RPC

Wealth and trusts quarterly digest

November 2016

Our quarterly digest aims to bring you up to date commentary and analysis on key sector developments. RPC's tax, wealth and trusts teams are able to provide a wide ranging service to assist you and your clients in responding to market trends and legal developments. We would welcome the opportunity to discuss any concerns you may have and always welcome feedback on the content of our publications.

Feature

The attractions of family investment companies

With the rate of corporation tax at 20%, holding income producing investments via a family investment company (FIC) rather than personally can be an attractive option. In addition, an investment company structure also offers a way of making an outright gift, whilst still retaining a degree of control, something which may appeal to clients who wish to transfer part of their wealth to their children or other family members. more›

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Panamania

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Feature

The attractions of family investment companies

With the rate of corporation tax at 20%, holding income producing investments via a family investment company (FIC) rather than personally can be an attractive option. An investment company structure also offers a way of making an outright gift, whilst still retaining a degree of control, something which may appeal to clients who wish to transfer part of their wealth to their children or other family members.

What is a FIC?

A FIC is a private UK company holding cash or investments for a family, with family members as its shareholders. What is attractive about a FIC is the bespoke elements of its articles of association and any shareholders' agreement, which define how specific family members will benefit in their capacities as shareholders with regards to voting rights, dividends and capital distributions.

How does a FIC work?

A FIC can hold any assets, for example, cash, a portfolio of shares, or property.

In a typical scenario, parents incorporate and provide funds to a FIC. Subscribing for voting shares in a FIC enables the parents to retain control of investments and dividend flow through appointing and acting as directors of the FIC and voting on shareholders' decisions. A separate class of share can then be subscribed by the parents and gifted to their children. Such shares may be non-voting with restricted entitlements to dividends and capital. As such, the assets can be invested for the benefit of the whole family, with the older generation controlling the investment strategy and distribution of profits.

Control and protection

With the older generation retaining full control, the FIC offers inheritance tax (IHT) advantages of passing assets down to a younger generation whilst retaining a high degree of wealth protection, both to protect the funds from the inexperience of the younger generation and from being claimed by third parties in situations such as divorce and bankruptcy.

Bespoke structure

The FIC's articles of association, which is a public document, and shareholders' agreement, which is a private document, offer a bespoke structure that can be tailored to suit a family's specific needs and concerns. Parents can include provisions in these documents to specify different classes of shares, restrictions on transfers of shares, voting rights, entitlements to dividends and capital. Further provisions can be included to restrict the powers of the FIC, for example, to invest only in particular asset classes, or to allow for specific purposes such as purchasing a property.

Privacy

As with any other UK company, a FIC has to file certain documents which are publicly available at Companies House, such as articles of association, personal information relating to the directors and annual accounts.

If the family wishes to maintain financial privacy, an alternative is to use an unlimited company, which is exempt from filing annual accounts at Companies House.

Tax on creation

If the FIC is funded with cash, there should be no immediate tax consequences. The gifts of shares or other assets in the FIC to family members will be "potentially exempt transfers" for IHT purposes, which mean there will be no immediate IHT liability. The value of the gifted shares will be outside the donor's estate for IHT purposes, once the donor has survived seven years.

If assets standing at a gain are to be transferred into the FIC, this may trigger a capital gains tax liability. Transfer of stampable assets may also trigger stamp duty or stamp duty land tax.

Tax within the FIC

Most income or gains received by the FIC will be taxed at corporation tax rates, currently 20%, (decreasing to 19% from April 2017 and 17% from April 2020). Dividends received from other UK companies and most offshore companies will not be subject to corporation tax, and so may be received by the FIC tax free.

Tax on shareholders

The only tax liability at shareholder level is on shareholder distributions made by way of dividend. There will be no additional personal liability for so long as any income or gains are rolled up within the FIC.

When distributions are made, the overall tax rates on dividends from the FIC are the same as if the dividends were received on the underlying shares held personally. Tax may be deferred by delaying the declaration of any dividends from the FIC. The tax advantages of the FIC are compounded by gross funds being available for re-investment within it where the FIC is used for long-term roll-up.

Who are FICs suitable for?

FICs are not suitable for everyone, and careful consideration with regard to a family's income and capital, as well as investment objectives, is necessary. FICs are an attractive and flexible alternative to trusts and they are particularly tax efficient for clients investing in dividend-generating assets with no need to withdraw funds in the short to medium term.

FICs may also be appropriate for UK domiciliaries who are seeking to make controlled gifts in excess of their available nil-rate band, UK resident non-domiciliaries who are "deemed" UK domiciled and do not wish to use trusts.

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News

Changes in the non-domicile rules

Many advisers will have clients who are UK resident, non-domiciled high net worth individuals with substantial assets overseas. These clients have often lived in the UK for many years.

