The Personal Tax Planning Review

CAPITAL LOSSES AND TRUSTS

Robert Venables QC[1]

1 Scope of Article

In this article, I consider the utilisation of capital losses of trustees, settlors and beneficiaries, in the light of the changes made by the 1998 and 1999 Finance Acts. I conclude that the rules have become much more complex and that more care than ever is required to ensure that losses are not "stranded" but are utilised in the most tax-efficient manner.

I note that while one scheme for the sale of trust losses has apparently been outlawed, one will often be able to achieve the same result by other means.

2 Trust Losses

2.1 General Principles

The general rule is that a loss on the disposal of an asset is only an allowable loss if, had there been a gain on the disposal, it would have been a chargeable gain: Taxation of Chargeable Gains Act section 16(2).

A loss which accrues to a person in a year of assessment during no part of which he is resident or ordinarily resident in the United Kingdom is not in general an allowable loss.[2] There are special rules dealing with the (restricted) utilisation of losses of non-UK resident trusts. These are immensely complex. In the Appendix

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2 An exception is where the gain would have been taxable under Taxation of Chargeable Gains Act section 10 ((non-UK resident with United Kingdom branch or agency).

to this article, I have collected various relevant extracts from Non-Resident Trusts 7th edition, updated to the 1999 Budget Speech.

Allowable losses sustained by trustees can thus in general be set off against gains of current and future years, in much the same way as can losses of individuals.

2.2 Transfer of Losses to Beneficiaries

2.2.1 Prior to June 16th 1999

A complication is caused, however, by Taxation of Chargeable Gains Act section 71. Before its amendment by Finance Act 1999, with effect from June 16th 1999, section 71(2) provided:

> "(2) On the occasion when a person becomes absolutely entitled to any settled property as against the trustee, any allowable loss which has accrued to the trustee in respect of property which is, or is represented by, the property to which that person so becomes entitled (including any allowable loss carried forward to the year of assessment in which that occasion falls), being a loss which cannot be deducted from chargeable gains accruing to the trustee in that year, but before that occasion, shall be treated as if it were an allowable loss accruing at that time to the person becoming so entitled, instead of to the trustee."

On the whole, this provision was highly advantageous. When it operated, although it deprived the trustees of an allowable loss, it transferred that loss to the recipient beneficiary,[3] in whose hands it might well be more valuable. One danger was that it operated automatically, even when the loss might be of more use to the trustees. It was important that assets representing the loss were transferred to the beneficiary. This could have been difficult where an investment had been a complete write-off and there was nothing representing it in the trust fund.

There was no limitation on the type of beneficiary who could become entitled to a loss. Hence, a market grew up in trust losses, the transfer being effected either by the sale to the desired recipient of the losses of a beneficial interest in the trust property which would shortly ripen into an absolute interest or by the appointment of trust property to such a person for a consideration. Schemes of the latter type presented difficulties of trust law, but were arguably less expensive in stamp duty terms as not involving any stampable conveyance on sale.

As long as the sales were limited to "real" trust losses, the Revenue do not appear to have been overly concerned. With the invention and marketing of schemes which aimed to generate artificial trust losses, the government stepped in and announced an amendment to the Finance Bill.[4] That has now resulted in section 71(2) being replaced by subsections (2), (2A), (2B),(2C) and (2D), which severely curtail the transfer of trust losses.

2.2.2 The New Law

2.2.2.1 The Statute

The new section 71(2) now provides:

> "(2) Where, in any case in which a person ("the beneficiary") becomes absolutely entitled to any settled property as against the trustee, an allowable loss would (apart from this subsection) have accrued to the trustee on the deemed disposal under subsection (1) above[5] of an asset comprised in that property—
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> (a) that loss shall be treated, to the extent only that it cannot be deducted from pre-entitlement gains of the trustee, as an allowable loss accruing to the beneficiary (instead of to the trustee); but
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> (b) any allowable loss treated as accruing to the beneficiary under this subsection shall be deductible under this Act from chargeable gains accruing to the beneficiary to the extent only that it can be deducted from gains accruing to the beneficiary on the disposal by him of—
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> (i) the asset on the deemed disposal of which the loss accrued; or

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4 It is the old story of tax planning being acceptable while it is tailor-made for private individuals who are not too greedy but provoking draconian amendments to the law when a highly artificial version of it is mass-marketed.

