All you need to know about

Private Capital

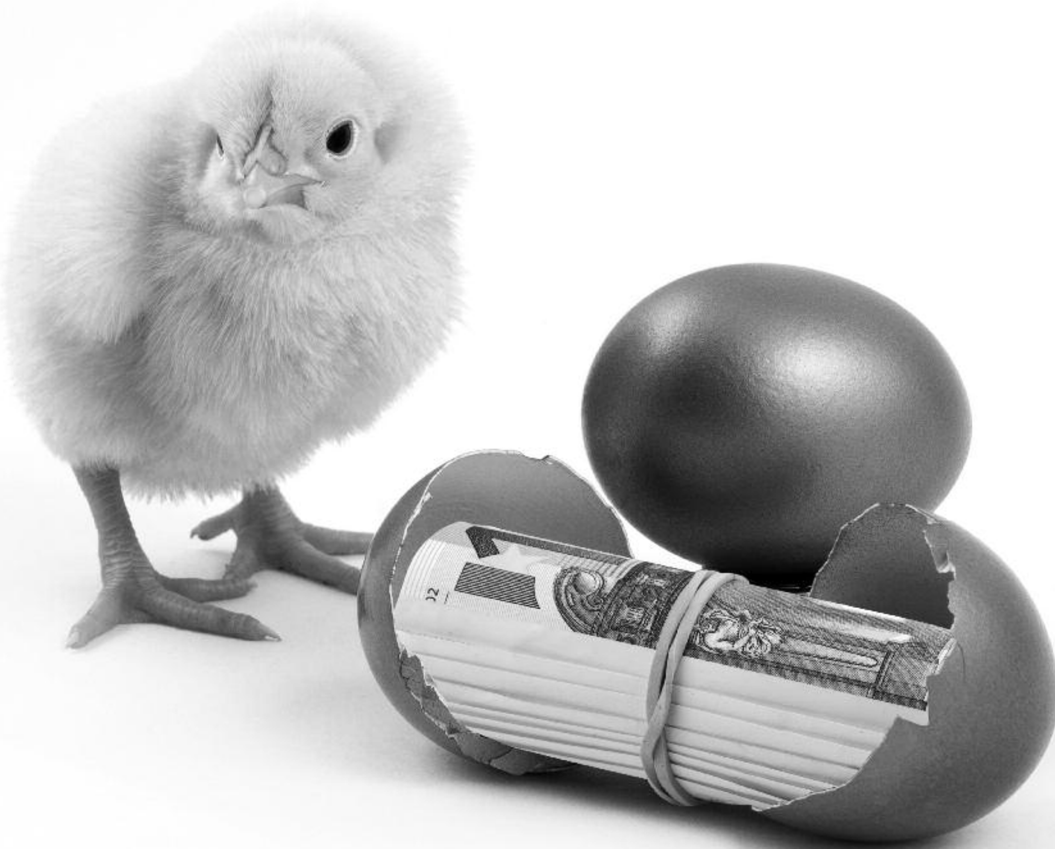
IN THIS ISSUE

Gaines-Cooper appeal – ongoing relevance

Family Courts – trust nemesis?

Surrender or compromise? The UK/Swiss tax agreement

French tax changes



LG

Newsletter Issue Number 10 Winter 2011

the angle

PC Angle 10 Winter 2011. © 2011 Lawrence Graham LLP. All Rights Reserved.

Gaines-Cooper – ongoing relevance

Two interesting points arise from a recent Supreme Court decision in the joint appeal in *R (on the application of Davies and another) v The Commissioners for Her Majesty's Revenue and Customs and R (on the application of Gaines-Cooper) v The Commissioners for Her Majesty's Revenue and Customs.*

Nicole Aubin-Parvu
Associate
T/ +44 20 7759 6827
E/ nicole.aubin-parvu@lg-legal.com

Private Capital

The first is in relation to the need for a 'distinct break' in the pattern of a taxpayer's life in the UK for him or her to become non-resident. In the Court of Appeal decision in the same case, Moses LJ stated that achieving a distinct break would require 'severance of social and family ties'. Wilson LJ has clarified the position, indicating that 'severance' pitched the requirement at too high a level and that a distinct break would instead encompass a 'substantial loosening' of such ties. Many taxpayers and advisers will be grateful for this clarification.

