TRANSFERS BETWEEN SETTLEMENTS: A LOOPHOLE?

Robert Venables QC[1]

1 The Scenario

Suppose S creates a settlement. Some time later, the trustees in exercise of their dispositive powers transfer the settled property to the trustees of another settlement, to be held by them on the trusts of that settlement. Let it be assumed that there are, as there usually will be, two separate settlements.[2] Who is the settlor of the transferee settlement? Does anything turn on the relevant definition of "settlement" and/or "settlor"?

I suggest in this article that the transfer can be tax-effective in two situations. The first is to prevent the Offshore Beneficiary Provisions (Taxation of Chargeable Gains Act 1992 section 87 onwards) from applying to the transferee settlement as regards trust gains realised and capital payments made before 17th March 1998, even if they applied to the transferor settlement.

I further suggest that in the case of a non-discretionary settlement, property contained in the transferee settlement can constitute excluded property even though property contained in the transferor settlement could not.

In the course of the discussion, I examine what is meant by "settlement" and "settlor" in certain tax contexts, in particular Taxation of Chargeable Gains Act 1992 section 87, in the Offshore Beneficiary Provisions.

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2 But see below on the effect of Inheritance Tax Act 1984 sections 81 and 82.

2 General Principles

Where S is the actual settlor of Settlement A and the trustees of Settlement A in exercise of their dispositive powers transfer the settled property to the trustees of another settlement, Settlement B, to be held by them on the trusts of that settlement, then, in my view as a matter of general principle, S is a settlor of Settlement B. The trustees of Settlement A are certainly not the settlor as the assets transferred were never theirs to give away. All that the trustees of Settlement A are doing is to perfect the gift of their settlor. There is considerable judicial support for this position, in particular the decision of the House of Lords in *Drummond v Collins* 6 TC 525. A more recent statement is to be found in the judgment of Buckley LJ in the Court of Appeal in *Eilbeck v Rawling* (1980) 54 TC 101 at 160:

> "It has long been firmly established law that the donee of a special power of appointment is charged with the exercise of a personal discretion which he cannot delegate. When he exercises that discretion in making an appointment, he acts as the delegate of the settlor. What the donee does in exercise of a special power of appointment is done vicariously by the settlor."

Trustees on whom are conferred discretions as to the distribution of trust property are either donees of a special power of appointment or in what is for present purposes an identical position.

Buckley LJ and Goff LJ in the Court of Appeal in the earlier 1979 decision of *Chinn v Collins* 54 TC 311 took a different view in the context of a somewhat different argument. The House of Lords, however, unanimously took the contrary view. Lord Wilberforce, with whom the other four Lords of Appeal in Ordinary agreed, said at 350:

> "It was part, an essential part, of the arrangement that interests under the settlement should be appointed to Anthony (and Steven). This was done on 28 October 1969. Before that date the interest of each son was liable to be overridden by an exercise of the power of appointment, which might wholly exclude him: after that date each son had a contingent interest - likely to become vested after three days - in 184,500 shares. I fail to see how this can be regarded otherwise than as an act of bounty in their favour and that, taken together with the sale and repurchase, makes an arrangement. If it be said that there must be an act of bounty of the settlor and that the latter had fully divested himself of his settled property when he made the settlement, I would reply that his bounty was at that point incomplete and became completed only when an appointment was made - thereby, as it were, filling in the names of his intended beneficiaries. If one looks at the whole scheme

> more broadly, Anthony and Steven at the end of it became entitled to shares worth over £350,000 for which they had not provided consideration (other than the small amount of Rozel's commission) and this was brought about by the action of the settlor and of the trustees. If the word arrangement does not cover this, its presence in the definition is hard to appreciate."

Lord Roskill similarly said, at 356:

> "Under this scheme there was an appointment without consideration. Anthony was among the objects of the 1960 settlement but before the power of appointment was exercised there was no absolute certainty - however strong the probability - that Anthony would receive any of the shares held by the trustees. In my judgment there was a very real "bounty" conferred when the trustees with the settlor's consent exercised the power of appointment in question in Anthony's favour. As Mr Nicholls QC, for the Crown, put it, when the power of appointment was exercised a blank was filled in the original settlement which left blank how the final distribution of the trust's assets was to be made. That in my judgment was a clear act of "bounty"."

