The Offshore Tax Planning Review

UK TAXATION OF NON-RESIDENTS: THE NEW SUBSTANTIVE RULES

Robert Venables QC

1 The Changes In Outline

1.1 The Background

Important changes to the taxation of non-United Kingdom residents and their agents were announced in two Inland Revenue 1994 Budget Press Statements of 29th November 1994. The first of these was called "*Investment Managers*" ("the Investment Manager Statement")[1] and the second "*Self-Assessment*" ("the Self-Assessment Statement").[2] It is quite extraordinary that the second of these Statements should deal with the new substantive rules for charging non-residents. If the Inland Revenue had sought to disguise their Press Statement, they could not have done a better job.

The Press Statements indicated that the changes would be fully operational only by 6th April 1996. The Press Statements are to some extent misleading, in that the terms of the 1995 Finance Act sometimes conflict with them. There were also substantial changes during the passage of the Finance Bill to the provisions concerning investment managers. The Press Statements are important in that they apparently contain Extra-Statutory Concessions which so far have not been published elsewhere.

In this article, I consider the substantive changes. In *UK Taxation of Non-Residents: Liability of UK Representatives*, the next article in this issue, I consider the equally important question of the liability of agents of non-United Kingdom resident persons.

---

1 Reproduced in Appendix A to the next article.

2 Reproduced in Appendix B to the next article.

1.2 Summary of Changes to the Substantive Charge

1.2.1 Pre 6th April 1995

Non-residents were in general liable to UK income tax on UK source income only. To this rule there were various exceptions:

(a) statutory exceptions - e.g., exempt government securities, eurobonds;

(b) some administrative concessions - e.g., bank interest;[3]

(c) double taxation arrangement relief.

1.2.2 6th April 1996 onwards

The present patchwork of rules and concessions under which tax is charged on non-residents will, we are told, be replaced by "clear simple rules",[4] which will be introduced in Finance Act 1996. While we are told that the "tax charge will be broadly unchanged", it will clearly be very different in certain cases. There will be a new ceiling on the amount of tax charged on most investment income. Income arising from or connected with a United Kingdom trade or profession carried on through an investment manager or broker will under certain conditions escape tax altogether. This corresponds roughly to existing ESC B40.

1.2.3 6th April 1995 - 5th April 1996

In principle, the law will not change except in one respect. A new statutory immunity from taxation of income arising from or connected with a United Kingdom trade or profession carried on through an investment manager or broker came into force this year.

1.2.4 Transitional Relief

The benefit of ESC B40 will be available for varying periods as regards arrangements set up before Budget Day 1994. See 3.6.[5]

---

3 See 2.4.

4 See the Self-Assessment Statement para 2.

5 See also the Investment Manager Statement para 14.

2 Need for United Kingdom Source

2.1 General Theory

The general theory is that a non-UK resident is chargeable to tax on income if and only if that income has a UK source. This theory is simply a rule of construction. There is no indication that this will change after 5th April 1996.

2.2 What is a UK source?

2.2.1 Some Specific Rules

Schedules A (income from United Kingdom land) and C (public revenue dividends) contain relatively specific rules which only rarely give rise to problems.

While the Cases I, II and III of paragraph 1 of Schedule E are reasonably specific, paragraph 5 is much vaguer. Territorial limitations must be implied in some cases to avoid absurdity.

Dividends and other distributions are taxable under Schedule F only if from a United Kingdom resident company.

2.2.2 Debt Claims

Examples of debt claims are loan interest or payments of annuities. The authorities are far from conclusive.[6] The old-fashioned Inland Revenue view was that everything depended on the residence of the debtor. This, in my view, was always misconceived. However, RI November 1993 [1993] STI 1413 showed a change of attitude on the part of the Revenue. Their present position is more realistic. They state:

> " ... the factors ... we regard the most important as -
>
> - the residence of the debtor, i.e., the place in which the debt will be enforced
> - the source from which interest is paid
> - where the interest is paid
> - the nature and location of the security for the debt"

---

6 The leading House of Lords authority, *National Bank of Greece SA v Westminster Bank Executor and Trustee Co (Channel Islands) Limited* [1971] AC 477; 46 TC 472, lays down little general guidance.

Although the matter is enormously complex, in my opinion, the most important factor by far is the source from which the interest (or annual payment) is intended to be paid.

