CHARITIES AND IMPUTED CAPITAL GAINS

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1 The Problem

Readers may be aware from articles by Geoffrey Simpson and myself which appeared in Volume 6 Issue 3, Volume 7 Issue 2 and Volume 8 Issue 1 of *The Offshore Taxation Review* that the Revenue were contending that where a capital payment is made from a trust which is (or has been) non-UK resident (or has received a transfer of assets from such a trust), then if the recipient is a charity, there would be no question of any chargeable gain imputed to it under TCGA 1992 section 87 enjoying the usual exemption for charities. Broadly speaking, section 87 is an anti-avoidance provision which aims at ensuring that non-UK resident trusts, which are in general outside the charge to UK capital gains tax, are not used as vehicles for tax avoidance. Given that a charity would not be taxable in respect of a chargeable gain it realised directly (provided it applied it for charitable purposes only), it would be surprising if section 87 did impose a charge.

2 The Revenue Interpretation

In a Revenue Interpretation of August 1998 the Revenue have to a large extent changed their minds:

> "Capital payments by offshore trusts to UK resident charities - change in Inland Revenue practice
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> Following recent legal advice the Inland Revenue are changing their practice

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on the capital gains tax treatment of capital payments by offshore trusts to UK charities.

Under the provisions of TCGA 1992 s.87, where gains have been realised by the trustees of an offshore settlement, chargeable gains may be treated as accruing to beneficiaries who are resident in the UK to the extent that they receive capital payments from the trust.

Under TCGA 1992 s.256, gains accruing to charities are not chargeable to tax if they are applicable and applied for charitable purposes. Until now, however, the Inland Revenue have always taken the view that this exemption is not available for gains which are treated by TCGA 1992 s.87 as accruing to a charity as the beneficiary of an offshore settlement.

Following recent representations on the matter, the Inland Revenue have taken legal advice on the application of these provisions and, in the light of that advice, have now concluded that the better view is that TCGA 1992 s.256 may exempt gains which would otherwise be charged on UK charities under TCGA 1992 s.87.

Consequently, where a UK charity, as beneficiary of an offshore settlement, receives a capital payment, in respect of which a chargeable gain would be treated as accruing to it under s.87(4), the charity will now be entitled to exemption from tax provided by TCGA 1992 s.256(1) to the extent that the capital payment is applicable and applied for charitable purposes.

This change of practice will apply to capital payments made to charities in the circumstances outlined above on or after 10th August 1998, and to any such payments made before that date where the tax liability is still open."

3 Charitable Trusts

While this means that a payment can be safely made to a UK resident company which is a UK charity, some significant problems still remain.

If the charity is a trust, then it is not deemed to realise a chargeable gain. Instead, a proportion of trust gains for the current and previous years will be carried over to it: TCGA 1992 section 90. That will almost always be a smaller amount than the amount which would be imputed to a UK corporate charity if it received a capital payment of the same amount.

The significance for the other beneficiaries is that there will be left in the distributing trust a larger amount of unwashed trust gains which can be potentially visited on them under section 87.

A further problem is that individuals who receive benefits from the charitable trust might well find capital gains imputed to them. The conventional view is that a person who is benefited by charitable trustees in the proper performance of their powers is not a beneficiary and that the benefit is not liable to income tax. This view depends on an interpretation of dicta in a 1932 House of Lords case, *Stedeford v Beloe* 16 TC 467.

Since the enactment of what is now TCGA 1992 section 97(8), it has been in general irrelevant for the purposes of section 87 whether a person who receives a capital payment from trustees is a beneficiary Even a benefit in kind can constitute a capital payment. A benefit conferred on a person who is resident or ordinarily resident in the UK will be a "capital payment" unless it is chargeable to income tax. That condition will not usually be satisfied in the case of a benefit conferred by a charitable trust. Hence, recipients of benefits from a charitable trust which has received a capital payment, directly or indirectly, from a section 87 trust will find they have realised a chargeable gain. The Revenue Interpretation does nothing to address this point.

4 A Solution

One way of circumventing the problem is for an appointment always to be made to an incorporated charity. Another possibility, if the terms of the trust so permit, is for the appointment to be made in favour of a UK corporation which is the wholly owned subsidiary of a UK charitable trust. Although a capital gain will be imputed to the company, it can make a "qualifying donation" to the trust which will negative the capital gain. The trust will not then have any section 87 gains imputed to it by section 90.

5 Gains of foreign companies imputed to charities under TCGA section 13

A very interesting position arises in relation to Taxation of Chargeable Gains Act 1992 section 13, another anti-avoidance provision, which imputes capital gains of a non-UK resident closely held company amongst its participators.[2] Suppose a UK

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2 See my *Non-Resident Trusts* 7th edition, to be published March 1999, Chapter 15A.

charity owns half of the shares in such a company. When the company realises a chargeable gain, one-half of it will be imputed to the charity. The gain will be exempt from capital gains tax if it "accrues to a charity and is applicable and applied for charitable purposes.[3]

Section 13 is headed: "Attribution of gains to members of non-resident companies". Section 13(2) is the operative section. It provides:

> "(2) Subject to this section, every person who at the time when the chargeable gain accrues to the company is resident or ordinarily resident in the United Kingdom, who, if an individual, is domiciled in the United Kingdom, and who is a participator in the company, shall be treated for the purposes of this Act as if a part of the chargeable gain had accrued to him."

"Person" will include an incorporated charity, the trustees of a charitable trust[4] or an unincorporated association which is a charity.[5]

In what sense can such an imputed gain be applied for charitable purposes only? Prima facie, it cannot.

Can the gain be distributed, so that it can be applied for charitable purposes, like any other cash receipt? Prior to the amendment of section 13 by FA 1996, if the gain was distributed within two years, section 13 did not apply. The charity would receive a dividend or capital distribution, exemption from tax on which could be secured by its being applied for charitable purposes only. Section 13(5A) as it now stands merely gives credit for the tax paid under section 13 against tax due on a later distribution. Section 13(7) allows the charity to deduct the capital gains tax payable under section 13 in computing its gain on an actual disposal of its shares. Neither of these provisions is of any use to it.

If the charity cannot otherwise avoid a section 13 charge, it should try to secure that its portion of the gain is distributed to it, probably by way of dividend, and then applied for charitable purposes. This cannot be guaranteed to work. If a charity does own shares in a non-UK resident company, it should ideally sell them before the company realises any section 13 gains.

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3 Taxation of Chargeable Gains Act 1992 section 256.

4 Taxation of Chargeable Gains Act 1992 section 69(1).

5 Taxation of Chargeable Gains Act 1992 section 288(1).