DISPOSALS OF INTERESTS IN SETTLED PROPERTY: TCGA 1992 Schedule 4A

Robert Venables QC[1]

1 The Mischief

1.1 General Exemption for Disposal of Interest in Settled Property

The general rule is that the disposal of an interest in settled property is exempt from capital gains tax. The trustees of a settlement are treated as a separate body of persons owning the settled property and liable to capital gains tax on deemed disposals of such property. Hence, it is thought unjust to tax the beneficiaries on a disposal of their beneficial interests, as this will give rise to a double charge to tax on the same underlying gain. Even before Finance Bill 2000, there were three broad exceptions from this rule; firstly where the trustees were non-UK resident; secondly where the settlement had at some time previously been non-UK resident or where it included property derived from such a settlement and, thirdly, in many cases where the beneficial interest had been obtained for a consideration.[2]

1.2 Strategies Involving Sale of Beneficial Interest

Capital gains tax avoidance schemes were developed which used UK resident trusts. An asset would be gifted to the trust with an election for holdover relief being made.[3] Some beneficiary, often the settlor, would have a very substantial interest

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2 See my *Non-Resident Trusts* 8th edition Chapter 15.

3 If the asset was already held in a UK resident trust which had never been non-UK resident, this step would not be necessary.

under the settlement[4] which would be sold to a purchaser. The nature of the interest would be such that within a reasonable time the purchaser was likely to become absolutely entitled to the settled property. The trustees and the purchaser would then make a further election for holdover relief. In this way, assets could be transferred from the settlor to the purchaser without the consideration received being chargeable to capital gains tax. While the potential inheritance tax complications were enormous and the trust drafting was far from easy, with skilled advice such schemes could be successfully implemented, although the increase in the rates of stamp duty and the tightening up of the stamp duty rules did make them even more complicated.

1.3 The First Attack: Restriction on Holdover Relief

The Chancellor effectively put an end to most of these schemes in his November 1999 Mini Budget. Holdover relief has now been abolished where the transferee is a company and the assets are shares and securities: see the amendments to TCGA, section 165 by Finance Act 2000.[5]

Even after the Mini Budget, the strategy was still in principle viable as regards gifts of business assets and land qualifying from agricultural property relief from inheritance tax. As regards shares and securities it was only viable in that very rare case where a purchaser could be found who was an individual, the trustees of a settlement or, possibly, the personal representatives of a deceased person.

1.4 The Second Attack: Deemed Disposal by Trustees

It was therefore all the more surprising that in the Budget Speech in March 2000 the Chancellor announced that further steps were to be taken to counter avoidance through the sales of interests in United Kingdom resident settlements. There is, to my mind, a fair argument that these new anti-avoidance provisions will on balance facilitate rather than discourage avoidance of tax! In particular, they exempt from a charge to capital gains tax certain disposals made by beneficiaries and allow generally allowable losses to be generated without the trustees disposing of assets. A new Schedule 4A to the TCGA has been inserted, by Finance Act 2000, as regards "any disposal of interest in settled property made, or the effective

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4 If the interest did not already exist, it might be created by the exercise of a power of appointment.

5 See my article *United Kingdom Mini-Budget Anti-Avoidance Measures* in *The Offshore and International Taxation Review* Volume 9 Issue 2.

completion of which"[6] falls on or after the 21st March 2000.

2 Overview

2.1 Schedule 4A

Schedule 4A is headed "Disposal of interest in settled property: deemed disposal of underlying assets". The Schedule applies only where:[7]

> there is a disposal of an interest in settled property[8] for consideration and
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> the trustees are United Kingdom resident in the relevant period,[9] and
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> the settlor is alive and United Kingdom resident in the relevant period,[10] and
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> the settlor has an interest in the settlement in the relevant period (see paragraph 7)[11] ..."

"The relevant year of assessment" is the year of assessment in which the disposal of the interest in settled property is made.[12]

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6 The phrase "effective completion" is to be construed in accordance with the new Schedule 4A.

7 See paragraph 4(1).

8 If the trustees of a settlement have elected that section 691(2) of the Taxes Act (certain income of maintenance funds for historic buildings not to be income of settlor etc) is to have effect in the case of a settlement or part of a settlement in relation to a year of assessment, then paragraph 12 of Schedule 4A provides that the Schedule is not to apply in relation to the settlement or part for that year.