It is sometimes considered that the estate duty situs rules are applicable. Under these rules, which are of considerable antiquity, if, say, interest is payable under a deed, then the situs of the right to the interest is where the deed itself is physically situate. In my opinion, these rules have no application whatsoever to income tax and should not be relied upon.[7]

2.2.4 Trading Profits

The position regarding the territorial source of trading profits is extremely complex. In this article, I shall attempt only a very brief discussion of the position.

In the old days, considerable emphasis was put on the place where relevant contracts were formed. It is clear however, from the *Firestone* case[8] that the real test is where are the profits substantially earned.

A duo of Privy Council cases on appeal from Hong Kong has served to obfuscate rather than clarify the position. In *IRC v Hang Seng Bank Ltd*[9] it was suggested that profits derived from a manufacturing trade are situate in the place of manufacture, and profits from the rendering of services in the place where the services are rendered. This seems perfectly unobjectionable. It is then stated, more controversially, that the source of income from letting property is the place where the property is let. Much more controversially, it is stated that the situs of the profits from lending money is the place where the money is lent. It is further stated that the situs of profits of dealing in commodities or securities is the place where the contracts of purchase and sale are effected and not, for example, the place where the commodities or securities are situate. Certainly, in paying little regard to the place where commodities or securities are situate, the decision must be right. Insofar as it places emphasis upon the jurisdiction in which the contracts are actually effected, as opposed to the place where the real work is done which earns the profits on successful contracts, it must be much more questionable.

Hardly had the *Hang Seng Bank* case been decided than the Privy Council decision in *IRC v KH-TVB International Ltd*[10] gave an altogether different impression. It

---

7 See, for example, *Scottish Widows' Fund v Surveyor of Taxes* 5 TC 502.

8 27 TC 111.

9 [1990] STC 733 (PC).

10 [1992] STC 723.

was held that profits derived by the granting by a Hong Kong resident company of sub-licences to exploit films in territories outside Hong Kong were "profits arising in or derived from Hong Kong". In other words, the Privy Council looked to the place where the real work was done rather than the jurisdiction where the intellectual property in the films was situate. There is an obvious conflict between the two cases.

2.3 Statutory exceptions

There are various statutory exceptions from the general rule. One is "exempt gilts". Taxes Act 1988 section 47 (government securities in beneficial ownership of non-UK residents) provides:

> "(1) The interest on securities which -
>
> (a) the Treasury have power to issue for the purpose of raising any money or any loan with a condition that the interest thereon shall not be liable to income tax so long as it is shown that the securities are in the beneficial ownership of persons who are not ordinarily resident in the United Kingdom, and
>
> (b) have been issued with such a condition,
>
> shall, subject to subsection (3) below, be exempt from tax accordingly.
>
> (2) A claim under this section shall be made to the Board."

There are theoretical difficulties in the case of securities held by trustees.[11] ESC B18, by concession, affords the relief to a beneficiary who becomes entitled to income from exempt securities in the exercise of a discretion by the trustees' of a discretionary trust. This presupposes that a beneficiary entitled to such income as of right could claim the benefit of the exemption, even though it is only the income of the securities and not the securities themselves which is in his beneficial ownership. Where no beneficiary is or becomes entitled to the income, because it is accumulated or used to defray trust expenses, the income will belong only to the trustees. It is a moot point whether they could be said to be the "beneficial" owner of the securities. *Prima facie*, they are not. However, it is arguable that in this special context, they are.[12]

---

[11] This topic is discussed in more depth in an article in the course of preparation for this *Review*: *The Alchemical Effect of Trusts on Income: the New Revenue Concession.*

[12] A similar question arises in the interpretation of double taxation arrangements, although in that case it is easier to say the term "beneficial ownership" is not being used in its technical English law sense.