3 Settlors for Income Tax Purposes

3.1 The Definitions in the Settlement Provisions

3.1.1 The Statute

The main income tax definition, which applies for the purposes of Taxes Act 1988 Part XV (Settlements), contained in section 660G is:

"(1) In this Chapter:

> "settlement" includes any disposition, trust, covenant, agreement, arrangement or transfer of assets, and
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> "settlor", in relation to a settlement, means any person by whom the settlement was made.

(2) A person shall be deemed for the purposes of this Chapter to have made a settlement if he has made or entered into the settlement directly or indirectly, and, in particular, but without prejudice to the generality of the preceding words, if he has provided or undertaken to provide funds directly or indirectly for the purpose of the settlement, or has made with any other person a reciprocal arrangement for

that other person to make or enter into the settlement."

3.1.2 Commentary

It is clear that, despite the apparent width of the words, a "settlement" requires an element of bounty. See *IRC v Plummer* (1979) (HL) 54 TC 1, *IRC v Levy* (1982) 56 TC 58 (Nourse J) and *Butler v Wildin* (1988) 61 TC 666. This must be read in the light of the speeches in *Chinn v Collins* (1980) 54 TC 311. Lord Wilberforce said, at 350:

> "The word "arrangement" is wide in scope, and may include a combination, or series, of transactions some of which may be for consideration or of a commercial character ... In *Commissioners of Inland Revenue v Plummer*[3] it was decided, in order to place some limitation upon the extent of the word, that there must be an element of bounty in the transaction - a conception admittedly not without its difficulty."

Lord Roskill said, at 355-6:

> "On the authorities as they now stand it seems clear that if the particular transaction is a commercial transaction devoid of any element of what has been called "bounty" it is not within the section and the majority of your Lordships in *Plummer's* case accepted that the transaction there in question escaped as being a commercial transaction without the necessary element of "bounty". ... My Lords, I would venture to point out that the word "bounty" appears nowhere in the Statute. It is not a word of definition. It is a judicial gloss upon the Statute descriptive of those classes of cases which are caught by the section in contrast to those which are not. The courts must, I think, be extremely careful not to interpret this descriptive word too rigidly. I would recall some sapient observations of Frankfurter J in *Tiller v Atlantic Coast Line Railroad Co.* (1943) 318 US 54, at p 68, "A phrase begins life as a literary expression; its felicity leads to its lazy repetition; and repetition soon establishes it as a legal formula, undiscriminatingly used to express different and sometimes contradictory ideas."
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> "What the cases have sought to do is to distinguish between those cases where the recipient has in return for that benefit which he has received accepted some obligation which he has to perform, either before receiving the benefit or at some stated time thereafter, and those cases where the recipient benefits without any assumption by him of any correlative

3 (1979) 54 TC 1.

obligation. In *Plummer's* case the transaction in question was for consideration. Under this scheme there was an appointment without consideration."

3.2 Mixed Residence Settlements

Finance Act 1989 section 110 lays down a test of residence of trustees of a settlement without defining "settlement"! It does go on, however, in subsection (4) partially to define, for the purposes of the section, "settlor" to include "in relation to a settlement ... any person who has provided or undertaken to provide funds directly or indirectly for the purposes of the settlement." Once one has identified a "settlement" for the purposes of section 110, the test of who is the settlor is very similar, mutatis mutandis, to that which appertains for the purposes of the income tax settlement provisions.

The test is needed where there is more than one trustee and at least one of them is not resident in the United Kingdom. If a certain condition is satisfied, then for all the purposes of the Income Tax Acts the trustees are to be treated as resident in the United Kingdom. If the condition is not satisfied, they are to be treated as not resident there: see section 110(1).

The condition, set out in section 110(2), is that "the settlor or, where there is more than one, any of them is at any relevant time:

(a) resident in the United Kingdom,

(b) ordinarily resident there, or

(c) domiciled there."

