

# NEW UK “FLIP FLOP” ANTI-AVOIDANCE PROVISIONS

Robert Venables QC<sup>1</sup>

## 1 Introduction

### 1.1 The Mischief

Prior to the 2000 Budget Speech, a capital gains tax avoidance scheme known as a “flip flop” was sometimes practised. The aim was to side-step one or more of the United Kingdom Settlor Provisions, the Offshore Settlor Provisions or the Offshore Beneficiary Provisions. The trust could be resident in or out of the United Kingdom. The Trustees would typically borrow funds in one year of assessment and appoint them so that they were no longer property comprised in the same settlement. There might then be a reorganisation of beneficial interests. In the next year of assessment, capital gains would be realised by the trustees and the borrowing repaid.

There were several versions of the scheme. If the purpose was simply to avoid the United Kingdom Settlor Provisions or the Offshore Settlor Provisions, then, after the appointment in Year 1, the trusts would be modified so as to ensure that the relevant Provisions did not apply to the trust for the next year of assessment. If the aim was to avoid the Offshore Beneficiary Provisions, the appointment would be to another trust. In calculating the section 87 gains which could be transferred to that trust, one would not take into account any gains realised in a subsequent year of assessment.<sup>2</sup> Hence, beneficiaries could receive capital payments from that trust in due course without any section 87 liability. In principle, it was possible to appoint out virtually

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<sup>1</sup> Robert Venables QC, Barrister of the Middle Temple and of Lincoln's Inn, Bencher of the Middle Temple, Council Member of the Chartered Institute of Taxation, Chartered Tax Adviser, TEP, Consulting Editor. Chambers: 24, Old Buildings, Lincoln's Inn, London WC2A 3UP. Tel+ 44 (020) 7242 2744; Fax + 44 (020) 7831 8095. e-mail taxchambers@compuserve.com.

<sup>2</sup> For the transfer of section 87 trust gains from one settlement to another see my *Non-Resident Trusts* 8th edition at 14.11.2.

the whole of the value of the trust fund without any beneficiary, including the settlor or his spouse, being charged to capital gains tax on gains realised by the trustees only in a later year of assessment.

#### 1.2 The March 2000 Budget Press Release

In the Inland Revenue 2000 Budget Press Release of 21st March 2000, Capital Gains Tax: Countering Avoidance Using Trusts,<sup>3</sup> it was stated:

“Trustees in debt

7. The third element in the package is designed to counter an avoidance device which has become commonly known as a "flip flop". This is a device for extracting gains from a trust tax-free or with a significant tax saving. At its simplest, the trustees of a trust in which a UK resident settlor has an interest (so that the settlor is charged in respect of trust gains) borrow money on the security of assets in the trust and advance the money to another trust. The settlor then severs his interest in the first trust. In the following tax year the trustees sell the assets and use the proceeds to repay the debt. The settlor receives his money from the second trust. If successful, the outcome of the device is that in the case of an offshore trust no tax is paid by the settlor. In the case of a UK trust there is a 6% tax rate saving for the higher rate taxpayer. The device can also be used to eliminate entirely the CGT liabilities of UK beneficiaries of offshore trusts who receive capital payments from trustees.

8. From today, where trustees, at a time when they are in debt, transfer funds to another person (whether by transferring or lending property) and any borrowed money has not been wholly used for normal trust purposes, the trustees will be treated as making a disposal and reacquisition of settled property. They will be deemed to dispose of the whole (or, where the amount transferred is less than the value of the chargeable assets remaining in the trust, an appropriate fraction) of those remaining assets at the time of the advance, and immediately reacquiring them at market value. Gifts hold-over relief will not be available on the gains arising on this disposal.”

### 1.3 Schedules 4B and 4C

The changes have been implemented by the addition<sup>4</sup> of new Schedules 4B and 4C to the Taxation of Chargeable Gains Act 1992. These Schedules apply as regards any "transfer of value" in relation to which the "material time" is on or after 21st March 2000.<sup>5</sup>

The effect of Schedule 4B is to deem trustees, in certain circumstances where they make a "transfer of value" which is "linked with trust borrowing", to dispose of and reacquire settled property for a market value consideration. Schedule 4C can come into play only where Schedule 4B has operated. It ring-fences any section 87 trust gains which non-UK resident trustees realise as a result of a Schedule 4B deemed disposal and lays down different rules for determining to which beneficiaries they are to be attributed under the Offshore Beneficiary Provisions.

The drafting of the Schedules is extremely complex; in my view needlessly so. Like much badly drafted anti-avoidance legislation, they result in a great deal of overkill while containing loopholes which the well-advised will be able to exploit. They arguably even facilitate tax avoidance in certain cases.

## 2.1 Taxation of Chargeable Gains Act 1992 Schedule 4B Deemed Disposals

### 2.1 Scope of the Schedule

#### 2.1.1 The Heading

Schedule 4B is headed "Transfers of value by trustees linked with trustee borrowing". It can apply in situations where there is no trustee borrowing. It is couched in a traditional style but with a fair amount of cross-referencing within the Schedule which needlessly increases its length. Can the draughtsman seriously have thought that these opaque provisions would thereby become more comprehensible to the educated layman?

#### 2.1.2 General Scheme

Clause 1 is headed "General scheme of this Schedule". Clause 1(1) sets out the

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<sup>4</sup> By Finance Act 2000.

<sup>5</sup> Finance Act 2000 section 92(5). The expressions "transfer of value" and "material time" have the same meaning in this subsection as in Schedule 4B to the Taxation of Chargeable Gains Act 1992. See 2.2.1 and 2.2.3 respectively.

conditions of application of the Schedule:

“(1) This Schedule applies where trustees of a settlement-

- (a) make a transfer of value (see paragraph 2) in a year of assessment in which the settlement is within section 77, 86 or 87 (see paragraph 3), and
- (b) in accordance with this Schedule the transfer of value is treated as linked with trustee borrowing (see paragraphs 4 to 9).”

Clause 1(2) sets out the result of the Schedule applying:

“(2) Where this Schedule applies the trustees are treated as disposing of and immediately reacquiring the whole or a proportion of each of the chargeable assets that continue to form part of the settled property (see paragraphs 10 to 13).”

#### 2.1.3 What is a “Settlement”?

“Settlement” bears two distinct meanings in the Taxation of Chargeable Gains Act 1992. Its normal meaning is a trust, excluding bare trusts and trusts involving joint absolute ownership. In section 87, however, it bears its income tax meaning.<sup>6</sup> In my view, there is nothing in Schedule 4B which imports the section 87 definition. This means that a settlement cannot be caught by the Schedule as being within section 87 unless it is both (a) a settlement within the normal capital gains tax definition and (b) also a settlement within the meaning of section 87.

The contrary view would rely on the wording of paragraph 3 of Schedule 4B (Settlements within section 77, 86 or 87), the material parts of which provide:

“(1) This paragraph explains what is meant in this Schedule by a settlement being “within section 77, 86 or 87” in a year of assessment.

...

(4) A settlement is “within section 87” in a year of assessment if, assuming-

- (a) there were trust gains for the year within the meaning of subsection (2) of that section, and

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<sup>6</sup> See 11.2 and 14.2.3



- (b) that beneficiaries of the settlement received capital payments from the trustees in that year or had received such payments in an earlier year,

chargeable gains would, under that section or section 89(2), be treated as accruing to the beneficiaries in that year.

Expressions used in this sub-paragraph have the same meaning as in section 87."

The argument for the contrary view would be that in paragraph 3(4) "settlement" bears its section 87 meaning, by virtue of the final sentence of the subparagraph. My reply is that the sentence does not apply for the purposes of paragraph 3(1); it is that paragraph which determines the scope of application of paragraph 3 and "settlement" there clearly bears its normal capital gains tax meaning, just as it does in paragraph 1(1)(a). In my view, the purpose and effect of the final sentence of paragraph 3(4) is simply to import the section 86 definitions of "trust gains for the year" (admittedly already done by paragraph 3(4)(a)), "beneficiaries of the settlement" and "capital payments". Even if it operates to give "settlement" its section 87 meaning for the purposes of paragraph 3(4), that is of no consequence; for any "settlement" within the general capital gains tax definition must also be a section 87 "settlement" for the condition in paragraph 3(4) to be satisfied.

## 2.2 Transfers of Value and Value Transferred

### 2.2.1 Transfer of Value

Clause 2(1) of the Schedule defines "transfer of value".<sup>7</sup> It provides:

"For the purposes of this Schedule trustees of a settlement make a transfer of value if they-

- (a) lend money or any other asset to any person,
- (b) transfer an asset to any person and receive either no consideration or a consideration whose amount or value is less than the market value of the asset transferred, or
- (c) issue a security of any description to any person and receive

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<sup>7</sup> "Transfer of value" and "valued transferred" have a well-defined meaning for inheritance tax purposes, which is irrelevant in this context.

either no consideration or a consideration whose amount or value is less than the value of the security.”

### 2.2.2 Value Transferred

The amount of the value transferred is calculated as follows:

- (a) in the case of a loan, it is the market value of the asset,<sup>8</sup>
- (b) in the case of a transfer, it is -
  - (a) if any part of the value of the asset is attributable to trustee borrowing, the market value of the asset;
  - (b) if no part of the value of the asset is attributable to trustee borrowing, the market value of the asset reduced by the amount or value of any consideration received for it.<sup>9</sup>
- (c) in the case of the issue of a security, it is the value of the security reduced by the amount or value of any consideration received by the trustees for it.<sup>10</sup>

### 2.2.3 Relevant Times

One ascertains the value of an asset immediately before “the material time”, unless the asset does not exist before that time in which case its value immediately after that time shall be taken.<sup>11</sup> References in Schedule 4B to “the material time”, in relation to a transfer of value, are to the time when the loan is made, the transfer is “effectively completed” or the security is issued.<sup>12</sup> The effective completion of a transfer means “the point at which the person acquiring the asset becomes for practical purposes unconditionally entitled to the whole of the intended subject

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<sup>8</sup> Schedule 4B paragraph 2(3).