9 See paragraph 5 and section 5 below.

10 See paragraph 6 and section 6 below.

11 See paragraph 7 and section 7 below.

12 Paragraph 4(2).

The way the Schedule operates is by deeming the trustees to make a disposal of the whole or part of the settled property ("the relevant underlying assets") for a market value consideration.[13]

It should be noted that the Schedule is not limited to operate only in the case of disposal by the settlor (or the spouse of the settlor).

One important feature of the Schedule is that there cannot in general be a charge to tax on the beneficiary's disposal of his interest and a deemed disposal by the trustees under the Schedule. Given that the deemed disposal by the trustees will usually merely accelerate a tax charge which would be due sooner or later, the Schedule can thus operate to reduce the amount of capital gains tax payable overall.

One ridiculously unfair aspect of the Schedule is that the tax payable by the trustees on the deemed disposal by them is recoverable from the beneficiary the disposal of whose interest brought the Schedule into operation.

2.2 Critique

It is not clear why the Schedule operates only where the settlor is alive and United Kingdom resident in the relevant period and the settlor has an interest in the settlement in the relevant period. The mischief at which the Schedule is aimed is present equally if (a) the settlor is not alive or (b) the settlor is not United Kingdom resident or (c) the settlor has no interest in the settlement.

Why the conditions as to the settlor being alive and United Kingdom resident and having an interest in the Settlement are extended to the relevant period and not just the time of disposal of the beneficial interest is not immediately apparent.

Nor is it clear that why it is enough that the trustees are United Kingdom resident at any time in the relevant period and do not need to be resident at the time of the disposal. The result is that the Schedule can apply to trustees who are non-UK resident even throughout the whole of the year in which the disposal occurs. If the trustees are non-UK resident at the time of the disposal, the disposal by the beneficiary of his beneficial interest will not be exempt from capital gains tax. Hence, there would appear to be no reason for the Schedule to apply.

It is equally difficult to see why the Schedule should operate where the disposal is not exempt or not taxable for some other reason, e.g., because the interest has been acquired for a valuable consideration, the trust has at some time been non-UK

13 Paragraph 4(1).

resident or the person making the disposal is non-UK resident.

3 Disposal of an Interest in Settled Property

3.1 The Statute

Paragraph 1 provides:

> "This Schedule applies where there is a disposal of an interest in settled property for consideration".

"Disposal" is not defined and thus *prima facie* bears its normal capital gains tax meaning. "Interest in settled property" is defined: see 3.2. "For consideration" is likewise defined: see 3.3.

3.2 "Interest in Settled Property"

An interest in settled property is defined, by paragraph 2(1) to mean "any interest created by or arising under a settlement." The meaning is extended, by paragraph 2(2) to "include":

> "any right to, or in connection with, the enjoyment of a benefit -
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> (a) created by or arising directly under a settlement, or
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> (b) arising as a result of the exercise of a discretion or power -
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> (i) by the trustees of a settlement, or
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> (ii) by any person in relation to settled property."

The expression "any interest created by or arising under a settlement" in paragraph 2(1) is already quite wide. It would, in my view, amply cover the situation where a settlement is wholly discretionary in terms when it is created but the trustees in the exercise of their discretion confer, say, a life interest on a beneficiary. The interest arises *under* the settlement even though it is not created contemporaneously with it.[14] However that may be, paragraph 2(2)(b) makes it clear beyond doubt that such an interest is covered.

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14 See *Drummond v Collins* 6 TC 525 (HL).

There is much learning as to whether the mere *spes* or hope of a beneficiary of a discretionary trust or the rights, such as they are, of the object of a power of appointment can be classified as an "interest".[15] Arguably, the answer to the question depends on the statutory context in which it arises. At first blush, one might consider the position to be academic; for such a right can have no value and therefore the disposal of it for a consideration would not confer on its holder any tax-free benefit; hence the Schedule does not need to operate in such a case. It is not beyond the ingenuity of crafty tax advisers, however, to devise arrangements whereby even such a right can be turned to considerable pecuniary account.

