# CAPITAL PAYMENTS

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Beneficiaries of non-resident trusts are naturally concerned about how they can enjoy the trust gains made by their non-resident trustees without creating a corresponding liability to capital gains tax under s.80 FA 1981. Much has been written in this Review about capital payments: how they are measured and the extent of any charge which might arise. My concern here is to examine the position of the UK resident and domiciled settlor who established a non-resident trust before 19 March 1991 for his own benefit simply for the purpose of sheltering a gain from capital gains tax. I am assuming that nothing has occurred which would cause the rules introduced in the Finance Act 1991 to be triggered and that the trust remains subject to the old rules - apart from the possible application of the supplementary charge.

For any number of reasons the settlor might remain chargeable to income tax on the whole of the trust income; he may be the life tenant or he may be within the scope of Part XV TA 1988 such that the whole of the trust income is deemed to be his income for all the purposes of the Income Tax Acts. He may not be greatly concerned about this aspect if his object was not income tax saving (which may have involved complications beyond his convenience) but solely the saving of capital gains tax.

Let us assume that the trustees have made a large capital gain which is safely invested abroad and that the settlor/beneficiary is content to live on (and pay tax on) the income without any immediate need to obtain money from the trust. If he does require further funds he will no doubt subscribe to this Review to see how best to arrange his capital payments.

Each month or each quarter the trustees pay to him the income arising from the settled property either because it belongs to him as life tenant or because they feel it is appropriate to do so under the terms of the settlement. Either way he may feel safe as this is income upon which he is liable to tax; it cannot be a capital payment. His reasoning would derive from s.83(1) FA 1981 which provides that:-

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"In sections 80 to 82A above `capital payment' means any payment which is not chargeable to income tax on the recipient".

**But is this a safe conclusion?**

The trust income is deemed to be his for all tax purposes as it arises whether or not the trustees make a payment to him of the income. There is of course no doubt that the payment to him by the trustees represents income, and that the trust income is chargeable to income tax on him, but that is not the same as saying that the payment is chargeable to income tax. The payment and the charge to tax are entirely separate matters. Should this be thought to be an unreal distinction, consider the position of a settlor of a discretionary trust who is within the charge to income tax by virtue of s.739 TA 1988 and is charged to income tax each year on the trust income. In year 3 he receives a payment from the trustees being a distribution of part of the income for the earlier years. He may say that he has been charged to tax on the income which he has now received but he cannot claim that the payment by the trustees is "chargeable to tax" on him. Not only does such a claim seem impossible on the wording, there is also s.743 to contend with. S.743(4) TA 1988 provides that where an individual has been charged to income tax on any income deemed to be his by virtue of s.739 and that income is subsequently received by him it shall be deemed not to form part of his income again for the purposes of the Income Tax Acts.

Accordingly there would appear to be nothing to prevent a payment of income to him by the trustees as being treated as a capital payment and chargeable to capital gains tax, limited only by the trust gains made by the trustees.

No help can be derived from s.83(3) FA 1981 because that applies only to s.740 TA 1988 which in turn applies only where the individual is not chargeable to tax under s.739. Indeed s.83(3)(a) provides that where income of the non-resident trust is treated as being the recipient's income for a year of assessment after that in which it was received, this does not preclude it from being treated as a capital payment in the year of receipt. This seems to cover the situation where an individual receives a payment which exceeds the amount of the relevant income of the trustees; the excess can be treated as a capital payment for s.80 purposes. However, this adds little to the argument because under s.740 the liability to tax only arises from the provision of a benefit, unlike s.739 where the income is deemed to be that of the individual as it arises for all the purposes of the Income Tax Acts.

The position seems to be different in the case of a life tenant of a non-resident trust. In that case it could be said that the income belongs to the life tenant; he is absolutely entitled to it. On that basis, at the point when the income arises it becomes property to which s.46 CGTA 1979 applies and becomes a capital payment within the definition of s.83(2) FA 1981. S.83(2) also provides that this occasion is a "payment" for the purposes of s.83(1) and accordingly the income arising, being the occasion or payment, is chargeable to income tax on the recipient.

The view of the Inland Revenue on this point is not clear, although in correspondence they have confirmed in one case that they will not seek to charge capital gains tax under s.80 on distributions of income to meet the tax liability of the beneficiary on the trust income. However, they do regard a payment in discharge of any interest on the tax, if it remains unpaid, as representing a capital payment. This seems to be misguided for other reasons but it leaves the beneficiary in the unsatisfactory position of wondering how long it will be before the Inland Revenue decide it would be a good idea to exact some more tax on these grounds, to discourage further the use of non-resident trusts - particularly if by doing so they can also obtain a useful addition

by way of supplementary charge.