

THE UK CHARITY AND DOUBLE TAXATION TREATIES

Robert Venables QC¹

PART A - THE NON-FISCAL BACKGROUND

Introduction²

I was asked recently by a friend who lives in a well-established and respectable tax haven, whether there would be any scope for the enactment of an International Charities Law to encourage the establishment of charities in the jurisdiction. After reflecting, I decided that about the only persons who would want to set up a charity in a conventional tax haven would be disgusting old frauds such as the late Robert Maxwell. And they already had their Geroldsteins with all their obscurity and anonymity. Then I went on to consider that any tolerably honest person, or, for that matter, any tolerably honest businessman, could hardly do better than the United Kingdom. The scope of "charity" is wide in the UK and charities enjoy a virtual immunity from taxation, such as one might find in any conventional tax haven. But by contrast with any other tax haven, the UK has a superb network of double taxation treaties, of which a UK charity can take the benefit, whereas a charity in a conventional tax haven could not. For a charity, the UK *is* a tax haven, and probably the best tax haven in the world.

It was with these thoughts in mind that I prepared an address to the International Tax Planning Association at its September 1993 conference in Monaco on the use of the UK charity in the context of tax treaty "shopping". Much of my address is also relevant to the established UK charity which wishes to invest abroad. In the absence of suitable treaty protection, the UK charity might well find that it was subject to foreign taxes on its foreign investments, whereas it would not be subject

¹ Robert Venables QC, 24 Old Buildings, Lincoln's Inn, London WC2A 3UJ. Tel: (071) 242 2744 Fax: (071) 831 8095.

Chairman of Advisory Editorial Board to this *Review* and author of numerous publications, which recently include *Non-Resident Trusts* - Fifth Edition published by Key Haven Publications PLC in June 1993, available in hardback only.

² May of the topics adumbrated in this article are pursued in further detail in *Venables & Kessler: Tax Planning and Fundraising for Charities* Second Edition (1994) published by Key Haven Publications PLC.

to UK taxes on its UK investments.³ It would be an obvious breach of trust for UK charity trustees to invest abroad without taking foreign taxes into account. Indeed, they could only prudently invest abroad if they were satisfied that the net return, after taking in account foreign taxes, would justify the investment.

1 What is a Charity?

The English⁴ concept of a charity is (a) a trust or (b) a corporation or (c) an unincorporated association established in each case for purposes which are exclusively "charitable".⁵ In practice, virtually all charities are either trusts or corporations.

2 Reasons for Establishing an English Charity

2.1 Direct Reasons

One reason for establishing a charity is to enable one's benefaction to go further, because of exemption from taxes, where one is genuinely philanthropic, or wishes to further a religion, cause or project, or to be a patron of the arts.

2.2 Indirect (but Legitimate) Advantages

Charitable giving may enable one to buy in a tax-efficient manner, reputation, votes, influence, publicity, or even a burial plot on the Mount of Olives.⁶ In the United Kingdom, of course, it is not possible to buy a title or honour by, say, donating a valuable painting to the National Gallery; titles and honours are on the contrary reserved for persons such as eminent musicians whose copyrights bring hard currency into the country.

³ It might be objected that EC legislation must surely prevent such distortion and disincentive to the free flow of capital around the European community. The short answer is that it does not. And fiscal harmonisation is about as near as a single European currency.

⁴ The charity law of England and Wales differs to a small degree from that of Ulster and to a larger degree from that of Scotland. In this article, I deal directly only with the English law. The fiscal law applicable to charities is the same throughout the United Kingdom and is based on the English law.

⁵ As to which see 3 below.

⁶ And why should one not buy a burial plot on the Mount of Olives, provided, of course, one's charitable donations come from one's own resources and not from the plundered trust funds of the pensioners who have slaved all their lives for one's companies?

