Technical Exchange - Issue 63

Published: 31 July 2002

Avoidance Using Isle Of Man Trusts And Partnerships

Readership

- Staff in Area offices dealing with SA taxpayers (especially RIATs and compliance teams)
- Staff examining company accounts

Contents

Summary

We have become aware of an avoidance device that aims to avoid income tax on UK business income by channelling it through an Isle of Man trust and a Manx partnership.

We need you to look out for the scheme in your examination of returns and send to the Centre for Non-Residents (CNR) details of any that you find. We want to know how widespread the scheme is and how much tax may be at stake. We will also be able to advise you on whether and how to enquire into the return.

The Scheme

The device aims to exploit the interaction between UK domestic taxation, Isle of Man (IoM) taxation and the UK/Isle of Man double taxation arrangement (DTA) to achieve double non-taxation of the income in question. Broadly, it works like this:

- UK resident individuals or their family companies have, or will have, a source of business income on which they wish to avoid paying tax. They set up a certain type of trust with IoM resident trustees and become the beneficiaries of that trust. The trustees become partners in a Manx partnership. Matters are arranged so that the business income arises to the partnership. The income may be paid to the partnership by a UK close company/family company.
- Under UK law we cannot tax the partnership or the trustees as they are non-resident. But the income of the partnership, via the trustees, belongs to the UK resident beneficiaries. This is because the trust is an "interest in possession" (IIP) trust, meaning that the beneficiaries have an absolute right to the income. We can usually tax the beneficiaries of this type of trust in exactly the same way as if the income arose directly to them. However because the scheme is set up in the Isle of Man –
- The UK/IoM DTA, which takes precedence over UK domestic law, says that the profits of a Manx enterprise are taxable only in the Isle of Man and not in the UK. A Manx partnership is

an "enterprise" within the terms of the DTA . So this overrides the UK tax charge on the beneficiaries and the income is taxable only in IoM and not in the UK. However–

- Under IoM law, partnerships are transparent entities so the partners (in this case the trustees) should be taxable on the income. But IoM law exempts IoM resident trustees from tax where the beneficiaries are not resident in the Isle of Man.

So, the result is that income is not taxed anywhere. In certain circumstances similar to this we might be able to use the anti-avoidance legislation dealing with transfers of assets abroad to tax the income, but for technical reasons it is extremely unlikely we will be able to do so here.

Although we have seen only IoM cases to date, it is possible that the device could be used in other countries.

We are considering how best to challenge the scheme. The more evidence we have of how the scheme works in practice, and the amount of tax at stake, the better.

↑ What to look for

We know that several hundred IoM trusts have been set up by UK residents, where the trustees have become partners in a Manx enterprise, in the last couple of years. These structures will filter through into the SA returns of the beneficiaries from their 2001-2 returns onwards.

The scheme may be used to avoid tax on various sorts of income. We are aware of examples of income from licence fees (royalties) and income from IT services (some people may be using this structure to get round the IR35 legislation). The following are indicators that a scheme like this may be being used:

- A claim that income is not taxable because of the terms of the UK/IoM DTA (either as part of the return or as a stand alone claim)
- Cessation of a source of income (probably business income)
- A new interest in a trust, as settlor or beneficiary, possibly with IoM trustees
- Company accounts show payment of royalties, fees, etc, to a new offshore (IoM) business/partnership, possibly disclosed as transactions with connected parties
- Involvement of new/different tax advisers

Some of the features mentioned above may also be indicators of other types of tax avoidance. See IM4620 to IM4622 for more information.

↑ Referral of cases to CNR

Where you see these features or think for any other reason this device may be in use, please send a brief summary, preferably by telephone or email, to:

John Robertson
CNR Bootle

Telephone: 0151 472 6223
Email: Robertson, John H at "FICO Liverpool"

Include the following details if possible, and any others you think may be relevant:

- Taxpayer's name and UTR
- Name of trust
- Nature of the income on which UK tax is being avoided
- Amount of income it is claimed is not taxable