In the summer budget technical briefing of 8 July 2015, the government set out its proposed changes to the non-domicile rules, scheduled to come into effect in April 2017. An open consultation was issued on the proposed changes on 30 September 2015, and more recently a "further consultation" on 19 August 2016.

It is now expected that, with effect from 6 April 2017, an individual who has been resident in the UK for more than 15 out of the past 20 years will be deemed to be UK domiciled for income tax, capital gains tax and inheritance tax purposes from the beginning of the 16th year of residence.

In the 30 September 2015 consultation document, the government said that it does not intend that non-domiciled individuals who become deemed UK domiciled should have to pay UK tax on income and gains that are retained in offshore structures which were set up before they became deemed domiciled. The 19 August 2016 further consultation document broadly confirmed this protection although it makes various changes to certain anti-avoidance legislation instead of confirming the previous suggestion of a benefit charge in respect of benefits received by the deemed domiciled individual.

Anyone who is non-domiciled and has substantial capital assets located abroad, may wish to consider settling such assets in an offshore trust before 6 April 2017.

The 19 August 2016 further consultation document confirmed that those individuals who will become deemed-domiciled in April 2017 will be able to rebase for CGT purposes their directly held foreign assets to their market value as at 5 April 2017. Those affected by the proposed changes should consider whether they need to take any action before 6 April 2017 in order to safeguard their position.

HMRC's consultation document can be found here.

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An apple a day won't keep the Taxman away...

Ireland's relationship with Silicon Valley has been under the microscope after the European Commission slapped Apple with a whopping $14.6bn tax bill.

The Commission argued that the "sweetheart" tax arrangements Ireland made with Apple between 1991 and 2015 allowed the tech giant to avoid tax on almost all profits from sales of its products across the EU's single market, booking the profits in Ireland rather than the country where the product was sold.

The reaction in Silicon Valley, as well as the wider tech community, has been one of shock and disappointment. A group of 185 American CEOs has urged national governments of 28 EU member states to intervene, calling the attempt to recoup the underpaid tax retroactively a "grievous self-inflicted wound". "Instead of saying 'going forward, this won't be allowed' –

which seems more fair – the EU is trying to change the rules of the game retroactively. It makes little sense to me," said Om Malik of the San Francisco venture capital firm True Ventures.

A press release from the European Commission can be found here.

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Trustees and professional advisers targeted in the government's consultation document "Strengthening Tax Avoidance: Sanctions & Deterrents"

The main thrust of this consultation document is the introduction of penalties for "enablers" of tax avoidance which is later "defeated". The proposals are aimed at people who undertake transactions where tax is saved in a way which was not intended by Parliament.

The proposals envisage charging penalties on those who enable others to avoid tax, such as trustees, accountants and lawyers.

If the proposals become law, trustees and professional advisers who have "enabled" persons to avoid tax by entering into certain arrangements which are perfectly lawful may therefore find themselves on the receiving end of penalties from HMRC.

HMRC have said that these penalties will not affect those who engage in "legitimate" tax planning, but one person's legitimate tax planning is another person's unacceptable tax avoidance. Trustees and professional advisers will need to ensure that they do not fall foul of these proposals if they wish to avoid being charged substantial penalties by HMRC.

HMRC's consultation document can be found here.

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HMRC's Worldwide Disclosure Facility goes live

HMRC's Worldwide Disclosure Facility (WDF) opened on 5 September 2016, and will continue until 30 September 2018. It is available for anyone wishing to disclose a UK tax liability relating wholly or partly to an offshore issue.

Historically, HMRC has offered incentives to encourage people to come forward and "regularise" their tax affairs. However, on 31 December 2015, all HMRC offshore facilities closed. The WDF is intended to provide a "final chance" to taxpayers to come forward and provide HMRC with details of an undisclosed UK tax liability relating to an offshore issue before it begins using Common Reporting Standards data, a programme in which over 100 countries have committed to exchange information on a multilateral basis in an attempt to increase international tax transparency.

After 30 September 2018, new sanctions will be imposed in relation to any undisclosed liability which could lead to the imposition of 100% penalties.

An "offshore issue" includes unpaid or omitted tax relating to:

- income arising from a source in a territory outside the UK
- assets situated or held in a territory outside the UK
- activities carried on wholly or mainly in a territory outside the UK
- anything having effect as if it were income, assets or activities of a kind described above.

Significantly, there is no immunity from prosecution following a disclosure under the WDF and those who require the comfort of immunity from a criminal prosecution may prefer to make a disclosure to HMRC under its Code of Practice 9 procedure which will provide protection from prosecution.

Further information on HMRC's WDF can be found here.

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Panamania

The Panamanian law firm Mossack Fonesca and the so called Panama Papers leak have dominated headlines in recent months.