2.3 Control Without Beneficial Ownership

Virtually all fiscal systems in the world today tax beneficial ownership and not the control of assets. No politician or civil servant has any incentive to suggest that power disassociated from beneficial ownership should be taxed. Charitable trustees possess much, if not quite all, of the degree of control of assets which beneficial ownership gives. The conversion, say, of a family business into a charity can therefore secure that control of assets passes down from generation to generation without inheritance tax or forced heirship.

It may be important to retain voting control of a corporation without the embarrassment of the associated taxes. How better than as first-named trustee of a charity with a suitably-worded constitution?

Then again, within limits a charitable trustee possesses a fair amount of patronage. He can provide jobs and commissions for his family, his friends and his protégés. And there is nothing in charity law to disqualify a protégé who is young and voluptuous.

2.4 Other Advantages of More Questionable Legitimacy

An English charity can undoubtedly use international tax planning for the benefit of a non-charity. Naturally, one must operate within the constraints of charity law. Even so, there are very considerable opportunities. The morality of this type of advance tax planning is not beyond question. My readers will therefore appreciate why I shall not put any examples in print.

3 What are "Charitable Purposes"?

3.1 General Considerations

3.1.1 Case Law

The definition of "charitable purposes" depends on a vast amount of case law, some of it of considerable antiquity. The categories are not altogether logical and are certainly not closed. There are many fuzzy edges, particularly in the realm of quasi-political purposes. The nineteenth century saw a great increase in the number of religious bodies recognised as charitable. The twentieth century has seen a great increase in cultural and educational charities and charities for improving social conditions.

3.1.2 Importance of the View of the Charity Commissioners

In practice, the attitude of the Charity Commissioners is very important. Registration by them of a body as a charity is conclusive (even against the Inland Revenue) that it is established for charitable purposes only.

3.1.3 The Need for Public Benefit

In theory, all charitable purposes need to be for the public benefit. This test varies from context to context. For historical reasons, it is quite possible to have two charities in direct opposition to each other. For example, Charity A might be promoting the use of contraceptives amongst the inhabitants of the Philippines with the motive of preventing the spread of disease or poverty caused through overpopulation, while Charity B might be threatening the same inhabitants with everlasting Hell Fire as the penalty for such use.

3.1.4 Purposes to be Effected Outside the United Kingdom

It is unclear to what extent the objects of a UK charity can be performed outside the UK or to what extent it can make grants to a foreign body. The view of the Charity Commissioners was previously that objects within the first three heads of charity⁷ remain charitable even if effected abroad whereas those under the fourth head are not. Thus, a school in Israel, a seminary in Waco, a hospital in Calcutta or famine relief in Monaco are all charitable, whereas the fitting out of a foreign army is not. It appears that the Commissioners may have relaxed their view even further. Yet there are clearly some purposes within the fourth head which would not be for the (UK) public benefit if effected in foreign countries.

3.2 The Four Heads of Charity

3.2.1 Relief of the Aged, Impotent and Infirm

This head is taken as covering the relief of distress caused through poverty, age or illness.

"Poverty" is a very flexible term. The "poverty" of a distressed gentlewoman may be the luxury of an inner-city black. The test of public benefit is very lax. A trust for the relief of poverty amongst the employees or former employees of a corporation and their dependents and former dependents is valid. An employer could thus build up a tax-free fund (by making probably tax-deductible contributions) which could be used to provide employees with an additional "perk". Such a charity could amount to little more than a self-insurance fund against, e.g., medical bills or other "obligations" the employer was content to assume, such as the payment of a pension in the case of early retirement through

⁷ See 3.2 below.

disability. Moreover, the employees and recipients of benefits might find they were not taxable on payments made for their benefit.

Such charities can undoubtedly be extra-territorial in their scope. For example, a good Moslem and a good Jew could via an English charity both support *bona fide* social projects in, say, Israel and Iraq, thus allowing the respective states to expend their resources on making war on each other, indirectly subsidised by the UK Exchequer.

