Transfer of assets abroad - new rules for transfers by companies

Synopsis: The transfer of assets abroad legislation.

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The transfer of assets abroad legislation can be found in sections 714 to 751 of the Income Tax Act 2007. It is a wide-ranging anti-avoidance provision that seeks to prevent the avoidance of UK taxation by transferring assets abroad. For the provisions to apply, there needs to be a transfer of assets by a UK resident individual, where income deriving from those assets becomes payable to a 'person' abroad.

In its simplest form, it will attach to arrangements involving non-UK trusts, companies and foundations into which 'assets' are transferred by a UK resident individual. The definition of asset is very widely cast and can be sited in the UK or outside of the UK.

In addition, there is a 'motive defence' to the charging provisions (please see below), which provides an exemption where there is no tax avoidance purpose or where a genuine commercial reason for the transfer exists. INTM600160 includes a checklist of indicators of arrangements caught by these provisions.

The provisions apply when a 'relevant transfer' occurs. To counter what is regarded as an avoidance transaction, the individual who makes the transfer or who benefits from it becomes subject to income tax.

A transfer is a 'relevant transfer' if it is a transfer of assets and as a result of the transfer and / or one or more associated operations, income from those assets becomes payable to a person abroad, e.g. a trust, company or foundation that is established outside the UK.

A 'person abroad' means a person who is resident or domiciled outside the UK. The following are considered resident outside the UK...

- a body corporate incorporated and resident outside the UK;
- a UK resident body corporate that is incorporated outside the UK;
- non-UK resident trustees of a non-resident settlement;
- non-UK resident personal representatives.

Transfers by companies – new rules

From 6 April 2024, where a transfer abroad is made by close company, or a non-resident company that would be close, if it were a UK resident, the transfer is deemed to have been made by individuals who are participators in the close company. This measure, which applies for income arising to persons abroad on and after 6 April 2024, is intended to ensure that individuals cannot use a company to bypass the transfer of assets abroad provisions and that a transfer made via a company, in which the individual is an owner or has a financial interest, will be considered a relevant transfer by that individual for the purposes of the transfer of assets abroad legislation.

The measure is not intended to impact transactions where there is no tax avoidance purpose or where the transactions are genuine commercial transactions, as set out in s736 to s742 Income Tax Act 2007.

Historically, HMRC have sought to argue that where a close company makes a transfer and an individual or several individuals have a controlling interest in that company, they should be treated as ‘quasi-transferors’ and potentially taxable on an amount equal to that income.

In November 2023, the Supreme Court ruled in the *HMRC v Fisher and another* case that where a company had made a transfer, the wording of the legislation was not sufficiently broad to allow the shareholders to be treated as quasi-transferors, regardless of the size of their shareholding. This effectively meant that, where companies made transfers overseas, their shareholders would not be taxable under the transfer of assets abroad provisions.

Measures announced at the March 2024 Spring Budget, have now reversed that decision, such that a transfer made by a close company may be treated as though it is made by individuals with a ‘qualifying interest’. A qualifying interest is very widely defined and includes all participators in close companies, including shareholders and loan participators. However, those who can show they are not directly or indirectly involved in the decision making of the company are excluded.

For participators who are ‘involved’, there is a purpose test (‘the avoidance condition’) which must also be met – for the provisions to apply tax avoidance must be one of the purposes for which the transfer was carried out. Even if this is the case, it may not apply if the individual can show that they objected to the transfer. However, this may be difficult to prove retroactively, particularly for transfers that took place some time ago or involved those with minority shareholdings.

Similar amendments are being made to treat those with a qualifying interest as transferors where a close company makes a transfer and the individual later receives a capital payment under the transfer of assets abroad provisions.

Two new sections (720A and 727A) are being added to the legislation, that will apply for the purpose of preventing the avoidance of a liability to tax where an asset has been transferred to a person abroad.

The first will apply to a transfer made by a closely-held company such that it will be treated as being made by an individual with a qualifying interest, where the individual will have the power to enjoy the income arising abroad.

The second will apply to a transfer made by a closely-held company such that it will be treated as being made by an individual with a qualifying interest, where the individual will have received a capital sum as a result of the relevant transactions.

Although the rules are designed only to reverse the decision in the Supreme Court, it appears that the provisions may actually be widened for companies which have made or are making transfers to which the transfer of assets abroad provisions might apply.

Examples of relevant transfers

At the simplest level, a relevant transfer might be the creation of a non-resident trust by a UK resident individual, such that the income from the trust assets becomes payable to the non-resident trustees.

Examples that have been considered in case law include...