5 It is section 71(1) which provides that on the occasion when a person becomes absolutely entitled to any settled property as against the trustee, all the assets forming part of the settled property to which he becomes so entitled are to be deemed to have been disposed of by the trustee, and immediately reacquired by him in his capacity as a trustee within section 60(1), for a consideration equal to their market value.

(ii) where that asset is an estate, interest or right in or over land, that asset or any asset deriving from that asset."

2.2.2.2 General Effect

Hence, the new section 71(2) applies only where a beneficiary becomes absolutely entitled to a trust asset in specie, that asset is a chargeable asset and the circumstances are such that the trustees would, but for section 71(2), have realised an allowable loss. Moreover, the loss which is transferred to the beneficiary can be used by him only to offset a gain arising on the disposal of the same asset. All this does is to prevent a charge to tax on what is, treating the trustees and the beneficiary as one, an unreal gain. For example, if trustees acquire an asset for £1,000, vest it in a beneficiary when it is worth £600 and he later sells it for £1,100, the real gain is only £100. By allowing him to set off the trustees' loss of £400 against his gain of £500, this result is achieved.

2.2.2.3 "Pre-entitlement" Gains

The term "pre-entitlement gain" is slightly misleading. It is defined, by section 71(2A), to mean, "in relation to an allowable loss accruing to a trustee on the deemed disposal of any asset comprised in any settled property, ... a chargeable gain accruing to that trustee on—

(a) a disposal which, on the occasion on which the beneficiary becomes absolutely entitled as against the trustee to that property, is deemed under subsection (1) above to have taken place; or

(b) any other disposal taking place before that occasion but in the same year of assessment."

Hence, the loss will first be set off against any other gains which the trustees have realised in the same year of assessment prior to or contemporaneous with the disposal vesting the asset in the beneficiary. Such a gain could be realised on the simultaneous vesting of another trust asset in the same or a different beneficiary.

2.2.2.4 Other Trusts Losses in Same Year

What if the trustees realise other losses in the same year of assessment as that in which the disposal to the beneficiary occurs? It is made clear by section 71(2D)(a) that the trustees utilise allowable losses accruing to the trustees on a deemed disposal under section 71(1) before any other allowable losses accruing to the trustees in that year are utilised. Hence, this will tend to reduce the amount of trust losses which are transferred to beneficiaries and increase the amount of trust losses which the trustees can utilise against future gains.

2.2.2.5 No Election

It should be noted that the rules apply automatically and can thus operate to the detriment of taxpayers. While this was in principle the case with the previous rules, the problem is greatly increased under the new rules. The risk of a beneficiary being unable to utilise a loss which the trustees could have utilised against subsequent gains is very much greater. Fortunately, if the trustees are alive to the problem, much can be done by appropriately timed realisations of trust assets and, provided the trustees have the necessary powers, by the timing of appointments and/or appropriations of trust assets.

2.2.2.6 Utilisation of Loss by Beneficiary

There is a rule designed to ensure that when a beneficiary does have a loss transferred to him, he can use it to best advantage. The loss transferred to him can, if otherwise unutilised, be carried forward by him from year to year until it can be so deducted: section 71(2D)(b). Where the beneficiary realises a gain against which he can set the transferred loss but realises other losses in the same year, the transferred loss is utilised first: section 71(2D)(c)(i). This is beneficial to the taxpayer. It is also provided that carried forward transferred losses are to be deductible as if they were losses actually accruing in the current year: section 71(2D)(c)(ii). One consequence of that is that the transferred loss must be utilised before the annual exemption is allowed, the rule being that losses of the current year are deducted before the annual exemption but carried forward losses are deducted only after the annual exemption.

2.3 Planning

2.3.1 Transfers of Gains To Trustees

If trust losses cannot be transferred to trustees, gains can be transferred to trusts with losses. In the simplest form of such planning, one will ensure that the trustees invest for capital growth so that they are likely to have chargeable gains in future against which to set their losses. One will ensure that a trust does not end prematurely if losses will be otherwise stranded.

A slightly more sophisticated version of the scheme would be to add further funds to the settlement which the trustees can then invest to produce further gains. Care will need to be taken that there is an addition to an existing settlement and not the creation of a new settlement for capital gains tax purposes.

An even more sophisticated version is for assets pregnant with gain to be transferred by way of gift to the trustees and an election for holdover relief to be made.[6]

In each case, it will not matter that the United Kingdom Settlor provisions, contained in Taxation of Chargeable Gains Act sections 77-79, apply to the settlement, as trust losses are deducted before gains are imputed to the settlor.

