
The Personal Tax Planning Review

TRANSITIONAL GAINS AND LOSSES OF GOLDEN TRUSTS

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1 The Question

I was asked at the recent Key Haven seminar in Jersey whether, in the context of the transitional provisions relating to "golden trusts":

- (a) net losses of a non-UK resident trust realised by the trustees in the transitional period March 19th 1998 - April 5th 1999 can be set off against gains actually realised by the trustees in the year of assessment 1999 / 2000
- (b) losses actually realised by the trustees in the year of assessment 1999 / 2000 can be set off against gains actually realised by the trustees in the transitional period

My initial view was that the answer to both questions was in the affirmative. I was then informed that the FICO of the Revenue apparently does not agree and has arguments against my view.

2 The Finance Act 1998 Changes²

Finance Act 1998 extended the Offshore Settlor Provisions (Taxation of Chargeable Gains Act 1992 section 86 and schedule 5) to so called "golden trusts", i.e. trusts which were already non-UK resident before March 19th 1991.

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² These changes are discussed in depth in my *Non-Resident Trusts* 7th edition published by Key Haven in 1999. The transitional provisions are discussed at 13.3.3B.

A settlement created before 19th March 1991 was to become capable of becoming a "qualifying settlement", i.e. caught by the Provisions, in the year 1999-2000, and subsequent years of assessment.

At first blush, it might appear that Parliament had been extremely kind to such non-qualifying settlements in not depriving them of their exempt status until 6th April 1999. The reality was that, in general, such settlements lost their exempt status with effect from 17th March 1998, since gains realised in the transitional period 17th March 1998 - 5th April 1999 were, subject to certain exceptions, visited on the settlor in 1999/2000. Finance Act 1998 schedule 23 contains transitional provisions relating to a trust which was created before 19th March 1991, which was not a qualifying settlement in the year 1998/99, which is a qualifying settlement in the year 1999/2000, yet which is not a "protected settlement" immediately after the beginning of 6th April 1999. Were it not for schedule 23, it would have been possible for trustees of trusts which would become qualifying on 6th April 1999 to realise all inherent trust gains in 1998/99 so that they would fall outside the scope of section 86. The aim of schedule 23 was to remove the apparent "window" which would otherwise be available.

Schedule 23 does not deem the settlement to be a qualifying settlement before 6th April 1999. Instead, it deems "relevant" gains (and losses) realised by the trustees in the transitional period from 17th March 1998 to 5th April 1999 to be gains (or losses) accruing to them on 6th April 1999. One consequence of this anti-avoidance mechanism being used is that any gains caught will be taxed one or two years later than would have been the case if the settlement had simply been treated as a qualifying settlement from 17th March 1998.

3 The Statute

Schedule 23 paragraph 1(2) provides:

"(2) Subject to sub-paragraph (3) below,³ section 86 of the 1992 Act (attribution of gains to settlor of non-resident or dual resident trusts) shall have effect in relation to any settlement to which this paragraph applies-

- (a) as if any relevant gains or relevant losses accruing to the trustees of the settlement on or after 17th March 1998 and before 6th April 1999 were gains or losses accruing to those trustees on 6th April 1999; and

³ Which is not in point.

- (b) where it is not the case, as if the trustees fulfilled the condition as to residence in the year 1999-00.”

The effect of section 86(4) is that in 1999/2000 “chargeable gains of an amount equal to that referred to in subsection (1)(e) above shall be treated as accruing to the settlor in the year”. Section 86(1)(e) provides:

- “(e) by virtue of disposals of any of the settled property originating from the settlor, there is an amount on which the trustees would be chargeable to tax for the year under section 2(2) if the assumption as to residence specified in subsection (3) below were made”

The “assumption as to residence” is that “the trustees are resident or ordinarily resident in the United Kingdom throughout the year”.

4 Author’s View

In my view, the provision whereby gains and losses of the transitional period are deemed to be realised by the trustees on April 6th 1999 applies for *all* capital gains tax purposes : see *Marshall v Kerr* [1993] STC 360, where the Court of Appeal re-established the rule that deeming provisions must be applied to their logical conclusion, unless that results in injustice or anomaly or would be inconsistent with the obvious purposes of the statute. The House of Lords ([1994] STC 638) approved the decision of the Court of Appeal on this aspect, allowing the appeal on a different point.

5 The Revenue View

5.1 Net Gains of Transitional Period

Apparently, FICO take the view that, where there are net gains in the transitional period, all that schedule 23 paragraph 1(2) does is to deem an amount of gains to be imputed to the settlor. With respect, the wording of paragraph 1(2) makes it clear that that is not the case. Nor does paragraph 1(2) of itself impute any amount of gains to the settlor: that is done by section 86(4).

5.2 Net Losses of Transitional Period

Where there are net losses in the transitional period, FICO takes the view that they cannot be set off against actual gains of 1999 / 2000 because of Finance Act 1998 section 132(4), which provides:

“(5) In construing section 86(1)(e) of the Taxation of Chargeable Gains Act 1992 (which specifies the amount by reference to which a charge arises under that section) as regards a particular year of assessment and in relation to a settlement created before 19th March 1991 which:

- (a) is a qualifying settlement in the year 1999-00, but
- (b) was not a qualifying settlement in any earlier year of assessment,

no account shall be taken of disposals made before 6th April 1999 (whether for the purpose of arriving at gains or for the purpose of arriving at losses).”

The earlier subsections of section 132 had amended the Taxation of Chargeable Gains Act 1992 so as to make golden trusts capable of being qualifying settlements from 1999 / 2000. With respect, this argument proves too much. The very next subsection provides:

“(6) Schedule 23 (which makes transitional provision in connection with the coming into force of this section) shall have effect.”

The main effect of schedule 23 is to deem gains and losses of the transitional period to be gains arising on April 6th 1999 and thus gains of 1999 / 2000, (whether of the same trustees or of transferee trustees.) Now there are two possibilities. Either section 132(4) completely overrides section 132(5) or it does not. In other words, section 132(4) either requires one to disregard all gains in fact realised in the transitional period (as well as in earlier periods) including gains deemed by schedule 23 to be realised after the end of that period, or it does not. If it does, then the Revenue have serious problems! In effect, most, arguably all, of schedule 23 has no effect! If, on the other hand, section 132(4) is subject to section 132(5) and schedule 23, it does not apply to gains deemed by the schedule to arise on April 6th 1999. It is only if section 132(4) is not subject to section 132(5) that the Revenue's argument on brought forward losses gets off the ground.

To my mind, it is inconceivable that the courts would construe section 132 in the manner contended for by the Revenue. Nor would it be any kindness to the Revenue to do so.

6 Conclusion

I therefore conclude that my initial view was the correct view and that on this occasion FICO have misinterpreted the law.