<sup>9</sup> Schedule 4B paragraph 2(4).

<sup>10</sup> Schedule 4B paragraph 2(5).

<sup>11</sup> Schedule 4B paragraph 2(6).

<sup>12</sup> Schedule 4B paragraph 2(2).

matter of the transfer".<sup>13</sup>

#### 2.2.4 Critique

One is immediately struck by the oddity of the provisions for quantifying a transfer of value in the case of (a) a loan by the trustees and of (b) the transfer of an asset part of the value for which is attributable to trustee borrowing. To the extent to which consideration is given, I have great difficulty in seeing why the Schedule needs to operate at all. If the trustees borrow assets e.g. cash, which they then lend to a beneficiary, there will not normally at that point be any diminution in the value of the trust fund. If there is,<sup>14</sup> then, the beneficiary will on any view be deemed to receive a capital payment equal to the value of the benefit conferred. If the loan is interest-free and repayable on demand, then<sup>15</sup> the beneficiary will still receive a capital payment for so long as the loan is outstanding. What cannot happen is for the trust assets to be depleted without a corresponding capital payment. Likewise, if the value of an asset the trustees transfer is attributable to trustee borrowing, it is still difficult to see how a transfer of it should constitute a transfer of value except to the extent to which less than full consideration is given for it.

### 2.3 Loans

#### 2.3.1 Definition

There is no definition of "loan" and no such extended meaning of the terms as one finds in other parts of the Taxes Acts.<sup>16</sup>

#### 2.3.2 Types of Loan

Loans are of two types, loans of fungibles and loans of non-fungibles. They differ in that in the case of the loan of a fungible, such as money or a commodity, the borrower becomes the legal and beneficial owner of the property lent and is free to deal with it as he sees fit. He simply incurs a contractual obligation to give back a like amount, with or without interest or some other compensation. In this case, the lender also makes the transfer of an asset when the loan is made (and normally

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<sup>13</sup> Schedule 4B paragraph 2(2).

<sup>14</sup> Because it is on favourable terms and the trustees cannot demand repayment for a period.

<sup>15</sup> Subject to *Billingham v Cooper* not being reversed on appeal: see my *Non-Resident Trusts* 8th edition 14.7.6.

<sup>16</sup> E.g. Taxes Act 1988 section 160(5)(a) (Schedule E) and section 412(2) (Schedule F).

makes a disposal of the asset for capital gains tax purposes).

In the case of a loan of non-fungibles, as in the case of the loan of a house or a painting, title to the lent object does not pass and there is no transfer of legal title to it or disposal of it. It is difficult to see how the loan of a non-fungible could be employed to perpetrate the mischief at which the Schedule is aimed.

#### 2.3.3 Leases

Does the granting of a lease over real property involve a "loan"? To the layman, it might appear to do so; to the lawyer, it does not. It is not strictly a transfer, even though it is the part disposal of an asset for capital gains tax purposes. The question is very important as the creation of a lease will probably not normally amount to a "transfer" either. Similar considerations apply to the creation of other proprietary interests in land, even if they confer a right of occupation.

#### 2.3.4 Other Rights

A person may be given a right to enjoy tangible property (whether land or chattels) which falls short of a proprietary right. It might be a contractual right or a gratuitous licence. Depending on the nature of the right, it might be said that the property had been "loaned" to him. For example, if trustees gratuitously permit a beneficiary to occupy a house, the arrangement could amount to a "loan". If they retained occupation and simply allowed him to enjoy it in some way which did not involve his being an occupier, one would not normally say that there had been a loan of it.

#### 2.3.5 Value Transferred by a Loan

In the case of a loan, the value transferred is the market value of the asset lent. This is incredible. If a valuable painting is lent for one day or one hundred years, the value transferred is the same. If cash is lent for full consideration, the value transferred is the whole amount of the cash. If the trustees subscribe for debentures in a quoted company on arms' length terms, they have made a loan and the value transferred is the amount subscribed. Arguably, if they deposit money in a current bank account, they have made a "loan" to their bankers and the value transferred is the full amount deposited.

I cannot fathom why the value transferred in category (a) should be calculated on any basis other than that of the loss to the trust arising from the transaction and why bona fide commercial or investment transactions should be caught at all.

## 2.4 Transfers of Assets

### 2.4.1 The Classic Case

Paragraph 2(1)(b) of Schedule 4B clearly covers the classic case whereby trustees make an out-and-out transfer, or appointment, of assets to a beneficiary or to the trustees of another trust.

### 2.4.2 Becoming Absolutely Entitled to Settled Property

What is not at all clear is whether it applies where someone other than the trustees exercises a power of appointment as a result of which a beneficiary becomes absolutely entitled to trust property, such as cash borrowed by the trustees. In reality the trustees transfer nothing. They cease to be the owners for capital gains tax purposes and the beneficiary becomes the owner without any act of theirs. The Revenue might argue that Taxation of Chargeable Gains Act 1992 section 71 deems the trustees to dispose of the asset to the beneficiary. Faced with the possibility of a significant loophole in the Schedule, the courts might well hold that they are also deemed to "transfer" the assets. The draughtsman of the Offshore Beneficiary Provisions had thought of a similar problem and expressly covered it, in section 97(2): "references to a payment [received from the trustees of a settlement] include references to the transfer of an asset and the conferring of any other benefit, and to any occasion on which settled property becomes property to which section 60 applies." The taxpayer could place reliance on (a) the lack of any comparable provision in Schedule 4B and (b) the contrast drawn in section 97(2) between the transfer of an asset and a beneficiary becoming absolutely entitled to settled property. It is for the reader to judge how easily a court intent on defeating tax avoidance could, in the name of purposive construction, sweep these arguments aside.

A similar question could arise where a beneficiary becomes absolutely entitled to part of the settled property as a result of the operation of the trusts e.g. on attaining twenty-five.

### 2.4.3 Deemed Disposals as Transfers

Paragraph 13(2) of Schedule 4B provides:

"Subject to sub-paragraph (3), references in this Schedule to the transfer of an asset include anything that is or is treated as a disposal of the asset for the

purposes of this Act, or would be if sub-paragraph (1)<sup>17</sup> above applied generally for the purposes of this Act.”

The inclusion of deemed disposals looks at first sight too wide. For example, the occasion of the entire loss, destruction, dissipation or extinction of an asset constitutes a disposal of the asset whether or not any capital sum by way of compensation or otherwise is received in respect of the destruction, dissipation or extinction of the asset.<sup>18</sup> It would be odd if the destruction of an asset were to bring Schedule 4B into play. Perhaps the answer is that, although in such a case there is a deemed disposal, and thus a transfer, there is not a transfer “to any person”, as is required by paragraph 2(1)(b).<sup>19</sup>

By contrast, a deemed disposal under Taxation of Chargeable Gains Act 1992 section 30(2) (value shifting out of shares in a company into other shares or rights over the company) could arguably be a “transfer of value” for the purposes of Schedule 4B.<sup>20</sup>

#### 2.4.4 Part Disposals

Paragraph 13(3) of Schedule 4B provides:

“(3) References in this Schedule to a transfer of an asset do not include a transfer of an asset that is created by the part disposal of another asset.”

The exclusion of part disposals looks very odd. Is it really the case that if the trustees vest a freehold in a beneficiary, there is the transfer of an asset to that beneficiary whereas if they grant a long lease out of that freehold in favour of the beneficiary there is not? Now paragraph 13(3) does not say that such a disposal is not a transfer. It merely says that it is not deemed to be a transfer by virtue of section 13(2). The question therefore remains whether it is a transfer independently of paragraph 13. It is highly arguable that it is not. See the next section.

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<sup>17</sup> Which deems sterling cash to be an asset.

<sup>18</sup> Taxation of Chargeable Gains Act 1992 section 24(1).

<sup>19</sup> Consider too the deemed disposal which occurs where a capital sum is derived from an asset: Taxation of Chargeable Gains Act 1992 section 22.

<sup>20</sup> For the difficulties of interpretation and application of section 29, see my article “Value Shifting Out of Shares” in *The Corporate Tax Review*, Volume 2, Issue 1.

#### 2.4.5 New Assets

The concept of a transfer involves, in my view, the assignment of an existing asset. If an asset is newly created, it is not transferred. For example, the freeholder who grants a lease does not "transfer" the lease: he creates it. The draftsman of the income tax anti-avoidance provisions aimed at avoidance of tax by transfers of assets abroad was aware of the problem. Hence, he provided that "transfer", in relation to rights, includes the creation of those rights".<sup>21</sup>

It might be argued that Schedule 4B paragraph 2(6) presupposes that an asset which does not exist can be the subject of a "transfer". It provides that references in paragraph 2 to the value of an asset are to its value immediately before the material time, "unless the asset does not exist before that time in which case its value immediately after that time shall be taken." This proviso, however, is needed simply to cover the case of a transfer of value of type (c) (the issue of a security).<sup>22</sup>

#### 2.4.6 Sterling Cash

Is a payment of sterling cash the transfer of an asset? It is questionable whether sterling cash is an "asset" for capital gains tax purposes, having regard to Taxation of Chargeable Gains Act 1992 section 22(1).<sup>23</sup> To put the matter beyond doubt, paragraph 13(1) provides that any reference in Schedule 4B to an asset includes money expressed in sterling. If the trustees pay sterling cash to acquire an asset, this too will be a "transfer".

#### 2.4.7 Value Transferred by Transfer: the Two Rules

In the case of the transfer of an asset, the value transferred is, subject to one important exception, the market value of the asset reduced by the amount or value of any consideration received for it.<sup>24</sup> If the trustees decide to confer a gratuitous benefit on a beneficiary by selling an asset at an undervalue, the value transferred will normally equal the amount of the undervalue, which makes perfect sense. There is, surprisingly, no exception if the trustees sell at less than market value by

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<sup>21</sup> Taxes Act 1988 section 742(9)(b).

<sup>22</sup> Cf also paragraph 4(3) of Schedule 4B, in the different context of the loan of an asset to the trustees.

