BOOK REVIEW

Capital Gains Taxation of Non-Resident Settlements

by Simon McKie.

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This was obviously a very good time to write a book on capital gains tax and how it affects non-resident trusts. The legislation introduced in 1989 and, in particular, in 1991 has altered this area of taxation almost beyond recognition. Any professional coming to this subject fresh faces a daunting task. Not only must he fully grasp the "trust gains" provisions now contained in TCGA 1992 ss.87-90 (formerly FA 1988 ss.80ff as amended in 1991), but he must come to terms with the parallel system for charging non-resident trusts which was introduced by FA 1991. Simon McKie has written a book which will take the newcomer a very great distance down the road towards understanding.

The book is broadly divided into three sections:

(i) an outline of the basics
(ii) the anti-avoidance provisions
(iii) planning

In the first of these sections, the author deals in some detail with fundamental concepts which are necessary to a proper understanding of the taxation of non-resident trusts. He therefore starts with the meaning of "settlement" and contrasts the wide definition given in TCGA 1992 s.97 (7) for the purposes of the "trust gains" regime and the narrower general capital gains tax definition (contained in TCGA 1992 s.68) which applies for the purposes of the taxation of settlor provisions in TCGA 1992 s.86. In this regard the author makes the point that FA 1991 Sch 17 did not contain any specific definition of "settlement". Therefore, he argues, one had to import the general capital gains tax definition of settled property. This led to the conclusion that, in order to come within Sch 17, there had to be property held upon trust. Any dispositions, covenants, agreements or arrangements which did not involve property held upon trust, although caught by FA 1981 s.80, would not be caught by Sch 17. In my view, this is not a conclusion to which a court would willingly come. Schedule 17 para 2(2) and (3) begin with the words:

> "If section 80 applies to a settlement..."

the general definition of "settled property" (then in CGTA 1979 s.51) applied "...unless the context otherwise requires...". Further, it only applies for the purposes of the 1979 Act. Therefore, even if Sch 17 was in some way part of the 1979 Act so that s.51 could apply, the context of para 2 clearly demonstrates that the word "settlement" has the same meaning as in section 80. If there ever was a problem, it appears to have been rectified on consolidation. TCGA 1992 s.97(7) provides that the wider meaning of "settlement" applies in sections 87 to 96. The Sch 17 legislation is now contained in ss.91 to 95.

The author deals thoroughly with the basics concerning the residence of trusts. He points out what he regards as an ambiguity in what is now TCGA 1992 s.69(1). That sub-section provides that a trust is resident in the UK unless the general administration of the trust is ordinarily carried on outside the UK and:

> "... the trustees or a majority of them for the time being are not resident or not ordinarily resident in the United Kingdom."

The author suggests that this might mean either:

(i) Each member of a majority of the trustees must be either not resident or not ordinarily resident in the UK; or

(ii) there must be a majority of trustees each of whom is not resident in the UK or a majority of trustees each of whom is not ordinarily resident in the UK.

The author plumps for construction (ii); however, construction (i) does seem the more natural one.

In his chapter on "Disposals, Gifts and Related Provisions" the author deals with the capital gains tax provisions which apply when a settlement comes to an end. In doing so, he puts forward a novel construction of CGTA 1979 s.56(1)(b) (now TCGA 1992 s.73(1)(b)). The argument is that the disposal and reacquisition under s.56(1)(b) is actually at market value. The reasoning is as follows. If a person becomes absolutely entitled to any settled property, s.54(1) deems there to be a disposal and reacquisition of the settled property at market value. Section 56(1) provides that where the s.54(1) event occurs on the termination of a life interest, there are two consequences:

i) no chargeable gain accrues on the disposal;

ii) where the property reverts to the settlor the disposal and reacquisition is deemed to be at a consideration which secures that neither a gain nor a loss accrues.

Even if a disposal is at market value s.56(1)(a) would prevent a gain accruing. Therefore, since there is nothing to displace the s.54(1) market value disposal, the disposal under s.56(1)(b) must be at market value.