Naturally, the inheritance tax consequences of such strategies would have to be taken into account. Much may depend on the terms of the trust in question, so that the advice of a trust lawyer could well be indispensable.

2.3.2 Sale of Trust Losses Mark II

It is in principle possible for trust losses to be "sold" by beneficiaries of an existing trust selling their interests to a stranger who will then ensure that the trustees realise capital gains, for example, by gifting to them shares in a private trading company pregnant with gain and electing for holdover relief. This is in essence a variant on the previous practice of selling an interest to a stranger who shortly thereafter becomes absolutely entitled to trust assets and the benefit of historic trust losses.[7]

One important difference is that the trust must continue as a "settlement" for the tax advantages to be obtained, which complicates the planning. It is very important to ensure that there are no adverse inheritance tax consequences of the sale[8] and that, if possible, a charge to ad valorem stamp duty at a rate of up to 3.5% is avoided. The sale and any resignation and appointment of trustees will have to be valid as a matter of trust law. This is definitely an area where one should not proceed without the advice of a lawyer skilled in both trust and tax law.

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6 For the situations when such an election can be made, see my *Inheritance Tax Planning* 3rd edition Part C.

7 This strategy always had one advantage over section 71(2) schemes: where investments had been complete write-offs and there was nothing in the trust fund representing them, the trustees would still be able to utilise the losses but they never could be transferred to a beneficiary.

8 The inheritance tax position is extremely complex and beyond the scope of this article.

2.4 Non-UK Resident Trusts[9]

I stated in my Non-Resident Trusts 7th edition, at 10.9.4 (Transfer of Trust Losses to Beneficiaries), before the proposed amendment to section 71(2) was announced:

> "Suppose it is intended to wind up a [non-UK resident] trust shortly and that there are unrealised capital losses, which taken together with realised losses will exceed the total of both realised and unrealised capital gains. In that case, it may well be advantageous for the trust to become UK resident in the year in which the trust comes to an end. In that event, any "allowable" losses which have accrued to the trustees are treated as losses sustained by the person becoming absolutely entitled to the property representing the loss (or property representing such property) at the time he becomes so entitled.[10] Normally, the allowable loss would be realised by the trustees at the moment the beneficiary becomes absolutely entitled. If the trustees have already realised the loss in the current year of assessment, however, it is not too late for the trust to become UK resident in the same year. The loss will thus become an "allowable loss" and so be capable of being transferred to the beneficiary."

Strictly speaking, the advice holds good. The difficulty is the enormously restricted use to which the loss can be put.

In principle, there is no reason why one should not adopt the strategy of keeping the trust in being and ensuring that gains arise to the trustees. If the planning is to make the trust United Kingdom resident and not to export it again, this will be relatively simple. There is always the possibility that the trust has Taxation of Chargeable Gains Act section 87 gains and/or relevant income within the meaning of Taxes Act 1988 section 740 which have not been visited on any beneficiary.

The sale of trust losses where the trust has been non-UK resident has been made much more difficult by the removal of the general exemption from capital gains tax on the disposal of such an interest.[11] While there are in my view ways round this problem, they are sophisticated and not for the faint-hearted.

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9 See also the Appendix to this article.

10 See Taxation of Chargeable Gains Act 1992 section 71(2).

11 See Taxation of Chargeable Gains Act section 76(1A) and (1B), inserted by Finance Act 1999.

One possibility is to keep the trust in existence but offshore. Trust losses can be deducted from future gains for the purposes of both the Offshore Settlor Provisions[12] and the Offshore Beneficiary Provisions.[13] It is important to note that they cannot be carried back and offset against gains of previous years, even where these have not yet been visited on a beneficiary under section 87.[14]

3 Personal Losses of Settlors and Beneficiaries

Gains realised by trustees can be imputed to settlors or beneficiaries under the United Kingdom Settlor Provisions, the Offshore Settlor Provisions or the Offshore Beneficiary Provisions. Prior to the passing of Finance Act 1998, personal losses of the person to whom the gains were imputed could be deducted from the imputed gains. Allegedly as the result of the introduction of taper relief by Finance Act 1998, this is no longer possible.[15]

Care should therefore be taken to ensure that gains are realised by the settlor or beneficiary in question so as fully to utilise their personal losses. Where this is not possible without resort to the trust, it may be appropriate for the trustees to vest assets in the relevant person and to make an election for holdover relief, thereby transferring a trust gain to him which he can realise in due course and against which he can set his personal loss. Care needs to be taken where the Offshore Beneficiary Provisions may result in a chargeable gain being imputed to the beneficiary.[16] The effect on taper relief should also be considered.