2.4 Revenue Concessions and Practice

Inland Revenue Extra-Statutory Concession B13, *Untaxed interest paid to non-residents*, provides:

> "Where for any year of assessment, for the whole of which he is regarded as being not resident in the UK, a person receives interest (eg bank or building society interest) without deduction of income tax and is not chargeable under TMA 1970 section 78[13] in the name of a trustee etc mentioned in TMA 1970 section 72[14] or in the name of an agent or branch having management or control of the interest, no action is taken to pursue his liability to income tax except so far as it can be recovered by set-off in a claim to relief (eg under TA 1988 section 278, in respect of taxed income from UK sources. This concession does not apply to the corporation tax chargeable on the income of the UK branch or agency of a non-resident company or to income tax which is chargeable on the profits of a trade carried on in the UK.
>
> This concession also applies to discount, to deep gains within FA 1989 Schedule 11, to profits on disposal of certificates of deposit, to dividends paid gross by a building society and to payments representing interest in respect of a general client account within the meaning of TA 1988 section 482(6) or Income Tax (Building Societies) (Dividends and Interest) Regulations 1990, reg 2."

It should be noted that the concession operates only if the income is *not* chargeable in the name of an agent. Note also the expression "no action is taken". The concession does not apply to interest paid under deduction of tax. Taxes Act 1988 section 349(2) imposes an obligation to deduct tax wherever *yearly* interest is paid to a person whose usual place of abode is outside the United Kingdom. Section 349(3) contains exceptions.

ESC B13 will cease to operate as from 6th April 1996. No doubt, it will be replaced by regulations made pursuant to Finance Act 1995 section 127(3)(e).[15]

---

[13] For Taxes Management Act 1970 section 78, see my article *UK Taxation of Non-Residents: Liability of UK Representatives* in this issue at 3.1.

[14] For Taxes Management Act 1970 section 72, see my article *UK Taxation of Non-Residents: Liability of UK Representatives* in this issue at 3.1.

[15] See 3.4.2.1.

3 Limit on Income Tax Charge on Non-Residents

3.1 Overview

"Excluded income" is to be subject to no tax beyond withholding tax (if any) *on condition* that the taxpayer does not claim any personal relief or double taxation relief.

"Excluded income" includes most types of investment income. It also includes trading income which would be assessable on a broker or investment manager as being the UK representative of the non-resident but for the express exemptions contained in section 127(1)(b) and (c) respectively.[16] "Excluded income" does not include income the tax on which is assessable on "a UK representative", i.e., an agent who under the new rules is liable for tax chargeable on his principal.

The new rules come into play on 6th April 1995, but in a modified form for 1995/96. There are similar provisions for income tax and corporation tax.

3.2 Importance of the Limitation

3.2.1 Investment Income

Given that income tax on investment income is withheld at the basic rate, this limitation can benefit only those who pay tax at a rate higher than the basic rate i.e., *individuals* and the *trustees of accumulation and discretionary trusts*[17]. Given that the limitation applies to trustees only subject to stringent conditions, which will usually not be fulfilled, the limitation is principally of importance to non-resident individuals.

Personal representatives pay tax at only the basic rate.

Non-resident companies in general pay income tax at only the basic rate. In certain exceptional cases, such a company may pay corporation tax on investment income at a higher rate. It might then be protected by section 129.

3.2.2 Trading and Professional Income

Where excluded income is trading income which would be assessable on a broker or investment manager as being the UK representative of the non-resident but for

---

16 See my article *UK Taxation of Non-Residents: Liability of UK Representatives* in this issue at 4.5.1.

17 The income tax on which is chargeable at "the rate applicable to trusts" by virtue of Income and Corporation Taxes Act 1988 section 686.

the express exemptions contained in section 127(1)(b) and (c) respectively, there will normally be no withholding, so that the "limitation" amounts in practice to a *complete exemption*. Thus, it can benefit individuals, trusts, companies and personal representatives.

A company might well be liable to corporation tax, rather than income tax. Section 129 imposes a similar "limitation" on the charge.

3.3 The Statutory Limit

Finance Act 1995 section 128(1) provides:

> "(1) Subject to subsection (5) below, the income tax chargeable for any year of assessment on the total income of any person who is not resident in the United Kingdom shall not exceed the sum of the following amounts, that is to say -
>
> (a) the amount of tax which, apart from this section, would be chargeable on that total income if -
>
> (i) the amount of that income were reduced by the amount of any excluded income; and
>
> (ii) there were disregarded any relief under Chapter I of Part VII of the Taxes Act 1988 to which that person is entitled for that year by virtue of section 278(2) of that Act or of any arrangements having effect by virtue of section 788 of that Act;
>
> and
>
> (b) the amount of tax deducted from so much of any excluded income as is income the tax on which is deducted at source."