There are of course perfectly legitimate reasons for holding offshore investments and it is not unlawful to utilise offshore jurisdictions or investment vehicles as part of an efficient financial planning strategy. Such arrangements can provide a secure and flexible environment for investors.

In the UK, the government has set up a new task force jointly led by HMRC and the National Crime Agency, to analyse the data which has become available following the leak. HMRC is under intense political pressure to increase the tax yield in the UK and be seen to take action in relation to the Panama Papers. In such an environment, those who consider that they have complied with their UK tax obligations should be mindful that they may still come under scrutiny from HMRC. HMRC are likely to focus on areas such as domicile and whether offshore companies are centrally managed and controlled from the UK and therefore UK resident for tax purposes.

The Panama Papers come at a time when many governments and their tax authorities are concerned that some taxpayers avoid or evade tax by holding money or investments outside their territory of residence and fail to declare income and gains in that territory. To combat this concern, a number of agreements and arrangements are now in effect. From 1 January 2016, all UK entities are potentially subject to the following four tax information exchange regimes:

- United States Foreign Account Tax Compliance Act
- Crown dependencies and Gibraltar regulations
- the Common Reporting Standard
- EU directive on administrative co-operation in tax matters.

The above do not only relate to large traditional financial organisations. Many trusts and personal investment companies will also be caught by the definition of "financial institution".

HMRC's sophisticated systems will be able to analyse the information it receives (whether the source of that information is the Panama Papers or otherwise) and we expect HMRC to carry out a thorough review.

This is a complex area and innocent mistakes can occur. Those affected will need to ensure that they have fully complied with all their legal obligations.

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Black letter law

Variation with a view to profit

Pemberton v Pemberton (unreported)

The court confirmed variation of a settlement on the basis that no beneficiary, current or future, would suffer as a result.

The estate had been in the same family for more than 300 years. The settlement, which the claimant sought to vary, had been created by his grandfather in 1965. There were a number of beneficiaries with interests in possession, namely, the claimant, his children and his father. The intention of the variation was to overhaul and extend the life of the trusts. In summary, the proposed variation would set the perpetuity period running for a further 125 years, add modern investment powers, preserve the existing life interests but widen the class of beneficiaries to spouses including civil partners and those in same-sex marriages, and take the settlement out of the Settled Land Act 1925. If the variation was not approved by the court, then the parties would create new trusts using the existing powers, but that would be less satisfactory and would not achieve some of the benefits of a court-sanctioned variation, such as extending the perpetuity period.

Held

The court was satisfied that the proposed scheme to vary and resettle the trusts was a proper one for approval. It conferred significant benefit on the minor beneficiaries and no minor, unborn or unascertained beneficiary would be worse off. It was for the benefit of the family as a whole and had been agreed to by the adult beneficiaries. The more modern settlement terms had the effect of removing uncertainty. Because the variation would create no real detriment, it only had to be shown that there was a modest benefit. There was a financial benefit in the postponement of tax and a non-financial benefit by increasing the class of discretionary beneficiaries. The court therefore exercised its discretion to approve the variation.

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Being held accountable

(1) RNLI (2) British Red Cross (3) Guide Dogs for the Blind Association (4) RSPCA (5) Leonard Cheshire Disability v (1) John G A Headley (2) Kevin A McCole[1]

The court has approved disclosure of trust accounts to beneficiaries as they were deemed necessary to appreciate their rights vis a vis the trustees.

Where a trustee had persistently failed to provide accounting information to the beneficiaries of a trust created in a will, the court considered whether the beneficiaries were entitled to information about the income, expenditure and distributions of and from the trust fund, as well as information about the accounts of the trust estate.

The claimant charities sought an order that the second defendant solicitor provide them with estate accounts.

The first and second defendants were the executors of a will. The will created two life interests for adult beneficiaries. Upon both their deaths, the estate would fall into the possession of trusts for the benefit of the claimants. The estate was administered in 1996 and one of the adult beneficiaries was still alive. The defendants provided some estate accounts in 2007, but despite several requests by the claimants during 2014 and 2015 for more information, none was provided. Proceedings were brought on 2 February 2016, by which time the first defendant had

1. [2016] EWHC 1948 (Ch).

died. The claimants sought disclosure of proper particulars and accounts of (i) the property comprising the trust estate; and (ii) the income, expenditure and distributions of the trust, in each case for the period since 1 October 2007.