<sup>23</sup> It provides: "(1) All forms of property shall be assets for the purposes of this Act, whether situated in the United Kingdom or not, including- ... (b) any currency other than sterling ..."

<sup>24</sup> Schedule 4B paragraph 2(4).

mistake, even if they have no gratuitous intent and the transaction is at arms' length.

The important exception is that if any part of "the value of the asset is attributable to trustee borrowing", the value transferred is the market value of the asset. It should be noted that there is no proportionality: even if only a modest part of the value of the asset is attributable to trustee borrowing, the value transferred is the whole of the market value of the asset.

## 2.5 Issue of Security

The trustees also make a transfer of value where they "issue a security of any description to any person and receive either no consideration or a consideration whose amount or value is less than the value of the security." There is no special definition of "security".<sup>25</sup>

The amount of the value transferred is the value of the security reduced by the amount or value of any consideration received by the trustees for it.<sup>26</sup>

This is no doubt aimed at the situation where the trustees incur indebtedness. They will not have made a loan. They will not have made a transfer. But they could have depleted the value of the trust fund. When the security is redeemed, while the trustees will make a transfer, it will be for full consideration, namely the satisfaction of their liability. Hence, were the issuing of a security not deemed to be a transfer of value, there would be a loophole in the Schedule.

## 2.6 Value Attributable to Trustee Borrowing

### 2.6.1 The Two Situations

Paragraph 12 of Schedule 4B determines when and to what extent the value of an asset transferred by trustees is attributable to trustee borrowing. Whatever rational purpose the draftsman may have had, I have had to admit defeat in my attempt to discover it.

There are two situations in which the value of an asset can be attributable to trustee borrowing. The first situation is where the asset transferred has itself been borrowed by the trustees. The second is where the value of the asset to some extent

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<sup>25</sup> The incorporation of the Taxation of Chargeable Gains Act 1992 section 132 definition in paragraphs 7(2) and 12(6) of Schedule 4B is only for the purpose of paragraphs 7 and 12 of the Schedule.

<sup>26</sup> Schedule 4B paragraph 2(5).



represents what has been borrowed by the trustees. The two tests are cumulative, in that the application of both can cause an asset to be attributable to trustee borrowing to a greater extent than the application of one alone.<sup>27</sup>

### 2.6.2 Asset Itself Borrowed

Where the asset itself has been borrowed by trustees, the value of the asset is attributable to trustee borrowing to the extent that the proceeds of that borrowing have not been applied for "normal trust purposes".<sup>28</sup>

What is meant by "the proceeds of the borrowing"? Normally, this would mean the asset which is borrowed. Yet paragraph 4(2)(a) of Schedule 4B suggests that in the context of the Schedule it is merely a notional arithmetical amount, equal to the market value of the asset borrowed, for it provides that "the amount borrowed (the "proceeds" of the borrowing) is taken to be- (a) in the case of a loan, the market value of the asset; (b) in the case of a transfer, the market value of the asset reduced by the amount or value of any consideration received for it." One cannot apply a notional amount. If, therefore, one applied the definition literally, it would follow that whenever the trustees borrow an asset and transfer it, then they make a transfer of value equal to its market value, even though both transactions are with parties dealing at arms' length on normal commercial terms. A striking example would be where trustees borrowed money from a bank and used it to buy "ordinary trust assets".<sup>29</sup> A subsequent sale of those assets for a market value consideration would then involve a transfer of value, the value transferred being their value at the time of sale.

This conclusion is so extraordinary, that one wonders whether some other interpretation is possible. Could it be that one looks to see what the trustees have done with the actual asset borrowed, and ignores the definition in paragraph 4(2)? That is almost certainly the case, as otherwise, the second limb of the test could not apply at all, given that it depends on the proceeds of borrowing having been applied by the trustees. If that conclusion is correct, a loan from a bank to buy "ordinary trust assets" would present no problem, at least so far as this limb of the test is

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<sup>27</sup> This could be important in the application of paragraph 11(5) of Schedule 4B, as to which see 2.12.

<sup>28</sup> Schedule 4B paragraph 12(2). The Treasury are empowered to make provision by regulations as to the circumstances in which the proceeds of trustee borrowing are to be treated for the purposes of the Schedule as applied for normal trust purposes: Schedule 4B paragraph 9.

<sup>29</sup> For the meaning of this term, see 2.10.

concerned.<sup>30</sup> Moreover, this view is reinforced when one considers that in other contexts “the proceeds of trustee borrowing” must, at least part of the time, only mean the assets borrowed.<sup>31</sup>

If that is the correct approach, what of the case where what is borrowed is an “ordinary trust asset”? It would be odd if it made a difference that the asset itself was borrowed, rather than the cash with which to buy it. The wording of paragraph 6(2) of Schedule 4B is not helpful in this regard.

#### 2.6.3 Application of Proceeds of Loan

The value of any asset is also “attributable to trustee borrowing” to the extent that-

- “(a) the trustees have applied the proceeds of trustee borrowing in acquiring or enhancing the value of the asset, or
- (b) the asset represents directly or indirectly an asset whose value was attributable to the trustees having so applied the proceeds of trustee borrowing.”<sup>32</sup>

For the purposes of this test an amount is “applied by the trustees in acquiring or enhancing the value of an asset” if “it is applied wholly and exclusively by them-

- (a) as consideration in money or money’s worth for the acquisition of the asset,
- (b) for the purpose of enhancing the value of the asset in a way that is reflected in the state or nature of the asset,
- (c) in establishing, preserving or defending their title to, or to a right over, the asset, or
- (d) where the asset is a holding of shares or securities that is treated as a single asset, by way of consideration in money or money’s worth

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<sup>30</sup> But see the next section for the second limb.

<sup>31</sup> See paragraphs 5(2)(b), 6, and 12 of Schedule 4B.

<sup>32</sup> Schedule 4B paragraph 12(3).

for additional shares or securities<sup>33</sup> forming part of the same holding."<sup>34</sup>

The determination whether the trustees have applied the proceeds of borrowing in acquiring or enhancing the value of the asset does not involve a simple tracing exercise. If and to the extent that at the time the expenditure is incurred there is "outstanding trustee borrowing", then it is deemed to be so applied.<sup>35</sup> The concept of "outstanding trustee borrowing" is discussed at 2.8.

This second test is potentially very wide. It applies even where the trustees have used loan proceeds to acquire a normal trust asset, as in the example above, where the trustees borrow from a bank in order to purchase such assets and then sell them on arms' length terms to an unconnected third party.

My feeble mind finds it very difficult to work out why an asset which has itself been borrowed is not attributable to trust borrowing if it is applied for normal trust purposes but an asset acquired with borrowed money is.

## 2.7 Trustee Borrowing

The Schedule is brought into play only if a transfer of value is linked with "trustee borrowing". "Trustee borrowing" is of two types. The "amount borrowed" is ascertained in a quite different way depending on the type of loan with which one is concerned.

The trustees of a settlement "are treated as borrowing if-

- (a) money or any other asset is lent to them, or
- (b) an asset is transferred to them and in connection with the transfer the trustees assume a contractual obligation (whether absolute or conditional) to restore or transfer to any person that or any other asset."<sup>36</sup>

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<sup>33</sup> As defined in Taxation of Chargeable Gains Act 1992 section 132: Schedule 4B paragraph 12(6).

<sup>34</sup> Schedule 4B paragraph 12(4).

<sup>35</sup> Schedule 4B paragraph 12(5).

<sup>36</sup> Paragraph 4(1) of Schedule 4B.

The first head seems straightforward enough, although difficulties can arise as to when an asset is in fact lent. See 2.3. The amount borrowed is the market value of the asset.<sup>37</sup>

The second head is much wider than one would expect. It clearly covers all loans within the first head. In view of the very different calculation of "the amount borrowed", it will be important to ascertain under which head a "borrowing" falls. Given that it will normally be advantageous to the Revenue for it to fall under the first head, I would expect the courts to hold that anything which falls within the first head is impliedly excluded from the second head.

The second head will cover any situation where an asset is acquired by the trustees and they thereby become indebted to pay money, as where they buy on credit. That is understandable. It will also include many other transactions which are totally removed from the mischief at which the Schedule is aimed. For example, the trustees contract to buy quoted shares, with settlement a few days ahead. Once the shares are transferred, there will be a loan, as the trustees will have assumed a contractual obligation to transfer to the vendor another asset, namely cash.

The "amount borrowed" in the case of a loan within the second head is "the market value of the asset reduced by the amount or value of any consideration received for it." Just as the second head is unbelievably wide, so the "amount borrowed" in relation to the second head is unbelievably narrow. In my view, it allows the Schedule to be very easily circumvented.

The "proceeds" of a borrowing is apparently the same as the "amount borrowed".<sup>38</sup> There is here a confusion between an "amount", which is an abstract, arithmetical concept, and "proceeds", which more commonly refers to assets.<sup>39</sup>

## 2.8 Transfer of value linked with trustee borrowing

A transfer of value by trustees is treated as linked with trustee borrowing if at the

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<sup>37</sup> Paragraph 4(2)(a) of Schedule 4B. References in paragraph 4 to the "market value" of an asset are to its market value immediately before the loan is made, or the transfer is effectively completed, unless the asset does not exist before that time in which case its market value immediately after that time is to be taken. The "effective completion" of a transfer means the point at which the person acquiring the asset becomes for practical purposes unconditionally entitled to the whole of the intended subject matter of the transfer: paragraph 4(3).

<sup>38</sup> Paragraph 4(2) of Schedule 4B.

<sup>39</sup> Cf 2.6.2.

material time there is "outstanding trustee borrowing".<sup>40</sup>

There is outstanding trustee borrowing at any time to the extent that-

- "(a) any loan obligation is outstanding, and
- (b) there are proceeds of trustee borrowing that have not been either-
  - (i) applied for normal trust purposes, or
  - (ii) taken into account under this Schedule in relation to an earlier transfer of value."