Supposing that property is settled upon trust for A for life, with remainder to B. Supposing B's interest becomes vested in C. (It does not matter whether this is by way of sale, gift bequest or otherwise.) As B's remainder was created by and arose under the settlement, it is still clearly an "interest in settled property" notwithstanding that ownership of it has changed hands. Suppose, however, that B has settled his remainder upon trust for D for life with remainder to E. Although the interests of D and E are carved out of the interest of B, they were neither created by nor arose under the settlement. They were certainly neither created by nor arose directly under the original settlement. Could it be said that they arose "as a result of the exercise of a discretion or power ... by any person in relation to settled property"?

While the man in the street might conceivably think so, no Chancery practitioner would agree. In a sense, everyone who is the owner of property can in their "discretion" dispose of it and has a "power" of disposing of it. Yet the composite phrase "discretion or power" conveys to the lawyer the power of a person who is not the owner of property to affect its beneficial ownership.[16] Hence, the settling by a beneficiary of settlement of his beneficial interest under that settlement on fresh trusts is not the "exercise of a discretion or power" by that beneficiary in relation

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15 Contrast *Leedale v Lewis* (1982) 56 TC 501; [1982] STC 835 with *Gartside v Inland Revenue Commissioners* [1968] AC 553.

16 In *Inland Revenue Commissioners v Botnar* [1999] STC 711, Morritt LJ, with whom Aldous LJ agreed, said, at page 728: "As stated in 36 Halsbury's Laws (4th edn) para 801 the word 'power' is a term of art denoting an authority vested in a person, called 'the donee', to deal with or dispose of property not his own and is to be distinguished from the dominion that a person has over his or her own property. It appears to me to have been used in that sense in [Taxes Act 1970] section 478(5)(d). If 'power' includes dispositions made of his property by an absolute beneficial owner then there is virtually no limit to the application of the section." The section referred to is now Taxes Act 1988 section 742(2)(d), under which a person has "power to enjoy" income if "he may, in the event of the exercise or successive exercise of one or more powers, by whomsoever exercisable and whether with or without the consent of any other person, become entitled to the beneficial enjoyment of the income ...'

to the original settled property.

The concept of a "right to ... the enjoyment of a benefit" is straightforward. What, however, is meant by the phrase "right ... in connection with ... the enjoyment of a benefit"? Did the draftsman have anything particular in mind or was he deliberately using vague and wide words of uncertain meaning to cover himself in case he had forgotten something, in the hope that, faced with tax avoidance, the courts would strain his language so far as possible so as to find in favour of the Revenue?

3.3 "For consideration"

3.3.1 Definition

For the purposes of this Schedule, a disposal is "for consideration" if "consideration is given or received by any person for, or otherwise in connection with, any transaction by virtue of which the disposal is effected": paragraph 3(1).

The term "consideration" is not defined. It must therefore, in my view, bear its normal meaning in the law of contract as the price or *quid pro quo* for something. It is enough that consideration is given "or" received by any person. I cannot myself imagine a situation in which consideration is given without being received or received without being given. As it is enough for the consideration to be given or received by any person, it would appear that the draftsman here has been making assurance doubly sure.

It is enough that consideration is given not for the transaction by virtue of which the disposal is effected but "otherwise in connection with" it. No case springs to my mind where the consideration will be given for the one but not the other. Possibly, the draftsman is simply exercising abundant care. If something of value is given *in connection with* a transaction of disposal but not *for* it, it is very possible that it might not constitute "consideration". If it is not given for the disposal transaction, then it will clearly not be consideration for that disposal transaction. While it is possible that it might be consideration for something else, it may be consideration for nothing at all, in which case it will be irrelevant that the benefit is conferred in connection with any disposal transaction.

3.3.2 Creation of New Beneficial Interest

Variants on the basic scheme sometimes involved not the disposal of a beneficial interest but the creation of a new beneficial interest by, say, the trustees in exercise of their dispositive powers, which interest was vested in the "purchaser". The

purchaser would, in connection with this exercise, make a payment to a beneficiary under the settlement. Such transactions were always problematic, as the purchaser needed first-rate trust advice, to ensure that he did in fact finish up with good title to the interest and that the purported exercise by the trustees of their powers was not void in equity. This method also had stamp duty advantages provided it did not involve a conveyance on sale.

