Tax Representation

TAX FACULTY

TAXREP 16/08

TRUSTEE RESIDENCE: OVERSEAS TRUST COMPANIES: DRAFT GUIDANCE

Memorandum submitted in March 2009 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to an invitation to comment on draft guidance published on 27 January 2009 by HMRC

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ICAEW Tax Faculty, Chartered Accountants' Hall, PO Box 433, Moorgate Place, London EC2P 2BJ www.icaew.com/taxfac	T +44 (0)20 7920 8646 F +44 (0)20 7920 8780 E taxfac@icaew.com

TRUSTEE RESIDENCE: OVERSEAS TRUST COMPANIES: DRAFT GUIDANCE

INTRODUCTION

1. We welcome the opportunity to comment on the draft guidance published on 27 January 2009 by HMRC at http://www.hmrc.gov.uk/cnr/trust-res.htm.

2. Details about the Institute of Chartered Accountants in England and Wales and the Tax Faculty are set out in Annex A. Our Ten Tenets for a Better Tax System which we use as a benchmark are summarised in Annex B.

KEY POINT SUMMARY

3. The policy change in Finance Act 2006 from where general administration was carried out (a term that was widely understood and on which there are court decisions) to branch/agency/permanent establishment has imposed a complex new regime. Whilst the concept of a permanent establishment can be made to work for a company, it is not appropriate for a trust, and the uncertainty resulting from the new rules is not appropriate to a self assessed tax system and is therefore contrary to our Ten Tenets for a Better Tax System. The most practical approach would be to revert to the test of where general administration is carried on.

4. As to the draft guidance, whilst the authors have made a valiant attempt to interpret the new rules, the lack of conclusions in many of the examples highlights the difficulties that the new rules impose on trustees.

GENERAL COMMENTS

The law

5. The policy change in Finance Act 2006 from where general administration is carried out (a term that is widely understood and on which there are court decisions) to branch/agency/permanent establishment has imposed complex new rules. Trusts are different from companies so trying to apply the company concept of a permanent establishment to trusts is flawed. The new rules create great uncertainty, which is contrary to our Ten Tenets for a Better Tax System (Annex B), and judicial comment in one area may have unintended impact on the other. We also think that in the years ahead the absence of a clear and simple test to determine trustee residence is likely to lead to sterile debate between trustees/advisers and HMRC, trustee caution and consequent loss of business to the UK.

6. The difference in treatment between different types of organisation, ie corporate or non-corporate trustee, is discriminatory; similarly, the burden that would be placed on an overseas trustee who wished to operate a permanent establishment (for other but related purposes) in the UK is a disincentive to such establishment. In the light of these issues, we question whether the rules and guidance conform to the freedoms enshrined in European law.

7. In a self assessment tax system it is essential to have residence rules which are easy to understand and apply.

8. We believe that greater certainty would be achieved if the existing aligned trust residence rules were retained and section 69(2D) TCGA 1992 and section 475(6) ITA 2007 were deleted. This would mean that trustees would no longer be treated as UK resident when the trustee acts as a trustee in the course of a business carried on through a 'branch, agency or permanent establishment' in the UK.

The guidance

9. In the circumstances, we congratulate the authors of the draft guidance for their valiant attempts to interpret the new rules, but the lack of definitive answers to the examples in the guidance is not helpful.

10. We note that the guidance seem to attach great weight to whether trustees talk to beneficiaries whereas the most that beneficiaries can do is express a view.

11. The basis for the limitation of the definition to permanent establishment for companies only is unclear. At the very least this must be clearly stated.

12. The guidance addresses in detail questions concerning non-resident corporate trustees, but does not cover in any detail the situation of non-resident non-corporate trustees, for example, individual partners of a non-resident professional practice. We should welcome clarification of whether it is intended that comment on that situation will be published.

13. We would welcome clarification on the status of the guidance. Taxpayers have long found that HMRC guidance, for example IR20, cannot always be relied upon.

DETAILED COMMENTS

14. Our comments are set down below by reference to the numbering adopted in the draft guidance.

Part 1: Background

Branch, Agency or Permanent Establishment

15. Condition B at paragraph 7 asks the question that if the corporate is carrying on a business in the UK is it carrying on that business through a permanent establishment in the UK? The commentary states that this "means that the corporate trustee is carrying on the activities from which it **substantially derives its profits**" (emphasis supplied). The clear inference here is that if the company does not substantially derive its profits from this source, then the test is not answered. It is not clear how the independent trusts tax adviser will be able to answer this question without having access to the current management accounts of the company concerned. Then there is the problem that the percentage share of fiduciary or other services may vary as the company's activities change under commercial usage or as a result of imposed business reorganisations by its owners or parent company. How is an independent trust adviser expected to know details of such changes or access such information?