"Loan obligation" includes "any such obligation as is mentioned in paragraph 4(2)(b)",<sup>41</sup> i.e. an obligation to restore or transfer an asset which is assumed in connection with the transfer of an asset to the trustees.<sup>42</sup>

We are not told when a loan obligation is outstanding. Presumably, it is outstanding if and to the extent to which it has not been performed.

An amount of trustee borrowing is "taken into account" in relation to a transfer of value if the transfer of value is treated as linked with trustee borrowing. The amount so taken into account is-

- "(a) the amount of the value transferred by that transfer of value, or
- (b) if less, the amount of outstanding trustee borrowing at the material time in relation to that transfer of value."<sup>43</sup>

The aim is no doubt to prevent unjust multiple applications of the Schedule.

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<sup>40</sup> Paragraph 5(1) of Schedule 4B.

<sup>41</sup> Paragraph 4(1) of Schedule 4B.

<sup>42</sup> See 2.7.

<sup>43</sup> Paragraph 5(3) of Schedule 4B.

## 2.9 Application of Proceeds for Normal Trust Purposes

### 2.9.1 The Tripartite Test

Paragraph 6 of Schedule 4B lays down an exhaustive<sup>44</sup> definition of when the proceeds of trustee borrowing are applied for normal trust purposes. There are three distinct situations. The first is where the trustees acquire an "ordinary trust asset"<sup>45</sup> which they have not actually disposed of at any time up to or including the time of the transfer of value. The second is where a loan is used to repay another loan the proceeds of which have been applied for normal trust purposes. The third is where the proceeds are spent in defraying current expenses of administration of the settlement.

### 2.9.2 Payments in Respect of Ordinary Trust Assets

Proceeds are applied for normal trust purposes:

"if they are applied by the trustees in making a payment in respect of an ordinary trust asset and the following conditions are met-

- (a) the payment is made under a transaction at arm's length or is not more than the payment that would be made if the transaction were at arm's length;
- (b) the asset forms part of the settled property immediately after the material time or, if it does not do so, the alternative condition in paragraph 8 below is met; and
- (c) the sum paid is (or but for section 17 or 39 would be) allowable under section 38 as a deduction in computing a gain accruing to the trustees on a disposal of the asset."<sup>46</sup>

Requirement (a) is fair enough. The trustees cannot borrow and use the proceeds to purchase an asset from a beneficiary at a vastly inflated price.

Requirement (b) is also reasonable in principle. Otherwise, the trustees could borrow to buy an ordinary trust asset and then vest it in a beneficiary absolutely.

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<sup>44</sup> Paragraph 6(1) of Schedule 4B.

<sup>45</sup> The meaning of this term is explained at 2.10.

<sup>46</sup> Paragraph 6(2) of Schedule 4B.

Consider, however the following case. The trustees entrust £1,000,000 to an asset manager for investment on a discretionary basis. £500,000 is provided out of trust capital and the other £500,000 is raised by borrowing. The manager firstly invests and then later realises and reinvests the fund, but at all material times it consists either of ordinary trust assets or cash awaiting investment in such assets. If the trustees make a transfer of value immediately after the borrowed funds have been invested for the first time, there is no problem. Once, however, the manager has churned the whole fund once, is condition (b) still satisfied? Only if the proceeds of the loan can be regarded as having been (indirectly) applied in acquiring the assets comprised in the fund immediately after that transfer of value.

The alternative condition relates to assets which no longer form part of the settled property and which are treated as having been disposed of by virtue of Taxation of Chargeable Gains Act 1992 section 24(1) (the occasion of the entire loss, destruction, dissipation or extinction of an asset). This exception will possibly be exploited by tax planners.

It is difficult to see why requirement (c) is needed. The requirement is simply that the amount paid must constitute part of the trustees' base cost for capital gains tax purposes. What if the trustees use the proceeds to acquire a residence for a beneficiary in circumstances such that any gain will not be a chargeable gain by virtue of Taxation of Chargeable Gains Act 1992 section 225? Section 38 applies to the computation of gains arising on the disposal of all assets, not just chargeable assets. Hence, requirement (c) will be satisfied.

### 2.9.3 Discharge of Loan Obligations

Proceeds are also applied for normal trust purposes if-

- “(a) they are applied by the trustees in wholly or partly discharging a loan obligation of the trustees, and
- (b) the whole of the proceeds of the borrowing connected with that obligation (or all but an insignificant amount) have been applied by the trustees for normal trust purposes.”<sup>47</sup>

If the trustees borrow, apply the proceeds for normal trust purposes and then take out a second loan to repay the first, the second loan will not involve any “outstanding trustee borrowing”. The position is the same if a third loan is taken out to repay the second.

#### 2.9.4 Trust Expenses

Loan proceeds are also applied for normal trust purposes if they are applied by the trustees "in making payments to meet bona fide current expenses incurred by them in administering the settlement or any of the settled property".<sup>48</sup>

A distinction is drawn for United Kingdom income tax purposes between expenses which are deductible in computing taxable income and general expenses of administering a trust, which are not. For example, remuneration paid to a trustee for managing trust real property will normally be deductible in computing the income from that property, whereas remuneration paid to a trustee for managing securities will not be deductible in computing the income from those securities. It would appear that the phrase "in administering the settlement or any of the settled property" is meant to show that both types of expenses are included.

Expenses of administering the trust which as a matter of general law would be chargeable to income are clearly included.<sup>49</sup> It is a moot point whether the use of the word "current" precludes expenses which are chargeable to capital.

#### 2.10 Ordinary trust assets

The following are "ordinary trust assets" for the purposes of this Schedule:

- "(a) shares or securities;<sup>50</sup>
- (b) tangible property, whether movable or immovable, or a lease of such property;
- (c) property not within paragraph (a) or (b) which is used for the purposes of a trade, profession or vocation carried on-
  - (i) by the trustees, or

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<sup>48</sup> Paragraph 6(4) of Schedule 4B.

<sup>49</sup> See *Carver v Duncan* [1985] STC 356 (HL).

<sup>50</sup> "Securities" has the same meaning as in Taxation of Chargeable Gains Act 1992 section 132: Schedule 4B paragraph 7(2). Section 132(3)(b) provides that "security" includes "any loan stock or similar security whether of the Government of the United Kingdom or of any other government, or of any public or local authority in the United Kingdom or elsewhere, or of any company, and whether secured or unsecured".



- (ii) by a beneficiary who has an interest in possession in the settled property;
- (d) any right in or over, or any interest in, property of a description within paragraph (b) or (c).<sup>51</sup>

The definition does not make much sense. Debt claims which are "securities" are covered. Other debt claims, such as money on deposit account, are not. Rights in or over, or any interest in, property are covered if the property falls within paragraph (b) or (c) but not if it falls within paragraph (a). Intangible property other than shares or securities is covered only if used for the purposes of a relevant trade, profession or vocation. Intellectual property rights held as an investment will therefore not qualify. Why not?

## 2.11 The Deemed Disposal

### 2.11.1 Nature

If a transfer of value by trustees is treated as linked with trustee borrowing, then the trustees are treated for capital gains tax purposes as having at the material time<sup>52</sup> disposed of, and as having immediately reacquired, the whole or a proportion of each of "the remaining chargeable assets", i.e. the "chargeable assets" that form part of the settled property immediately after the material time.<sup>53</sup> The deemed disposal and reacquisition is deemed to be for a consideration equal to the whole or, as the case may be, a proportion of the market value of each of those assets.<sup>54</sup> This will obviously be capable of giving rise to a chargeable gain which can be visited on the settlor under the Offshore Settlor Provisions (or the UK Settlor Provisions if the trust is United Kingdom resident at any time in the year). If neither set of provisions applies, the gain can be attributed to a beneficiary in accordance with Schedule 4C, which in effect applies with modifications the Offshore Beneficiary Provisions.<sup>55</sup>

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<sup>51</sup> Paragraph 7(1) of Schedule 4B.

<sup>52</sup> See 2.2.3.

<sup>53</sup> Schedule 4B paragraph 10(1).

<sup>54</sup> Schedule 4B paragraph 10(2).

<sup>55</sup> See 3.

### 2.11.2 Chargeable Assets

The phrase "chargeable asset" means an asset a gain on a disposal of which by the trustees at the material time would be a chargeable gain.<sup>56</sup> In my view, this is not limited to assets the disposal of which would in fact give rise to a gain if they were disposed of at the material time. One assumes that the disposal would give rise to a gain and then asks whether it would be a chargeable gain. All gains accruing to a person on the disposal of an asset are *prima facie* chargeable gains. It is irrelevant that the person making the disposal is not in fact charged to tax in respect of the gain, e.g. because he is the sole trustee of a non-UK resident trust.

### 2.11.3 Holdover Relief

The deemed disposal and reacquisition is deemed to be under a bargain at arm's length.<sup>57</sup> This precludes the trustees from electing for holdover relief.

### 2.11.4 Rollover Relief

There appears to be nothing in Schedule 4B to prevent the trustees in a suitable case from first disposing of an asset and transferring the proceeds to a beneficiary or to the trustees of another settlement and then borrowing to acquire another asset into which the gain on the disposal of the first asset will be rolled over.

## 2.12 Disposal of Proportion of Assets

The default rule is that the deemed disposal and reacquisition is of the whole of each of the remaining chargeable assets.<sup>58</sup>

There are two exceptions to this rule. Which rule, if either, will operate will depend on whether the amount of value transferred is or is not less than the amount of outstanding trustee borrowing.<sup>59</sup> Neither rule will come into play unless the amount of value transferred is less than "the effective value of the remaining chargeable

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<sup>56</sup> Schedule 4B paragraph 10(3).

<sup>57</sup> Schedule 4B paragraph 10(2).

<sup>58</sup> Schedule 4B paragraph 10(4).