Section 110(3) provides:

"For the purposes of subsection (2) above the following are relevant times in relation to a settlor:

(a) in the case of a settlement arising under a testamentary disposition of the settlor or on his intestacy, the time of his death, and

(b) in the case of any other settlement, the time or, where there is more than one, each of the times when he has provided funds directly or indirectly for the purposes of the settlement."

3.3 Transfers Between Settlements

Suppose that S made Settlement A when he was domiciled and resident in the UK. At a later time, the trustees in exercise of their dispositive powers, transfer assets of Settlement A to Settlement B. At that time, S is no longer UK domiciled and resident or ordinarily resident. If the trustees of Settlement B are of mixed residence, does section 100 deem them to be UK resident?

The wording of section 100(3) is very different from that of Taxation of Chargeable Gains Act 1992 section 87 and Inheritance Tax Act 1984 section 48(3), discussed below. It is a moot point whether, if S made Settlement A on his death, Settlement B can be said to arise "under a testamentary disposition of the settlor". There is a plausible argument that it can. It may be that even in such a case Settlement B cannot for said to arise under a testamentary disposition S. Where Settlement A was created by S *inter vivos*, section 110(3)(a) will clearly not apply. If section 110(3)(a) does not apply, what is "the time ... when [S] has provided funds directly or indirectly for the purposes of ..." Settlement B? There is a plausible argument that it was when he provided funds for the purposes of Settlement A and not at the time of the transfer. It may well be therefore that the transfer between settlements has no consequence for the purposes of section 110.

4 Settlors for Inheritance Tax Purposes

The inheritance tax legislation employs a narrower definition of "settlement" but an equally wide definition of "settlor as the income tax legislation in relation to something which is a settlement for inheritance tax purposes. Inheritance Tax Act 1984 section 43 contains the definition of "settlement", which is a narrow "conveyancing" description akin to that of "settled land" in the Settled Land Act 1925.:

> "(1)The following provisions of this section apply for determining what is to be taken for the purposes of this Act to be a settlement, and what property is, accordingly, referred to as property comprised in a settlement or as settled property.
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> (2) "Settlement" means any disposition or dispositions of property, whether effected by instrument, by parol or by operation of law, or partly in one way and partly in another, whereby the property is for the time being:
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> (a) held in trust for persons in succession or for any person subject to a contingency, or

(b) held by trustees on trust to accumulate the whole or part of any income of the property or with power to make payments out of that income at the discretion of the trustees or some other person, with or without power to accumulate surplus income, or

(c) charged or burdened (otherwise than for full consideration in money or money's worth paid for his own use or benefit to the person making the disposition) with the payment of any annuity or other periodical payment payable for a life or any other limited or terminable period,

or would be so held or charged or burdened if the disposition or dispositions were regulated by the law of any part of the United Kingdom; or whereby, under the law of any other country, the administration of the property is for the time being governed by provisions equivalent in effect to those which would apply if the property were so held, charged or burdened."[4]

Inheritance Tax Act 1984 section 44 contains the definition of "settlor":

"(1) In this Act "settlor", in relation to a settlement, includes any person by whom the settlement was made directly or indirectly, and in particular (but without prejudice to the generality of the preceding words) includes any person who has provided funds directly or indirectly for the purpose of or in connection with the settlement or has made with any other person a reciprocal arrangement for that other person to make the settlement.

(2) Where more than one person is a settlor in relation to a settlement and the circumstances so require, this Part of this Act (except section 48(4) to (6)) shall have effect in relation to it as if the settled property were comprised in separate settlements."[5]

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4 Subsection (3) deals with leases for life, subsection (4) with Scotland and subsection (5) with Northern Ireland.

5 For a quite extraordinary interpretation of this subsection see the decision of Chadwick J in *Hatton v Inland Revenue Commissioners* [1992] STC 140.

5 Settlors for Capital Gains Tax purposes

5.1 "Settlement" and "Settlor" in General

The capital gains tax position is more complex. The income tax definition is used for most of the purposes of the capital gains tax Offshore Beneficiary Provisions,[6] but not otherwise.