3.2.2 The Advancement of Religion

This category is unbelievably wide. Nineteenth century religious tolerance in England and the unexpected results of changes in the law produced the present position whereby virtue every religion is accorded charitable status even if it is one of the most pernicious forces for evil on earth. Whereas in John Milton's days, the church ruled by "The Triple Tyrant" was regarded as "superstitious" and therefore not charitable, there is nothing nowadays to stop him, should he unaccountably lose confidence in the Italian banking system, from transferring all the worldwide assets of his church to an English charity.

Again, the test of public benefit is lax indeed in this area. The area is ripe for reform. But that is another article.

3.2.3 Education

This extends not only to schools and universities but to research, including scientific and medical research. The only limit is that a charity cannot be political. Yet where is the line to be drawn?

A trust simply to stop ratification of the Maastricht treaty would not be charitable, but a trust to promote research into and discussion of the present and future consequences of further European integration would normally be charitable. Such education could teach two entire generations that European union as such is not necessarily a desirable end in itself; that we in the United Kingdom had the opportunity of such union fifty-five years ago and violently opposed it, even though it would have no doubt brought a strong central government, a unified currency, a comprehensive plan for the disabled, trains which ran on time and a solution to the Romany problem.

3.2.4 The Fourth Head

This is the most difficult of all. It is a rag-bag of objects, falling into many sub-categories, of which the most important are cultural - performances of plays, concerts, operas; encouragement of plastic arts; museums etc; preservation of the national heritage; patronage of individual artists by scholarships etc. Even sporting and recreational facilities *may* qualify.

4 Charitable Trust or Charitable Corporation?

4.1 Ease of Creation

A charitable trust can be established as freely as a private trust.

A charitable corporation can be created under the Companies Acts just as easily as a trading corporation. Such companies are usually companies limited by guarantee without a share capital. They have members instead of shareholders and a board of directors who manage the affairs of the corporation.⁸

4.2 Registration and Regulation

Most charities need to be registered with the Charity Commissioners and to submit annual accounts. The Charity Commissioners have powers to investigate abuse by those governing charities.

A charitable corporation is in addition subject to the requirements imposed on companies in general, such as the requirements of:

- audit of accounts by a qualified auditor,
- the publication of accounts,
- the holding of an annual meeting of members, and
- the making of an annual return to the Registrar of Companies.

5 Comparison with Similar Non-Charitable Entities

5.1 Charitable Trusts Compared with Other Trusts

A charitable trust does not have beneficiaries in the normal sense of the term.⁹ Instead, the trustees are under an obligation to pay or apply its *income* to or for charitable purposes. In some cases, trustees will have power to pay or apply *capital* for such purposes.

A charitable trust can be perpetual.

⁸ Charitable companies can also be created by Royal Charter, in which case they usually have no members other than the directors.

⁹ Another charity can, however, be a beneficiary of a charitable trust.

5.2 Charitable Corporations Compared with Other Corporations

A charitable corporation must normally apply its *income* for charitable purposes and may so apply its *capital*.

A charitable corporation cannot normally make any distribution of its funds to its members and on its liquidation its surplus funds must be transferred to another charity.

There is nothing to prevent the directors of a charitable corporation being the same persons as the members.

5.3 Control without Beneficial Ownership

While charitable trustees¹⁰ have, subject to their fiduciary duties and to any limitations imposed by the trust instrument/constitution of the corporation, a large amount of power and control of the trust funds and a large degree of discretion as to how they will apply funds to or for the benefit of charitable purposes, yet they own nothing in their own right which is capable of being taxed.

5.4 Enforcement of Duties Imposed on Trustees and Directors of Charity

Charitable trustees are thus not normally subject to control by beneficiaries. The directors of a charitable corporation are not subject to control by shareholders if there are no members of the corporation other than the directors. For that reason, the Attorney-General has standing to enforce the fiduciary obligation of the trustees and/or the directors. By statute, some of the Attorney's functions are now transferred to the Charity Commissioners. Other persons who are not strictly speaking beneficiaries may have an indirect interest in ensuring that the fiduciary duties are fulfilled.