It is extremely unlikely that the trust officer assigned to dealing with a trust's affairs will have access to this level of information either.

16. The commentary to Condition C provides that while a corporate trustee might be acting in relation to one trust through a fixed place of business in the UK, other trusts must be considered separately by reference to their facts and circumstances. Again this will mean that the independent tax advisers for the trustees and the beneficiaries will have to scrutinise in detail the precise way that the corporate trustee operates in practice. This could be time consuming and depends entirely upon the cooperation of the trustee company, and the information made available to them. We would greatly prefer a simpler and more readily applicable system that offers greater transparency and certainty. Whilst the rules that applied prior to 6 April 2007 may not have been ideal, they did offer greater certainty, and were therefore more aligned than the current rules with our Ten Tenets for a Better Tax System (see Annex B).

Core activities

17. Paragraphs 8-10 seek to differentiate between activities which are auxiliary or preparatory. This is an important area, as the guidance here should enable practitioners to assess when core activities are undertaken. For this reason we were puzzled that at 9.5 'accounting, making tax returns and record keeping' are expressed to be core activities. Where these activities are undertaken would not seem to be relevant as regards the location where the essential fiduciary duties of the trustees are undertaken. If this test is to be applied, it would seem to be more relevant to identify where the trustees undertook their essential fiduciary duties which would include the approval of the accounts and the UK tax returns.

18. In paragraph 11 we agree that the right approach is to look at where the core activities are carried out. This is a qualitative test rather than a quantative one and so we cannot see the relevance of frequency. To meet regularly with investment managers to hear of their approach or to receive news on developments is not core. Nor is meeting similarly with beneficiaries to ensure that the trustees are aware of their changing circumstances. What matters is where the trustees take the decisions on investment strategy or distributions that make use of that preliminary information. In our view trustees could meet beneficiaries every month in the UK without carrying on core activities in the UK.

19. We are concerned about cases where trustees seek advice from counsel in London, say in relation to litigation with beneficiaries or in connection with the preservation of trust assets, or suing their advisers for negligence. These clearly all constitute key elements of the trustees' fiduciary duties. Would the simple fact that the trustees sought advice in the UK be problematic? If at the meeting in London they decided together with their legal advisers to instigate legal proceedings, could that make them UK resident or to be safe would they have to fly back to their offices in Zurich or the Channel Islands before proceeding further?

Part 2: Examples and scenarios

Part 2, Section 2: Trustee carrying out work for the administration of any trust – Examples 2-2b

20. The objective behind these examples appears to be to examine whether the corporate trustee is carrying on the business of a particular trust in the course of their

business through the permanent establishment. The particular point of emphasis is whether the frequency of the meetings will be looked at as well as their significance and quality.

Example 2

21. In this example the trustees meet with their investment managers simply to collect purely factual information. Presumably the information could simply have been sent to them by mail or electronically, so the meeting was not really required.

22. We should welcome clarification of whether the position would have been different had the trustees discussed with their investment advisers:
    - A change in investment strategy in view of the current market conditions, or
    - Selling shares in certain sectors in the immediate future, or
    - How to raise funds.

    We do not think it should be different as these are not core activities.

23. Our concern is that if trustees are unable to discuss key decisions whilst in the UK (lawyers, counsel, brokers, and bankers), the pre-eminence of London as a financial, legal and accounting centre may be undermined. As a result we would like a lot greater detail about what trustees can and cannot discuss or decide whilst in the UK.

Example 2a

24. It is said that the decisions taken outside the UK 'are in reality merely "rubber stamping" all the UK work'. As a result it is said that the Trust is resident in the UK. Unfortunately this example does not address the trust law background. If the trustees were acting as mere ciphers, none of their decisions would have any legal validity. We would refer you to the case of *Turner v Turner* [1984] ch. 100 where the trustees did not direct their minds to the decisions they had to make, and the exercise of a power of appointment was invalid. The question would also have to be asked as whether there was a legal sham. The issue would not be so much as to whether the trustees were UK resident, as the example pre-supposes, but as to whether any of the decisions that they had taken had any legal or fiscal consequence or whether a trust did in fact exist.

25. The text should make it clear that in this example the investment and distribution policies are prepared discussed and decided in the UK. We do not think that preparation of options in the UK would make the trustees resident if they discussed those options outside the UK.

26. We think that this example demonstrates the weakness in seeking to apply these tests in this type of situation. Trusts are not companies, and tests that seek to equate their treatment are unlikely to succeed with the degree of certainty required.