4 Conclusion

With the changes to the capital gains tax legislation effected by Finance Act 1998 and Finance Act 1999, it is more difficult yet more important than ever to ensure that trust and personal losses are not stranded but are fully utilised. The Inland Revenue in its Consultative Document on Trusts endorsed the principle that property

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[12] Taxation of Chargeable Gains Act section 86 and schedule 5.

[13] Taxation of Chargeable Gains Act section 87 et seq.

[14] See also the Appendix to this article.

[15] Finance Act 1998 schedule 21 paragraph 2, inserting in the Taxation of Chargeable Gains Tax Act section 2(4)and (5).

[16] See my *Non-Resident Trusts* 7th edition at 10.7.5.2

held in trust should be taxed neither more nor less heavily than property owned absolutely. Where losses are stranded because property is held not only absolutely but in one or more trusts, that principle is not respected. It is thus highly legitimate tax planning to plan to avoid such stranding.

Strategies which ensure that trust losses enure to the advantage of those who were perhaps not originally intended to benefit from the trust are of more debatable morality. The Revenue may fund them objectionable. On the other hand, provided the losses are real losses, the Revenue is benefiting from the accident of their being otherwise de facto unutilisable and it might be thought not inappropriate that the "real" beneficiaries should be able to turn them to pecuniary account while putting the Revenue in no worse position than if they had themselves been able to realise gains against which to set them.

APPENDIX

EXTRACTS FROM ROBERT VENABLES' NON-RESIDENT TRUSTS 7TH EDITION RELATING TO LOSSES OF NON-UK RESIDENT TRUSTS[17]

CHAPTER 10 PLANNING STRATEGIES

10.9 What if there are Capital Losses?

10.9.1 The Offshore Settlor Provisions

For the (complex) position as to capital losses where the Offshore Settlor Provisions apply, see 13.7.3. In this section I shall assume that the Offshore Settlor Provisions do not apply.[18]

10.9.2 Offshore Beneficiary Provisions

Capital losses realised by a non-resident trust are set against capital gains for the same year of assessment in determining whether there are any "trust gains" for the year for the purposes of the Offshore Beneficiary Provisions. Excess capital losses can be carried forward and set against chargeable gains of subsequent years for the same purpose.[19] Excess trust losses cannot be carried back and set off against trust gains of early years, even if such gains have been carried forward to the year of loss for the purpose of calculating the "trust gains" for that year. It would thus normally be a sound policy for the trustees to realise any unrealised capital losses year by year to the extent necessary to reduce trust gains for the year to nil.

10.9.3 Carry Forward of Trust Losses

In earlier editions of this work, the view was taken that, as losses realised by non-UK resident trustees are not normally "allowable losses", hence if the trust were to become UK resident, they could not be carried forward and set against gains of the trustees in later years. For that reason I advised that it might be disadvantageous to realise trust losses in excess of trust gains for the year; for if ultimately the trust

[17] Not all footnotes are reproduced.

[18] For the treatment of losses by the Offshore Beneficiary Provisions, see generally 14.17.

[19] Taxation of Chargeable Gains Act 1992 section 97(6).

would have realised greater capital losses than capital gains, no one would get the benefit of those losses if they were realised in a year when the trust was entirely non-UK resident.

John Tallon has made out a powerful argument, in his article "The Immigration of Non-Resident Trusts with Losses" in The Offshore Tax Planning Review, Volume 2, Issue 2 p.93, that surplus losses realised by trustees in years for which the Offshore Beneficiary Provisions apply to a trust can indeed be carried forward and set against taxable gains realised by the trustees in a year in which they are UK resident. While this view may well commend itself to the courts, especially given the obvious justice of the result, prudent trustees may wish to continue to follow the advice given above wherever possible and to rely on John Tallon's argument where it is appropriate for other reasons to immigrate a non-resident trust with unutilised losses.