The UK is not the best home for international fraudsters.

¹⁰ I shall henceforth in general use this term, as do the Charities Acts, to include directors of a charitable corporation, although they are not strictly speaking "trustees".

PART B - THE TAX BACKGROUND

6 United Kingdom Fiscal Privileges of United Kingdom Charities

6.1 The General Exemptions for a Charity

A United Kingdom charity¹¹ enjoys enormous UK fiscal privileges. It is in general exempt from:

- (a) taxes on income, except trading income;¹²
- (b) taxes on capital gains;
- (c) taxes on gifts, estates and trusts (inheritance tax); and
- (d) *ad valorem* stamp duty on conveyances to the charity.

6.2 Gifts to Charities

In addition, individuals, corporations and trusts which make gifts to the charity can, subject to the satisfaction of certain conditions, obtain a deduction in computing their taxable income, and/or escape capital gains tax on any gift of assets and/or escape gift and estate taxes on any gift or distribution of assets, whether *inter vivos* or on death.

6.3 Anti-Avoidance Provisions

There are certain anti-avoidance provisions aimed at charities, which are beyond the scope of this article. While they should not normally be a cause for concern for *bona fide* charities, they should always be borne in mind by professional advisors.

6.4 Acceptable Tax Planning

Even the lack of exemption from income tax/corporation tax on most types of trading income is routinely circumvented by the use of a captive trading corporation. The trading corporation carries on a trade in respect of the profits of which it is *prima facie* liable to corporation tax. The trading corporation makes just before the end of the accounting period an appropriate payment to the charity by way of gift. This is so structured as to amount to "a charge on income" of the trading subsidiary, which

¹¹ It is not entirely clear what constitutes a UK charity for the purposes of the various tax exemptions which are available. A trust governed by UK proper law and a company incorporated under the law of some part of the UK, which is in each case resident principally or solely in the UK will always be a UK charity. Other entities may be.

¹² but see below for an established method of circumventing this restriction.

thus reduces its taxable profits to zero. The payment received by the charity is not trading income in the hands of the charity and is thus exempt from income tax and corporation tax. This well-established device could also prove useful in the context of treaties: see 13.1 below.

6.5 Charitable Trusts and Charitable Corporations

Whether a charity is a trust or a corporation does not usually matter. It can, however, be crucial to the application or non-application of certain anti-avoidance provisions and/or to the rate at which tax has to be paid if there is no immunity or the immunity has been forfeited. It can also be highly relevant to the availability of double taxation treaty relief.

7 Double Taxation Treaties and Arrangements

7.1 The Basic Principle

The basic principle is that a UK charity, as a resident of the UK, is entitled to the same reliefs from foreign tax under a DTT as any other UK resident, notwithstanding that in general it will not bear any UK tax on its income! Naturally, everything depends upon the terms of the individual treaty.

7.2 Draftsman's Oversight

I very much doubt whether the application of such treaties to charities was ever within the draftsman's mind. I know of no treaty in which charities are referred to specifically. Usually, there will be a reference to "persons" or "trusts" or "corporations". Surprising as it may appear, it may well be that the tax treatment of a UK charity under a DTT will depend upon whether it is a trust or a corporation.

7.3 Advantages of Charitable Groups

As charities can freely make donations between themselves, assuming their constitutions so permit them, without in general incurring any United Kingdom tax charge, there may be something to be said for having twin charities, one a trust and the other a corporation, so as to take the maximum advantage of any particular provision in any given double tax treaty.

In some cases it may also be appropriate to have an underlying corporation which is not a charity, as that entity will secure an exemption which would not be available to its parent.

PART C - EXAMINATION OF SELECTED TREATIES

8 Treaties Considered

I shall consider:

the OECD 1977 Model Agreement,¹³

UK and France of 22nd May 1968,

UK and the German Federal Republic of 26th November 1964,

UK and Japan of 10th February 1969

UK and the USA of 31st December 1975.