Example 2b

27. The concern here is that where trustees have UK resident beneficiaries, or significant UK assets, there may be a number of one-off meetings of this nature. As a result the guidance needs to be more detailed. If the rules are applied rigorously it is possible that trustees may decide to limit their investments in the UK, so as to reduce the potential risk of becoming UK resident. Such an approach would not appear to be in

the general interests of the UK economy, and would appear to be at variance with the policy thinking behind changes made in the Finance Act 2007 to the taxation of offshore trusts with non-UK domiciled beneficiaries. These rules seemed to have been framed in such a way as not to discourage such trusts investing in UK sited assets.

28. As to the scenario set out in the example, we do not think this is a core activity and note that the example itself comes to no clear answer which is not helpful. The trustees have correctly discussed a possible distribution with the beneficiary and indicate the conditions they would be minded to attach to it. This is normal as it would be inefficient to propose a distribution on terms to which the beneficiary would not agree. If the trustees took this background information out of the UK with them and then discussed and made the decisions outside the UK, they should not be UK resident.

Part 2, Section 3: Activities carried on for the trust other than by the non-UK resident corporate trustee, ie

Dependent agents

29. Section 3 of the draft guidance is concerned with activities carried on for the trust other than by non-resident trustees. The trust law implications of this are very complex, and do not seem to mesh with the structure of the rules. It would appear that what is intended is best summed in the following extract taken from 3.2: “If, on the other hand, the person is providing services to the trust over and above its contractual obligations to the trustee, then it may be regarded as acting in the place of the non-resident trustee, rather than simply providing a service to it”.

30. Such a person would appear to be intermeddling with the trust assets without due authorisation. The validity of any decisions or steps taken by him would be uncertain and their fiscal consequence unclear. This is because the situation you envisage would have far greater ramifications than simply whether they caused the trust to be UK resident or not. We would suggest that this simply underlines that seeking to structure residence rules that have no clear relevance to trusts and trustees, based on rules relating to permanent establishments is unlikely to make the law in this area enforceable or certain.

Part 2, Section 4: UK resident directors or other employees of a non-UK resident corporate trustee

31. Here the activities of a UK resident director or other employees have to be taken into account. It is not immediately apparent how an independent tax adviser would gain access to the information required without conducting a detailed assessment of the way the corporate trustee operated through its directors and employees. This information may not be immediately available, or may only become accessible at an excessively disproportionate cost.

32. We would welcome clarification of whether the same or different factors apply where non-UK resident employees of trust companies visit the UK.

Example 4a

33. The wording of this example is curious. The following is an extract from HMRC's view cited there:

> "If no office accommodation as at his disposal Mr Monday could still constitute a dependent agent permanent establishment of the non-resident trustee **if he has authority to do business on behalf of the beneficiaries of the trusts** i.e. more than simply meeting them and he habitually exercises that authority on behalf of his employer for the trust (emphasis supplied)".

34. There appears to be an inference that the existence of the trust can be ignored. If Mr Monday works for the beneficiaries, whatever he does or does not do can have no relevance as regards the trustees. If he works for the trustees, he will have no authority to do business on behalf of the beneficiaries. This example suggests that the legal structure of the trust is to be ignored, which cannot be correct.

SPECIFIC COMMENTS ON DRAFTING

35. Paragraph 2 on page 2 refers to the new residence rules for income tax being contained in section 475(6) ITA 2007. They are contained in the whole of section 475 (as supplemented by section 476).

36. The third bullet point of paragraph 3 is misleading with its reference to 'these rules'. The rule in the first bullet point is unaffected. Arguably the rule in the second bullet point is unaffected too but the third bullet point is merely clarification.

PCB
13.3.09

ANNEX A

ICAEW AND THE TAX FACULTY: WHO WE ARE

1. The Institute of Chartered Accountants in England and Wales (ICAEW) is the largest accountancy body in Europe, with more than 128,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.

2. The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department for Business, Enterprise and Regulatory Reform through the Financial Reporting Council. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy, including taxation.

3. The Tax Faculty is the focus for tax within the Institute. It is responsible for tax representations on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter *TAXline* to more than 10,000 members of the ICAEW who pay an additional subscription.

4. To find our more about the Tax Faculty and ICAEW including how to become a member, please call us on 020 7920 8646 or email us at taxfac@icaew.com or write to us at Chartered Accountants' Hall, PO Box 433, Moorgate Place, London EC2P 2BJ.

ANNEX B

THE TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. **Statutory:** tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.

2. **Certain:** in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.

3. **Simple:** the tax rules should aim to be simple, understandable and clear in their objectives.

4. **Easy to collect and to calculate:** a person's tax liability should be easy to calculate and straightforward and cheap to collect.

5. **Properly targeted:** when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.

6. **Constant:** Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.

7. **Subject to proper consultation:** other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.

8. **Regularly reviewed:** the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.

9. **Fair and reasonable:** the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.

10. **Competitive:** tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as **TAXGUIDE 4/99**; see www.icaew.co.uk/index.cfm?route=128518.