10.9.4 Transfer of Trust Losses to Beneficiaries

Suppose it is intended to wind up a trust shortly and that there are unrealised capital losses, which taken together with realised losses will exceed the total of both realised and unrealised capital gains. In that case, it may well be advantageous for the trust to become UK resident in the year in which the trust comes to an end. In that event, any "allowable" losses which have accrued to the trustees are treated as losses sustained by the person becoming absolutely entitled to the property representing the loss (or property representing such property) at the time he becomes so entitled.[20] Normally, the allowable loss would be realised by the trustees at the moment the beneficiary becomes absolutely entitled. If the trustees have already realised the loss in the current year of assessment, however, it is not too late for the trust to become UK resident in the same year. The loss will thus become an "allowable loss" and so be capable of being transferred to the beneficiary.

[This paragraph must now be read in the light of the amendment of Taxation of Chargeable Gains Act section 71.]

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20 See Taxation of Chargeable Gains Act 1992 section 71(2).

CHAPTER 11 CAPITAL GAINS TAX

11.5 Deemed Disposals by Settlements

11.5.5 Losses of Trustees

11.5.5.1 Restriction of Loss Relief

Where trustees realise a loss on the disposal of an asset to a connected person, the loss is deductible against only a chargeable gain accruing to them on some other disposal of an asset to the same person and provided that he is at that time still a connected person: Taxation of Chargeable Gains Act 1992 section 18(3). By Taxation of Chargeable Gains Act 1992 section 286(3), trustees of a settlement are connected with (1) any individual who in relation to the settlement is a settlor (2) any person who is connected with the settlor if he is an individual and (3) a body corporate which is connected with the settlement.

A body corporate is connected with a settlement if:

> it is a close company or only not a close company because it is not resident in the United Kingdom and the participators include the trustees of the settlement, or
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> it is controlled[21] by such a company.

It should be noted that the trustees are not necessarily connected with any beneficiary.

Extreme care must therefore be taken to ensure that the trustees are not left with losses which are difficult to utilise or that, if such losses have been created, future chargeable gains are realised in such a way as to take advantage of them. In the case of a UK resident trust, unutilised allowable losses of the trustees can, subject to certain conditions, be transferred to beneficiaries who become entitled to trust capital: Taxation of Chargeable Gains Act 1992 section 71(2). *[This sentence must now be read in the light of the amendment of Taxation of Chargeable Gains Act section 71.]*

11.5.5.2 Transfer of Loss to Beneficiary

When a person becomes absolutely entitled to an asset comprised in the settlement

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[21] Within the meaning of Taxes Act 1988 section 840.

as against the trustees, they will normally be deemed to dispose of and reacquire that asset as bare trustees for him for a market value consideration: Taxation of Chargeable Gains Act 1992 section 71(1). In my opinion, section 71 in substance, if not in direct terms, deems the trustees to dispose of the asset to the beneficiary. A prior allowable loss sustained as a result of a disposal to such a beneficiary by the trustees in exercise of their administrative powers could therefore be utilised against a chargeable gain arising from the assets to which he becomes absolutely entitled. Where the prior allowable loss arose on the vesting of the asset in the beneficiary in exercise of the trustees' dispositive powers, special considerations apply, which are discussed at 11.5B.

11.5.5.3 Non-UK Resident Trusts

Losses accruing to trustees who are neither resident nor ordinarily resident in the UK during any part of the year of assessment are not allowable losses unless a corresponding gain would have been chargeable to capital gains tax under Taxation of Chargeable Gains Act 1992 section 10: Taxation of Chargeable Gains Act 1992 section 16(3). Trustees, like individuals, therefore should preferably make disposals giving rise to losses in a period of residence, rather than of non-residence, in the UK.

Losses made by trustees in a non-resident period may be taken into account in reducing the chargeable gains which may otherwise be attributed to beneficiaries under sections 87-90 and sections 97-98: see 14.17. The realisation of a loss during a period of non-residence may therefore be sensible to the extent to which UK beneficiaries are thereby saved capital gains tax.

Losses realised by trustees in a non-resident period may also be taken into account to reduce a charge on the settlor under the Offshore Settlor Provisions: see 13.7.3.

See further 10.9 on tax planning where there are trust capital losses.[22]

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[22] Section 11.5B, Transfer of Trust Losses to Beneficiaries, is omitted as it has been largely overtaken by the amendments to Taxation of Chargeable Gains Act section 71.

