



KPMG Island Group Tax Webinar Series

Offshore Trustees – *New year; old issues*

Thursday 19 January

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Introduction



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With you today



Paul Beale
Director, Tax & Head
of Family Office and
Private Clients
KPMG in the
Crown Dependencies
paulbeale@kpmg.com



Tom Neill
Tax Director
KPMG in Bermuda
tomneill@kpmg.bm



Justine Howard
Associate Director
KPMG in the
Crown Dependencies
jhoward@kpmg.co.im



Katie Kneale
Senior Manager
KPMG in the
Crown Dependencies
kkneale@kpmg.co.im



Joseph Milward
Manager
KPMG in the
Crown Dependencies
jmilward@kpmg.com

Agenda

- 01** Introduction
- 02** Common slip ups – USA
- 03** Common slip ups - UK
- 04** Questions?

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Common slip ups - USA



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Grantor or Non Grantor Trusts

Tax treatment of Grantor and Nongrantor trusts is very different

Grantors taxed on income/gains of a **Grantor** Trust on an annual basis

Beneficiaries taxed on distributions from a **Nongrantor** Trust. Tax liability can vary significantly. Planning is essential!

Establishing trust status - grantor vs nongrantor



If U.S. person made contributions to a trust with U.S. beneficiaries, **grantor trust**.



Easy to have **US beneficiaries**: if income or corpus may be paid to, or for benefit of, US person:

- If contingent on a future event, or if trustee has discretion to make distribution to *any person*, trust treated as having U.S. beneficiary
- IRS may presume that any foreign trust, to which a US person has made a transfer, has a U.S. beneficiary unless adequately shown otherwise
- Treasury Regulation example – a trust to benefit any person studying Ancient Greek is treated as having a U.S. beneficiary
- to avoid this: class of beneficiary must be specifically identified and no member of the class is a U.S. person.

Establishing trust status - grantor vs nongrantor



If non-U.S. person made contributions or gratuitous transfer to a trust which has U.S. beneficiaries, generally this is a **nongrantor trust**.



Exceptions: if grantor can revoke the trust, or if only permissible distributions during grantor's life are to grantor and spouse, trust may be deemed grantor.



Grantor trust becomes non-grantor trust on the event of the grantor's death

Establishing trust status - grantor vs nongrantor



Loans to a trust are considered contributions, unless structured correctly as a “qualified obligation”



Guarantor of a trust obligation is deemed to have made a transfer to trust, and therefore a (part) owner of the trust

Taxation of FNGTs: Three layers

First taxable on **Distributable Net Income (DNI)**. Modest tax.

Next, taxable on **Undistributed Net Income (UNI)**. Adverse tax.

If no DNI or UNI, distribution is **corpus**. Not Taxable

Taxation of FNGTs: Three layers

First taxable on **Distributable Net Income (DNI)**. Modest tax.



DNI is deemed to be **distributed first**. Beneficiaries report their share of DNI on a pro-rata basis

KEY PLANNING POINT – 65 Day Election

- Distributions made in first 65 days of Year 2 are treated as if paid in Year 1.
- Gives Trustees time to calculate, and distribute, appropriate amount of income
- Effective tool to prevent the build-up of UNI

Taxation of FNGTs: Three layers

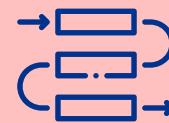
Next, taxable on **Undistributed Net Income (UNI)**. Adverse tax.



Accumulation Distributions (AD) are taxed punitively to the extent they are made from UNI. Some strategies:



Distribute to non-US taxpayer beneficiaries first. Often a multi-year strategy, advance planning is essential



Use “**Default Method**”:

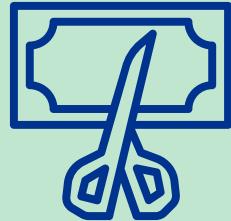
- Distribution deemed not to be UNI if < average distribution of three prior years, multiplied by 1.25
- Once chosen, must stick with ‘default’ going forward



Make Qualifying Obligations rather than loans. Can have maximum term of 5 years, must be in USD and must carry interest, plus other conditions.

Taxation of FNGTs: Three layers

If no DNI or UNI, distribution is **corpus**. Not Taxable



Restructure trust as grantor trust?