For capital gains tax purposes generally, there is no definition of "settlor". There is a definition of "settled property" in section 68: "In this Act, unless the context otherwise requires, "settled property" means any property held in trust other than property to which section 60[7] applies." A "settlement" is presumably the state of affairs which exists when there is settled property. There is no general definition of "settlor", the meaning of which must be something like "the person who created the settlement". There is obviously some scope for argument for example, as to how much of the income tax definition this imports.

5.2 The UK Settlor Provisions

In certain specific contexts, there is an express definition of "settlor". Taxation of Chargeable Gains Act 1992 section 79 contains a definition for the purposes of the UK Settlor Provisions (contained in sections 77-79 of that Act):

> "(1) For the purposes of this section and sections 77 and 78 a person is a settlor in relation to a settlement if the settled property consists of or includes property originating from him.
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> (2) In this section and sections 77 and 78:
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> (a) references to settled property (and to property comprised in a settlement), in relation to any settlor, are references only to property originating from that settlor, ...
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> (b) ...
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> (3) References in this section to property originating from a settlor are references to:

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6 The provisions are contained in Taxation of Chargeable Gains Act 1992 sections 87 to 97. The definition, contained in section 97(6), somewhat oddly does not apply for the purposes of section 97(7)-(10). This is possibly an oversight, with some unexpected consequences.

7 Nominee property and property owned jointly or as tenants in common.

(a) property which that settlor has provided directly or indirectly for the purposes of the settlement,

(b) property representing that property, and

(c) so much of any property which represents both property so provided and other property as, on a just apportionment, represents the property so provided.

(4) ...

(5) In subsection (3)

(a) references to property which a settlor has provided directly or indirectly include references to property which has been provided directly or indirectly by another person in pursuance of reciprocal arrangements with that settlor, but do not include references to property which that settlor has provided directly or indirectly in pursuance of reciprocal arrangements with another person, and

(b) references to property which represents other property include references to property which represents accumulated income from that other property."

Hence, when there is a settlement for the purposes of the UK Settlor Provisions, the definition of "settlor" in relation to it is not unlike the income tax one.

5.3 The Offshore Settlor Provisions

These are contained in Taxation of Chargeable Gains Act 1992 section 86 and Schedule 5. While the definition of "settlement" is again the normal capital gains tax one, there is an extended definition of "settlor", similar to that applicable to the UK Settlor Provisions. It is even wider in that it catches persons who control certain companies which would otherwise be settlors of settlements.

Schedule 5 provides:

"7 (Meaning of "settlor")

For the purposes of section 86 and this Schedule, a person is a settlor in relation to a settlement if the settled property consists of or includes property originating from him.

"8 (Meaning of "originating")

(1) References in section 86 and this Schedule to property originating from a person are references to:

(a) property provided by that person;

(b) property representing property falling within paragraph (a) above;

(c) so much of any property representing both property falling within paragraph (a) above and other property as, on a just apportionment, can be taken to represent property so falling.

(2) References in this Schedule to income originating from a person are references to:

(a) income from property originating from that person;

(b) income provided by that person.

(3) Where a person who is a settlor in relation to a settlement makes reciprocal arrangements with another person for the provision of property or income, for the purposes of this paragraph:

(a) property or income provided by the other person in pursuance of the arrangements shall be treated as provided by the settlor, but

(b) property or income provided by the settlor in pursuance of the arrangements shall be treated as provided by the other person (and not by the settlor).

(4) For the purposes of this paragraph:

(a) where property is provided by a qualifying company controlled by one person alone at the time it is provided, that person shall be taken to provide it;

(b) where property is provided by a qualifying company controlled by 2 or more persons (taking each one separately) at the time it is provided, those persons shall be taken to provide the property and each one shall be taken to provide an equal share of it;

(c) where property is provided by a qualifying company controlled by 2 or more persons (taking them together) at the time it is provided, the persons who are participators in the company at the time it is provided shall be taken to provide it and each one shall be taken to provide so much of it as is attributed to him on the basis of a just apportionment;

but where a person would be taken to provide less than one-twentieth of any property by virtue of paragraph (c) above and apart from this provision, he shall not be taken to provide any of it by virtue of that paragraph.