Held

The court held that the trustees had to be ready to account to their beneficiaries for what they had done with the trust assets. Every beneficiary, whether in possession or in reversion, was entitled to an accounting, and to see the documents which justified that accounting. However, the issue in the instant case was what kind of accounting different classes of beneficiary were entitled to. Not all documents had to be disclosed to all beneficiaries. Disclosure depended on what was needed in the circumstances for the beneficiaries to appreciate, verify and, if needed, vindicate their own rights against the trustees in respect of the administration of the trust. That would vary according to the facts of the case. In the instant case, the claimants' entitlement was only to capital on the death of both life tenants. There was no basis for the claimants having an accounting as to the income accrued or paid to the income beneficiaries, one of whom was still alive and receiving it. The same applied to expenses being charged to income. If the defendants did not pay the income to the remaining life tenant, only she, and not the claimants, could complain about it.

The court also concluded that there was no objection in principle to the claimants obtaining an accounting as to the capital in which they were interested as remaindermen. So far as expenses and distributions were concerned, the accounting to the claimants as to capital would show what capital expenses and capital distributions had been made. Accordingly, the claimants were entitled to the accounts of capital and list of investments since 1 October 2007. They were also entitled to a breakdown of trustees' fees and expenditure, but only so far as the trustees sought to deduct such fees and expenditure from trust capital. They were also entitled to information confirming the identity of the present trustees and to be informed when their interests fell into possession. Once the second life interest beneficiary died, the claimants would also be entitled to the income accruing thereafter, and would be entitled to an accounting of everything, capital and income, for the future.

The judgment can be found here.

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Last orders

(1) Philip Thomas Baker (2) Raymond William Preedy v (1) Jonathan Anthony Dunne (2) Sarah Fenton (3) Peter Lee Dunne[2]

The court authorised trustees under a will to obtain vacant possession of a pub which was the principal asset of the trust. One of the deceased's children, who had been running the pub, had no right to possession of it. His entitlement, as a beneficiary of the trust, ranked equally alongside those of his siblings.

The claimants were trustees of the trust arising under the defendants' mother's will. The principal asset of the trust was a pub. The defendant children were equal beneficiaries under the trusts. The first defendant had been running the pub as his business. The trustees had been granted an order for possession of the pub. They had been advised that they should seek vacant possession to get the best market value. The first defendant objected and alleged that it would be a breach of trust for the trustees to seek vacant possession because the value of the premises would be increased by him remaining in possession and running the business. The first defendant offered to acquire

2. [2016] EWHC 2318 (Ch).

the freehold of the pub and threatened proceedings for breach of trust and passing off on the basis that he had acquired the goodwill in its name, logo and reputation.

Held

The court concluded that the first defendant had never had any legal or personal interest in the pub and no right to possession of it. His entitlement as a beneficiary of the trust created by his mother ranked equally alongside those of his siblings and did not include any interest in the pub. Some of the goodwill relating to the business was personal to him but inevitably much of the goodwill was adhesive to the property itself. The right to use the pub's name and the goodwill of the business was given to the trustees by the will and it was not open to the first defendant to appropriate that goodwill to himself by virtue of his occupation and use of the pub without legal entitlement. Such goodwill as was his could be taken with him. The trustees had received unequivocal advice that the value of the property with the first defendant in occupation was nil whereas it was £2.1 million without. It was inconceivable that the first defendant could safely be left in occupation of the property while a sale was taking place. The trustees had no legal means to regulate his activity and he had no legal arrangement with them. If he remained in possession there was a real risk that they would not be able to realise the full value of the property. The proposed claims by the first defendant against the trustees had emerged at an extremely late stage in the proceedings and after the order for possession had been obtained. The first defendant's passing off claim had no substance and no real prospect of success. His attempt to bring a claim against the trustees was an abuse of the court's process and should not be allowed. The trustees were accordingly authorised to obtain vacant possession of the pub against any persons in occupation and to sell it. They were also entitled to an indemnity in respect of their costs from the trust.

The judgment can be found here.

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About RPC

RPC is a modern, progressive and commercially focused City law firm. We have 79 partners and over 600 employees based in London, Hong Kong, Singapore and Bristol.

"... the client-centred modern City legal services business."

At RPC we put our clients and our people at the heart of what we do:

- **Best Legal Adviser status every year since 2009**
- **Best Legal Employer status every year since 2009**
- **Shortlisted for Law Firm of the Year for two consecutive years**
- **Top 30 Most Innovative Law Firms in Europe**

We have also been shortlisted and won a number of industry awards, including:

- **Winner – Law Firm of the Year – The British Legal Awards 2015**
- **Winner – Competition and Regulatory Team of the Year – The British Legal Awards 2015**
- **Winner – Law Firm of the Year – The Lawyer Awards 2014**
- **Winner – Law Firm of the Year – Halsbury Legal Awards 2014**
- **Winner – Commercial Team of the Year – The British Legal Awards 2014**
- **Winner – Competition Team of the Year – Legal Business Awards 2014**
- **Winner – Best Corporate Social Responsibility Initiative – British Insurance Awards 2014**

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