SECTION 77 TCGA 1992

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This article explains why, in the author's view, allowable losses which accrue to trustees of a settlement under section 72 Finance Act 1991 cannot be used to reduce the chargeable gains attributable to the settlor by section 77 TCGA 1992.

S.77 applies to settlements where the settlor has an interest in the settlement, and where the settlor and the trustees have been resident or ordinarily resident in the UK for a part of the year of assessment. It operates by attributing to the settlor an amount of chargeable gains equal to those which accrue to the trustees *"from the disposal of any or all of the settled property after making any deduction provided for by section 2(2) in respect of disposals of the settled property"*. It is these words in italics which restrict the scope of section 77 TCGA 1992 when given their ordinary and natural meaning and which are the subject of this article.

The phrase "settled property" is defined by section 68 TCGA 1992 as "any property held in trust other than property to which section 60 applies". It follows that in cases where trustees of settlements dispose of cash or other property held in trust (other than bare trust) and thereby realise a chargeable gain, all the words in section 77(1)(a) are satisfied. And if they realise a loss which is allowable as a deduction under section 2(2), then all the words in section 77(1)(b) are satisfied. The basic case therefore supposes that the words "from disposals of settled property" and "in respect of disposals of settled property" carry their ordinary and natural meaning.

The relevant provision is section 77(1) TCGA 1992 which provides:

> "77(1) Where in a year of assessment –
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> (a) chargeable gains accrue to the trustees of a settlement from the disposal of any or all of the settled property,

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(b) after making any deduction provided by section 2(2) in respect of disposals of the settled property there remains an amount on which the trustees would, disregarding section 3, be chargeable to tax for the year in respect of those gains, and

(c) at any time during the year the settlor has an interest in the settlement

the trustees shall not be chargeable to tax in respect of those but instead chargeable gains of an amount equal to that referred to in paragraph (b) shall be treated as accruing to the settlor in that year."

Section 2(2) provides:

"2(2) Capital gains tax shall be charged on the total amount of chargeable gains accruing to the person chargeable in the year of assessment, after deducting –

(a) any allowable losses accruing to that person in that year of assessment, and

(b) so far as they have not been allowed as a deduction from chargeable gains accruing in any previous year of assessment, any allowable losses accruing to that person in any previous year of assessment (not earlier than the year 1965-66).

More complicated cases work equally well. For example, where s.116(10) TCGA 1992 applies to a reconstruction, rather than sections 127 to 135, the deferred chargeable gain is deemed "for the purposes of this Act", to accrue "on" the subsequent disposal of the trustees' new asset. A gain which accrues "on" the disposal of an asset which is settled property will accrue if, and only if, there is a disposal of that settled property and at moment of that disposal. In the author's view this is sufficient to cause the deemed gain to accrue "from" the disposal of the settled property.

Another example is the operation of section 80 TCGA 1992 which provides that on the emigration of trustees of a UK settlement,

"(2) The trustees shall be deemed for all purposes of this Act –

structure, one must consider also capital gains tax and commercial implications. Remember that not only the stamp duty rules but also the whole structure of taxation may be very different in the future from what it is now. Bear in mind also that the professional costs of selling a company tend to be greater than where selling land, as it involves a due diligence exercise and warranties by both directors and shareholders.

Tax Within the Company

Once the asset concerned is in the company, the duty on transfer of the shares for consideration would only be at 0.5%. The problem again, however, becomes capital gains tax, with the notorious double charge on appreciating assets held within a company: taper relief operates only for the benefit of the shareholders. Given appreciation in value, the company will ultimately be liable to corporation tax on chargeable gains on the gains arising within the company (subject to indexation allowance), whether this occurs on sale or on liquidation, and the shareholder will similarly be chargeable on the consequential increase in value of the shares post-taper relief (subject to the tax free uplift to market value on death). If, of course, the company is going to be a long term holder of the assets, it may not much matter that the gain accrues within the company.

The UK Resident Foreign Incorporated Company

Consider the planning possibilities offered by holding UK property within a company incorporated outside the UK (even if resident here for tax purposes). No share register would be kept in the UK and any transfers of shares in the company could be executed and kept outside the UK, with no liability to stamp duty or stamp duty reserve tax (the shares not being "chargeable securities" for purposes of the latter).

If therefore, having acquired the shares in the shares of a foreign company, which owns assets situated in the UK, the purchaser wants to obtain beneficial ownership of those assets, he can simply procure a liquidation of the company. The transfer of the assets to him in the liquidation can be certified under the 1987 Exempt Instruments Regulations and no duty is therefore chargeable.