- a UK resident transferring shares in an Irish private company to a Guernsey trust of which he was a beneficiary. The transfer resulted in income (dividends) becoming payable to a person abroad (the trustees) - (*IRC v McGuckian* [1997] STC 908);
- a UK resident transferring overseas property to a non-UK discretionary trust. The non-UK resident trustees received the income from the property for the benefit of the transferor - *(Vestey v IRC* [1980] STC 10).

Note that the transfer does not need to be a transfer from the UK to a non-resident location. The assets may already be 'abroad'. As the creation of a trust always involves a transfer of assets from the settlor to trustees, the scope of the provisions is very wide. Trusts which are purely foreign in origin and intention, but which happen to have UK resident beneficiaries, can rely on the motive defence to exempt them from the provisions.

Matching rules

The individual receiving the benefit is subject to income tax on the amount of income deemed to be received. If the individual does not receive a benefit in the tax year, there will be no tax charge.

The deemed income is calculated by matching the value of the benefit received against the Available Relevant Income (ARI) within the trust. The whole of the benefit or payment received is taxed as income if there is sufficient ARI within the trust. If the value of the benefit exceeds the ARI, it is taxed up to the value of the ARI and the excess is carried forward to match against future income. ARI is based on the total amount of income arising in the current and previous years as a result of the relevant transfer. It is reduced by the amount of income which has been...

- used to pay expenses;
- distributed as income;
- charged to tax under the transferor provisions;
- allocated in prior distributions and charged to tax under these provisions.

ARI is calculated separately for each individual beneficiary. It is defined as the amount of income arising within the trust, which could be used for the individual's benefit. So, in the case of a discretionary trust with several beneficiaries, all of the unattributed income goes into calculating the balance of ARI for each individual and it only falls out of the calculation once it has been allocated.

Note that, where applicable, this charge takes precedence over the capital gains tax charge on capital payments under s 87 TCGA 1992.

Additional provisions relating to non-UK domiciles and non-UK residents

The benefits charge, which was originally a charge on 'non-transferors' receiving a benefit, was extended by the complex anti-avoidance provisions of Finance (No 2) Act 2017 and Finance Act 2018. The charge may apply to the settlor by default when they receive a benefit which is not taxable under the transferor provisions of ITA 2007, ss 720 or 727 as described above.

For example, a non-domiciled settlor is not taxed on foreign income (PFSI) as it arises under those provisions, but they are taxed under the benefits charge if the foreign income is paid to them.

Where the person receiving the benefit is 'closely related' to the settlor but is not taxable on it either because they are not UK resident or they are a remittance basis user, the charge may be transferred to a UK resident settlor. In other cases where the person receiving the benefit is not taxable on it either because they are not UK resident or they are a remittance basis user, but there is an intention or an expectation that the benefit will be passed on subsequently to a UK resident, the subsequent recipient becomes liable for the charge.

In the March 2024 Spring Budget, the Chancellor announced that, the whole concept of domicile in taxation is to be gradually replaced with system based on residence. From 6 April 2025, the current remittance basis of taxation (affecting income tax and capital gains tax) will be abolished for UK resident non-domiciled individuals. However, it will be replaced from the same date with a new four-year foreign income and gains (FIG) regime for individuals who become UK tax resident after a period of ten tax years of non-UK residence.

The motive defence

The provisions include an exemption for genuine commercial transactions and those with no avoidance motive. Without the motive defence, the provisions are drafted so widely that it would catch all transactions where there is a relevant transfer and the income of any overseas entity would be taxable in the hands of any UK 'transferor' on an arising basis. This exemption is crucial in allowing UK resident individuals to undertake commercial activities outside the UK. The legislation offers exemption according to three different sets of criteria according to when the relevant transaction occurred...

- before 5 December 2005;

- after 5 December 2005;
- after 5 April 2012.

The latest change arose from litigation in the European Court of Justice, in which the European Commission contended that the code was inconsistent with the EC treaty provisions on the free movement of capital. In essence, all versions of the 'motive defence' prevent the attribution of income under the code provided that there was no tax avoidance motive and that the transactions were genuine commercial transactions.

The differences between the versions hinge on the precise wording of the conditions. The latest version in ITA 2007, s 742A (introduced by Finance Act 2013) includes more detailed criteria on the nature of genuine commercial transactions and specifically excludes a liability if an individual's freedoms under the EC treaty are contravened. The onus is on the taxpayer to prove that the conditions are satisfied.

Guidance on reporting and calculating the income to be charged is given in the notes to the Foreign pages SA106 and HMRC Helpsheet 262. The full guidance is in HMRC's International Manual INTM600000 onwards. However, this is a complex area of UK tax legislation and specialist tax advice should be sought.