THE APPLICATION OF SECTION 86 TCGA 1992 TO THE MIGRATION OF TRUSTS

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Suppose a UK resident and domiciled individual settled shares onto trusts for the benefit of his wife and children. The trustees of his settlement are resident in a jurisdiction such as Belgium which has a suitable double tax convention. The non-resident trustees sell the shares then retire in favour of UK resident trustees. From then on the general administration of the trust is carried on in the UK.

The trustees are advised that they have avoided any charge to capital gains tax on the disposal of the shares as a result of article 13(4) of the double tax convention with Belgium. Article 13(4) stipulates that the alienator shall only be taxable in the state in which he is resident. For the purposes of Article 13(4) of the convention the trustees were resident in Belgium at the time of the disposal. This means that they are not taxable in the UK. Therefore there is no charge under section 2 TCGA 199 and because there is no amount on which the trustees are chargeable to tax, there is no amount which can be deemed to accrue to the settlor under section 77 TCGA 1992.

But what about section 86 TCGA 1992? If the trustees satisfy the condition as to residence in section 86(1)(b), chargeable gains equal to those accruing to the trustees will be deemed to accrue to the settlor who does not have the protection of article 13(4).

Section 86(1)(b)

Section 86 has two alternative residence conditions. The first (which clearly does not apply) is that the trustees are non-resident throughout the whole year of assessment. The second is that the trustees are resident or ordinarily resident in

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the UK during a part of the year of assessment but at some time during that period of residence they fall to be regarded for the purposes of the double taxation arrangements as resident outside the UK.

This second condition identifies two types of residence: The residence and ordinary residence of trustees for capital gains tax purposes (determined in accordance with section 69(1) TCGA 1992), and the "residence" of the trustees for the purposes of the double tax arrangements with Belgium. This is determined by article 4 of the convention. Broadly, for article 4 purposes a person is "resident" where it is liable to tax. If it is liable to tax in both States, it is deemed to be "resident" where it has its place of effective control (article 4(3) of the convention).

In this case at the time of the disposal the trustees are neither resident nor ordinarily resident in the UK for capital gains tax purposes. They are resident in Belgium. Therefore they do not fall to be regarded as resident in Belgium for the purposes of article 4 at a time when they are resident or ordinarily resident in the UK. It follows that the second residence condition is simply not satisfied.

Can one argue that article 4 determines where the trustees are resident for the purposes of the convention so that the trustees do satisfy the residence test in the year of assessment? The answer is No. Article 4 is no more than a series of tests which are to be applied in sequence to determine where a person is resident for any particular purpose of the convention (e.g. for the purposes of article 13(4)).

What about the argument that section 86(2)(b) applies because at the time of the disposal the trustees are "resident" in the UK (under article 4(1)), and therefore fall to be regarded as "resident" in Belgium for the purposes of the double taxation arrangement (under article 4(3))? Again such an argument is flawed. Firstly, it misinterprets Article 4. Secondly, section 86(2)(b) is concerned with residence or residence in the UK. It therefore applies only where the disponor is actually resident in the UK but is deemed not to be for the purposes of the double taxation arrangements. An example would be a disponor who had a dual residence at the time of the gain, but had a place of effective control in Belgium. He would be resident in the UK but deemed to be resident in Belgium for the purposes of determining where the gain should be taxed.

In summary, where the trustees switch their residence from one jurisdiction to another there is no reason why section 86 TCGA 1992 should apply. This is significant not only for offshore trustees who wish to sell chargeable assets prior to coming onshore, but also for UK trustees who wish to sell chargeable assets and are prepared to emigrate the trust. For example, in the same year of assessment UK trustees could retire in favour of Belgian trustees who would then make the disposal. No charge would arise under section 2 and section 77 on the disposal because of the double tax convention. No charge would arise under section 86 because the trustees would not satisfy the conditions as to residence. The disadvantage is the section 80 emigration charge. However, a strategy for a trustee holding quoted shares is to sell the quoted shares to a broker, emigrate with cash to avoid the section 80 charge, and then repurchase the same number of shares of the same class within 30 days, relying upon section 106A to undo the disposal.

Finally, although section 80 (the emigration charge) recognises that such a clean switch of residence is possible, care should be taken to ensure it is achieved in practice.