Put more shortly:

> "(1) No income tax shall be chargeable on the excluded income of a person for a year of assessment beyond that deducted at source except to the extent necessary to make good to the Crown tax which would have been payable by such person for the year but for any personal or double taxation relief."

Prima facie, this looks like a policy of "don't bother us and we won't bother you". It should have the advantage of simplifying the administration of the tax system.

A parallel is to be found in ESC B13 *Untaxed interest paid to non-residents*,[18] where "no action is taken to pursue his liability to income tax except so far as it can be recovered by set-off in a claim to relief (eg under Taxes Act 1988 s.278) in respect of taxed income from UK sources."

In general, it will be useless to claim personal and/or double taxation reliefs for a year of assessment unless the amount of the tax saving exceeds the "tax spared"[19], i.e., the difference between tax at the basic rate[20] and tax at the higher rate or rates (if any) on excluded income.

There will be no penalty if the taxpayer does mistakenly make a claim and the reduction in his tax liability by virtue of the relief(s) is less than the tax spared. He cannot be subject to higher taxation than if section 128 had not been enacted.

3.4 Excluded Income

3.4.1 Income Assessable on UK representative

Finance Act 1995 section 128(2) defines excluded income as follows:

> "(2) For the purposes of this section income arising for any year to a person who is not resident in the United Kingdom is excluded income in so far as it -
>
> (a) falls within subsection (3) below; and
>
> (b) is not income in relation to which that person has a UK representative for the purposes of section 126 above and Schedule 23 to this Act."

While income from a trade, profession or vocation, taxable under Schedule D Case I or II would not in any case fall within subs.(3), investment income which otherwise would so fall can be assessable on a UK representative if it is connected with the trade, profession or vocation carried on through him.

---

18 See 2.4.1.

19 My expression.

20 Or, in the case of Schedule F, lower rate,

3.4.2 Types of Income

3.4.2.1 The Statute

Finance Act 1995 section 128(3) lists five types of income which qualify as excluded income subject to not being assessable on a UK representative:

> "(3) Income falls within this subsection if -
>
> (a) it is chargeable to tax under Schedule C, Case III of Schedule D or Schedule F;
>
> (b) it is chargeable to tax under Case VI of Schedule D by virtue of section 56 of the Taxes Act 1988 (transactions in deposits);
>
> (c) it is chargeable to tax under Schedule E by virtue of section 150 or 617(1) of the Taxes Act 1988 or section 139(1) of the Finance Act 1994 (social security benefits etc.);
>
> (d) without being chargeable as mentioned in paragraphs (a) to (c) above or chargeable in accordance with section 171(2) of the Finance Act 1993 (profits of the underwriting business of a member of Lloyd's), it is income arising as mentioned in subsection (1)(b) or (c) of section 127 above; or
>
> (e) it is income of such other description as the Treasury may by regulations designate for the purposes of this subsection;
>
> and the power to make regulations for the purposes of paragraph (e) above shall be exercisable by statutory instrument subject to annulment in pursuance of a resolution of the House of Commons."

3.4.2.2 Investment Income

The omissions from the list are:

(a) income taxable under Schedule A (income from United Kingdom land) - this is deliberate.[21]

---

21 See Finance Act 1995 sections 37-40 and especially section 38 "Non-residents and their representatives".

(b) income assessable under Schedule D Case VI (subject to the express inclusion of certificates of deposit etc. taxable under Income and Corporation Taxes Act 1988 section 56). This may be an accidental omission. For example, income from the leasing of chattels situate in the United Kingdom (otherwise than by way of trade) is taxable under this Case.

(c) income taxable under Schedule E (subject to the express inclusion of job release scheme allowances, maternity pay, statutory sick pay and statutory maternity pay (Taxes Act section 150), specified benefits under the Social Security Contributions and Benefits Act 1992 (Taxes Act section 617) and incapacity benefit (Finance Act 1994 section 139)).

3.4.2.3 Income from Trade Profession or Vocation

3.4.2.3.1 The General Rule

Income from a trade, profession or vocation is unaffected, subject to two important exceptions concerned with brokers and investment managers.