(5) For the purposes of sub-paragraph (4) above a qualifying company is a close company or a company which would be a close company if it were resident in the United Kingdom.

(6) For the purposes of this paragraph references to property representing other property include references to property representing accumulated income from that other property.

> (7) For the purposes of this paragraph property or income is provided by a person if it is provided directly or indirectly by the person."[8]

5.4 The Offshore Beneficiary Provisions

5.4.1 Taxation of Chargeable Gains Act 1992 Section 87

Taxation of Chargeable Gains Act 1992 section 87 (Attribution of gains to beneficiaries) formerly read:

> (1) This section applies to a settlement for any year of assessment during which the trustees are at no time resident or ordinarily resident in the United Kingdom [if the settlor or one of the settlors is at any time during that year, or was when he made his settlement, domiciled and either resident or ordinarily resident in the United Kingdom].

The words in square brackets have been deleted by FA 1998 section 130, with effect from 17th March 1998.

Section 87 is a consolidation of Finance Act 1981 section 80. Earlier legislation, initially Finance Act 1965 section 42, later consolidated in Capital Gains Tax Act 1979, operated in a rather different way but came into play only when the same conditions were satisfied.

5.4.2 Section 87 and Transferee Settlements

Suppose that S made Settlement A when he was domiciled and resident in the UK. At a later time, the trustees in exercise of their dispositive powers, transfer assets of Settlement A to Settlement B. At that time, S is no longer UK domiciled and resident or ordinarily resident. In my view, section 87 did not apply to Settlement B. If S is dead at the time of the transfer, he has no domicile or residence status and section 87 similarly did not apply to Settlement B.[9]

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8 Subparagraphs (8) and (9) contain definitions.

9 Of course, section 87 might have applied to Settlement B if it had another settlor in respect of whom the conditions were satisfied.

5.4.3 The Income Tax Definition

5.4.3.1 The Definition

The definition of "settlement" in the income tax settlement provisions is used for section 87 purposes. See 3.1 above. The adoption of this definition was not properly thought through.[10] In its original income tax context, it is enough for one to find that there has been a settlement (in effect, an act of bounty) by a person, who is therefore the settlor, and then to find income arising under the settlement. If the provisions apply, the income is deemed to be that of the settlor. That presents no logistical problems. It does not matter whether there is a trust or not.

5.4.3.2 Problems in Applying the Definition

In the context of section 87, the position is much more difficult. In order for the section to apply, there must be "trustees" of the settlement who realise chargeable gains and persons who receive capital payments from them. Such trustees must have a residence status and be chargeable to capital gains tax but for that residence status. Now one can realise capital gains and make capital payments to another and have a residence status and be chargeable to capital gains tax only if one is a person for the purposes of the tax. Thus, one must find an individual, a "company", as defined, personal representatives or the trustees of a "settlement" within the narrower, general definition of that term for capital gains tax purposes. Although one may find a "disposition, trust, covenant, agreement, arrangement or transfer of assets", none of these is a person.

5.4.3.3 *Chinn v Collins*

5.4.3.3.1 The Facts

It is possible that two trusts could be regarded as one "settlement" for section 87

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10 I made representations on this point to the Revenue through the Technical Committee of the Institute of Taxation, as it was then called, when it was first proposed to introduce the income tax definition for the purposes of what was then Finance Act 1980. I am not sure to what extent they were understood. They could not be answered and were consequently ignored.

purposes. The leading case in this context[11] is the decision of the House of Lords in *Chinn v Collins*.[12] In that case, an existing trust was exported to Guernsey, and the trustees appointed, with the consent of the settlor, interests in favour of the settlor's two sons which would become absolute on their surviving for three days. The sons then assigned by way of sale their interests, while still contingent, to Rozel, a Jersey company. The trust property consisted of quoted shares. The sons also contracted to buy from the Rozel the same number of the quoted shares as Rozel expected to become absolutely entitled to as a result of the assignment. In those days, a gain accruing on the disposal of an interest under a non-UK resident settlement was in general exempt from capital gains tax.