9 Charities as "Residents" of a Contracting State

9.1 The Question

Is a charity entitled to take advantage of the DTT as a resident of one of the contracting states?

9.2 OECD Model Treaty

Under OECD Article 4.1 "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criteria of a similar nature. "Person" is partially defined by Article 3.1 to include "an individual, a corporation and any other body of persons".

A charitable corporation is thus a resident of the United Kingdom.

A charitable trust is almost certainly a "body of persons" and is therefore also a resident of the United Kingdom.¹⁴

The treaties between the UK and *France*, *Germany* and *Japan* respectively are in very similar, if not identical, terms.

9.3 UK - USA Treaty

¹³ This has now been replaced by the 1992 Model Agreement. The 1977 Model is more important as more extant treaties are currently based on it than on the 1992 Model.

¹⁴ I hope to pursue this question further in an article to appear in the *Offshore Tax Planning Review*.

The treaty between the UK and the USA is entirely specific on the question of trusts, which are expressly stated to be within the definition of "person": see Article 3(1)(c).

A trust resident in the United Kingdom for the purposes of United Kingdom tax is a "resident of the United Kingdom": Article 4(1)(a)(i).

A corporation is only a resident of the "United Kingdom" if its "business management and control is in the United Kingdom". It would thus be highly abnormal for a UK corporate charity not to be a "resident of the United Kingdom" for the purposes of this treaty.

10 Charities as "Enterprises" of the United Kingdom

When (if at all) is a UK charity an enterprise of the UK, so as to confer on it a qualified exemption from tax on business profits?¹⁵ The OECD Treaty "definition" is pretty useless: "the term "enterprise of a Contracting State" means an enterprise carried on by a resident of a Contracting State". In my view, this is the wrong question. For what is exempt from tax is "the business profits of an enterprise of a Contracting State". This is a description of the source of the profits and not of the entity which is entitled to them. Hence, provided a charity owns an "enterprise" it will be exempt from tax on the profits of the enterprise even though it is not itself an enterprise.

11 Treaty Relief - the OECD Model

11.1 The Exemptions

The OECD Model Agreement of 1977 provides that a resident of one Contracting state shall not in general be liable to tax in the other Contracting State in respect of *royalties* (Article 12) or "*other income*" (Article 21).

It also provides for a ceiling on the liability of the resident of one Contracting state for tax imposed by the other Contracting State on *interest* (Article 11).

It provides that [*business*] *profits* of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein (article 7).

It provides for a ceiling on the liability of the resident of one Contracting state for tax imposed by the other Contracting State on *dividends* (Article 10).

¹⁵ See 11.1 below.

11.2 No Restriction for Exempt Taxpayers

The OECD Model Agreement does not contain any restriction restricting relief from tax in the Contracting state of non-residence in a case where the taxpayer is exempt from tax in the country of residence on the same income or gains. It does, however, contain various specific provisions which may impinge upon charities. for example, Article 10(2) provides:

"However, [dividends paid by a corporation which is a resident of a Contracting State to a resident of the other Contracting State] may also be taxed in the Contracting State in which the corporation paying the dividends is a resident and according to the laws of that State but if the recipient is the beneficial owner of the dividends the tax so charged will not exceed:

- (a) 5 per cent of the gross amount of the dividends if the beneficial owner is a corporation (other than a partnership) which holds directly or indirectly 25 per cent of the capital of the corporation paying the dividends ... "

Note, firstly, that the question of beneficial ownership is vital and, secondly, that a charitable corporation would obtain greater relief than a charitable trust.

