The Offshore Taxation Review

CAPITAL GAINS TAX - NON-RESIDENT TRUSTS - RESTRICTIONS AND SCOPES: AN OUTLINE SUMMARY

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In the light of Finance Act 1991 ss.83-92 and Schs 16-18 (now Taxation of Chargeable Gains Act 1992 ("TCGA") ss.80-98 and Sch 5 and the amendments contained in Finance Act 1998) it is largely true that Monday, 18th March 1991, and Tuesday, 17th March 1998, proved to be black days for non-resident trusts subject to one year's respite (i.e. until 5th April 1999) for offshore trusts created prior to March 1991).

The legislation referred to now taxes non-resident trusts created before or after 19th March 1991 in three main situations which are discussed below as to the impact and remaining scope for tax planning.

(1) Trustees ceasing to be UK resident.

When the UK trustees retire and new non-resident trustees are appointed, the assets of the trust are revalued as if they had been sold at full value and taxed to CGT on the UK trustees. Previously, the assets may well have been put into trust years before at a very low value via holdover relief and on exportation only that low value was taxed.

Trustees can also become non-resident where they remain UK resident, but become resident in another country as well ("dual resident trustees") and by virtue of the relevant double taxation agreement, gains accruing on the disposal of assets of the settled property are outside the UK charge.

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Remaining scope: Where the present value is itself manageable but future growth is anticipated, e.g. newly formed businesses, assets settled by will, assets temporarily depressed in value.

(2) Charge on the settlor - Position pre-Spring 1998 Budget.

Before the 1991 anti-avoidance legislation, a taxpayer had relished the use of non-resident trusts because he did not have to be excluded from benefiting - a "cake and eat it" situation. Since then, the settlor is taxed on the non-resident trust gains, if he, his spouse, children (*not* limited to minors) or their spouses or a company controlled by him and/or such relatives are interested in the trust. See extension to *grandchildren* under (3) below.

Up to 17th March 1998, there was no CGT charge if the settlor was not UK domiciled or non-UK resident when he set up the trust and when the trustees made the distribution to beneficiaries. In such circumstances, the fact that he and/or the beneficiaries was interested was immaterial. Therefore, for such "foreign" settlors, the scope remains, i.e. for gains accruing to trustees pre 17/3/98 or capital payments received pre 17/3/98! (TCGA 1992 s.87) - As to "Robinson" changes see (3) and (4) below.

(3) Charge on settlor - Position post-Spring 1998 Budget.

Gains made by non-resident trusts set up *before* 19th March 1991 were generally *not* subject to the settlor charge rules unless the trusts became "tainted", e.g. if assets were *added* after that date.

As from 6th April 1999 gains of such *pre* March 1991 trusts will be treated in the same way as *post* March 1991 as regards chargeable disposals made on or after 6 April 1999. Finance Act 1998 s.132. Meanwhile trustees and advisers should consider appropriate re-organisation, e.g.

- exclusion of the defined relatives and companies they control as beneficiaries (subject to certain exceptions for minors etc).
- winding up of the trust. Let assets be owned by individuals absolutely, i.e. outside trusts: but other taxes e.g. IHT have to be considered!
- repatriation of the trust to UK (but without sale of the interest - see Press Release 6th March 1998 and FA 1998s.128.)
- convert capital into INCOME gains (but note wide definition of capital payments TCGA s.97(1)).

Grandchildren's Trusts

Grandchildren of the settlor or his spouse or spouses of grandchildren come within the definition of close relatives but only for trusts created on or after 17 March 1998 or earlier trusts that are "tainted" e.g. by gifted assets - with some exceptions. Remember, certain settlements can remain the "golden trusts" for tainting and Inland Revenue Statement SP5/92 continues to be relevant. FA 1998 s.131.

(4) Charge on the UK beneficiaries.

As a general rule, the benefit has only been one of deferral - and if a UK resident and domiciled beneficiary receives benefits, that is a capital payment on which he is charged CGT. Meanwhile, the non-resident trustees are able to invest gross, i.e. without a CGT charge. There is also a supplementary charge of 10% on the tax due - a grossing up process. This supplementary charge applies to a capital payment made to a UK resident beneficiary on or after 6 April 1992, and is at the rate of 10% per annum on the tax otherwise payable for each year for which gains remain undistributed up to a maximum of 6 years (i.e. a maximum of 4% per annum of the gain: 10% x 40% x 6). This should be considerably less than the tax free investment return/yield received by the non-resident trustees gross (say 10% per annum). The aim of this supplementary charge is clearly to encourage non-resident trustees to make capital payments to UK beneficiaries.

As regards the non-UK domiciled or non-UK resident settlor - TCGA s.87 - referred to in (2) above, the CGT exemption ceases to apply to any gains realised and capital payments made on or after 17 March 1998 to beneficiaries domiciled and resident or ordinarily resident in the UK (see further below), particularly as to beneficiaries NOT UK domiciled or resident. "Taxation" 2nd April 1998 p 2 "gains realised by all trusts worldwide will potentially be within the UK capital gains tax net unless the offshore trustees will never distribute any capital to a beneficiary resident in the UK".

Contrast the position of the non-UK domiciled but resident individual (i.e. without a trust) who can avoid CGT on overseas gains by merely not remitting them!

The charge on beneficiaries - whether as a capital payment or a supplementary charge - will not apply to non-UK resident *or* non-UK domiciled beneficiaries.

The capital gains element can therefore be paid out to such exempt beneficiaries first. However, in these circumstances, the charge on the settlor (see (2) and (3) above) can still apply in its wide context.