5.4.3.3.2 The Decision

The Revenue's first argument, which was accepted by the House of Lords, was that it was the *sons* who in fact became entitled to the settled shares as against the trustees of the trust, so that the trustees' gains could be imputed to them under section 42. At the time, this decision was highly suspect in terms of trust law. The decision of the Court of Appeal, in favour of the sons, seemed to be obviously correct. With hindsight, it is clear that it had nothing to do with trust law and was simply a harbinger of *Ramsay*: it was foreordained that the sons would become entitled to the trust shares and the sale of the contingent interest and the purchase of shares by the sons, being steps inserted purely to avoid tax, were consequently ignored.

An alternative argument of the Revenue, which was also accepted by the House of Lords, was that the scheme as a whole constituted an arrangement, under which each son was a beneficiary, and that the trustees of that arrangement were the trustees of the trust. As their Lordships dealt with the point but shortly, it is more revealing to see how it was set out by Templeman J at first instance,[13] who dismissed the son's appeals:

> "In the alternative, the Crown claimed that if Anthony was not the beneficiary under the settlement, Anthony was, when the interest vested, the beneficiary under an arrangement. By s.42(7) of the Finance Act 1965 a

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11 Technically, the case concerned Finance Act 1965, section 42. Although it attributed trust gains to beneficiaries on a different basis, it is in the relevant respects indistinguishable from Taxation of Chargeable Gains Act 1992 section 87.

12 (1980) 54 TC 311.

13 At page 328.

> settlement is defined so as to include an arrangement. On behalf of Anthony it was submitted that there were no trustees or settlor of any arrangement and that s.42(7) does not apply in the present circumstances. In my judgment, all the relevant events which took place between the appointment of new trustees dated 31st March 1969 and the final transfer of the shares to Anthony were part of an arrangement instigated by the settlor and carried into effect by him, by the trustees, by Rozel and by Anthony. The trust fund, the subject of the arrangement, consisted of 184,500 shares. That trust fund was vested in N M Rothschild & Sons (CI) Ltd. and the other three trustees of the settlement. They were the trustees of the arrangement because they held the trust fund which was comprised in the arrangement. Similarly, the settlor was the settlor of the arrangement because he was the person who had provided the trust fund comprised in the arrangement. There is no doubt that for the purposes of the arrangement the only beneficiary was Anthony, and that when the contingent interest vested he was, pursuant to the arrangement, absolutely entitled to the shares. Accordingly it seems to me that the Crown are entitled to succeed on this alternative ground also."

5.4.3.3.3 Problems

The main difficulty in reading the case is that Charles Potter QC for the sons, appears to have argued that for there to be an "arrangement" there must be bounty and therefore a person who has provided bounty; that there could therefore be no "arrangement" in this case on that account. That argument was rejected for the reasons mentioned at 3.1.2 above. According to the speech of Lord Roskill, however, that was the only argument put forward on this aspect of the case.[14] The resulting position is highly unsatisfactory. While answering some questions, it leaves more unanswered.

The first difficulty was mentioned by Goff LJ in the Court of Appeal, in rejecting the Revenue's submissions:

> "First, I do not for myself see how the Crown can mount a case under s.42(7) unless they can show, which was not shown, that the arrangement in some way superseded the classic settlement [i.e. the trust]. Under that settlement and in the events which happened, Rozel was the only beneficiary

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14 Bottom of page 355: "My Lords, the sole question here is whether there was the requisite element of "bounty"." For my own part, I find it more difficult to believe that Charles Potter QC should have failed to raise the points I go on to discuss than that Lord Roskill should have overlooked them because they were too difficult to deal with.