If the scheme were now to be operated, it could plausibly be said that the payment made by the "purchaser" to the beneficiary was "consideration" given in connection with the appointment of the new interest. The payment would arguably be "consideration" if it was given in return for the beneficiary helping to procure the trustees to exercise their powers as to vest the new interest in the "purchaser". Schedule 4A would only apply, however, if there were a "disposal" of an interest in settled property. To my mind, if such a route is followed, there is no disposal. The interest comes into being and is acquired by the "purchaser" but it is not disposed of by the trustees. The trustees never owned any beneficial interest. All they ever owned was the legal interest. They had a power to create beneficial interests, not to assign or transfer them.

I believe that the Revenue, too, would be reluctant to argue that there had been a disposal by the trustees in such circumstances. If there were, then it would follow that the beneficiary's base cost for his interest would be its market value at the time it was created.[17] In the case of a non-UK resident discretionary trust, the trustees could appoint an interest in capital to a beneficiary contingently on his surviving a certain period and he could dispose of his interest later the same day to a non-UK resident purchaser without paying any capital gains tax. While Finance Act 1981[18] brought a disposal of a beneficial interest in a non-resident settlement within the charge to capital gains tax, that would be of no consequence if the base cost were as high as the disposal proceeds so that there was no taxable gain.

3.3.3 Variations of Trusts

In determining for the purposes of the Schedule whether a disposal is for consideration, one disregards any consideration consisting of another interest under the same settlement that has not previously been disposed of by any person for consideration: paragraph 3(2). This means that the traditional variation of a trust by beneficiaries within a family context will often not trigger the operation of the

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17 Whereas, if there were no corresponding disposal, then his base cost would normally be nil: TCGA 1992, section 17(2).

18 See now Taxation of Chargeable Gains Act 1992 section 85(1).

Schedule. Even in such a context, care must be taken to avoid "extraneous" consideration as where, for example, one of the parties bears the costs of another of the parties. This provision mirrors the proviso to the exception from the exemption from capital gains tax[19] on the disposal of interest under a settlement conferred by Taxation of Chargeable Gains Act 1992 section 76(1).

3.3.4 Deemed Consideration

It is made clear, by paragraph 1(3) that in the Schedule "consideration" means actual consideration, as opposed to consideration deemed to be given by any provision of the Taxation of Chargeable Gains Act 1992. Thus, where property is settled on A for life remainder to B and B, during A's lifetime, gifts his interest to his son, C, although he is deemed for capital gains tax purposes to receive a market value consideration, such deemed consideration is ignored for the purposes of the Schedule so that it is not thereby brought into play.

4 Deemed Disposal of Underlying Assets

4.1 The Deemed Disposal

The effect of the operation of the Schedule is that "the trustees of the settlement are treated for all the purposes of the Taxation of Chargeable Gains Act 1992 TCGA as disposing of and immediately reacquiring the "relevant underlying assets":[20] paragraph 4(1). This is referred to in the Schedule as the "deemed disposal".

4.2 Time of Deemed Disposal

The deemed disposal normally takes place when the disposal of the settled interest in property is made. Where, however, the beginning of disposal and its "effective completion", fall in different years of assessment, different rules apply.[21]

4.3 Consideration for Deemed Disposal

Paragraph 9(1) provides that the deemed disposal is to be taken:

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19 I regret I cannot state the matter more intelligibly!

20 For the definition of this phrase, see section 8 below.

21 See paragraphs 4(3) and 13(3)(a).

"(a) to be for a consideration equal to the whole or, as the case may be, a corresponding part of the market value of each of the assets concerned, and

(b) to be a disposal under a bargain at arm's length."

There is a special rule where the value of the assets changes during the period between the beginning of the disposal and its effective completion.[22]

As the deemed disposal is deemed to be under a bargain at arm's length, the trustees cannot elect to hold over any gain which arises.

5 Condition as to UK Residence of Trustees

5.1 The Statute

The condition as to UK residence of the trustees is that the trustees of the settlement were either

"(a) resident in the United Kingdom during the whole or part of the relevant year of assessment, or

(b) ordinarily resident in the United Kingdom during that year."[23]

5.2 Migrant Trustees

It should be noted that it is enough that the trustees were resident during *a part* of the relevant year of assessment, which need not include the time at which the disposal of the interest in settled property is made. If the trustees are non-UK resident at such time, then the disposal will not be exempt from capital gains tax: Taxation of Chargeable Gains Act 1992 section 76(1A) and (1B) and section 85(1). It is difficult to see why the Schedule should operate in such a case.