03

Common slip ups - UK

Why should trustees care?



Trustees have duty of care to beneficiaries and thus, responsibility to get it right

Litigation – a real possibility!

Reporting obligations and tax liabilities for trustees and beneficiaries

FTC penalty regime may mean higher penalties and increased scrutiny by HMRC

Losing business and potentially lengthy HMRC enquiries

CRS, FATCA, TRS, ROE, CONNECT – increased focus on offshore tax non-compliance means trustees could be caught on the back foot

The domicile of the settlor is not really what the trustees think it is

- **IHT Rule**
 - If settlor domiciled – all assets may be liable to IHT
 - If settlor non-UK domiciled – only UK assets liable to IHT
 - Trustees liable to IHT at 6% on ten-year anniversaries and when property leaves the settlement
- **Who is the settlor?**

Section 44(1) IHTA 1984: "includes any person by whom the settlement was made directly or indirectly, and ... includes any person who has provided funds directly for the purposes of or in connection with the settlement..."

 - More than one settlor?
 - Nominal / dummy settlor?
 - Indirect / conduit settlor?
- **Finance Act 2020 changes**
- **Domicile rules**

Action points:

- Review domicile status of settlor(s) with the April 2017 changes in mind
- Analyse any additions made to the trust
- Don't just take settlor's word for it – get tax advice

The trustees fail to recognise chargeable assets



Does the trust have any chargeable UK assets?

- UK assets held in non-UK company can convert UK situs assets to non-UK situs assets (if trust created by non-UK domiciled settlor) but watch out for UK residential property!
- UK real estate
- CGT/CT on direct and indirect disposals of UK real estate. NB property-rich CIVs
- ATED



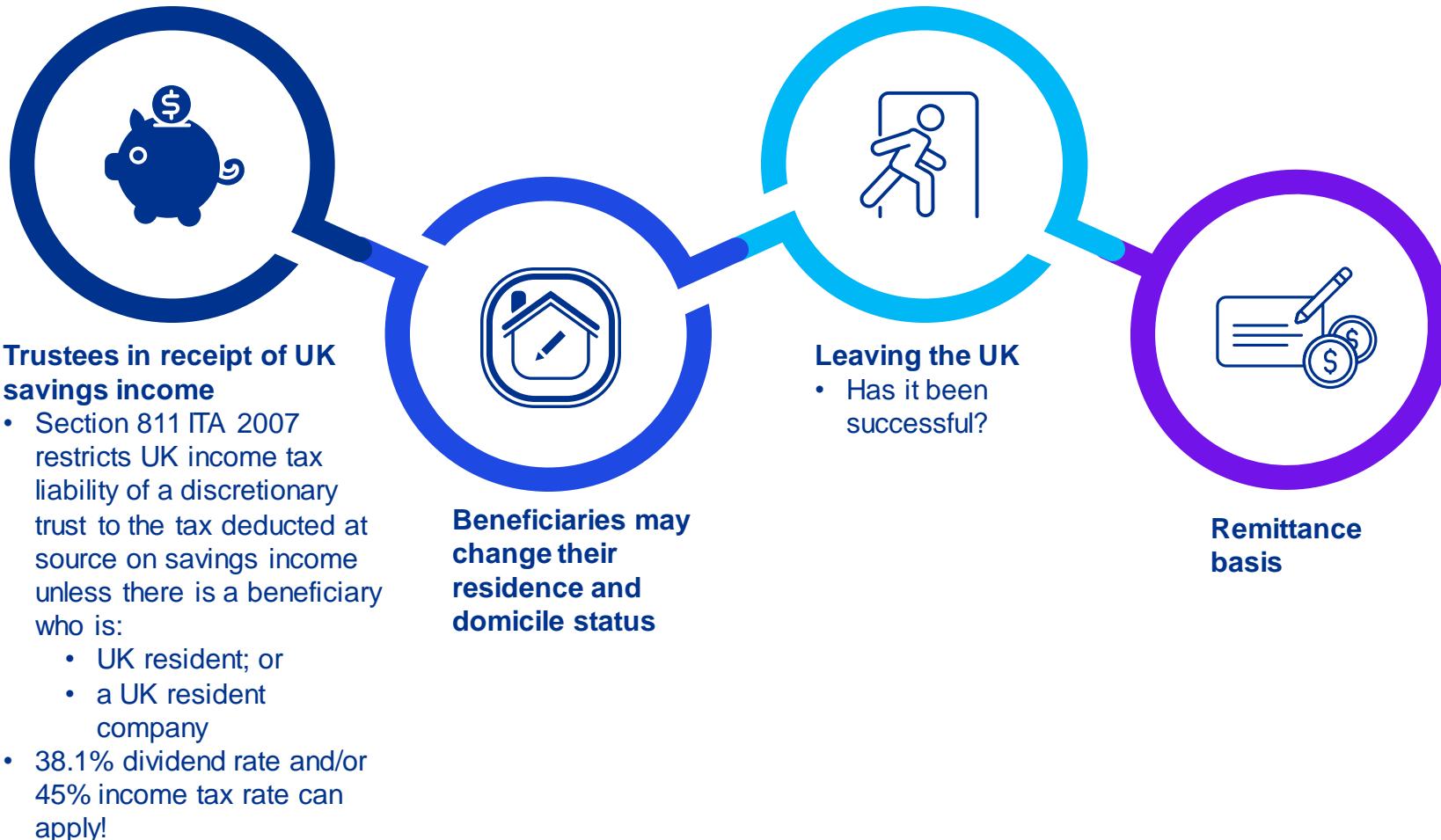
Loans to UK resident beneficiaries (whether interest free or not)