<sup>59</sup> References in paragraph 10 to amounts or values are to amounts or values immediately after the material time: paragraph 10(6). This does not apply to references to the amount of value transferred.

assets". This phrase is defined<sup>60</sup> to mean "the aggregate market value of those assets reduced by so much of that value as is attributable to trustee borrowing".<sup>61</sup>

Exception 1: Value transferred Less than Outstanding Trustee Borrowing

If the amount of value transferred is less than the amount of outstanding trustee borrowing (and is also less than the effective value of the remaining chargeable assets), then the deemed disposal and reacquisition is of the same proportion of each of the remaining chargeable assets as the amount of the value transferred bears to the effective value of the remaining chargeable assets.<sup>62</sup>

Exception 2: Value transferred Not Less than Outstanding Trustee Borrowing

If the amount of value transferred is equal to or greater than the amount of outstanding trustee borrowing (but is in addition less than the effective value of the remaining chargeable assets), then the deemed disposal and reacquisition is of the same proportion of each of the remaining chargeable assets as the amount of the outstanding trustee borrowing bears to the effective value of the remaining chargeable assets.<sup>63</sup>

2.13 A Suggestion

Schedule 4B is deeply flawed. Why did the draughtsman not simply provide that the trigger for the Schedule to apply would be the reduction by the trustees (otherwise than in a transaction (as at) arms' length) of the value of the settled property? If, immediately after such a transfer, they are indebted, then they should be deemed to make a disposal of a part of their chargeable assets. That part would be such that its market value would be the lesser of

- (a) the amount of the chargeable assets they would need to realise to discharge the indebtedness and
- (b) the amount of the transfer of value.

Perhaps such a solution was too simple!

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<sup>60</sup> By paragraph 11(5) of Schedule 4B.

<sup>61</sup> As to when value is attributable to trustee borrowing, see 2.6.

<sup>62</sup> Schedule 4B paragraph 10(2).

<sup>63</sup> Schedule 4B paragraph 10(3).

### 3 Transfers of Value: Attribution of Gains to Beneficiaries

#### 3.1 Conditions of Application of Schedule 4C

##### 3.1.1 Scope of the Schedule

Taxation of Chargeable Gains Act 1992 Schedule 4C can come into play only where Schedule 4B has already operated so as to cause the trustees of a settlement to make a deemed disposal of settled property. Schedule 4C lays down special rules for attributing resultant trust gains to beneficiaries. The rules may operate to increase or decrease the amount of capital gains tax payable. They are, in my view, to some extent misconceived and can actually increase the possibility of what might be regarded as tax avoidance by well-advised taxpayers.<sup>64</sup>

One would expect Schedule 4C to be construed as one with Schedule 4B and/or with the Offshore Beneficiary Provisions. While that is not the case, several of the definitions in Schedule 4B and the Provisions are expressed to apply for Schedule 4C purposes.<sup>65</sup>

The Schedule applies:<sup>66</sup>

“... where in any year of assessment a chargeable gain or allowable loss accrues by virtue of Schedule 4B to trustees of a settlement within section 87.

For this purpose a settlement is “within section 87” for a year of assessment if in that year the conditions specified in section 87(1) or section 88(1) are met in relation to the trustees of the settlement.”

The condition specified in section 87(1) is simply that “the trustees are at no time resident or ordinarily resident in the United Kingdom”. Section 88(1) applies to certain dual resident trustees.<sup>67</sup>

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<sup>64</sup> For a critique, see 3.6.

<sup>65</sup> See 3.1.2 and 3.2.2.

<sup>66</sup> Paragraph 1(1).

<sup>67</sup> Broadly speaking, the provisions of Schedule 4C apply in the same way *mutatis mutandis* to dual resident trusts which benefit from treaty protection from United Kingdom capital gains tax as to trusts which are non-UK resident.

### 3.1.2 "Settlement"

I have expressed the view that for a "settlement" to be caught by Schedule 4B as being within section 87, it must be both (a) a settlement within the normal capital gains tax definition and (b) also a settlement within the meaning of section 87.<sup>68</sup> That must likewise be the case in determining whether Schedule 4C is brought into play, given that it can apply to a settlement only if Schedule 4B has operated with respect to it.

It is true that the section 87 definition of "settlement" is specifically incorporated for Schedule 4C purposes.<sup>69</sup> That presents no problems. On my view, a settlement which falls within Schedule 4B must also be a section 87 settlement, so that it will clearly be a "settlement" within the meaning of Schedule 4C. But Schedule 4B can have applied to it only if it is also a "settlement" for general capital gains tax purposes. Nor is the incorporation of the section 87 definition for the general purposes of Schedule 4C in anyway redundant. It will apply in construing, for example, "transferee" settlement".<sup>70</sup>

### 3.1.3 Ring Fencing of Gains and Losses

The Schedule applies in relation to a chargeable gain or allowable loss which accrues by virtue of Schedule 4B *in place of* the provisions of Taxation of Chargeable Gains Act 1992 sections 86A to 95. Schedule 4C paragraph 1(2) provides:

"The provisions of this Schedule have effect in relation to any such chargeable gain or allowable loss as is mentioned in sub-paragraph (1) above in place of the provisions of sections 86A to 95."

For the avoidance of any doubt that the Offshore Beneficiary Provisions and Schedule 4C are in every way mutually exclusive,<sup>71</sup> paragraph 1(3) of Schedule 4C

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<sup>68</sup> See 2.1.3.

<sup>69</sup> Taxation of Chargeable Gains Act 1992 section 97(7), as amended by Finance Act 2000 Schedule 26 paragraph 4.

<sup>70</sup> See 3.2.2.

<sup>71</sup> Nor does Taxation of Chargeable Gains Act 1992 section 90 (transfers between settlements) apply "(a) to a transfer to the extent that it is in accordance with Schedule 4B treated as linked with trustee borrowing; or (b) to any chargeable gains arising by virtue of that Schedule": section 90(5), inserted by Finance Act 2000 Schedule 27. While not all "transfers of value" within the meaning of Schedule 4B will be "transfers" for section 90 purposes, all section 90 transfers will be transfers of value.

states:

“(3) No account shall be taken –

- (a) of any such chargeable gain or allowable loss in computing the trust gains for a year of assessment in accordance with sections 87 to 89; or
- (b) of any chargeable gain or allowable loss to which those sections apply in computing the Schedule 4B trust gains in accordance with this Schedule.”

The term “Schedule 4B trust gains” which the draughtsman uses is a defined one.<sup>72</sup> These are not simply chargeable gains which accrue by virtue of Schedule 4B. They are gains which so accrue and which in addition are capable of being attributed to beneficiaries who receive capital payments from the trustees. To help reduce confusion, I shall reproduce the defined term as “Schedule 4B Trust Gains”, although in the statute the last two words are not capitalised.

In theory, a chargeable gain which accrues by virtue of Schedule 4B but which neither is, nor is taken into account in computing, Schedule 4 Trust Gains will fall out of account for both the Offshore Beneficiary Provisions and Schedule 4C.

The reference in paragraph 1(2) is to “sections 86A to 95”. It is sections 87 to 97 which contain the Offshore Beneficiary Provisions.<sup>73</sup> Section 96 (payments by and to companies) has been amended<sup>74</sup> so that it applies for the purposes of Schedule 4C just as it does for the purposes of sections 87-90. Section 97 (supplementary provisions) contains the definitions of “capital payment”, “settlement”, “settlor” and “settled property”; it also determines when a capital payment is “received by a beneficiary from the trustees of a settlement” and when the recipient of a capital payment is deemed to be a “beneficiary”. It has similarly been amended<sup>75</sup> so that

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<sup>72</sup> See paragraph 3, discussed at 3.3.

<sup>73</sup> While section 86A is concerned primarily with the application of the Offshore Settlor Provisions to temporarily non-UK resident settlors, it does contain rules as to the priority of application of section 86 and section 87 in certain cases. Schedule 4C paragraph 12 contains a special rule relating to this situation, discussed at 3.4.3.

<sup>74</sup> By Finance Act 2000 Schedule 26 paragraph 3.

<sup>75</sup> By Finance Act 2000 Schedule 26 paragraph 4.

all but subsection (6) applies for the purposes of Schedule 4C too.<sup>76</sup>

#### 3.1.4 Chargeable Gains and Allowable Losses

References in Schedule 4C to "chargeable gains" are straightforward. All gains accruing to a person on the disposal of an asset are *prima facie* chargeable gains. It is irrelevant that the person making the disposal is not in fact charged to tax in respect of the gain. Hence, gains deemed to be realised by non-UK resident trustees on which neither they nor the settlor is taxable are still "chargeable gains".

The reference to "allowable losses" is potentially more difficult. A loss realised (or deemed to be realised) by trustees will *prima facie* not normally be an allowable loss if they are not resident or ordinarily resident in the United Kingdom in any part of the year of assessment in which the loss is realised, which *ex hypothesi* will be the case if Schedule 4C is to apply.<sup>77</sup> The only situation in which Schedule 4B could operate so that an allowable loss accrued to non-UK resident trustees would be the rare case where they disposed of an asset a gain on which would be taxable in their hands under Taxation of Chargeable Gains Act 1992 section 10 (non-UK residents with United Kingdom branch or agency).

My hunch is that the draftsman of Schedule 4C was under the, *prima facie* erroneous, impression that by "allowable loss" is meant a loss which would be an allowable loss if the trustees were United Kingdom resident at any time in the year of assessment in which it were realised by them. Given that there is no definition of "allowable loss" for the purposes of the Schedule, is there any means of it reaching that conclusion by statutory construction? Let us consider Taxation of Chargeable Gains Act 1992 section 97(6), which provides:

"Section 16(3) shall not prevent losses accruing to trustees in a year of assessment for which section 87 of this Act ... applied to the settlement from being allowed as a deduction from chargeable gains accruing in any later year (so far as they have not previously been set against gains for the purposes of a computation under either of those sections or otherwise)."

Although section 97(6) does not apply *directly* for the purposes of Schedule 4C, it does apply to losses accruing to trustees in a year of assessment for which section 87 applies to the settlement and Schedule 4C can apply only to gains and losses deemed to be realised in such a year.

<sup>76</sup> As to whether section 97(6), which deals with trust losses, can apply indirectly for Schedule 4C purposes, see 3.1.4.

<sup>77</sup> Taxation of Chargeable Gains Act 1992 section 16(3).