3.4.2.3.2 Transactions Carried out through a Broker

What is meant by "income arising as mentioned in subsection (1)(b) ... of section 127 above"?[22] The context in which it appears is:

> "(1) For the purposes of section 126 above and Schedule 23 to this Act, none of the following persons shall be capable of being the non-resident's UK representative in relation to income or other amounts falling within paragraphs (a) to (d) of section 126(2) above, that is to say-
>
> (a) ...
>
> (b) where the income arises from, or the other amounts are chargeable by reference to, so much of any business as relates to transactions carried out through a broker and falling within subsection (2) below, that broker;"

"Income or other amounts falling within paragraphs (a) to (d) of section 126(2)" are, putting aside chargeable gains and overseas life insurance companies:

---

[22] See section 128(3)(d) at 3.4.2.1.

> "(a) the amount of any such income from the trade, profession or vocation as arises, directly or indirectly, through or from that branch or agency" and
>
> "(b) the amount of any income from property or rights which are used by, or held by or for, that branch or agency".

Hence, the income referred to in the main body of section 127(1) must be income arising through or from or connected with a branch or agency in the United Kingdom through which the non-resident carries on (whether solely or in partnership) any trade, profession or vocation. This is also the income referred to in section 127(1)(b). It is clear that if such income relates to protected transactions[23] carried out through a broker, then it will be excluded income within Finance Act 1995 section 128(3).[24]

But suppose that income arises from business which relates to protected transactions carried out through a broker, within the meaning of section 127(1)(b), but is not income of the type described in the opening part of section 127(1), namely income or other amounts falling within paragraphs (a) to (d) of section 126(2). Suppose, for example, that a non-resident carrying on a trade in the United Kingdom has no UK representative, yet in the course of that trade carries out a protected transaction through a broker? The broker may fail to be the UK representative of the non-resident for a variety of reasons. He may not constitute a "branch or agent".[25] Or he may not carry on the regular agency of the non-resident.[26] Is the income then excluded income? On the wording, one could argue either way. Logic takes one nowhere: as the distinction is arbitrary, it is equally arbitrary where one draws the line.

Is it possible for income to arise "directly or indirectly, through or from the branch or agency"[27] or to be "income from property or rights which are used by, or held by or for, that branch or agency"[28] without the income arising from "so

---

23 i.e., transactions falling within Finance Act 1995 section 127(2).

24 It will, *ex hypothesi*, satisfy the condition in section 128(2)(b) that it "is not income in relation to which [the broker is] a UK representative for the purposes of section 126 above and Schedule 23 to this Act."

25 See section 126(1).

26 See section 127(1)(a).

27 Within section 126(2)((a).

28 Within section 126(2)((b).

much of any business as relates to [protected] *transactions* carried out through the broker"?

What of "other amounts"? In my view, the only "other amounts" which are not income are capital gains and it is clear that they cannot constitute excluded income. Hence the failure of 128(3) to refer, in addition to "income", to "other amounts", is not material.

3.4.2.3.3 Transactions Carried out through an Investment Manager

Very similar considerations apply to this category of excluded income as to the broker category. Section 127(1) provides:

> "For the purposes of section 126 above and Schedule 23 to this Act, none of the following persons shall be capable of being the non-resident's UK representative in relation to income or other amounts falling within paragraphs (a) to (d) of section 126(2) above, that is to say-
>
> (a) ...
>
> (b) ...
>
> (c) where the income arises from, or the other amounts are chargeable by reference to, so much of any business as relates to investment transactions carried out through an investment manager and falling within subsection (3) below, that manager"

3.4.2.3.4 Comment

The complete immunity from taxation on trading profits from a United Kingdom trade relating to transactions carried out through a broker or investment manager is irrational.

While it makes perfect sense for certain brokers and investment managers to be excepted from personal liability as UK representatives, that is no reason in itself to put the non-resident in a better position than if he had no United Kingdom branch or agent at all.

A simple and sensible course would have been to provide that a non-resident was not to be liable to United Kingdom tax on the profits of a trade unless and to the extent that it carried on business in the United Kingdom through a UK representative. This is not without precedent. For example, a non-resident company is liable to corporation tax only if it carries on a trade in the United Kingdom through a branch or agency. It is then liable only on trading income arising directly or indirectly through or from the branch or agency and on property

or rights used by, or held by or for, the branch or agency.[29] Even in so far as companies are concerned, the difficulty remains that if a non-resident company escapes a charge to corporation tax, it is still liable to income tax.