The second point relates to the issue of legitimate expectation of a taxpayer in relation to the construction of HMRC guidance or HMRC's settled practice in applying such guidance. The case confirms and indicates that HMRC accepts that, if either the proper construction of HMRC guidance or HMRC's settled practice in interpreting it is more benevolent to a taxpayer than the general law, a legitimate expectation arises which requires that the taxpayer's tax status should be determined in accordance with that more benevolent interpretation.

In this case, the appellants were arguing the legitimate expectation point in respect of the then Inland Revenue's guidance in relation to the residence and ordinary residence of individuals published in the 1999 edition of their booklet, IR20.

Wilson LJ held that IR20 should have been much clearer in its exposition, but that when the relevant passages were considered together, they informed the ordinarily sophisticated taxpayer of requirements to achieve non-residence which were unlikely to come as a surprise to him and which demanded a 'multifactorial evaluation of his circumstances on the part of the Revenue albeit subject to appeal'. The taxpayer might reasonably have summarised what the booklet required as a 'distinct break', as required by the ordinary law.

The majority decision (with one dissenting judgment from Lord Mance) was that the guidance in question did not give rise to a legitimate expectation that a more benevolent interpretation would be applied to the determination of the taxpayer's status.

Since IR20 has been superseded by HMRC6 with effect from 6 April 2009, the case will be of direct relevance only to taxpayers with issues in relation to their residence status for tax years prior to that date.

The two points mentioned above, however, are likely to be of more enduring interest. The meaning of 'distinct break' is part of the existing residence rules. Although a statutory residence test is proposed for tax years from 6 April 2012 onwards, unless the statutory residence test incorporates transitional rules, which the Treasury consultation suggested it would not, the existing rules for determining residence will still be relevant for a number of tax years after its proposed introduction in 2012/13. To determine how the test applies to them, individuals may need to establish their residence status in up to three tax years immediately preceding the one in question – potentially looking back to 2009/10. As such, the meaning of 'distinct break' would still be relevant to this determination.

The decision may also be of continuing importance in relation to the doctrine of legitimate expectation as it applies to the interpretation of technical guidance published by HMRC, whether with regard to residence or otherwise. This could be viewed as good news for taxpayers seeking to rely on HMRC guidance. However, given Lord Wilson's view that representations in such guidance should be 'clear, unambiguous and devoid of relevant qualifications', it may be that little of HMRC's guidance (including HMRC6) will fall within the doctrine.

Family Courts – trust nemesis?

Trusts have always been a battleground in financial proceedings on divorce. Settlors and trustees are often shocked at the seemingly cavalier way judges in the family courts of England and Wales will effectively cut through careful tax or dynastic planning in order to make an award to a less wealthy spouse where the free assets of the marriage are not deemed sufficient on their own.

Catharine Bell
Partner and Head of the Contentious Trusts and Estates Group
T/ +44 20 7759 6727
E/ catharine.bell@lg-legal.com

Different trust scenarios relevant to matrimonial orders were discussed recently in the case of *BJ v MJ (Financial Remedy Overseas Trust) [2011]* heard by Mostyn J in the Family Division of the High Court. Mr Mostyn suggested there are broadly three such trust scenarios.

The first is a trust which has the requisite connection to the marriage to qualify as a nuptial settlement within the meaning of the *Matrimonial Causes Act 1973 (the 'MCA')*. Here, an effective order varying the settlement may be made by the court under the MCA, even if the trust is overseas, either on the basis that the English court is satisfied that the overseas court will enforce its order or because trust assets are within the jurisdiction and direct power of the English court.

The second is a scenario typically referred to as 'judicious encouragement' where sufficient free assets are available outside the trust to discharge the proposed order. *Charman v Charman* and *Whaley v Whaley* are examples of this scenario. Here the court expects the trustees (on the basis of their past behaviour) to make funds available to provide for the beneficiary, a large proportion of whose free assets have been awarded to their former spouse (94% in *Whaley v Whaley*). Mostyn J referred to this as the court 'indirectly encouraging [the trustee] to provide for its own beneficiary' rather than 'judiciously encouraging the trustees to make money available to the claimant'.

