DOUBLE CHINN

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The purpose of this article is to discuss a possible way for a beneficiary of an offshore trust which has trust gains within s.87 of the Taxation of Chargeable Gains Act 1992 to obtain a benefit free of capital gains tax.

Consider the following case. X is the UK resident and domiciled settlor and life tenant of a settlement made in 1988. It is not a "qualifying settlement" within Sch 5 of the 1992 Act. The trustees have been non-UK resident since 1990. The trust fund consisted of private company shares until March 1994 when the trustees sold them for £5 million, realising trust gains of about that amount within s.87 of the 1992 Act. The trustees have an overriding power to appoint fresh trusts in favour of X, amongst others. X wants to break the settlement. The trustees are willing to appoint the trust fund (now invested in gilts) to him. X asks you: how can he receive it tax-free, without having to emigrate?

Of course, you will advise X that he would be taxable under s.87 on receipt of any "capital payment" from the trustees. You might also advise X (rightly, in my view) that he would receive a "capital payment" even if the trustees were to sell the gilts and lend him the £5 million proceeds whether interest-free or not given that the beneficial owner of any interest payable under the loan will be X himself. You would be right to conclude that X cannot receive the trust fund from the trustees tax-free. However, consider an alternative. The trustees should appoint the trust fund to X absolutely, but contingently on him surviving for, say, 30 days. Then the trustees should be asked to resign in favour of new, UK resident, trustees.

Now X is in a position to obtain (almost) £5 million tax-free, not from the trustees, but from a non-resident purchaser of his contingent interest in the trust fund. That is, X can sell his beneficial interest, and the gain accruing to X on that disposal will be exempt from capital gains tax by virtue of s.76(1) of the 1992 Act. Section 85(1) will not prevent s.76(1) from applying, because the trustees are UK resident at the time of X's disposal. Moreover, since X will receive the proceeds of sale of his contingent interest from the purchaser, and not from the trustees, the

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sale will not trigger a charge on X under s.87. Section 97(5) provides that a capital payment shall be regarded as received by a beneficiary from the trustees if:

(a) he receives it from them directly or indirectly, or

(b) it is directly or indirectly applied by them in payment of any debt of his or is otherwise paid or applied for his benefit, or

(c) it is received by a third person at the beneficiary's direction.

Provided that the purchaser of X's contingent interest pays the purchase price immediately out of his own resources, and not later on out of the proceeds of the gilts to which he becomes entitled at the end of the 30 days (assuming X is then living), I do not think it could be said that X has received anything from the trustees directly or indirectly, or that the trust fund has been paid or applied for X's benefit. That leaves (c): the trust fund will be received by a third person, namely the purchaser; but will it be so received at X's direction?

In my view, it will not. The purchaser will receive the trust fund from the trustees because he is the owner of the contingent beneficial interest formerly owned by X, by virtue of X's assignment of it to him. X no longer has any standing to give a direction to the trustees. This is confirmed by the following piece of legislative history. The predecessor of s.97(5) is s.83(5) of the Finance Act 1981. Section 42(7) of the Finance Act 1981 amended s.451 of the Taxes Act 1970 (now s.677 of the Taxes Act 1988) to deem a capital sum to be paid to the settlor by the trustees for income tax settlement purposes where the sum was "paid by them to a third party at the settlor's direction *or by virtue of the assignment by him of his right to receive it*". Section 46(3) of the Finance Act 1981 also amended s.478 of the Taxes Act 1970 (now s.739 of the Taxes Act 1988) to provide that "there shall be treated as a capital sum which an individual receives or is entitled to receive any sum which a third person receives or is entitled to receive at the individual's direction *or by virtue of the assignment by him of his right to receive it*". These amendments show beyond doubt that the draftsman of the Finance Act 1981 distinguished between a direction on the one hand and an assignment on the other. The italicised words do not appear in (what is now) s.97(5) of the 1992 Act. The Inland Revenue apparently agree that s.97(5) does not treat the assignor of a beneficial interest as in receipt of a capital payment from the trustees, where the assignment is by way of gift in settlement. The position must be the same where the assignment is a sale.

The result is that the purchaser, not X, will receive a capital payment from the trustees at the end of the 30 days, when he becomes absolutely entitled to the trust fund: see s.97(2). Therefore s.87 will apply to treat the trust gains as chargeable gains accruing to the purchaser, but if the purchaser is non-resident (or nondomiciled) he will not be liable to capital gains tax on those chargeable gains. Therefore the trust gains will not come into charge to capital gains tax at all.

For completeness, I should mention that the trustees' appointment of the trust fund to X if he survives for 30 days could not itself be treated as a capital payment received by X from the trustees. Neither X nor the purchaser will receive anything at all from the trustees unless and until X survives for 30 days. The contingent beneficial interest is not itself a capital payment, nor is it received from the trustees (it is not theirs to give).