If this argument is correct the provisions of s.56(1)(b) are completely otiose. However, the argument is based on a misunderstanding of the difference between "gains" and "chargeable gains". Capital gains tax is charged on "chargeable gains": CGTA 1979 s.1(1). The purpose and effect of s.56(1)(a) is to ensure that there is no capital gains tax charge where the s.54(1) disposal occurs on the termination of a life interest. That does not mean, however, that the disposal cannot result in a "gain" accruing. A gain may not be a chargeable gain, for instance because of some exemption. This is apparent if one examines the provisions of, for instance, CGTA 1979 s.102(1):

> "No part of a gain to which section 101 above applies shall be a chargeable gain ..."

One first computes the gain accruing on a disposal by applying CGTA 1979 Part II, Chapter II. One then applies the indexation allowance to that gain to produce "the gain or loss for the purposes of the Capital Gains Tax Act 1979 ... " (FA 1982 s.86(4)). Therefore, in order to ensure that there was no gain or loss for capital gains tax purposes, the deemed consideration under s.56(1)(b) must be equal to the deductions under s.32 and the indexation allowance. As the author accepts, this clearly coincides with the legislative intent. It is also technically correct on the wording of the provisions.

The real meat of a book on non-resident trusts ought to be provided by the section on the anti-avoidance provisions. The section entitled "The Anti-Avoidance Provisions", although it takes up the bulk of the book, is a little disappointing. This can in part be explained by the date on which the book was published. The author's preface is dated 31st August 1991. This was, of course, just after the Finance Act 1991 received royal assent. Therefore, the provisions introduced in 1991 were very new and it would be unreasonable to expect the author to have given them mature consideration. Also the author did not at that time have the benefit of the Revenue's published views on the interpretation of Sch 16, given in Statement of Practice 5/92 ([1992] STI 535) and their responses to questions on the Statement of Practice put by the Tax Faculty ([1992] STI 1113). However, even in mid to late 1991, it was fairly clear that the critical provision in Sch 16 was the "first condition" in para 11(3). The author deals with the first condition in approximately two pages. This is the same amount of space which he devotes to

the third condition and the fourth condition. There is no real discussion on the many problems thrown up by the proviso to the first condition. There are also two pages in Chapter 17 "Protecting the Status of Old Settlements". This was always likely to be an issue of great practical importance and merited much more detailed consideration. Also I feel it is confusing to talk about six "qualifying conditions". For instance, it is not very helpful to describe the fact that for Sch 16 to apply at all the trustees must have realised a chargeable gain as a condition. The author's terminology is misleading because the legislation itself talks about the four conditions, only one of which must be satisfied before a settlement becomes a qualifying settlement. However, these four conditions are all described as "sub-conditions" within the author's first qualifying condition. Similarly, it is odd to describe an exclusion from charge as a qualifying condition.

Turning to the chapter which the author entitles "The Capital Payments Charge", one finds the author dealing with legislation which has been in force for some ten years. Generally he deals with these provisions well and points out interesting arguments and anomalies. In particular, there is a very useful discussion of the argument that a life tenant does not receive a capital payment when he is permitted to occupy trust property rent free or is given an interest free loan from the trustees. There is also a detailed discussion on the question whether the appointment of a beneficial interest amounts to a capital payment.

This book must be treated as one which takes someone from beginner to intermediate level. This is particularly evident in the section on "Planning". The basic structure of CGT planning by the use of non-resident trusts and companies is well outlined. However, there are no very detailed or exciting ideas. This can be excused as far as the 1991 provisions are concerned. However, one might have expected more discussion on the ways of avoiding or mitigating the charges under the trust gains regime. There is, in fact, very little discussion of tax efficient ways of making capital payments to UK resident beneficiaries.

In retrospect, this book has suffered from the fact that it was published so soon after the 1991 provisions came into force. A second edition would doubtless benefit from more mature consideration of the provisions in practice and the various Statements of Practice and other Revenue pronouncements. It is also unfortunate that the capital gains tax legislation was consolidated after the book was published. All in all this is an interesting book for those who wish a detailed introduction to the taxation of non-resident trusts. However, any reader ought to be very careful in relying on the author's views on controversial areas. That having been said, any author who is prepared to deal with difficult questions and express controversial views ought to be encouraged.