> within [Finance Act 1965] s.42(2) and would have been liable for the whole tax had it not been an overseas company, and I do not see how the Crown can escape that difficulty by looking to a different beneficiary under a different settlement, namely that constituted by the arrangement, but necessarily including the classic settlement itself, without in some way showing that the classic settlement taken alone had somehow ceased to be operative at the moment of the deemed disposal under s.25(3) of the Finance Act 1965. Mr Nicholls sought to skate over this thin ice by using a variety of descriptions of the position. He said the arrangement was "superimposed upon" or "flowed out of" or "was engrafted upon" the classic settlement, but the stark fact remains that I do not think you can have both operative at the same time and producing concurrently a different result."

This reasoning is very powerful. The House of Lords simply ignored it: a well-tried judicial technique for dealing with a troublesome impediment to reaching the desired result. What therefore is its status? Were the matter to arise in the context of Taxation of Chargeable Gains Act 1992 section 87, one could rely on an important point of distinction between the old and new Offshore Beneficiary Provisions. Under Finance Act 1965 section 42, trust gains were apportioned only to beneficiaries who were domiciled and either resident or ordinarily resident in the United Kingdom during a year of assessment. Under Taxation of Chargeable Gains Act 1992 section 87, gains are apportioned to all beneficiaries and others, such as assignees of beneficial interests, who may be not strictly be beneficiaries. The fact that gains of the trustees of the trust would now be attributed to Rozel as a beneficiary of the trust proper makes it very difficult to say that the very same gains should also be attributed to the sons as "beneficiaries" of the arrangement.

A more difficult problem is the basis on which trust gains under the "arrangement" were attributed to the sons. There is nothing in the decision, judgments or speeches dealing with this point. To my mind, there is no sensible distinction between the original trust and the arrangement. In each case, the sons were beneficiaries yet in neither case did they (ignoring the first ground of their Lordships' decision) become entitled to settled property as against the trustees. If they could be made chargeable under the arrangement, why could not they be equally chargeable under the trust?

5.4.3.3.4 Relevance of *Chinn* to Section 87

If one were faced with a similar argument today, rather than deal with this conundrum, it would be easier to circumvent it. There is another very important point of distinction between the old and new Offshore Beneficiary Provisions. Under Finance Act 1965 section 42, trust gains were apportioned each year of

assessment to beneficiaries "during" that year irrespective of whether they received any capital payments from the trustees or not. Had *Leedale v Lewis* (1982) 56 TC 501 already been decided, *Chinn v Collins* could have been disposed of on the simple ground that it was just and reasonable to apportion all the gains of the trustees of the trust to the sons, on the basis that they were the beneficiaries who had received the gain. By contrast, under Taxation of Chargeable Gains Act 1992 section 87, gains of trustees can be visited only on persons who receive capital payments from the trustees of a settlement. Unless one takes the view that the appointment of a less than absolute beneficial interest to a beneficiary does involve the making of a capital payment, the sons could not now be made liable under section 87 even if there was an "arrangement" of the type contended for by the Revenue in *Chinn v Collins*. While the Revenue are now apparently taking that point for the first time since 1981, the weight of legal opinion appears to be heavily against them.[15]

5.4.3.4 Two Trusts One Arrangement?

Although the apparent relevance of this rather unsatisfactory authority is much diminished by crucial differences in the wording and operation of the old and new Offshore Beneficiary Provisions,[16] it is none the less just plausible that two trusts could be regarded as one settlement for the purposes of Taxation of Chargeable Gains Act 1992 section 87. If so, it might further be argued with some plausibility that that settlement was "made" when the first trust was created, so that the domicile and residence status of the settlor would be relevant only at this point.

Chinn v Collins itself does not go this far. It decided at the very most that an appointment of a beneficial interest under a trust could itself constitute a separate settlement of which the appointee was the beneficiary. The actual arrangement in that case was more complicated, involving the assignment on sale of the interests appointed and the contract of sale of shares. Given, however, that the Revenue accepted[17] that the assignment and the sale agreement were not by themselves within the extended definition of "settlement" because they contained no element of bounty and were effected for full consideration in money or money's worth, they just *might*

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15 This point is discussed more fully in my *Non-Resident Trusts* 7th Edition (1999).