3.4.2.4 Other Earned Income

Income taxable under Schedule E is in general unaffected. Income for casual services taxable under Schedule D Case VI is likewise unaffected.

3.4.2.5 Lloyd's Income

Profits arising from the underwriting business of a member of Lloyd's are unaffected. (They are chargeable under Case I of Schedule D, by virtue of Finance Act 1993 section 171(2) and therefore not affected by Finance Act 1995 section 128(3)(a) or (b) and are expressly excepted from the effect of Finance Act 1995 section 128(3)(c).)

3.5 Trustees

3.5.1 The Statute

Section 128 has only a narrow application to trustees. As often happens, the draughtsman was obviously not as intimately acquainted with trust law as he might have been.

Section 128(5) and (6) provide:

> "(5) This section shall not apply to the income tax chargeable for any year of assessment on the income of trustees non-resident in the United Kingdom if there is a relevant beneficiary of the trust who is either -
>
> (a) an individual ordinarily resident in the United Kingdom, or
>
> (b) a company resident in the United Kingdom.
>
> (6) In subsection (5) above, the reference to a relevant beneficiary, in relation to a trust, is a reference to any person who, as a person falling wholly or partly within any description of actual or potential beneficiaries, is either -

[29] See Taxes Act 1988 section 11. These words are echoed in Finance Act 1995 section 126(2)(a) and (b).

(a) a person who is, or will or may become, entitled under the trust to receive the whole or any part of any income under the trust; or

(b) a person to or for the benefit of whom the whole or any part of any such income may be paid or applied in exercise of any discretion conferred by the trust;

and for the purposes of this subsection references, in relation to a trust, to income under the trust shall include references to so much (if any) of any property falling to be treated as capital under the trusts as represent amounts originally received by the trustees as income."

It is difficult to see what (6)(b) adds to (6)(a).

3.5.2 The Policy

What on earth was the draughtsman *trying* to achieve? My guess is that he was trying to remove or reduce[30] the charge on excluded income provided the income could not be used to benefit a beneficiary who was ordinarily resident in the United Kingdom at the time at which it arose. In my opinion, he has done both more and less than that.

3.5.3 Relevant Beneficiaries

3.5.3.1 Relevant Beneficiary in relation to which Income?

One would have thought that the definition of "relevant beneficiary" would have been in relation to the income in question. For example, if a trust has two funds, Fund A and Fund B, and the income of Fund A must be accumulated and later distributed amongst one or more non-residents and the income of Fund B must be accumulated and later distributed amongst one or more United Kingdom residents, then one would have expected that the section would have applied to income arising in Fund A. Yet the beneficiaries of Fund B appear to be relevant beneficiaries in relation to the trust as a whole, not simply in relation to the income of Fund B, so that, on a strict interpretation, the section would not apply to the income of Fund A.

3.5.3.2 "A person falling wholly or partly within any description of actual or Potential Beneficiaries"

---

30 In the case of income subject to withholding tax, the charge would be reduced from the rate applicable to trusts (for 1995/96 35%) to the basic rate (for 1995/96 25%). In the case of trading income which qualified as excluded income by virtue of being related to protected transactions carried out through a broker or investment manager, the charge would be abolished altogether.

It is difficult to see why these words were added. They introduce a quite unnecessary limitation to the definition. To a philosopher, a name and a description are totally different. A name denotes; a description connotes. If the trustees must in their discretion distribute income amongst Alan, Beatrice and Cecil, who happen to be children of the settlor, none of Alan, Beatrice or Cecil fall within any "description" of actual or potential beneficiaries. Names are not descriptions. If, on the other hand, the trustees must in their discretion distribute income amongst the children of the settlor alive at the date of the settlement, who happen to be A, B and C, then each of them falls within a "description" of actual beneficiaries.

3.5.4 The Position of Beneficiaries

3.5.4.1 Interest in Possession Trust

3.5.4.1.1 General Position

In my opinion, where there is an interest in possession trust, so that the income of the trustees belongs beneficially to the beneficiary entitled in possession the moment it arises, the income is not "the income of trustees". In so far as they are taxable on it at all, they are taxable only in a representative capacity. The limitation on charge will therefore still be in point provided that the beneficiary is not resident in the United Kingdom.