The draftsman clearly presupposes that it is possible for trustees to be ordinarily resident in the United Kingdom during a year of assessment without being resident in the United Kingdom in any part of it. That is somewhat questionable. In all probability, he is simply picking up the language of section 2(1) of the Taxation of

22 Paragraph 9(2) and 13(1)(b).

23 See paragraph 5(1).

Chargeable Gains Act 1992. I have yet to meet a case where the Revenue have alleged that trustees have been ordinarily resident in the United Kingdom during a year of assessment in no part of which they have been resident here.

5.3 Dual Resident Trustees

Trustees may be resident or ordinarily resident in the United Kingdom for UK tax purposes yet be regarded for the purposes of a double taxation convention as resident in some other jurisdiction. It is expressly provided that trustees are not to be regarded as resident or ordinarily resident in the United Kingdom for the purpose of the condition as to UK residence of trustees at any time "when they fall to be regarded for the purposes of any double taxation relief arrangements as resident in a territory outside the United Kingdom."[24]

Let us suppose that the trustees are resident in the United Kingdom for UK tax purposes and resident in Ruritania for Ruritanian tax purposes and that under the UK-Ruritanian double taxation convention they are regarded as a resident of Ruritania. The disposal of a beneficial interest in the settlement does not cease to be exempt from capital gains tax by virtue of Taxation of Chargeable Gains Act 1992 section 85(1), for that only applies if at the time of the disposal "the trustees are neither resident nor ordinarily resident in the United Kingdom" and, *ex hypothesi*, they will be. The exemption, however, has been removed by the amendments made to Taxation of Chargeable Gains Act 1992 section 76 by Finance Act 1998 section 128. Because there "has been a time" when the trustees of the settlement "fell to be regarded for the purposes of any double taxation relief arrangements as resident in a territory outside the United Kingdom", the disposal is now chargeable: section 76(1B)(b). Hence, the Schedule does not need to apply to such trusts as they cannot be used to effect the mischief at which it is aimed.

6 Condition as to UK Residence of Settlor

The "condition as to UK residence of the settlor" is that:

> "in the relevant year of assessment, or any of the previous five years of assessment, a person who is a settlor[25] in relation to that settlement either -

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24 Paragraph 5(2).

25 The provisions of section 79(1) and (3) to (5)(meaning of "settlor" for the purposes of the United Kingdom Settlor provisions) apply for the purposes of Schedule 4A as they apply for the purposes of sections 77 and 78: paragraph 12 of Schedule 4A.

(a) was resident in the United Kingdom during the whole or part of the year, or

(b) was ordinarily resident in the United Kingdom during that year."[26]

No account is to be taken for the purpose of this paragraph for any year of assessment before the year 1999-00. Hence, the Schedule imposes a charge to retrospective taxation in that it can apply to a settlor who was at no time resident or ordinarily resident in the United Kingdom after 20th March 2000 but was so resident at a time after April 5th 1999.

I discuss the purpose of this rule at 7.4.

7 Condition as to Settlor Interest in the Settlement

7.1 The Statute

The "condition as to settlor interest in the settlement" is that:

"at any time in the relevant period of the settlement–

(a) was a settlor-interested settlement, or

(b) comprised property derived, directly or indirectly, from a settlement that at any time in that period was a settlor-interested settlement."[27]

7.2 The Relevant Period

The "relevant period" for this purpose is normally the period:-

"(a) beginning two years before the beginning of the relevant year of assessment, and

(b) ending with the date of the disposal of the interest in settled

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26 Paragraph 6(1).

27 Paragraph 7(1).

property."[28]

The relevant period is not to be treated as beginning before the 6th April 1999.[29] Again, this involves a degree of retrospective taxation.

Just as, where the beginning of the disposal and its effective completion fall in different years of assessment, there is a special rule for determining the relevant year of assessment, so too, there is a special rule for determining the relevant period in such a case.[30]

7.3 Settlor-interested Settlement"

A "settlor-interested settlement" means a settlement in which a person who is a settlor in relation to the settlement "has an interest or had an interest at any time in the relevant period."[31] The test of whether a settlor has an interest in a settlement is broadly the same as that which applies for the purposes of Taxation of Chargeable Gains Act 1992 section 77 (charge on settlor with interest in UK resident settlement) in that Schedule 4A, paragraph 7(4) incorporates by reference section 77(2) to (5) and (8).