The third scenario is where there are few or no assets outside the trust, which is not a qualifying nuptial settlement, and a 'court might find its findings as to the likelihood of advancement are frustrated by a refusal by the trustees to do what the court expects them to do'. Mostyn J suggested that in such a case a degree of worldly realism was called for.

In the event, in *BJ v MJ,* Mostyn J found two Jersey trusts set up by the husband during the marriage, and an underlying company, to be together a post-nuptial settlement, over which the court had direct powers of variation. He gave the trustees the opportunity to comply with his suggested order of a 50% division of all assets by making certain trust distributions (which expanded on an offer they had made) and accepting a charge over the former matrimonial home, also a trust asset. At the same time, he made it clear that, if they refused to comply, he would make orders directly against trust assets within the court's jurisdiction and, therefore, within his dispositive powers. This would involve a sale of the former matrimonial home in which the husband, who is unwell, continues to live.

This case is a reminder to wealthy individuals seeking to protect their assets against the possibility of a divorce that, regardless of the location of the trustees, the governing law of the trust and the willingness or otherwise of the local courts to enforce orders of the English court, if the trust qualifies as a nuptial settlement under the MCA, any assets located within England or Wales are within the court's direct power.

Placing all or nearly all one's assets into an overseas trust which does not qualify as a nuptial settlement may frustrate the court's powers of 'judicious encouragement', as described in Mostyn J's third scenario. However, from a practical perspective, such an arrangement may be neither achievable nor convenient.

In the end, the pre- or post-nuptial agreement may be the best solution for wealthy individuals. Following the case of *Radmacher v Granatino* earlier this year where a pre-nup was upheld by the Supreme Court, a carefully drafted pre-nup should be upheld in the English courts unless, in the particular circumstance of the case, it would be unfair to do so. This case has recently been followed in the High Court case of *Z v Z*, in which a marriage contract made under French law has been upheld. Depite this change in the approach of the courts to such agreements, if the Law Commission's proposals for enforceable pre-nups, made in a consultation earlier this year, were to be introduced, many wealthy individuals, trustees and practitioners would consider it a welcome step forward.

On a separate note, an interesting comment in the *BJ v MJ* case was Mostyn J's assertion that he found it 'hard to see why participation by the trustees in a helpful or meaningful way in this court's inquiry qua witness could be construed as a submission to the jurisdiction'. (The trustees had been joined as parties to the proceedings but declined to participate). Trustees in Jersey and other offshore jurisdictions may be curious as to the basis for this assertion. Unfortunately, Mostyn J did not expand on his reasoning.

Surrender or compromise?
The UK/Swiss tax agreement

On 6 October 2011, the UK and Switzerland signed a tax agreement under which UK residents may be taxed on the income and gains in their Swiss accounts both retrospectively and for the future. The agreement is expected to come into force on 1 January 2013.

Nicola Weil
Associate
T/ +44 20 7759 6431
E/ nicola.weil@lg-legal.com

One of our concerns with the original proposals published in August was the lack of detail as to how UK resident non-domiciliaries would be treated. Under the remittance basis, many such individuals only pay UK tax on income and capital gains arising in, or brought to the UK, and so they might not owe any UK tax in respect of the funds they hold in Swiss accounts.

Under the terms of the agreement, non-UK domiciled individuals can ensure that they are taxed on a remittance basis on the income and gains in their accounts by providing their Swiss bank with a certificate from their lawyer, accountant or suitably qualified tax adviser confirming their non-domicile status and that they have claimed and/or are claiming the remittance basis for relevant tax years. Nevertheless, there will continue to be confidentiality concerns for those non-domiciliaries who prefer, where possible, not to disclose details of their assets.

One-off payment in lieu of past tax liabilities

A non-domiciliary with unpaid UK tax liabilities in relation to a Swiss account held on the prescribed date (expected to be 31 May 2013) can choose, like a UK domiciled individual, to make a payment of between 19% and 34% of the relevant account balance, the exact percentage being determined by the size of the account and how long it has been held. For non-domiciliaries, the one-off payment is referred to as the "capital method".

Alternatively they can opt for the 'self-assessment method', based on taxable UK source income and/or gains and non-UK income and gains which have been remitted to the UK arising from the funds in the account, but which have not been taxed in the UK. In that case, the non-domiciliary must disclose the taxable amount to the bank and instruct the bank to make a one-off payment of 34% on it.