- UK situs for IHT purposes
- Interest received is UK source income

Action points:

- Keep an eye on investments and where they are located for IHT, CGT and IT purposes
- Remember that loans are located where the debtor is
- If the trustees are in receipt of UK rents, they have an obligation to make an application to receive rents gross

The trustees are unaware that a beneficiary's residence/domicile status has changed



Action points:

- Review beneficiaries' residence status annually especially where the trustees are in receipt of UK source income
- Be conscious of beneficiaries' domicile status to ensure that remittances are not made inadvertently

The trustees are not familiar with the IHT rules



Finance Act 2006 changes

- Interest In Possession Trusts can be subject to IHT when interest in possession comes to an end
- Accumulation & Maintenance Trusts also chargeable



Discretionary trusts

- When is the ten-year anniversary? Is there more than one?
- Transfers between trusts
- Distributions liable to IHT

Action points:

- If unsure, obtain advice as to whether the trust is liable to IHT.
- Keep an eye on the situs of assets within a trust
- Monitor ten-year anniversary dates
- Ascertain as to whether any distributions being made to beneficiaries are liable to IHT

IHT UK residential property code



Finance (No. 2) Act 2017 changes

- Indirect interests now in scope
- Loans to persons with interests in residential property
- Use of trust assets as security or collateral
- UK residential property held at trust level has always been relevant property for IHT. This is unchanged.
- Commercial property not in scope.



Impact

- Principal and exit charges
- Two-year tail
- Other concerns such as ATED or SDLT

Action points:

- Review trust structures where UK residential property is held or has been disposed
- Monitor ten-year anniversary dates
- Take appropriate advice before lending funds to entities in structure or affiliated persons

The settlor can also benefit from the trust



Settlor also listed as a beneficiary

- Applicable to both discretionary and non-QIIP life interest trusts.
- Settlor not irrevocably excluded
- Most relevant to trusts with UK domiciled or deemed domiciled settlors or trusts with UK situs assets



Impact

- Trust fund subject to a reservation, tax chargeable will depend on specific circumstances
- Trustees subject to tax on death of settlor
- Seven-year tail if trustees decide to exclude settlor, so advance planning required!

Action points:

- Think about exclusion of the settlor if UK situs assets held
- Review trust deed wording to see if settlor can be added as a beneficiary
- Confirm domicile and deemed domicile status of settlor

The trustees don't know how income and/or capital distributions should be taxed

- Income distributions versus capital distributions
- Trustees need to maintain accurate accounts as well as relevant income pools and stockpiled gains pool to match distributions against. The longer it goes unrecorded the harder it gets!
- Benefits provided also need to be considered and may include:
 - loans not at arm's length; and
 - beneficial occupation of a property or use of assets owned by the trustees or an underlying company
- Distributions to non-UK domiciled beneficiaries
- Trustee borrowing and trust to trust transfers
- Are beneficiaries declaring these correctly?
- NB Beneficiary may not have the money to pay the tax due!

