CHARTER TAX

Helpsheet

Offshore Trusts – Closely Related Beneficiaries and Onward Gifting Rules

Background

Following the introduction of the concept of 'protected settlements' from April 2017, HMRC did not want to allow the provisions in relation to offshore trusts/structures to become too generous.

In particular, they wanted to discourage any possibility for funds to be paid by trusts to individuals considered as close family members in relation to the settlor, where those close family members would not be paying tax on the trust distribution. They also wished to discourage "onward gifting" of trust funds from non-UK residents to UK residents.

With this in mind, the transfer of assets abroad legislation, the settlements legislation and the stockpiled gains legislation have all been amended to provide a further basis of charge in two circumstances:

(a) where trust distributions are made to close family members of the settlor (generally, spouses and children) who will not be taxed on the money as they are either non-resident beneficiaries, or UK resident beneficiaries who pay tax on the remittance basis but who do not remit the distribution made to them; and

(b) where distributions are made to non-UK residents, or UK residents who claim the remittance basis, and the distributed funds, or assets derived from them, later find their way back to a UK resident beneficiary.

The changes to the transfer of assets abroad legislation were introduced first, followed by equivalent changes to the settlements legislation and the stockpiled gains legislation a year later.

The legislation covering these areas is lengthy and complex. This helpsheet seeks to provide an outline of the rules and the issues arising; however, we would always recommend that detailed advice is sought to see whether the rules will impact on your own particular circumstances and we will be happy to discuss this further, if required.

Who is a "close family member"?

A person is a close member of the family of the settlor if the person is:

(a) the settlor's spouse or civil partner; or

(b) a child of the settlor, or of a person within paragraph (a), if the child has not reached the age of 18.

In this connection:

(i) two people living together as if they were spouses of each other are treated as if they were spouses of each other; and

ii) two people of the same sex living together as if they were civil partners of each other are treated as if they were civil partners of each other.

The rules for determining the amount on which tax is due varies slightly depending on which part of the legislation is in play, i.e. transfer of assets abroad, settlements and/or stockpiled gains. Essentially, HMRC wants to ensure that an income or gain benefit will be taxed either on the recipient or – if the recipient is a close family member in relation to the settlor but not himself taxable on the benefit – taxed on the settlor (if the settlor is a UK resident).

What is an "onward gift"?

Where an offshore trust makes a distribution to a non-UK resident beneficiary or to a UK resident beneficiary who is a remittance basis user where, in either case, tax will not be paid on that distribution because the recipient himself is not taxable on it, if that distribution, or an asset derived from it, is later gifted to a UK resident settlor or beneficiary, HMRC will seek to tax the UK resident in the tax year that they receive that onward gift.

The key conditions for the onward gifting rules to apply are:

(a) a payment ('the original payment') is received in a tax year (the payment year – *which can be before or after April 2018*) by X from the trustees of a settlement;

(b) at the time of the receipt, there are arrangements or an intention to pass on the whole or part of the original payment directly or indirectly;

(c) it is reasonable to expect that in the event of the whole or part of the original payment being passed on as intended to the donee by X, the donee will be UK resident when he receives it;

(d) X is not a close family member at a time when the settlor is UK resident (as otherwise different rules apply);

(e) X makes directly or indirectly a gift ('the onward payment') to the donee within three years of the distribution – or at any time before the original payment is received where it is reasonable to assume this was in anticipation of the receipt from the trust.

(f) the gift includes the whole or part of the original payment (from the trust) or anything that derives its value from the original payment;

(g) the donee is in fact resident in the UK in the tax year in which the onward payment is received; and

(h) X is non-UK resident or a remittance basis user.

It should be noted that, if the gift to the donee (or other UK resident person) is made within three years of the distribution to X, it is likely to be presumed – unless the contrary can be shown – that there was an arrangement in place at the time of the distribution to make the onward payment. The burden will be on the donee to show there was no such arrangement.

The rule will generally apply if the onward gift by X takes place within three years of a trust distribution and the rule affects all onward gifts after April 2018, even if the original payment to X is made before this date. In effect, it will be necessary always to look three years back from the date of the onward payment.

Interaction between close family member rules and onward gifting

If the onward gift were to be made to a close family member who is UK resident, but who claims the remittance basis, and the funds are not remitted to the UK (i.e. that individual would not otherwise pay UK tax on the gift), the close family rules come into play and the settlor will be taxed on the onward gift if he is UK resident (although this does not apply if the settlor is UK-domiciled, instead the settlor attribution rules would probably apply).

Note, however, that where the settlor has to pay tax on the onward gift as a result of the close family rules, he has the option to obtain a certificate from HMRC to confirm the amount of tax paid so that he can seek recovery from the beneficiary concerned.

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