11.6 Rates of Capital Gains Tax

11.6.4 Charge on Settlor with Interest in Settlement - United Kingdom Settlor Provisions

11.6.4.7 Losses

The Provisions never purported to achieve full fiscal transparency.[23] Losses of the trustees have never been imputed to the settlor. Such losses could indirectly benefit him in being utilised to reduce trust gains which could be imputed to him.

For years before 1998/99, the settlor could set personal losses against trust gains imputed to him by the Provisions. Allegedly as the result of the introduction of taper relief by Finance Act 1998, this is no longer possible. The provisions are therefore even less transparent than before.

CHAPTER 13 THE OFFSHORE SETTLOR PROVISIONS

13.7 The Fifth Condition - Chargeable Amount

13.7.3 Losses

13.7.3.1 The General Rule for Capital Gains Tax Purposes

Taxation of Chargeable Gains Act 1992 section 2(2) permits one, in calculating the total amount of chargeable gains accruing to a person in a year of assessment on which capital gains tax is to be charged, to deduct any allowable losses accruing to the person in the year of assessment and "so far as they have not been allowed as a deduction from chargeable gains accruing in any previous year of assessment" any allowable losses accruing to that person in any previous year of assessment. A loss is not an "allowable loss" if it accrues to a person in a year of assessment during no part of which he is resident or ordinarily resident in the UK.

While this is the prima facie rule in computing gains for the purposes of the section, there are some express exceptions.

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[23] For example, disposals between the settlor and the trustees of a trust caught by the Provisions are still "recognised". There is no deemed disposal by the trustees when the Provisions cease to bite.

13.7.3.2 The Statute

Paragraph 1(2) provides:

> "(2) In construing section 86(1)(e) above as regards a particular year of assessment:
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> (a) any deductions provided for by section 2(2) shall be made in respect of disposals of any of the settled property originating from the settlor, and
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> (b) section 16(3) shall be assumed not to prevent losses accruing to trustees in one year of assessment from being allowed as a deduction from chargeable gains accruing in a later year of assessment (so far as not previously set against gains)."

13.7.3.3 Multiple Settlor Settlements - Defective Drafting

Paragraph 1(2)(a) is no doubt directed to the situation where there is more than one settlor of a settlement and only part of the trustees' gains are taken into account under section 86(1)(e) in relation to any particular settlor. What the draftsman no doubt intended to say was that deductions in respect of losses provided for by Taxation of Chargeable Gains Act 1992 section 2(2) should be made only in respect of disposals of any of the settled property originating from that settlor. That, as a matter of plain English, he has utterly failed to do. Instead, paragraph 1(2)(a) is completely redundant. For deductions for losses in respect of disposals of any of the settled property originating from the settlor are already taken into account under Taxation of Chargeable Gains Act 1992 section 2(2), as are all other allowable losses realised by the trustees in the current or any previous year of assessment (except insofar as are otherwise utilised)! Of course, there is nowadays the possibility of the court, adopting a purposive canon of construction, being minded to read in the word "only" before "in respect of disposals of any of the settled property originating from the settlor", despite the fact that it is plainly not there.[24]

13.7.3.4 Certain Non-Allowable Losses Deductible

In computing "trust gains" for the purposes of Taxation of Chargeable Gains Act 1992 section 87, one is, exceptionally, allowed to deduct certain (but not all) non-allowable losses sustained by the trustees. See section 97(6).

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[24] Compare *Bricom Holdings Limited v IRC* [1997] STC 1179 and 13.7.1.3.3.

Paragraph 1(2)(b) appears at first sight to be merely the counterpart of Taxation of Chargeable Gains Act 1992 section 97(6), i.e., it enables one to take into account losses sustained by the trustees even though they were realised in a year of assessment in no part of which the trustees were resident in the UK. Yet in some ways it is wider and in other ways narrower than section 97(6). It is wider in that it is not necessary for the losses to have been sustained in a year for which the Offshore Settlor Provisions applied to the settlement. In fact, two further provisions seriously curtail the apparent generosity of paragraph 1(2)(b).