Suppose that I am wrong on that point. Even if the income is "the income of trustees", then, provided the beneficiary is himself a non-resident - and, if he is not, then section 128 will in any case not be in point - no United Kingdom resident will be entitled to receive the income, either as income or capital. It therefore *may* be that section 128 would still apply to the income.

3.5.4.1.2 Trading Trust

The position of a trading trust under which the trustees carry on a trade in the United Kingdom but a beneficiary is beneficially entitled to the income is an interesting one. Suppose there is a broker or investment manager who would be the UK representative of the trustees but for section 127(1)(b) or (c). If the trustees were beneficially entitled to the income, it is clear that they would not be chargeable to tax at all. Yet the broker or investment manager cannot be the UK representative of the beneficiary, as the latter carries on no trade at all. While that would prevent the broker or investment manager being chargeable, whether or not he can rely on section 127(1)(b) or (c), it also follows that the beneficiary cannot rely on section 128(3)(d) to make the income excluded income.[31] This anomalous

[31] There is nothing to stop him relying on some other paragraph of section 128(3).

result would not, or course, arise, had the draughtsman dealt sensibly with the matter.

3.5.4.2 Discretionary Trust

Suppose that taxable income arises to non-resident trustees of a discretionary trust whose beneficiaries include both United Kingdom residents and non-residents but that the trustees pay out the income to a non-resident. Does section 128 apply?

Much depends on the correct analysis of the situation as a matter of basic law of the taxation of trusts. In my view, when the trustees exercise their discretion, the income which has arisen to them becomes the income of the beneficiary. Any tax they have suffered is treated as having been paid on behalf of the beneficiary. At the end of the day, the position is the same as in the case of an interest in possession trust. The beneficiary will be entitled to rely on section 128, subject to the difficulty mentioned in the case of trading income.[32]

The other view, that of the Revenue, is that the income the beneficiary receives in the exercise by the trustees of their discretion, is not the same income as that which the trustees receive. It has a foreign source, namely the trust. Therefore the question of the applicability of section 128 vis-à-vis the beneficiary does not arise. As a matter of strict law, the trustees remain liable to United Kingdom tax. They will not be able to take advantage of section 128 on a strict interpretation of it.

I very much suspect that the Revenue will, as a matter of practice, grant relief in such cases. See, for example, their treatment of income paid to a non-resident for the purposes of Taxes Act 1988 section 740 and their Extra-Statutory Concession B18.

3.5.4.3 Accumulation Trust

Where the income is accumulated and paid out to a non-resident as income, then in strict law the income is the income of only the trustees. They must therefore stand or fall by section 128(6) and (7). It is rather less likely that the Revenue will as a matter of practice grant relief in such a case.

---

[32] See my *Comments on The Inland Revenue Consultative Document on Trusts* published March 1991, Appendix C.

3.5.5 Transitional Arrangements for 1995/96

3.5.5.1 Fiction that sections 126 and 127 in force.

While ss.126 and 127 do not come into force until 6th April 1996, for the purposes of the limitation on charge, one assumes that they are in force in 1995/96: section 128(9)(b).

3.5.5.2 Limitation on Investment Income as Excluded Income

Investment income will not fall within section 128(3)(a) or (b) unless, broadly speaking, it arises from a transaction carried out on behalf of the non-resident by a broker or investment manager in the ordinary course of business for full consideration.

If income is chargeable as mentioned in section 128(3)(a) or (b), it will not fall within section 128(3)(c), so that it cannot qualify as excluded income under that head.

3.6 Transitional Relief for Arrangements in Force 29th November 1994.

3.6.1 1995/96 Only

In certain cases, income which before 6th April 1995 escaped taxation under ESC B40 will as a matter of strict law be taxable from that date. The conditions for the exception from liability as agents of non-United Kingdom residents of investment managers and brokers are being changed.[33] ESC B40 applied where the agent was protected under the old rules. There will therefore be some persons who were protected by the old rules who will not be protected by the new rules.

As regards arrangements set up before Budget Day 1994, the benefit of ESC B40 will continue to be available up to 5th April 1996.[34]

3.6.2 Indefinite

In the case of marketed jointly held funds set up before Budget Day 1994, the benefit of the ESC will be extended indefinitely.

---

[33] See my article *Taxation of Non-Residents: Liability of UK Representatives* in this issue.

[34] See the Investment Manager Statement para 14.