The test of "settlor-interested settlement" does not incorporate section 77(6) (which provides that a settlor does not have an interest in a settlement in a year of assessment for the purposes of the United Kingdom Settlor Provisions if (a) the settlor dies during the year, or (b), in a case where the settlor is regarded as having an interest in the settlement by reason only of (i) the fact that property is, or will or may become, payable to or applicable for the benefit of his spouse, or (ii) the fact that a benefit is enjoyed by his spouse, where the spouse dies, or the settlor and the spouse cease to be married, during the year. While this test is not incorporated in determining whether a settlor *has an interest in a settlement* for the purposes of paragraph 7 of Schedule 4A, it is incorporated for another purpose, namely determining whether the *condition as to settlor interest in the settlement* is met in a year of assessment.[32]

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28 Paragraph 7(2).

29 Paragraph 7(3).

30 See paragraphs 7(2) and 13(3)(d).

31 See paragraph 7(4).

32 See paragraph 7(5) of Schedule 4A.

Suppose that a settlor has an interest in a settlement between April 6th 1999 and his death on April 1st 2001. If the test in the United Kingdom Settlor Provisions were incorporated wholesale without more, he would have an interest in the settlement in 1999/2000 but not in 2000/2001. The condition as to settlor interest in the settlement would be satisfied as regards both years. In 1999/2000 the settlor would have an interest in the settlement in that year and in 2000/2001 he would have had an interest in the settlement in the relevant period i.e. the period from April 6th 1999 to the date of the relevant disposal in 2000/2001, namely in the year of assessment 1999/2000. By incorporating the United Kingdom Settlor Provisions with modifications, the draughtsman has ensured that Schedule 4A cannot apply at all in the year of assessment 2000/2001.

7.4 Critique of Condition as to UK Residence of Settlor and as to Settlor Interest in the Settlement

Why does the Schedule apply to a settlor-interested settlement only? Why should the Schedule apply even if the settlor had an interest under the settlement which ceased almost three years before the disposal? Why should the Schedule apply even if the condition as to United Kingdom residence of the settlor ceased to be satisfied almost six years before the date of the disposal?

8 The Relevant Underlying Assets

8.1 The Statute

The deemed disposal under the Schedule is only of "the relevant underlying assets". Paragraph 8 of the Schedule provides:

> "8(1) Where the interest disposed of is a right in relation to a specific fund or other defined part of the settled property, the deemed disposal is of the whole or part of each of the assets comprised in that fund or part. In any other case the deemed disposal is of the whole or part of each of the assets comprised in the settled property.
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> (2) Where the interest disposed of is an interest in a specific fraction or amount of the income or capital of-
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> (a) the settled property, or
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> (b) a specific fund or other defined part of the settled property,

the deemed disposal is of a corresponding part of each of the assets comprised in the settled property or, as the case may be, each of the assets comprised in that fund or part.

In any other case the deemed disposal is of the whole of each of the assets so comprised."[33]

8.2 Specific Fund

What is a "specific fund"? This would cover the case where a settlement has, say, an A Fund and a B Fund held on different trusts, perhaps for different branches of a family. If a beneficiary disposes of his interest in Fund A it would be inappropriate for that to cause a deemed disposal by the trustees of Fund B.

8.3 Defined Part of Settled Property

What is mean by "other defined part of the settled property"? Even if there is only one fund, if that fund included, say, a shareholding in a private company, that shareholding would in my view constitute a "defined part of the settled property", so that if the beneficiary disposed of his interest only in that shareholding, the trustees would not be deemed to dispose of any of the other settled property.

8.4 Deemed Part Disposals

When is the deemed disposal to be, not of the whole, but of only part, of each of the assets comprised in that fund or part? Paragraph 8(1) in itself gives no guidance. If, say, a beneficiary has an interest in only half of Fund A of a settlement, paragraph 8(2) makes it clear that if he disposes of his interest, the trustees are deemed to dispose of only one-half of that fund. Similarly if the beneficiary disposes of a right in one-half of a defined part of the settled property.