11.3 Beneficial Ownership

In Articles 10, 11 and 12 reference is made to "the beneficial owner" of the dividends interest and royalties respectively. What is meant by this term? Under English law, a charitable corporation is the beneficial owner of its assets; yet it would normally be considered an abuse of language to describe charitable trustees as the beneficial owner of their trust funds. Quite the contrary, they are the fiduciary, non-beneficial owners. Yet it seems likely that in the context of DTTs "beneficial owner" has a somewhat different meaning. It would exclude a mere nominee or agent for a third party but would include someone, such as the trustees of a charitable trust, who were themselves the only persons entitled to the income in question, so that there was no third party who could claim, as the income arose, that he had a superior title to it than the trustees.¹⁶

11.4 Other Income

Article 21 (other income) provides:

¹⁶ cf the House of Lords decision in *Williams v Singer* (1920) 9 TC 387, HL.

- "1. Items of income of a resident of a Contracting State, wherever arising, not dealt with in the foregoing Articles of this Convention shall be taxable only in that State."

Note that this does not require in express terms the resident of a Contracting State to be the beneficial owner of the income.

11.5 Capital Gains Tax

Article 13 (capital gains) follows a familiar pattern. Firstly, a resident of a Contracting State is not protected from liability to tax in the other Contracting State in respect of gains derived by him from the alienation of immoveable property of three specified types situated in the other Contracting State. Subject thereto, Article 13.4 provides that gains from the alienation of any other property are to be taxable only in the Contracting State of which the alienator is a resident. There is no reference to beneficial ownership.

11.6 Non-Discrimination

Article 24 ("non-discrimination") provides that "nationals" of a Contracting State shall not be subject in the other Contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances are or may be subjected. "Nationals" is defined, by Article 24.2, to mean, *inter alia*, "all legal persons, partnerships and associations deriving their status as such from the laws in force in a Contracting State." While a corporation incorporated under the laws of England would clearly constitute a UK national, it is questionable to what extent and under what circumstances the trustees of a UK trust would be "nationals" of the UK. The difficulty is the greater where the trust is UK resident but governed by foreign law.

12 Treaty Relief - The UK-French Treaty

12.1 Dividends

Article 9(6) provides that dividends paid by a company which is a resident of France to a resident of the United Kingdom may be taxed in the United Kingdom:

"Such dividends may also be taxed in France but where such dividends are beneficially owned by a resident of the United Kingdom the tax so charged shall not exceed:

- (a) 5 per cent of the gross amount of the dividends if the beneficial owner is a company which controls the company paying those dividends;

- (b) in all other cases 15 per cent of the gross amount of the dividends."

Article 9(7) confers on a United Kingdom resident the right to a credit equal to the *avoir fiscal*¹⁷ if it is an individual, a company or an approved pension fund, but (except in the case of a pension fund) only if the recipient is "subject to United Kingdom tax in respect of the dividends." The use of a non-charitable subsidiary corporation may be appropriate. See 13.1.

12.2 Interest

Article 11 (*interest*) provides that interest arising in a Contracting State and paid to a resident of the other Contracting State shall be taxable only in that other State if that resident is the beneficial owner of the interest. Article 11(7) provides, however:

"The provisions of this Article shall not apply if the debt-claim in respect of which the interest is paid was created or assigned mainly for the purposes of taking advantage of this Article and not for "*bona fide*" commercial reasons."

12.3 Royalties

Article 12 contains very similar provisions relating to *royalties*.

12.4 Capital Gains

Article 13 is in fairly standard form, providing, subject to certain exceptions, that "Gains from the alienation of any property other than ... shall be taxable only in the Contracting State of which the alienator is resident."

12.5 Other Income

Article 22 (income not expressly mentioned) is very similar to the OECD Model Agreement.

13 Treaty Relief - The UK-German Treaty

13.1 Dividends

Article VI (*Dividends*) provides:

¹⁷ This is in effect a rebate of part of the mainstream tax paid by the company on its profits.