One view - the wider view - is that section 97(6) operates not only for the purpose of ascertaining whether there are trust gains for a year of assessment for section 87 purposes but also enables the trustees to set-off losses against gains realised by them in future years when they are resident in the United Kingdom. If the courts accepted the wider view, they could equally accept that section 97(6) would allow a loss to be deducted for Schedule 4C purposes and, in that sense, to be an "allowable loss" within the meaning of the Schedule.

The difficulty is that section 97(6) refers in terms only to deduction of losses from chargeable gains accruing in a *later* year and not the current year. Now in the context of section 87, this is of no relevance. If the wider view is correct, then the *practical* effect of section 97(6) in the context of section 87 is indeed to convert a non-allowable loss into an allowable loss. One calculates section 87 trust gains for a year of assessment on the hypothesis that the trustees are resident in the United Kingdom in the year.<sup>78</sup> On that hypothesis, losses of the current year are allowable losses. Section 97(6) is therefore not needed in relation to losses of the current year.

By contrast, in the case of Schedule 4C, while losses realised on a Schedule 4B deemed disposal can be taken into account to reduce chargeable gains arising on the same disposal, yet if there is a balance of losses on such disposal there is *prime facie* nothing in the Taxation of Chargeable Gains Act which makes them allowable losses, if they are not already.

I therefore conclude that "allowable loss" in Schedule 4C must bear its ordinary meaning with the result that it will apply to very few losses other than losses arising on one Schedule 4B deemed disposal which are utilised to offset the amount of chargeable gains realised on the same disposal. The result, in my view, is that non-allowable losses which cannot be so utilised (and, arguably, ones which have been so utilised) can be set against any gains other than gains realised on another Schedule 4B disposal. Perversely enough, this would probably on balance cause less losses to be stranded. See further 3.3.2.4.

## 3.2 General Scheme of the Schedule

### 3.2.1 The Statute

The general scheme of this Schedule is that-

- "(a) Schedule 4B trust gains are attributed to beneficiaries-



- (i) of the transferor settlement, or
- (ii) of any transferee settlement,

who have received capital payments from the trustees; and

- (b) any allowable loss accruing by virtue of Schedule 4B may only be set against a chargeable gain so accruing.<sup>79</sup>

### 3.2.2 Definitions

The term "Schedule 4B trust gains" bears a complex and unusual meaning, discussed at 3.3.

The vexed question of what constitutes an "allowable loss" is discussed at 3.1.4. See also 3.3.2.4.

"Settlement" has its Taxation of Chargeable Gains Act 1992 section 87 meaning. As to the consequences of this, see 3.1.2.

"Transferor settlement" and "transferee settlement" are defined, by paragraph 14(2), as follows:

"(2) In this Schedule, in relation to a transfer of value-

- (a) references to the transferor settlement are to the settlement the trustees of which made the transfer of value; and
- (b) references to a transferee settlement are to any settlement of which the settled property includes property representing, directly or indirectly, the proceeds of the transfer of value."

Hence, the term "transferee settlement" is not limited to a settlement to which the trustees of the transferor settlement made a *direct* transfer.

It should be noted that it is not necessary, for Schedule 4C to operate, that there should be any transfer to a transferee settlement. A transfer to an individual is quite sufficient. Why Schedule 4C should deal with such a case is even more mysterious than why it should deal with transfers to transferee settlements. See 3.6.

While "transfer of value" has the same meaning as in Schedule 4B,<sup>80</sup> "the proceeds of the transfer of value" is not defined.<sup>81</sup>

"Beneficiary" bears the extended meaning contained in Taxation of Chargeable Gains Act 1992 section 97(8)-(10). In addition paragraph 14(3) of Schedule 4C provides:

"References in this Schedule to beneficiaries of a settlement include-

- (a) persons who have ceased to be beneficiaries by the time the chargeable gains accrue, and
- (b) persons who were beneficiaries of the settlement before it ceased to exist,

but who were beneficiaries of the settlement at a time in a previous year of assessment when a capital payment was made to them."

It is interesting that there is no comparable provision in the Offshore Beneficiary Provisions.<sup>82</sup>

"Capital payment" has the same meaning as for section 87 purposes.<sup>83</sup>

### 3.3 Schedule 4B Trust Gains

#### 3.3.1 The Formula

One computes Schedule 4B Trust Gains in relation to each transfer of value to which the Schedule applies.<sup>84</sup> One ascertains the amount thereof by performing the following calculation:

$$CA - SG - AL$$

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<sup>80</sup> Schedule 4C paragraph 14(1)(a). The time at which a transfer of value is made for the purposes of Schedule 4C is "the material time" for the purposes of Schedule 4B.

<sup>81</sup> The phrase is not used in Schedule 4B.

<sup>82</sup> See 14.6.3.

<sup>83</sup> Taxation of Chargeable Gains Act 1992 section 97(1), (2), (4) and (5).

<sup>84</sup> Schedule 4C paragraph 3(2).

CA is the "chargeable amount".<sup>85</sup>

SG is the amount of any gains attributed to the settlor that fall to be deducted under paragraph 6.<sup>86</sup>

AL is the amount of any allowable losses that may be deducted under paragraph 7.<sup>87</sup>

The intention is thus that one should take the net gains arising from the Schedule 4B deemed disposal and deduct (a) any part of those gains which are attributed to the settlor and (b) any unutilised allowable losses arising from other Schedule 4B disposals.

### 3.3.2 Chargeable Amount

#### 3.3.2.1 The Basic Rule

If the transfer of value is made in a year of assessment during which the trustees of the transferor settlement are at no time resident or ordinarily resident in the United Kingdom<sup>88</sup> the chargeable amount is:

"the amount on which the trustees would have been chargeable to tax under section 2(2) by virtue of Schedule 4B if they had been resident or ordinarily resident in the United Kingdom in the year."<sup>89</sup>

United Kingdom resident trustees are chargeable to capital gains tax for a year of assessment under section 2(2) on the "total amount of chargeable gains accruing to [them] in the year of assessment, after deducting-

- (a) any allowable losses accruing to [them] in that year of assessment, and
- (b) so far as they have not been allowed as a deduction from chargeable

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<sup>85</sup> The computation of the "chargeable amount" is discussed at 3.3.2.

<sup>86</sup> See 3.3.2.6.

<sup>87</sup> See 3.3.2.7.

<sup>88</sup> In the case of a dual resident trust, the chargeable amount is limited by reference to the disposal of "protected assets": paragraph 5.

<sup>89</sup> Paragraph 4(1) and (2).

gains accruing in any previous year of assessment, any allowable losses accruing to [them] in any previous year of assessment ...”

#### 3.3.2.2 Annual Exemption

Trustees will benefit from an annual exemption from capital gains tax: see section 3. It is a moot point whether in calculating "trust gains" one takes into account the trustees' annual exemption. For a similar problem in relation to the Offshore Beneficiary Provisions, see 14.3.4.<sup>90</sup> The difficulty is compounded here when one takes into account that Schedule 4B can operate on more than one occasion in the same year of assessment and the calculation needs to be performed on each occasion.

#### 3.3.2.3 Taper Relief

The trustees may also be entitled to taper relief: see section 2A. Questions thus potentially arise as to how to calculate "the amount on which the trustees would have been chargeable to tax under section 2(2) by virtue of Schedule 4B". Does one disregard taper relief? In my view, one does not. Section 2A(2) requires one to deduct taper relief in calculating the amount on which a person is charged under section 2(2). Moreover, paragraph 11 of the Schedule, which makes it clear that gains treated as accruing to beneficiaries under the Schedule are not eligible for taper relief, is "without prejudice to so much of this Schedule as requires section 2A to be applied in the commutation of the amount of Schedule 4B trust gains". There is no express reference in the Schedule to section 2A. The only implied reference is that in paragraph 4(2), through the express reference there to section 2(2). The result is thus the same as in the case of section 87 trust gains. Taper relief is allowed in computing the trust gains but is not allowed a second time when the gain is imputed to a beneficiary. That is fair.

#### 3.3.2.4 Losses Arising on Same Transfer of Value

A difficult point is the extent to which trust losses can be taken into account. If one performs the calculation on the assumption that the trustees are United Kingdom resident in the year of the Schedule 4B deemed disposal, then losses generated as the result of such disposal would (for the purposes of that calculation) be in general<sup>91</sup> allowable losses, notwithstanding that the trustees are in fact non-UK resident. For that is the necessary consequence of applying the statutory hypothesis as to United

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<sup>90</sup> Non-Resident Trusts 8th Edition.

<sup>91</sup> The exception is losses which would not be allowable losses if realised by a person who was in fact United Kingdom resident e.g. a loss on the disposal of a qualifying corporate bond.

Kingdom residence.<sup>92</sup> It would thus appear to be irrelevant that the losses may not in fact be allowable losses. Nor, in my view, does the statement in paragraph 1(2) of the Schedule require one to take into account only losses which are in reality allowable losses.<sup>93</sup>

Provided therefore gains exceed losses on any particular operation of Schedule 4B, this should not give rise to any injustice, at least to the taxpayer.

Where on an occasion of Schedule 4B applying the amount of losses which would be allowable losses if the trustees were United Kingdom resident exceed the amount of chargeable gains, there will clearly be no Schedule 4B Trust Gains, as the "chargeable amount" will be zero. It will not be a negative amount. What of the excess losses? If they are "allowable losses", they can be utilised to reduce the amount of Schedule 4B Trust Gains arising on another Schedule 4B deemed disposal, whether in the same or subsequent years.<sup>94</sup> If they cannot be so utilised, then they are "stranded". This could easily give rise to considerable injustice.

Suppose that the settled property includes technology shares which have been acquired at a cost of £10 each. At the time the Schedule 4B deemed disposal takes place, they have taken a temporary dip in value and are worth only £6, so that the disposal gives rise to a loss of £4 per share. That loss is stranded. They are subsequently sold for £15. The real gain is £5 per share but the capital gains tax position is that the trustees have realised a chargeable gain of £9 from which they cannot deduct their stranded loss of £4.