Where part only of an asset is comprised in a specific fund or other defined part of the settled property, that part of the asset is to be treated for the purposes of this Schedule as if it were a separate asset.[34] Hence, if the trustees own an office block company and a one-half undivided share of the block is held in Fund A, the disposal

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33 There is a special rule where the identity of the underlying assets changes during the period between the beginning of the disposal and its effective completion: see paragraphs 8(3) and 13(4)(a).

34 Paragraph 8(4).

of an interest in the whole of Fund A will cause the trustees to be deemed to dispose of only a one-half share in the block.

8.5 Critique

The paragraph may not work well where a beneficiary has an annuity charged on, say, the whole of the settled property. In that case, it is arguable that even if only a small fraction of the income is needed to pay the annuity, a disposal of the annuity would cause a deemed disposal of the entire trust fund.[35]

If the interest disposed of is an interest (whether in the income or capital) of the whole of the fund, it would appear that the trustees are deemed to dispose of the whole of that fund, no matter how insignificant the interest is, for example, a default gift which will take effect only if all the members of a family are wiped out.

9 Avoidance of Double Counting

9.1 The Principle

Paragraph 10 of the Schedule is headed "Avoidance of double-counting". In summary, no chargeable gain is treated as accruing on the disposal of the interest in the settlement provided that the chargeable gain on the disposal of the interest would be less than the "net chargeable gain" on the deemed disposal by the trustees. This might conceivably form the basis of tax planning in a suitable case where the settlement has in the past been non-UK resident and has stockpiled section 87 trust gains. The complexities of such planning should not be underestimated.

Paragraph 10(1) states that the "provisions of this paragraph have effect to prevent there being both a deemed disposal under this Schedule in relation to the disposal of an interest in settled property and a chargeable disposal of the interest itself."

A "chargeable disposal" means "one in relation to which section 76(1) does not apply" i.e. provided the gain is not exempt from capital gains tax under section 76(1), it does not matter that, for some reason or another, the beneficiary who disposes of his interest will not be liable to pay any actual capital gains tax in respect of the disposal.

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35 Compare the different inheritance tax treatment: Inheritance Tax Act section 50.

Paragraph 10(5) defines "net chargeable gain" and "net allowable loss" unexceptionally:

> (a) there is a net chargeable gain on a deemed disposal if the aggregate of the chargeable gains accruing to the trustees in respect of the assets involved exceeds the aggregate of the allowable losses so accruing; and
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> (b) there is a net allowable loss on a deemed disposal if the aggregate of the allowable losses accruing to the trustees in respect of the assets involved exceeds the aggregate of the chargeable gains so accruing.

It should be noted that one is concerned with the amount of the gains, not with the amount of tax which will or will not be payable in respect of those gains. One does not pay any attention to the fact that the beneficiary or the trustees may be non-UK resident or may have allowable losses to set against the gains. One ignores the fact, if such it be, that the beneficiary is a non-UK domiciliary who is taxable only on the remittance basis or that he may be eligible from some exemption from capital gains tax. One does not ask what rate of tax the trustees and the beneficiaries will pay. One ignores the effect of taper relief, although one does take indexation relief into account. Hence, the Schedule may not necessarily work to the Revenue's advantage.

9.2 Rule 1

There are three rules. If there would be a chargeable gain on the disposal of the interest in the settlement, the first rule applies, which is contained in paragraph 10(2):-

> "(a) if –
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> (i) the chargeable gain on the disposal of the interest would be greater than the net chargeable gain on the deemed disposal, or
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> (ii) there would be no net chargeable gain on the deemed disposal,
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> the provisions of this Schedule as to a deemed disposal do not apply; and

(b) in any other case, the provisions of this Schedule as to a deemed disposal apply and no chargeable gain is treated as accruing on the disposal of the interest in the settlement."

Firstly, one sees whether there will be a "chargeable" gain on the disposal of the beneficiary's interest.[36] If there is not, then paragraph 10 has no application. If there is, one then calculates which would be greater, the chargeable gain on the disposal of the beneficial interest or the "net chargeable gain on the deemed disposal" by the trustees. If the former, then the Schedule does not apply. If the latter, the Schedule does apply but the gain on the disposal of the beneficial interest is exempt.

