

NON-RESIDENT TRUSTS A REVENUE SETBACK Robert Venables QC

A Case Note

The decision of Hoffmann J in *Jones v Lincoln-Lewis* [1990] STC 307 is a rare modern example of taxpayers successfully avoiding anti-avoidance provisions. It has breathed new life into the prospects of some moribund appeals relating to years before 1981/82 which neither the Revenue nor the taxpayers had seemed anxious to pursue.

The Questions

The provision in this case - already rendered infamous by the House of Lords decision in *Leedale v Lewis* [1982] STC 835 - were aimed at beneficiaries of non-UK resident trusts. The relevant statutory provision was FA 1965 s.42, which became CGTA 1979 s.17 and was replaced by FA 1981 ss.80-84. The relevant part was subs.(2), which provides:

"Any beneficiary under the settlement who is domiciled and either resident or ordinarily resident in the United Kingdom during any year of assessment shall be treated for the purposes of this Part of this Act as if an apportioned part of the amount, if any, on which the trustees would have been chargeable to capital gains tax under section 20(4) of this Act, if domiciled and either resident or ordinarily resident in the United Kingdom in that year of assessment had been chargeable gains accruing to the beneficiary in that year of assessment; and for the purposes of this section any such amount shall be apportioned in such manner as is just and reasonable between persons having interests in the settled property, whether the interest be a life interest or an interest in reversion, and so that the chargeable gain is apportioned, as near as may be, according to the respective values of those interests, disregarding in the case of a defeasible interest the possibility of defeasance."

The tantalising question was: "At which time must a person be a beneficiary to be capable of being caught by s.42(2)?" A further question, which did not fall to be answered but on which light is thrown by the decision, is: "To what extent does one, in making an apportionment, take into account past benefits received directly or indirectly from the settlement?"

The Facts

UK resident beneficiaries under a non-UK resident trust assigned their interests to a Guernsey company on 5th June 1973. On 6th June 1973 the trustees sold the trust property, thereby realising appreciable capital gains. On 2nd July 1973 the trust

terminated and the proceeds were paid over to the Guernsey company. Could any part of the gains be apportioned to the beneficiaries who had made the assignment?

The facts did not look promising. The beneficiaries who had assigned their interest were beneficiaries in the same year of assessment as that in which the gains were realised. On the other hand, the only person who was a beneficiary on the day the gains were realised was a non-UK resident.

The First Argument

Counsel for the taxpayer argued firstly that gains could be apportioned only to persons who were beneficiaries *at the end of the year* of assessment in which the gain was realised or, if earlier, at the date in the year when the settlement came to an end. This argument was not surprisingly rejected out of hand. It is quite possible that the experienced counsel for the taxpayer did not take it very seriously himself.

The Second Argument

Counsel for the taxpayer's second argument was that the apportionment could only be between persons who had interests in the settled property *at the time the gain arose*. By contrast, counsel for the Crown argued that the apportionment could be made amongst the persons having interests in the settled property at any time in the year of assessment in which the gain arose. Counsel for the Crown, somewhat surprisingly in my view, conceded that if the interests had been assigned in the previous year of assessment, then no apportionment could have been made on the assignors! The Judge took the view that the relevant time was *either* the date of disposal *or* the entire life of the settlement and that there could be no intermediate logical stopping place. He, in fact, opted for the date of disposal.¹

Will the Judgment be Overruled?

While the decision is no doubt a very welcome one for taxpayers, especially coming from a Judge who does not have a reputation as being pro-taxpayer, it is by no means certain that it would not be overruled by the Court of Appeal. I do not myself see any difficulty at all in treating the relevant time as the year of assessment. After all, apportionable gains can be calculated only on a year-by-year basis. What this would enable one to do in *Lincoln-Lewis* is to enlarge the range of persons amongst whom an apportionment *could* be made. There is then no difficulty in making the apportionment amongst the UK resident beneficiaries as one can take into account the fact that the company has purchased its interest whereas the assignors have received

¹ It would seem, contrary to my view expressed here, that Counsel for the taxpayer considers that Hoffmann J accepted the First Argument, which was the only argument addressed to him.

a tax-free consideration for the assignments. Even Hoffmann J agreed with this,² which makes his conclusion all the more surprising.

Scope of Decision

Even if the judgment stands, it would be possible for the Revenue to distinguish it from other cases. It would appear that in *Lincoln-Lewis* the trust was not discretionary and once the principal beneficiaries had assigned their interests to the Guernsey company they no longer had any interest whatsoever under the settlement. In other cases, that feature may not be present. What if, for example, the Guernsey company had become entitled only on the satisfaction of a contingency which occurred after the gains had been realised and the assignors had still remained discretionary beneficiaries? The answer is probably that if it is right to apportion the gain only amongst beneficiaries who have interests at the time the gain is realised, it must follow logically that one performs the apportionment as at that date. Thus, it is at that date that one applies the dicta in *Leedale v Lewis*.³ If at the date the gains were realised it was clear that the trust funds would in all probability be distributed to the Guernsey company, then all the gains should be apportioned to it. If, with the benefit of hindsight, it in fact became shortly afterwards absolutely entitled to all the settled property, the case is so much the stronger.

² See 316 J - 317A. The Judge's attitude was that a just and reasonable apportionment could hardly avoid inquiry as to the terms on which the interest was assigned from the one to the other. This leaves open the possibility that an assignment by way of gift might be different.

³ particularly those of Lord Fraser of Tullybelton and of Lord Scarman.

Borrow, Appoint and Sell Strategies

How far does the decision extend? It would certainly be relevant to an alternative strategy often employed, namely for the trustees to borrow a large amount of money and make absolute appointments to UK resident beneficiaries. The beneficiaries would then be excluded from benefit and, in the next year of assessment, the assets would be sold, virtually the whole proceeds being used to repay the borrowing. It would follow from the decision that the exercise would have worked even if everything took place in the same year of assessment (but in the same order). One could even argue that the combined result of this decision and of *Leedale v Lewis* is that the scheme would still have worked if the beneficiaries had not been excluded at the date of the sale, provided that it was then clear that the net value left in the settlement was destined to go elsewhere, for example to a charity or a non-UK resident or foreign domiciliary.

A General Moral

If I had been advising the taxpayers in consultation, I would not have held out too much hope of victory. I would have explained that judicial attitudes to tax avoidance had changed enormously in the last twenty years; that most judges would do down tax-avoiders if there was any intellectually respectable ground on which they could find for the Revenue! The decision shows that tax-avoiders still have a sporting chance and that in a case where the amount at stake is large in relation to the likely costs, it would not be irresponsible to invite a commercially minded taxpayer to "have a go". The advice should come with a warning that such litigation is definitely not for "old ladies" of any age or sex.