Older readers may be saying to themselves that this idea, of selling a beneficial interest to a non-resident, is nothing new, and has already been held by the House of Lords not to work, in a case called *Chinn v Collins* [1981] AC 533. However, that concerned earlier, and different, legislation and involved an additional, fatal, step which my idea does not.

In *Chinn*, the taxpayer was a beneficiary of an offshore trust whose trustees owned 184,500 shares in Lex Garages Limited. Under the legislation then in force, if the trustees disposed of the shares and realised a gain, the gain would be automatically apportioned among the beneficiaries having interests in the settled property, whether they actually received any benefit or not. The trustees appointed the trust fund to the taxpayer absolutely, contingently on him surviving for 3 days. The taxpayer sold his contingent interest to a non-resident company called Rozel Limited, and at the same time agreed to buy 184,500 shares in Lex Garages Limited from Rozel. The House of Lords held that the scheme, viewed as a whole, involved the vesting in the taxpayer of the shares previously held by the trustees of the offshore trust, because it was never intended that Rozel should purchase or hold the Lex shares. The taxpayer argued that he agreed to buy 184,500 shares in Lex from Rozel, but not any particular shares, so that there was nothing to show that what he acquired were the shares previously held in the settlement. The House of Lords rejected this argument as "wholly unreal": after all, Rozel had no money with which to buy 184,500 Lex shares in the market, and there was no certainty that it could acquire such a block at the right price. The mutual intention can only have been that the shares to be sold to the taxpayer should be the trust shares. Therefore, the taxpayer became the beneficial owner of the trust shares on surviving the requisite 3 days, and so the trustees' gain could be apportioned to him as a beneficiary having an interest in the settled property.

Under the current legislation, it is not relevant to consider whether X is a beneficiary. However, if X not only sold his contingent interest but also agreed to buy the gilts in the trust fund the *Ramsay* principle would apply to treat X as in receipt of a capital payment from the trustees. Therefore it is vital that X should sell his interest without more, and that the purchaser should have the money to pay X immediately, so that the trust fund does not find its way back to X in any shape or form. There should be no difficulty here.

In *Chinn*, the Revenue advanced an alternative argument. If the taxpayer had ceased to be a beneficiary of the settlement by selling his interest to Rozel before the trustees' gain accrued, nevertheless he was still a beneficiary of an "arrangement" (the trustees' contingent appointment coupled with the sale and re-purchase) which was also a "settlement"; and the gain accrued to the trustees of this arrangement-settlement. The House of Lords accepted this argument as well.

The current legislation also has the wide definition of "settlement", including an arrangement: see s.97(7) of the 1992 Act. However, the Revenue's argument in *Chinn* could not be relied on now against X. On the facts the gains accrued (in March 1994) before any arrangement was contemplated, so that there are no trust gains of the arrangement-settlement. But it would make no difference if the trustees' gains accrued later, for even if these are trust gains of the arrangement-settlement, X still does not receive a capital payment from the trustees of that (or any other) settlement. He receives the proceeds of sale of his interest from the non-resident purchaser, not from the trustees.

Therefore, I do not think that the arguments which succeeded in *Chinn* would succeed today.

Turning to inheritance tax, X's life interest will terminate at the end of the 30 days, when the purchaser becomes absolutely entitled. That will be the occasion of a transfer of value by X, under s.52(1) of the Inheritance Tax Act 1984, the value transferred being £5 million. This transfer of value will be a PET if and only if the purchaser is an individual, not a company: see s.3A(2)(a) of the 1984 Act. Therefore a non-resident corporate purchaser will not do.

The upside with this idea is that X receives £5 million tax-free. But if I am wrong, and tax is payable, what is the downside? The sale price will be less than the value of the trust fund, because the purchaser will wish to make a profit from his purchase, calculated after deducting the cost of insuring against X's death within the 30 days. Assuming that X is determined to break the settlement (and would not be content with receiving an interest-free loan, paying tax each year on a capital payment equal to interest at a commercial rate, in which case there may be more tax payable overall given the surcharge under s.91 of the 1992 Act and the possibility of a general increase in tax rates) then in my view there is no other downside.

In my example, where X is the life tenant, there can be no income tax charge on him under s.740 of the Taxes Act 1988.

Suppose that the settlement was an accumulation and maintenance settlement and that the trustees have accumulated a substantial amount of income which is "relevant income" for s.740 purposes. X's son Y is the life tenant and wishes to break the settlement and take the trust fund. If Y were to sell his beneficial interest, would he be taxable on the proceeds under s.740? In my view, no, and I shall explain why in another article.