It will be observed that the two ways in which the Schedule can operate are not at all similar. If the Schedule does not apply, the inherent gain of the trustees is not "washed" but is still there waiting to be realised and taxed on the next actual or deemed disposal. If the gain on the disposal of the beneficial interest is exempt, that exemption is definitive. Hence, paragraph 10(2) offers opportunities for tax planning in an appropriate case.

9.3 Rule 2

If there would be an allowable loss on the disposal of the interest in the settlement, then the second rule, contained in paragraph 10(3), provides:

"(a) if there would be a greater net allowable loss on the deemed disposal, the provisions of this Schedule as to a deemed disposal do not apply; and

(b) in any other case, the provisions of this Schedule as to a deemed disposal apply and no allowable loss is treated as accruing on the disposal of the interest in the settlement."

This is the mirror image of paragraph 10(2). Just as that paragraph offers opportunities for tax planning in an appropriate case, so paragraph 10(3) contains a trap in that an allowable loss may be definitively lost quite unfairly and for no good reason.

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36 If section 76(1) applies, there will in any event be no chargeable gain.

9.4 Rule 3

If there would be neither a chargeable gain nor an allowable loss on the disposal of the interest in the settlement, then the third rule, contained in paragraph 10(4), provides:

> "(a) if there would be a net allowable loss on the deemed disposal, the provisions of this Schedule as to a deemed disposal do not apply; and
>
> (b) in any other case, the provisions of this Schedule as to a deemed disposal apply."

Sub-paragraph (a) is not that much of a problem as the trustees can always effect a disposal to a non-connected person so as to realise the inherent losses and make them allowable losses.[37]

10 Generation of Trust Allowable Losses

It will be perceived that the effect of the Schedule may be to deem the trustees to realise losses. Provided the trustees are resident or ordinarily resident in the United Kingdom in the year in which the disposal occurs, these will be allowable losses, freely available to be set against all gains. Taxation of Chargeable Gains Act 1992 section 18(3) will not operate so as to ring-fence the loss, as the trustees are not connected with themselves.

11 Recovery of Tax From Person Disposing of Interest

11.1 The Statute

Paragraph 11 provides:

> "11(1) This paragraph applies where chargeable gains accrue to the trustees on the deemed disposal and –
>
> (a) tax becomes chargeable on and is paid by the trustees in

37 Unless the trustees are not resident or ordinarily resident in the United Kingdom in any part of the year in which the disposal occurs.

respect of those gains, or

(b) a person who is a settlor in relation to the settlement recovers from the trustees under section 78 an amount of tax in respect of those gains.

(2) The trustees are entitled to recover the amount of the tax referred to in sub-paragraph (1)(a) or (b) from the person who disposed of the interest in the settlement.

(3) For this purpose the trustees may require an inspector to give that person a certificate specifying-

(a) the amount of the gains in question, and

(b) the amount of tax that has been paid.

Any such certificate shall be conclusive evidence of the facts stated in it."

11.2 Critique

This is the most extraordinary provision. While it is true that it will be the disposal by the beneficiary which will have provoked the deemed disposal, the gain which is deemed to be realised is a gain of the trustees. It is difficult to see how in all justice anyone but they should ultimately bear the tax in respect of it.

Suppose the trustees of a United Kingdom discretionary trust appoint to trustees for Gordon Brown absolutely a remainder contingent on a contingency which is very unlikely to occur. The second set of trustees feel they cannot refuse an offer to purchase it for £100, which is much more than its value. The first set of trustees are deemed to realise gains under the Schedule and are liable to pay a substantial amount of tax. Mr Brown is bound to reimburse them.

11.3 Non-UK Resident Trustees

Where the trustees are not United Kingdom resident or ordinarily resident in the year of disposal, it is a moot point to what extent the right of indemnity applies. Taxation of Chargeable Gains Act 1992 section 78 will not be in point, but section 86 and Schedule 5 paragraph 6 may be. The settlor clearly has no direct right of indemnity against the beneficiary.

In my view, if the settlor is chargeable under section 86 and is reimbursed by the trustees under paragraph 6, then the trustees have a right of reimbursement against the beneficiary who made the disposal under paragraph 11(1)(a) of the Schedule.

Where neither the trustees nor the settlor are liable but the gains arising on the deemed disposal are simply added to the section 87 stockpile, I do not see how a beneficiary who is chargeable to capital gains tax in respect of those gains has any right of indemnity against the beneficiary who disposes of his interest.