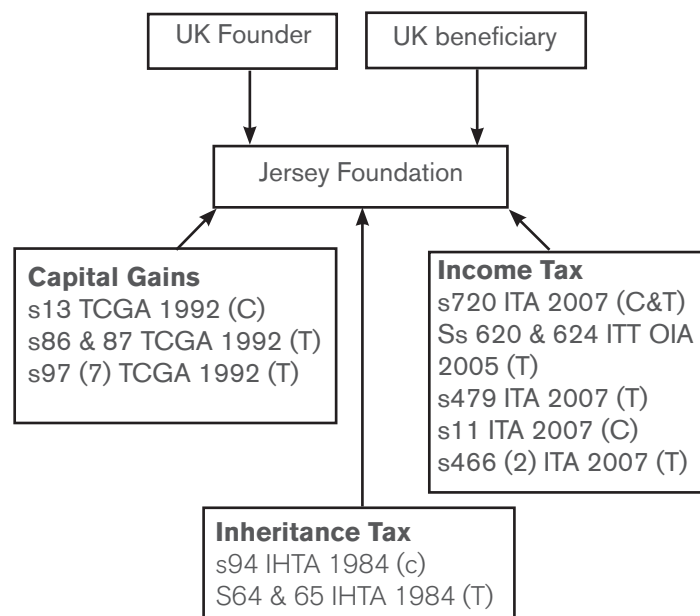
However it has certain potential trust-like characteristics which could bring it within the broad definition of a trust provided by the so-called "Settlement Code" now contained in ITTOIA 2005.

- Therefore the Foundation can be regarded as having hybrid features, with much depending on the construction of its Regulations. John Dewhurst referred to the chameleon-like

quality of the Foundation. This should prove to be a strength, but the danger of double tax charges resulting from a hybrid state will need to be watched.

The principal direct taxes

For the panel session, the anti-avoidance rules for capital gains tax, income tax and inheritance tax were identified and examined. The anti-avoidance rules are represented in the diagram below. Whether the legislation is directed against companies (C) or trusts (T) or both (T & C) is indicated in brackets next to the relevant legislation.



Capital gains tax : s13 TCGA 1992 (C)

- s13 TCGA applies to companies which are close companies (i.e. controlled by five or fewer 'participators').
- A participator has a share or interest in the capital or income of the company and 'participator' includes holders of voting rights and persons entitled to acquire rights to receive distributions or to secure that income or assets of the company will be applied for his or her benefit.
- It was felt that HMRC would seek to treat named beneficiaries as participators to enable apportionment of Foundation gains. However this could be vigorously challenged where no-one has been granted an entitlement to any part of the assets of the Foundation, because no person would then have any "share or interest in the capital or income".
- It was suggested therefore that a Jersey Foundation should not appoint any beneficiaries prior to or at the time of a capital gain being realised.

Capital gains tax : s86 TCGA 1992 (T)

- s86 is directed against UK resident settlors who create offshore discretionary trusts. It attributes the gains of the settlement or trust to the settlor on an arising basis if he or a related person (e.g. a child or grandchild) may benefit under the trust.
- For s86 to apply there must be "property held in trust". It was noted that it is Robert Venables' view that s86 cannot therefore apply to Jersey Foundations, as its property is not held in trust.
- This could be a significant potential advantage of the Foundation for UK resident and domiciled clients. Nevertheless it is for discussion whether the assets of a Foundation which has not appointed beneficiaries but in respect of which the Founder has written a Letter of Wishes expressing a desire to benefit certain persons amount to "property held in trust". Does the fact that the Council of the Foundation has no fiduciary duty towards the persons named in the Letter of Wishes mean that the Foundation's assets are not properly held in trust?

Capital gains tax : s87 TCGA 1992 (T)

- s87 attributes the gains of offshore trusts (where s86 does not apply) to UK resident beneficiaries who receive capital payments from a trust.
- It was felt that there was no doubt that s87 could apply to UK resident beneficiaries of Foundations as a broader definition of trust is used for s87, than is used for s86 (see s97(7) TCGA 1992).
- Nevertheless it was noted that s87 does not tax trust or Foundation gains on an arising basis; there is scope for unlimited deferral; and trust or Foundation gains can be washed out via capital payments to non-UK resident beneficiaries.

s94 IHTA 1984 : Inheritance Tax (C)

- s94 could be applied to levy IHT charges on UK resident participators based on the value of gifts made by the Foundation. Nevertheless for the reasons mentioned above when dealing with s13 TCGA, a Foundation is not likely to have participators where no person has been granted an entitlement to any part of the assets of a Foundation.
- The definition of "participators" is even narrower than is the case for s13 TCGA 1992 (see s102 IHTA 1984).
- It was felt that the dangers of a s94 charge could be challenged on the same principles discussed in the context of s13 TCGA 1992.
- s94 would not in any event be in point for non-UK domiciled participators in respect of gifts of excluded property made by a Foundation.

s64 and 65 IHTA 1984 (T)

- Sections 64 and 65 levy ten yearly and exit charges of up to 6% of the value of relevant property held in trust.
- One needs first to consider s43(2) IHTA 1984 to determine if a Foundation holds property either a) "in trust", or b) "by trustees on trust".

- It was felt that a Foundation would not come within a) or b) because a Jersey Foundation is the beneficial owner of its assets, and owes no fiduciary obligations to the beneficiaries. As Christopher Scholefield remarked, a Foundation is essentially a “deal” between the Foundation and its beneficiaries.

- However, one still needs to worry about whether a Foundation is “equivalent in effect” to a trust.

- On this point it is difficult to give a precise answer, but much is likely to depend on the drafting of the Regulations.

- If the Foundation does not appoint beneficiaries at the outset, and is not obliged by its Regulations to make gifts, and there is no duty upon the Council to give special consideration to a particular person or class of persons, it may be possible to avoid the ten yearly and exit charges. If this is not possible, it leaves the Foundation in the same position as a trust.

Income tax : s720 ITA 2007 (T & C) and s624 ITTOIA 2005 (T)

- It was noted that both these anti-avoidance provisions can apply to attribute income arising to the Foundation to a UK Founder.

- Charges under s720 and s624 are on an arising basis.

- Charges are subject to the remittance basis for non-UK domiciled but UK resident Founders.

- There appeared to be no particular advantage to the Foundation as opposed to the trust or company in relation to these anti-avoidance rules.

- However, it was noted that if the Founder and his or her spouse or civil partner were irrevocably excluded, then s720 and s624 could be avoided for the Founder. This still left open the possibility of income tax charges arising to other UK beneficiaries who received benefit from the Foundation. Nevertheless such charges on non-Founder beneficiaries gave the possibility of deferral of UK tax and with appropriate planning, avoidance.

- It was noted that where Founders and their spouses or civil partners are excluded, the taxable person would be the Foundation itself. Foundations would be taxed at the basic

rate of income tax on UK source income (20%) where no beneficiaries had been appointed (query the position where a Letter of Wishes indicates that the beneficiaries were likely to be appointed in the future). Where a Foundation has appointed beneficiaries and is clearly a trust, the tax on UK source income will be 40% (rising to 50% in 2010).

Conclusion

The Jersey Foundation's widest application will be as a “corporate trust” for civil code settlors, many of whom will not be resident in the UK.

Nevertheless the Foundation is likely to be used in future as an alternative to the trust for UK Founders.

In particular there are likely to be UK CGT advantages to be obtained in using Jersey Foundations.

There may also be UK income tax advantages compared with trusts, where the Founder and his or her spouse or civil partner are excluded from benefit (to avoid s624 and s720 charges) and the Foundation is receiving UK source income.



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