Offshore Companies

Alternatively, consider the use not of registered shares but of bearer instruments such as warrants which are issued for an insubstantial price. While stamp duty at 1.5% will be payable on the price paid, future transfers of the warrants at their then market value will attract no further charge to stamp duty, as title will pass by delivery, nor will there be a liability to stamp duty reserve tax .

Assets Subject to A Liability

Finally, a significant difference between transfers of unincorporated assets and transfers of shares in companies can be seen with land that is mortgaged. A transfer of mortgaged land where the transferee takes over liability for the mortgage will attract stamp duty on its gross value. If on the other hand the land is held within a company, not only will the rate of duty be reduced from 4% maximum to 0.5%, the 0.5% will be charged on the net value rather than the gross. Thus, a purchaser may acquire shares in such a company. If he then chooses to extract the property from the company either through liquidation or, assuming that the company has sufficient distributable reserves, paying up a dividend in specie with no liability to stamp duty, there can be no further liability to duty: see above.

Conclusion

Fiscal considerations have always played a part in the choice of an appropriate business structure. Now, more than ever, stamp duty among other taxes needs to be taken into account. In cases where an interest in land forms part of the unincorporated business section 119 FA 2000 poses new problems. It can safely be said that stamp duty will continue to evolve; developments are likely to take the form of new anti-avoidance and other rules, as well as increases in rates.

(a) to have disposed of the defined assets immediately before the relevant time and

(b) immediately to have reacquired them".

Subject to certain exceptions, "defined assets" are "all assets constituting settled property of the settlement immediately before the relevant time". The "relevant time" is the time of emigration. There seems little doubt therefore that chargeable gains accruing to trustees under section 80 would be "from" the (deemed) disposal of the settled property, and therefore properly attributable to the settlor of a section 77 settlement.

Whereas sections 116(10) and 80 TCGA 1992 show that there is no reason not to give the words "from", and "in respect of", "the disposals of settled property" their natural meaning, sections 79(7) and 13 TCGA 1992 show that Parliament must have intended the words to take their natural meaning and to thereby impose an additional condition on section 77 computations.

A gain or loss which is attributed to trustees under section 13 TCGA 1992 will not be a gain or loss actually accruing from or in respect of disposals of settled property. Nor does section 13 deem them to be. On the face of it therefore section 13 gains and losses cannot be taken into account under s.77. However, since section 79(7) provides that:

> "The reference in section 77(1)(a) to gains accruing to trustees from the disposal of settled property includes a reference to gains treated as accruing to them under section 13 and the reference in section 77(1)(b) to deductions in respect of disposals of the settled property includes a reference to deductions on account of losses treated under section 13 as accruing to the trustees."

The existence of section 79(7) shows that the draftsman was concerned that, in its absence, the section 13 gains and losses could not be taken into account under section 77.

It follows from the above that there is a limit on the scope of s.77 attributions. This is a significant conclusion if the trustees of a settlement in which the settlor has an interest wish to make a claim under section 72 Finance Act 1991. This provision deems excess trading losses to be allowable losses. It does not deem them to be in respect of disposals of settled property. Therefore, unless the excess trading loss arose, as a matter of fact, in respect of disposals of settled property, the relief cannot reduce the s.77 gain.

In order to obtain the sum which is deemed to be an allowable loss by s.72, the balance of trading profits less expenditure is found for the year. The resulting sum is the amount of trading losses (a net figure). From this net figure is deducted trading losses set-off against general income of the claimant for that year or taken into account for giving relief for any other year. It is only this second net figure which is available to be used as allowable losses for capital gains tax purposes. If one cannot say that the original amount of trading expenditure incurred has been "brought into account" in the final computation (and cases such as *Bibby v Prudential* do say this), then in the author's view, one cannot say that the sum produced by the final computation is "in respect of" one of the ingredients in the initial computation. The original figure is simply too remote from the final net figure.

There is another difficulty. Not every instance where expenditure is incurred will be a disposal of settled property. The disposal of the settled property is the actual payment. However, under the contract the expenditure may not have been incurred on the date of the disposal.

It follows that trustees cannot reduce the chargeable trust gains which are attributed to the settlor under s.77 TCGA 1992 by making a claim under s.72 FA 1991 in respect of excess trading losses. This is the result of the clear language of s.72 FA 1991 which neither expressly, nor impliedly, deems the allowable losses to be in respect of disposals of settled property. The words cannot be implied into s.72 because not all allowable losses accrue to trustees from disposals of settled property. See for example, section 13 TCGA 1992.

The result of a claim under s.72 by trustees of a s.77 trust is therefore an allowable, but unusable loss.