If excess losses realised on a Schedule 4B disposal are not "allowable losses",<sup>95</sup> then they cannot be otherwise utilised under the Schedule. If they are not "allowable losses", however, the Schedule does not apply to them at all and nothing in the Schedule precludes their being taken into account in computing trust gains for the purposes of section 87 to 89.<sup>96</sup>

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<sup>92</sup> See *Marshall v Kerr* [1993] STC 360 in the Court of Appeal. 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: see my *Non-Resident Trusts* 8th edition 1.7.2.

<sup>93</sup> It should be noted that paragraph 7, discussed at 3.3.2.7, is silent as to which losses can be deducted in computing the Schedule 4B Trust Gains in relation to a *single* Schedule 4B disposal.

<sup>94</sup> Paragraph 7 of Schedule 4C, discussed at 3.3.2.7.

<sup>95</sup> As to which thorny question, see 3.1.4.

<sup>96</sup> See paragraph 1(2) and (3) of Schedule 4C, discussed at 3.1.3.

Suppose that the one and only Schedule 4B deemed disposal made by trustees in 2000/2001 involves their realising chargeable gains of £1,000,000, no allowable losses and £400,000 of non-allowable losses which would be allowable losses if the trustees were a United Kingdom resident. The chargeable amount calculated under paragraph 4 is £500,000. Suppose that, in the same year the trustees realise £500,000 of chargeable gains and no losses, allowable or otherwise, as a result of actual disposals. Can the £400,000 non-allowable losses be deducted from the £500,000 in order to calculate the trust gains for the year for section 87 purposes? As they are not in fact allowable losses, paragraph 1(2) of Schedule 4C would not preclude them from being so deducted. Nor would anything else in Schedule 4C.

The Revenue would have to argue that the effect of Taxation of Chargeable Gains Act 1992 section 2(3), which provides that "relief" is not to be given under the Act more than once in respect of any loss or part of a loss, was to prevent the loss being deducted for both Schedule 4C and section 87 purposes. Yet that raises the question as to order of priority. Is "relief" given simply because a calculation of gains which can be visited on beneficiaries is made? If so, does the Schedule 4C calculation take priority because that falls to be made at an earlier time, namely the date of the deemed disposal, whereas the section 87 calculation cannot be made until the end of the year of assessment. Or does one apportion the losses just once for every year of assessment and, if so, on what conceivable basis?

Does "relief" involve the reduction of an amount of chargeable gains imputed to a beneficiary? If so, the attribution of losses will have to be on a wait-and-see basis. In this case, it will be done on a year by year basis. Does the loss result in a "relief" if it reduces the amount of chargeable gains imputed to a person who is not liable to capital gains tax because of his residence or domicile? One could no doubt multiply the problems *ad nauseam*.

### 3.3.2.5 Hypothetical Application of UK Settlor Provisions

What if the trustees would not be liable to United Kingdom tax because their gains would be deemed to be those of the settlor under Taxation of Chargeable Gains Act 1992 section 77? One is expressly directed to ignore that possibility.<sup>97</sup>

### 3.3.2.6 Application of Offshore Settlor Provisions

For the purposes of the Schedule, the chargeable amount in relation to a transfer of value is to be reduced by the amount of any chargeable gains arising by virtue of that transfer that-

- "(a) are by virtue of section 86(4) treated as accruing to the settlor, or
- (b) where section 10A applies, are treated by virtue of that section (as it has effect subject to paragraph 12 below) as accruing to the settlor in the year of return."<sup>98</sup>

Limb (a) looks simple enough. If a gain is attributed to the settlor under section 86 (the Offshore Settlor Provisions), it would be wrong to attribute it to beneficiaries under the Schedule. Now an argument might be raised that under section 86(4) no part of the trustees' gain is treated as accruing to the settlor by virtue of section 86(4); true, chargeable gains of an amount equal to the amount on which the trustees would be chargeable to tax for the year if they were United Kingdom resident are treated as accruing to the settlor in the year, but they are not the same gains as those of the trustees. If this argument were now to be raised for the first time, one would dismiss it out of hand and advise its proponent to read what had been said in *McGuckian v IRC* about the purposive construction of statutes. Yet it is this very argument which has been used by the Revenue to deny double taxation relief to settlors. That the draughtsman of the Schedule should, consciously or unconsciously, have regarded this argument as hopeless is not at all surprising.<sup>99</sup>

In the simple case where neither section 10A nor section 86A applies, i.e. where the settlor is not "temporarily non-UK resident", section 86 will continue to apply as it did before the enactment of Finance Act 2000 because Schedule 4C does not affect its operation.<sup>100</sup> Suppose in the same year of assessment the trustees realise gains of £A on one actual disposal and losses of £B on another actual disposal. On a Schedule 4B deemed disposal, they realise gains of £C and losses of £D. The settlor will have imputed to him under section 86 net gains of £(A-B+C-D).

In determining for the purposes of paragraph 6(1)(a) the amount of chargeable gains arising by virtue of a transfer of value that are treated as accruing to the settlor, one disregards any losses which arise otherwise than by virtue of Schedule 4B.<sup>101</sup> Suppose in the same year of assessment the trustees realise losses of £400,000 on an actual disposal. On their one and only Schedule 4B deemed disposal in the year, they realise gains of £600,000 and no losses. The settlor will have imputed to him under section 86 net gains of £(-400,000 + 600,000) = £200,000. If paragraph 6(1)

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<sup>98</sup> Paragraph 6(1).

<sup>99</sup> See generally my *Non-Resident Trusts* 8th edition 13.9.6.2.

<sup>100</sup> Paragraph (2) refers only to sections 86A to 95.

<sup>101</sup> Paragraph 6(2).

stood alone, SG would consequently be £200,000.

The apparent effect of paragraph 6(2) is that one ignores the loss of £400,000 on the actual disposal so that SG is deemed to be £600,000, reducing to that extent the trust gains which can be visited on beneficiaries by virtue of the Schedule. The result is thus that where net trust gains for the year have all been visited on the settlor, the Schedule 4B Trust Gains are reduced to zero and Schedule 4C has no operation, which is what one would expect. It is only where section 86 applies to only part of the gains realised by the trustees (for example, where there is more than one settlor) that section 86 and Schedule 4C can both operate in relation to the same settlement.

Suppose the facts are slightly different. On the Schedule 4B deemed disposal, the trustees realise gross gains of £600,000 (as before) but in addition £100,000 of losses which are not allowable losses but would have been allowable losses had the trustees been United Kingdom resident. As these are losses which do arise by virtue of Schedule 4B, they do not fall to be disregarded. The settlor will have imputed to him under section 86 net gains of  $\pounds(-400,000 + 600,000 - 100,000) = \pounds100,000$ . If paragraph 6(1) stood alone, SG would consequently be £100,000. The effect of paragraph 6(2) is that one ignores the loss of £400,000 on the actual disposal but not the loss of £100,000 on the deemed disposal, so that SG is deemed to be £500,000. That, however, is the chargeable amount. The result is once again that, net trust gains for the year having all been visited on the settlor, Schedule 4C has no operation.

For the position where section 10A applies, see 3.4.3.

#### 3.3.2.7 Reduction for Allowable Losses

"AL" in the formula for the computation of Schedule 4B Trust Gains, "CA - SG - AL" is "the amount of any allowable losses that may be deducted under paragraph 7" of Schedule 4C. It will be recalled that any losses, allowable or otherwise, arising on the *same* Schedule 4B deemed disposal will be taken into account in determining "CA".<sup>102</sup> For what is meant by "allowable loss", see 3.1.4.

Paragraph 7(1) and (2) of Schedule 4C provide:

"7(1) An allowable loss arising under Schedule 4B in relation to a transfer of value by the trustees of a settlement may be taken into account in accordance with this paragraph to reduce for the purposes of this Schedule the chargeable amount in relation to another transfer of value by those



trustees.

(2) Any such allowable loss goes first to reduce chargeable amounts arising from other transfers of value made in the same year of assessment. If there is more than one chargeable amount and the aggregate amount of the allowable losses is less than the aggregate of the chargeable amounts, each of the chargeable amounts is reduced proportionately."

Hence, one first ascertains if there are chargeable amounts arising from other transfers of value made in the same year of assessment. If there are, the loss is used to reduce these chargeable amounts. If the loss is less than the aggregate of the chargeable amounts, each of them is reduced proportionately.<sup>103</sup> If the loss is greater than the chargeable amounts of the same year, the excess is carried forward and treated for the purpose of set-off as if it were an allowable loss arising in relation to a transfer of value made in that year.<sup>104</sup> Thus, the surplus can be carried forward indefinitely.

Where, in applying the formula, SG and AL are greater than CA, one deducts SG first and utilises only so much of the paragraph 7 losses as are necessary to bring the result to zero. Hence, the balance of the paragraph 7 losses are available to be used elsewhere.<sup>105</sup>

### 3.4 Attribution of Gains to Beneficiaries

#### 3.4.1 The Basic Rule

Paragraph 8 lays down the rules for attributing Schedule 4B Trust Gains to beneficiaries of the transferor settlement and of any transferee settlement.

The Schedule 4B gains are to be treated as chargeable gains accruing to beneficiaries who –

- “(a) receive capital payments from the trustees in the year of assessment in which the transfer of value is made, or
- (b) have received such payments in any earlier year,

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<sup>103</sup> Paragraph 7(2).

<sup>104</sup> Paragraph 7(3).

<sup>105</sup> Paragraph 7(4).

to the extent that such payments exceed the amount of any gains attributed to the beneficiaries under section 87(4) or 89(2)."<sup>106</sup>

A capital payment is disregarded for the purposes of the Schedule if it is made before 21st March 2000.<sup>107</sup>

It is irrelevant that the beneficiary did not benefit, directly or indirectly, from the transfer of value which gave rise to the Schedule 4B gains, just as it is irrelevant in applying section 87(4) (and section 89(2)) that a capital payment received by a beneficiary did not in reality represent a trust gain.