Action points:

- Maintain good records of all accumulated untaxed income and capital gains with the trust or trust and company structure
- Monitor distributions made and identify and track benefits provided
- Understand where the beneficiaries are tax resident

The trustees unintentionally remit income and/or capital gains to the UK



What constitutes a remittance?

- Individual or “relevant person” brings to, receives, uses money or property in the UK that is, or represents, his or her foreign income or gains or property that was acquired using, or otherwise “derives from”, those foreign income or gains
- Includes foreign income or gains used to pay for services provided in the UK for the benefit of a relevant person
- A “relevant person” includes trustees of a settlement of which any other category of relevant person is a beneficiary



Trustees can unintentionally remit foreign income and gains:

- purchasing UK investments;
- using UK brokers;
- by utilising UK service providers in respect of UK assets, eg tax, accountancy or legal advisory services

Action points:

- Trustees need to ensure that if they have non-UK domiciled beneficiaries, they take care when using foreign income for any purpose

Winding up a trust and/or company structure



Immediate tax charges – CGT/CT

- Direct and indirect disposals of UK real estate all now taxable
- Stockpiled gains and relevant income issues depending on course taken
- Tax advice vital to determine whether liquidation route or dividend in specie route more tax efficient
- Missed filing obligations



Tax charges on the settlor or beneficiary

- IT/CGT depending on relevant income and stockpiled gains in the structure
- Settlor may have to pay tax if the trust is settlor-interested

Action points:

- There are various options available regarding winding up and one may be more tax-efficient than another
- Tax advice could equal tax savings!

Trust tax changes wef 6 April 2017

- Trust tax changes wef 6 April 2017 are complex!
 - New domicile rules
 - Also, a number of fundamental changes regarding:

Changes	Income Tax	Capital Gains Tax
Trust Protections	6 April 2017	6 April 2017
Close family member payments	6 April 2017	6 April 2018
Onward Gifts	6 April 2018	6 April 2018
Capital payments to non-residents	N/A	6 April 2018

Protected Trusts – in a nutshell

To be “protected”, a trust must be settled by a non-dom before they become deemed domiciled under the 15/20 rule.

A trust can never be protected when the settlor is a “returning non-dom” or UK domiciled under general law in the tax year.

No property or income can be added to a protected trust at any time from the later of the creation of the trust and 6 April 2017 when settlor deemed dom under 15/20 rule or UK dom under general law (also known as “tainting”).

Protected trust” status means:

- trust income sheltered until benefits received: usual s731 regime applies;
- trust capital gains sheltered until benefits received: usual s87 regime applies;

Failure to meet protected trust status means all income and capital gains may be taxed as it arises on the settlor – no “remittance basis”.

Once protected status is lost, it can never be reinstated.