If non-domiciled individuals choose not to make a one-off payment, whether because they do not owe any UK tax or otherwise, they have two other alternatives – they can authorise their bank to disclose their details to HMRC via the Swiss tax authorities in the same way as UK domiciliaries or they can take the 'opt-out method' by informing their Swiss bank that they choose to take none of the other options. The opt-out method may be preferred by tax compliant non-domiciliaries who wish to retain confidentiality in respect of their Swiss assets, but it does not provide clearance for past liabilities.

The individual must have selected one of the above options and provided the bank with a certificate as to their tax status by the prescribed date. Otherwise, the bank will be required to deduct the one-off payment automatically.

Withholding tax

Going forward, the UK resident account holder will be charged an annual 'withholding tax' on interest income (at 48%), dividend income (at 40%), other income (at 48%) and capital gains (at 27%) arising from the funds in their account. Definitions of the different types of income and of the meaning of capital gains are included in the agreement. The rates are being set marginally below the highest UK rates for each tax apparently to reflect the fact that HMRC will receive the funds sooner than they would have done through the usual tax reporting system. There is provision for these rates to change in line with any future changes in the UK tax rates. Any tax retained under the EU Savings Directive will be credited against withholding tax under the new agreement.

The Swiss bank will deduct the withholding tax from the funds in the account within two months of the end of each calendar year and issue the account holder with a certificate at the end of each tax year which will be accepted by HMRC as evidence that payments of withholding tax have been made.

An account holder may avoid the withholding tax by authorising their bank to disclose the income and/or capital gains arising on their account to HMRC, together with specified details about the individual.

In the case of a non-UK domiciled individual, the withholding tax only applies to UK source income and gains and non-UK source income and gains remitted to the UK if they provide the bank with a certificate that they are non-UK domiciled, and confirm that they will be claiming, and do actually claim, the remittance basis. In this case, they must notify the bank by 31 March before the start of the tax year in question that they intend to claim the remittance basis and provide the bank with a certificate confirming that they have done so by 31 March following the end of the relevant tax year.

There is no opt-out route provided for non-UK domiciliaries in respect of the withholding tax. Tax compliant non-domiciliaries who retain assets in Switzerland on or after a prescribed date following the agreement coming into force will need to take the disclosure route if they wish to avoid paying the withholding tax. For this reason, it may be that some such non-domiciliaries may choose to move their Swiss accounts to other jurisdictions before 1 January 2013.

Requests for information

The agreement also provides for HMRC to request bank account information from the Swiss authorities for a maximum of 500 UK taxpayers per year for the first three years the agreement is in force. There are provisions for this number to be adjusted upwards or downwards in subsequent years depending, broadly, upon how successful the previous requests have been in identifying unpaid UK tax liabilities.

Switzerland has also agreed to provide HMRC with information as to the top 10 destinations for funds which leave Switzerland prior to the prescribed date referred to above and the numbers of relevant persons who have moved their assets to each of those jurisdictions. No details of individuals will be included in this report. It is likely that the UK will target these destinations for future tax and exchange of information agreements.

General comments

Switzerland has already signed a similar agreement with Germany, and Greece is also in talks with the Swiss Government on this issue. Agreements in this form are attractive from a Swiss perspective as they enable Switzerland to be seen internationally to be addressing the problem of tax evasion whilst, at the same time, maintaining their reputation for confidentiality. From the perspective of HMRC and the tax authorities of other states, they provide for a much-needed injection of cash at a time when it is sorely needed.

It has not gone unnoticed, however, that the Swiss agreements bear many similarities to the EU Savings Tax Directive (‘EUSD’), albeit covering a broader range of taxes and assets. An EU Commissioner has previously commented on the UK and German agreements, noting that they may cover aspects already covered by the EUSD or the EU-Swiss agreement and that, if the bilateral agreements are found to cover areas of exclusive EU competence, the EU would not hesitate to take corrective steps. The EU Commissioners have a particular concern that the levy payable under the agreement is a lump sum rather than a tax on named individuals. Recent commentary suggests that the EU is trying to persuade Germany and the UK to renegotiate their agreements with the Swiss and, if they do not do so, it may commence infringement proceedings against them before the end of the year.

There also appears to be some uncertainty as to whether funds in discretionary trusts can be caught under the agreement.