Any surplus, unattributed, Schedule 4B gains for the year are carried forward to the following year of assessment and treated for the purpose of attribution as if they were gains from a transfer of value made in that year.<sup>108</sup>

The Schedule operates to impute a chargeable gain to a beneficiary, not necessarily to make him taxable on that gain. If he is not resident or ordinarily resident in the United Kingdom in the year of imputation, he will not be chargeable on normal principles.<sup>109</sup> If he is not domiciled in the United Kingdom in the year of imputation he will not be chargeable.<sup>110</sup> Hence, gains can be "washed" by being imputed to non-taxable beneficiaries, just as they can in the case of section 87.

It is in general immaterial for the purposes of paragraph 8 (which imputes chargeable gains to beneficiaries) that the trustees of the transferor settlement, or any transferee settlement, are or have at any time been resident or ordinarily resident in the United Kingdom.<sup>111</sup> (One must of course bear in mind that unless the transfer of value occurred in a year of assessment during no part of which the trustees were

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<sup>106</sup> Paragraph 8(2). Section 89(2) applies in a year in which the trustees are at some time United Kingdom resident or ordinarily resident but where there are unattributed trust gains brought forward from a non-resident period. While in the following discussion, I shall not refer to it separately from section 87, the Schedule applies to it *mutatis mutandis* as it does to section 87 trust gains.

<sup>107</sup> Schedule 4C paragraph 10(3)(a).

<sup>108</sup> Paragraph 8(3). This mirrors the effect of section 87(2).

<sup>109</sup> Taxation of Chargeable Gains Act 1992 section 2(1).

<sup>110</sup> Paragraph 9(2), mirroring section 87(7).

<sup>111</sup> Paragraph 10(1).

resident or ordinarily resident in the United Kingdom,<sup>112</sup> the Schedule does not apply at all.<sup>113</sup>)

An exception to the general rule is that a capital payment received by a beneficiary of a settlement from the trustees in a year of assessment (a) during the whole of which they are resident in the United Kingdom or (b) in which they are ordinarily resident in the United Kingdom is to be disregarded for the purposes of paragraph 8 if it was made before, but not made in anticipation of, chargeable gains accruing under Schedule 4B or of a transfer of value being made to which that Schedule applied.<sup>114</sup> Hence the exception is not in point if both the trustee is not resident in the United Kingdom at any time in the year and the trustee is not ordinarily resident in the United Kingdom for any part of a year. The condition is very curious. It is a moot point whether, having regard to Taxation of Chargeable Gains Act 1992 section 69(1) (residence and ordinary residence of trustees of settlements), it is in fact possible for trustees to be resident in the United Kingdom for part of a year without also being ordinarily resident there for that part. (The general view is that section 69 lays down an exhaustive test of when trustees are United Kingdom resident and that, if they satisfy that test, they are also United Kingdom ordinarily resident, so that it is not possible for their residence and ordinary residence status to diverge.) If it is not, then the requirement in paragraph 10(2)(a) that the trustees must be resident in the United Kingdom during the whole of the year of assessment is otiose, given that, if they are resident in the United Kingdom for part of the year, they will be ordinarily resident in the United Kingdom "in" that year so that the alternative condition in paragraph 10(2)(b) will be satisfied.

For the purposes of the exception, the trustees of a settlement are not to be regarded as resident or ordinarily resident in the United Kingdom 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. It is immaterial whether or not the trustees own "protected assets" at any relevant time.

### 3.4.2 Comparison and Interaction with Section 87

Schedule 4C paragraphs 8 to 10 broadly mirror section 87: it is simply that there are two pools of gains and that the Schedule 4C pool can additionally be visited on

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<sup>112</sup> Or during which they were dual resident.

<sup>113</sup> Paragraph 1(1): see 3.1.1.

<sup>114</sup> This is an echo of section 89(1), which operates in relation to section 87 trust gains.

beneficiaries of transferee settlements while ordinary section 87 gains cannot.<sup>115</sup>

A capital payment received by a beneficiary is attributed to a normal section 87 trust gain before it is attributed to a Schedule 4B gain. If and to the extent to which it cannot be attributed to such gains, it is then attributed to Schedule 4B gains.

The attribution of chargeable gains to beneficiaries under the Schedule is made in proportion to, but is not to exceed, the amounts of the capital payments received by them.<sup>116</sup> If and to the extent that a capital payment has resulted in chargeable gains being imputed to the recipient under the Schedule in an earlier year of assessment, it cannot operate as to result in further gains being imputed to him in a later year of assessment, whether under section 87 or section 89.<sup>117</sup> Otherwise, it is carried forward to future years and can in principle operate to impute a gain to the beneficiary under section 87 or section 89,<sup>118</sup> just as it could before the enactment of Finance Act 2000. An important point of distinction is that a capital payment can, in my view, be carried forward for the purposes of the Schedule for only two years. For although paragraph 8(2) refers to beneficiaries who have received capital payments in "any" earlier year, paragraph 9(3)(b) makes it clear that a capital payment received before the year of assessment preceding the year of assessment in which the transfer of value is made is to be disregarded. For example, a capital payment made on April 1<sup>st</sup> 2000 can be carried forward for the purposes of the Schedule to 2000/2001 and to 2001/2002 but not to any later year. This opens up possibilities for tax planning which were not available before the addition of Schedules 4B and 4C!

A capital payment which has operated to cause a chargeable gain to be attributed to a beneficiary under section 87 or section 89 is to be left out of account for the purposes of the Schedule.<sup>119</sup>

### 3.4.3 Temporarily Non-UK Resident Settlers

As from 1998/99, Taxation of Chargeable Gains Act 1992 charges to capital gains

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<sup>115</sup> Unless they have been carried over to a new settlement by the operation of section 90.

<sup>116</sup> Paragraph 8(4). This mirrors section 87(5).

<sup>117</sup> Paragraph 9(1).

<sup>118</sup> Of, for that matter, Taxes Act 1988 section 740 or section 762.

<sup>120</sup> Paragraph 8(2).

tax certain gains of certain individuals who have been "temporarily" neither resident nor ordinarily resident in the United Kingdom. The provisions operate on a "wait and see" basis. A difficulty arises in the case of gains attributed to a settlor by the Offshore Settlor Provisions on account of their interaction with the Offshore Beneficiary Provisions. If gains are imputed to the settlor under the former, they are disregarded for the purposes of the latter. The Offshore Beneficiary Provisions operate on a year by year basis. It would be cumbersome, and a sacrifice of one of the advantages to be gained from self-assessment, if the calculation for one year in respect of a beneficiary could be reopened as much as four years later. Taxation of Chargeable Gains Act 1992 section 86A was therefore inserted to deal with the problem of trust gains which would be imputed by section 86 to a settlor were he UK resident or ordinarily resident in a year of assessment. Although the wording is complex, the general idea is simple. In the years of non-UK residence of the settlor, one assumes that he will not be merely "temporarily" non-UK resident so that all the trust gains for each year are taken into account for section 87 purposes. If and when the settlor returns so as to bring section 10A into play, one does not attribute to him any gain on which beneficiaries of the relevant settlement have been charged to tax under the Offshore Beneficiary Provisions. One does, however, attribute to him gains which have been imputed to beneficiaries who have not been charged to tax.

A similar difficulty arises in the case of the Schedule and is solved in the same way. Paragraph 12 applies where

"by virtue of section 10A an amount of gains-

- (a) arising under Schedule 4B in an intervening year, and
- (b) falling within section 86(e),

would (apart from this Schedule) be treated as accruing to a person ("the settlor") in the year of return."

Where the paragraph applies:

"only so much (if any) of the Schedule 4B trust gains falling within section 86(1)(e) as exceeds the amount charged to beneficiaries shall fall in accordance with section 10A to be attributed to the settlor for the year of return."

### 3.5 Surcharge

When a trust gain is imputed to a beneficiary under Taxation of Chargeable Gains

Act 1992 section 87 and he is charged to tax in respect of it, he may be liable to pay a surcharge in the nature of interest: see sections 91 - 95. Paragraph 13 of Schedule C imposes a surcharge, which is similar to that imposed by sections 91-95.<sup>120</sup>

### 3.6 Critique

What is the purpose of Schedule 4C? I can see none. If there was one, it has been well concealed. It is certainly not to be found in the Treasury Explanatory Notes on the Finance Bill. Where the transfer is to a transferee settlement, Taxation of Chargeable Gains Act 1992 section 90 would (had Finance Act 2000 Schedule 26 not been enacted) have operated to transfer a proper proportion of realised trust gains (including gains deemed to be realised by Schedule 4B) to the transferee settlement.

One of the effects of Schedule 4C is that Schedule 4B Trust Gains can be imputed to beneficiaries who receive capital payments either from the transferor or the transferee settlement. While this may seem attractive to the Revenue, it is not necessary to counteract tax avoidance and makes the imputation of gains to beneficiaries even more capricious and remote from the reality of which beneficiaries receive trust capital gains and which receive trust pure capital. Why does this special rule apply only to Schedule 4B Trust Gains and not to gains realised (apart from the operation of Schedule 4B) on a transfer to another settlement? Why should section 90 continue to operate in this latter case?

It has already been noted that it is not necessary, for Schedule 4C to operate, that there should be any transfer to a transferee settlement. A transfer to an individual is quite sufficient. In that case, however, why does Schedule 4C need to operate at all? The transfer will have resulted in the realisation of inherent capital gains which would (but for Schedule 4C) be taken into account for section 87 purposes. Hence, all such gains will be visited on one or more beneficiaries at the earliest opportunity.

As matters stand, where no transferee settlement is involved, the only effect of Schedule 4C which is beneficial to the Revenue is the possibility of the grossly unfair stranding of trust losses. Admittedly, there are other effects of Schedule 4C applying in such a case which are beneficial to the taxpayer in opening up possibilities of tax planning and/or tax avoidance. Yet that can hardly have been the Revenue's object.

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<sup>119</sup> Except that sections 94 and 95, which apply where trust gains are transferred from one settlement to another are not needed in the context of the Schedule.