"(1) Dividends paid by a company resident in one of the Territories to a resident of the other territory may also be taxed in the former territory. Tax shall not, however, be charged in that former territory at a rate in excess of 15 per cent on the gross amount of such dividends *provided that those dividends are subject to tax in the other territory or ...* "

"(2) Notwithstanding the provisions of paragraph (1) of this Article Federal Republic tax on dividends paid to a company resident in the United Kingdom by a company resident in the Federal Republic at least 25 per cent of the voting shares of which are owned directly or indirectly by the former company may be charged at a rate exceeding 15 per cent but not exceeding 25 per cent if [a certain condition is satisfied and if not] at a rate exceeding 15 per cent but not exceeding 20 per cent."

Is a UK charity "subject to tax" on foreign dividends in the UK? While there are arguments that it is, one would prefer not to have to rely on them. What therefore if the dividends belong beneficially to a non-charitable corporation owned by a charity to which it covenants its profits? In my opinion, the dividends would be "subject to tax" in the UK, even though the corporation did not pay tax on them, just as much as if the reason it did not pay tax on them was that it had a charge on income for interest payments or had trading losses which it set against them for UK tax purposes.

If a UK charitable corporation owns at least 25 per cent of the voting shares in the German company paying the dividend, is it protected by Article VI(2)? Or does Article VI(2) simply provide a limit to the (non-existent) protection of Article VI(1)? The latter is the literal meaning, but then double taxation treaties are not always interpreted literally.

13.2 Interest and Royalties

Article VII(1) (*Interest and royalties*) provides:

"Any interest or royalty, derived from sources within one of the territories by a resident of the other territory *who is subject to tax in that other territory in respect thereof*, shall be subjected to tax only in that other territory."¹⁸

13.3 Other Income

Article XV provides:

¹⁸ Article VII(4) contains a similar immunity as respects payments received as consideration for the alienation of any property or rights mentioned in paragraph (2).

"Any income not dealt with in the foregoing provisions derived by a resident of one of the territories *who is subject to tax in that territory in respect thereof* shall be subject to tax only in that territory."

14 Treaty Relief - The UK-Japan Treaty

14.1 Dividends

Article 11 provides that dividends paid by a Japanese resident company to a resident of the UK may be taxed in Japan:¹⁹

"... but if the beneficial owner of the dividends is a resident of the United Kingdom the tax so charged shall not exceed:

- (a) 10 per cent of the gross amount of the dividends if the beneficial is a *company* which owns at least 25 per cent of the voting power in the company paying the dividends during the whole of the period twelve months immediately before the end of the accounting period for which the distribution of profits takes place.
- (b) 15 per cent of the gross amount of the dividends in all other cases."

Article 11(6) contains an anti-avoidance provision:

"Relief under this Article from the tax of a Contracting State shall be subject to the same limitations as are imposed in respect of relief or exemption from tax under the law of the Contracting State by any provisions enacted in order to maintain the proper incidence of liability to tax and to prevent the obtaining of undue tax advantages."

¹⁹ See also the no less inept Article 12(6): "Relief under this Article from the tax of a Contracting State shall be subject to the same limitations as are imposed in respect of relief or exemption from tax under the law of the Contracting State by any provisions enacted in order to maintain the proper incidence of liability to tax and to prevent the obtaining of undue tax advantages."

What a fruitful source of litigation is this provision! Does it do any more than ensure that the Treaty does not override anti-avoidance provisions of municipal law? What is the "proper incidence of tax"? When is a tax advantage "undue"?

14.2 Interest

Article 12(2) imposes a general ceiling of 10% on tax on interest levied by the Contracting State of non-residence. Article 12(7) could catch a UK charity:

"The relief from tax provided for in paragraph (2) of this Article shall not apply to interest on any form of debt-claim dealt in on a stock exchange where the beneficial owner of the interest:

- (a) does not bear tax in respect thereof in the Contracting State of which it is a resident; and
- (b) sells (or makes a contract to sell) the debt-claim from which such interest is derived within three months of the date on which such beneficial owner acquired such debt-claim."

What would be the position if the interest belonged beneficially to a UK non-charitable company owned by a UK charity to which it had covenanted to pay its income?