Given these potential issues, it will be interesting to see whether the UK/Swiss agreement comes into force in 2013, as proposed, and if so, what form it takes.

French tax changes

Frédéric Mege
Associate and Head of French Tax
T/ +377 93 10 55 10
E/ frederic.mege@lg-legal.com

Two important changes for French property owners:

New French CGT regime on sale of French properties

Currently, the taxable gain is reduced by 10% for each year of ownership after the fifth year, so that the gain is totally exempt after 15 years of ownership. As of 1 February 2012 the reduction will apply as follows: 2% per year between 6 and 16 years (10 years = 20%); 4% per year between 17 and 24 years (8 years = 32%) and 8% between 25 and 30 years (6 years = 48%) so that the gain is totally exempt after a lengthy period of 30 years of ownership. For instance for a property owned for 15 complete years, the relief available is 100% if the sale occurs now (ie no CGT), but only 20% if the property is sold after 1 February 2012 (ie CGT on 80% of the gains).

French property owners who have owned a property in France for more or less 15 years and are thinking of selling in the foreseeable future might consider doing it before 1 February 2012 (even at a lower price depending on the potential future CGT). If no purchaser can be found and the sale completed before that date, they might think about restructuring the ownership of the property now to benefit from the current exemption and purge any latent capital gains for the future sale.

Restructuring now might give important CGT savings for the future provided that completion effectively occurs before 1 February 2012. In this respect, given the pre-emption rights which may apply in France, the process of restructuring should start more than two months before that date. However, before doing anything an analysis of the specific circumstances must be made to check that this costly exercise is worth implementing. In particular, taxation in the State of residence of the Seller must be checked to ensure that the CGT not due in France does not arise in that country.

Wealth tax and deductibility of loans to companies

As of 1 January 2012 shareholders' loans held by non French tax resident shareholders in French or foreign companies owning French real estate will no longer be deductible when assessing the value of the shares in the company for wealth tax purposes. In other words, such loans will no longer be considered as qualifying debts for the company.

Non French tax residents who currently rely on their shareholder's loans to avoid or mitigate French wealth tax might face a wealth tax liability next year. A refinancing or restructuring of the debts can be envisaged before the end of this year but this exercise needs to be balanced with the future wealth tax liability incurred. It might not be worth doing.

As of 1 January 2012, French sited assets of a net value of between €1,300,000 and €3,000,000 will be taxed at a flat rate of 0.25% and assets of a net value exceeding or equal to €3,000,000 will be taxed at a flat rate of 0.50%. In both cases tax will be payable from the first euro.

Important note: In order to avoid any risks of requalification by the French tax authorities of the CGT or Wealth Tax planning French anti-avoidance tax legislation must always be considered to ensure that the tax authorities cannot challenge the planning on the basis it has been implemented only for the purpose of avoiding tax.

In other news from the Private Capital team

The eighth LG Debate will take place on Monday 19 March 2012. The topic will be The Arab Spring: One year on.

If you would like to attend, please contact Paula Maycock at:

paula.maycock@lg-legal.com

Recent awards and nominations gained by the team include:

- The Private Capital team was recently commended for client service in the FT Innovative Lawyers Report 2011; and
- Alastair Glover and Daniel Ugur were named in Private Client Practitioner's 2011 'Top 35 under 35', a list of young and upcoming stars within the private client advisory professions.

Lawrence Graham LLP
4 More London Riverside
London SE1 2AU

T/ +44 20 7379 0000
F/ +44 20 7379 6854

Lawrence Graham LLP
Unit 2, Level 6
Currency House Office Building 1
The Gate District
Dubai International Financial Centre
PO Box 506503
Dubai, United Arab Emirates

T/ +971 4 437 5100
F/ +971 4 437 5101

Lawrence Graham
Est-Ouest
24 bd Princesse Charlotte
MC 98000 Monaco

T/ +377 93 10 55 10
F/ +377 93 10 55 11

Lawrence Graham (CIS) LLP
1-st Troitsky Pereulok 12/5
Moscow, 129090
Russia

T/ +7 495 799-5501
F/ +7 495 799-5502

info@lg-legal.com
www.lg-legal.com

the angle is designed to provide a summary of recent developments in tax and trust law. It does not purport to be comprehensive or a substitute for specialist legal advice in individual circumstances