16 The old provisions being those in force from 1965 to 1981.

17 See the speech of Goff LJ at page 344.

be able to argue that a mere appointment out of a trust is an "arrangement".[18] Another difficulty they would have to overcome is that the settlor was actually a necessary party to the appointment in *Chinn v Collins*.

Even if an appointment of a beneficial interest under a trust could itself constitute a separate settlement of which the appointee was the beneficiary, this would still not mean that a trust and an appointment under it constituted one and the same arrangement. Indeed, the Revenue's argument in *Chinn* was quite the contrary: it was only if there were two distinct "settlements" that they had a second bite at the cherry with their alternative argument.

In my view, the Revenue will have a realistic argument that two trusts constitute one "arrangement" only where it was planned by the settlor of the first trust at the time he created or funded it that assets would be transferred from it to the second trust. In this situation, the first trust would be in the nature of a conduit.

5.4.4 Restrictive Aspect of Income Tax Test

Oddly enough, the main effect of applying the apparently wider income tax definition of "settlement" may be to reduce the scope of section 87 by preventing it applying to trusts set up without any element of bounty, for example, an employee remuneration trust set up by a quoted company for its employees generally.

6 Inheritance Tax Excluded Property Settlements

6.1 The General Rule

Property comprised in a settlement can be "excluded property" and thus in effect outside the charge to inheritance tax. The test is contained in Inheritance Tax Act 1984 section 48(3):

> "(3) Where property comprised in a settlement is situated outside the United Kingdom:

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18 The alternative argument, which is more compelling, is that although it was the appointment which supplied the scheme with the essential element of bounty, it was not the appointment by itself which was claimed or held to constitute the "arrangement".

(a) the property (but not a reversionary interest in the property) is excluded property unless the settlor was domiciled in the United Kingdom at the time the settlement was made, and

(b) section 6(1) above applies to a reversionary interest in the property but does not otherwise apply in relation to the property."

6.2 Transfers Between Settlements

Suppose that S made Settlement A when he was domiciled and resident in the UK. At a later time, the trustees in exercise of their dispositive powers, transfer assets of Settlement A to Settlement B. At that time, S is no longer UK domiciled and resident or ordinarily resident. In my view, the property comprised in Settlement B is excluded property provided that it is situate outside the United Kingdom. If S is dead at the time of the transfer, he has no domicile or residence status and the property comprised in Settlement B is similarly excluded property provided that it is situate outside the United Kingdom.

6.3 Relevant Property Settlements

Charges to inheritance tax on settlements are under either chapter II or Chapter III of Inheritance Tax Act 1984 Part III. Chapter II applies to interest in possession settlements. Chapter III applies to "relevant property" settlements, these are largely, but not exclusively, discretionary trusts.[19]

For the purposes of a charge under Chapter III, even though settled property moves between settlements, it is still deemed to be comprised in the original settlement: see section 81. Hence, a transfer from Settlement A to Settlement B at a time that the settlor of Settlement A is not domiciled in the United Kingdom cannot create an excluded property settlement.

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19 The precise definition is contained in Inheritance Tax Act 1984 sections 58 and 59.

7 Variations of Estates of Deceased Persons

Where the dispositions of the estate of a deceased person are varied within two years of his death and an appropriate election is made then, subject to certain conditions being satisfied, the variation is deemed to have been made by the deceased.

It is accepted by the Revenue that, in the case of inheritance tax,[20] the deceased will be deemed to be the settlor of any settlement resulting from the variation.

In the case of capital gains tax, it was decided by the House of Lords in *Marshall v Kerr* [1994] STC 638, 67 TC 56, that the effect of the differently worded provision in what is now Taxation of Chargeable Gains Act 1992 section 62 was not in all cases to deem the deceased to have been the settlor of such a settlement.

8 Conclusion

Paradoxical as the result may be, it would appear that a transfer of property between settlements can in an appropriate case create excluded property for inheritance tax purposes. Moreover, such a transfer might well have prevented the Offshore Beneficiary Provisions from applying to the transferee settlement until 17th March 1998. It is more problematical whether such a transfer could affect the residence status of the transferee settlement for income tax purposes.

20 See Inheritance Tax Act 1984 section 142.