Certain income is not protected and taxed on settlor as it arises – e.g. OIGs

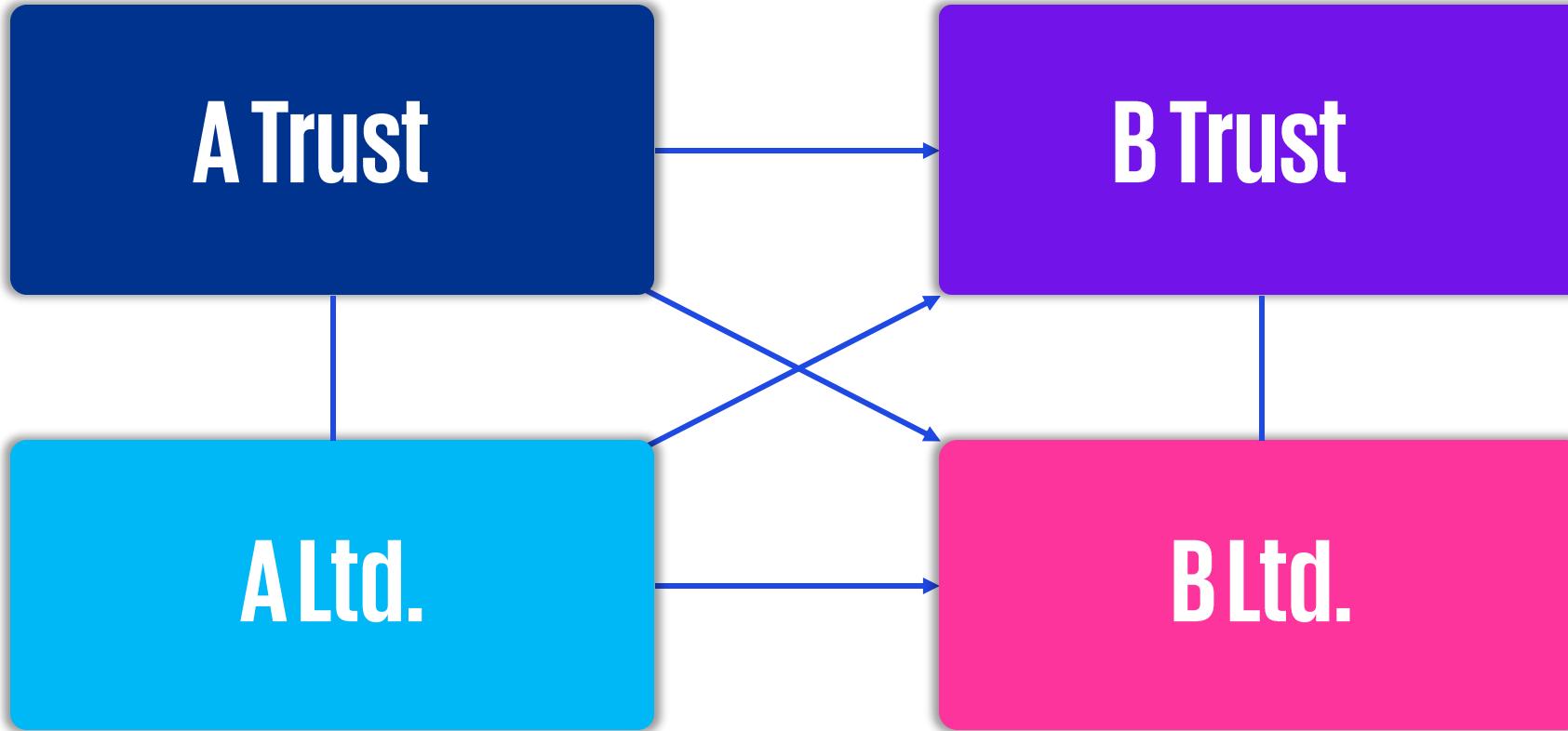
Tainting – a costly affair

Tainting is where “*property or income is provided directly or indirectly for the purposes of the settlement by the individual, or by trustees of any other settlement of which the individual is a beneficiary or settlor...*”

IE it involves adding property or value to the trust. Watch out for:

- I. Indirect additions from other trusts and underlying companies.
- II. Loans, loans and loans!
- III. Provision of the settlor’s knowledge or expertise to a settlement or underlying company.
- IV. Adding to a settlement where settlor and spouse excluded from benefit still poses a CGT risk.
- V. UK income still taxable.
- VI. IHT impact (no impact on tainting but can create separate settlement).
- VII. Offshore Income Funds.

Indirect Tainting



Action points for Trustees regarding protected trusts

- 01** NB Trust changes wef 2017 & 2018 and if unsure get tax advice.
- 02** **Identify protected trust structures and monitor them carefully.** In particular, avoid tainting protected trusts by carefully considering any transactions between the trustees and the settlor or a trust of which they are a beneficiary or indirect additions to underlying companies.
- 03** Consider planning before settlor become deemed domiciled under 15/20 rule.
- 04** Consider investment policy re protected trusts.

Questions?



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Paul Beale
Director, Tax & Head
of Family Office and
Private Clients
KPMG in the
Crown Dependencies
paulbeale@kpmg.com



Tom Neill
Tax Director
KPMG in Bermuda
tomneill@kpmg.bm



Justine Howard
Associate Director
KPMG in the
Crown Dependencies
jhoward@kpmg.co.im



Katie Kneale
Senior Manager
KPMG in the
Crown
Dependencies
kkneale@kpmg.co.im



Joseph Milward
Manager
KPMG in the
Crown Dependencies
jmilward@kpmg.com

Thank You



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