14.3 Royalties

Article 13(2) imposes a general ceiling of 10% on tax on royalties levied by the Contracting State of non-residence.

14.4 Capital Gains

Article 14(4) provides that capital gains derived by a resident of a Contracting State from the alienation of any property other than [certain specified items] shall be taxable only in that Contracting State.

14.5 Other Income

Article 23 provides that "items of income of a resident of a Contracting State, wherever arising, other than income paid out of trusts, which are not dealt with in the foregoing Articles of this Convention shall be taxable only in that Contracting State."

What is meant by "income paid out of trusts"? Would it catch, say, Japanese-source income arising to a UK charitable trust which was then paid out by the trust?²⁰

15 Treaty Relief - The UK-USA Treaty

15.1 Dividends

Article 10(2) imposes a general ceiling of 15% on USA tax on dividends paid by a USA corporation where the beneficial owner is a resident of the UK. The ceiling is only 5 per cent, however, where the dividends are paid:

"to a corporation which is a resident of the United Kingdom and controls, directly or indirectly, at least 10 per cent of the voting stock of the United States corporation paying such dividend."²¹

Article 10(6) provides:

"A corporation which is a resident of the United Kingdom shall be exempt from United States tax on its accumulated or undistributed earnings, profit, income or surplus, if individuals (other than nationals of the United States) who are residents of the United Kingdom control, directly or indirectly, throughout the last half of the taxable year, more than 50 per cent of the entire voting power in such corporation."

What of a UK charitable corporation? What is meant by voting power "in" such corporation? Can one look to the voting rights of individual directors as such? or of individual members as such? What if the corporation is chartered? In my view, one will look to the members if there are members and they have voting control of the corporation and if there are no such members one will look to the directors.

What of a UK charitable trust which owns a non-charitable UK resident corporation? Do the trustees control the voting power? In my view, they do. Are the trustees "individuals"? For the purposes of the charge to the higher rate UK tax on income it is clear that they are not. In my view, individual trustees are "individuals" for the purposes of this Article. What if the trustees are themselves corporations rather than

²⁰ This is another difficult topic which I intend to pursue further in the forthcoming article a the *Offshore Tax Planning Review*.

²¹ See Article 10(2)(b)(i).

individuals? In that case, one must trace through to the individuals who ultimately control such corporation.²²

What of a charitable corporation which owns a non-charitable UK resident corporation?

15.2 Interest

Article 11(1) provides that interest derived and beneficially owned by a resident of the UK shall be exempt from tax by the United States.

15.3 Royalties

Article 12(1) provides that royalties derived and beneficially owned by a resident of the UK shall be exempt from tax by the United States.

15.4 Anti-avoidance

Article 16, headed "*Investment or holding companies*" provides that Articles 10, 11 and 12 are not to apply to:

"a corporation which is a resident of one of the Contracting States and which derives dividends, interest or royalties arise within the other Contracting State if:

- (a) (i) the tax imposed on the corporation by the first-mentioned Contracting State in respect of such dividends, interest or royalties is substantially less than the tax generally imposed by that State on corporate profits; or
- (ii) ...; and

- (b) 25 per cent or more of the capital of such corporation is owned, directly or indirectly, by one or more persons who are not individual residents of the first-mentioned Contracting State and are not nationals of the United States."

²² The question of whether and in what circumstances a company can be controlled by trustees or directors as such is an extremely thorny one in English law. It is extensively discussed in my *Control of Companies*, to be published by Key Haven Publications PLC in 1994.

This could clearly catch a corporate charity.

15.5 Capital Gains

Article 13 provides that in general there shall be no treaty protection in respect of capital gains.

16 Summary

The United Kingdom charity is one of the most tax-efficient vehicles in the world, especially for investing in high-tax countries with which the United Kingdom has a suitable worded treaty. Even where the treaty is not suitable worded, it may be possible to obtain relief against foreign taxes indirectly by means of a subsidiary corporation.