13.7.3.5 Losses Sustained in Year in which Trustees UK Resident

The way in which the draftsman deals with the utilisation of allowable losses which have accrued to the trustees in a year in at least some part of which they were UK resident is indeed draconian. Paragraph 1(6) provides:

> "(6) The following rules shall apply in construing section 86(1)(e) as regards a particular year of assessment ("the year concerned") in a case where the trustees fall within section 86(2)(a) —
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> (a) if the conditions mentioned in section 86(1) are not fulfilled as regards the settlement in any year of assessment falling before the year concerned, no deductions shall be made in respect of losses accruing before the year concerned;
>
> (b) if the conditions mentioned in section 86(1) are fulfilled as regards the settlement in any year or years of assessment falling before the year concerned, no deductions shall be made in respect of losses accruing before that year (or the first of those years) so falling,
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> but nothing in the preceding provisions of this sub-paragraph shall prevent deductions being made in respect of losses accruing in a year of assessment in which the conditions mentioned in section 86(1)(a) to (d) and (f) are fulfilled as regards the settlement."

Thus, allowable losses which were not utilised in computing the trustees' own liability by the end of a resident period are in general to be discounted altogether for the purposes of the section! This is quite monstrous. The trustees are not even allowed to deduct such losses once!

Consider another way in which paragraph 1(6) is too tightly drawn. Suppose, for example, a trust is non-UK resident for 1991/92 and the settlor provisions do not apply to it in that year. These provisions nevertheless do apply but there are net losses for that year. If in 1992/93 the settlement is a qualifying settlement, it is difficult to see why the losses should not be carried forward from 1991/92 and set off against gains for the purposes of the section.

The italicised words were added at a late stage in the passage of the Finance Bill. If in a year of assessment for which the Offshore Settlor Provisions would otherwise apply to the settlement, the trustees realised only losses, then, technically, the Offshore Settlor Provisions would not apply for the year. For the Provisions apply in terms only where there are chargeable gains capable of being imputed to the settlor. The purpose of these final words is to ensure that losses for the year can be deducted provided that gains for the year would have been imputed to the settlor under the Provisions had there been any.

13.7.3.6 Pre-19th March 1991 Losses

If the draftsman had got his basic act in order, he would not have needed to make any special provision for losses sustained before 19th March 1991. Instead, he provides that no account should be taken of disposals made before 19th March 1991 for the purpose of arriving at losses: paragraph 1(7). That is quite monstrous.

13.7.3.7 Multiple Utilisation of Losses

In computing trust gains for Taxation of Chargeable Gains Act 1992 section 87 purposes, one is also apparently allowed to deduct the same allowable losses year after year unless and until they have been utilised in reducing chargeable gains on which the trustees are actually taxable.

Is the same true of section 86 and Schedule 5? One obvious difficulty is paragraph 1(6). Does not that prevent one bringing forward an allowable loss from an earlier resident period? Not in every case. Suppose a trust is non-UK resident and caught by the Schedule in 1991/92. In 1992/93 it is UK resident and realises allowable losses. In 1993/94 it is again non-UK resident. Nothing in paragraph 1(6) prevents the allowable losses realised in 1992/93 being deducted in making the computation in section 86(1)(e). Prima facie, the same amount could also be deducted in the computation for 1994/95, if the trust is still caught by section 86 in that year!

13.7.3.8 Reform

All that is needed is one omnibus provision to the effect that losses (whether otherwise allowable or not) cannot be utilised more than once for any one or more of the following purposes, namely the reduction in the chargeable gains of the trustees for which they are liable to tax under Taxation of Chargeable Gains Act 1992 section 2(2), a reduction in the trust gains which are actually visited on beneficiaries under Taxation of Chargeable Gains Act 1992 section 87 and a reduction in trust gains which are deemed to accrue to the settlor under the section. Paragraph 1(2)(b), paragraph 1(6) and paragraph 1(7) could then be repealed.

CHAPTER 14 THE OFFSHORE BENEFICIARY PROVISIONS

14.17 Treatment of Losses

Taxation of Chargeable Gains Act 1992 section 2(2) permits one, in calculating the total amount of chargeable gains accruing to a person in a year of assessment on which capital gains tax is to be charged, to deduct any allowable losses accruing to the person in the year of assessment and "so far as they have not been allowed as a deduction from chargeable gains accruing in any previous year of assessment" any allowable losses accruing to that person in any previous year of assessment. A loss is not an "allowable loss" if it accrues to a person in the year of assessment during no part of which he is resident or ordinarily resident in the UK.

In computing "trust gains" for the purposes of section 87, one is, exceptionally, allowed to deduct non-allowable losses accruing to trustees in a year of assessment for which section 87 applied to the settlement "so far as they have not previously been set against gains for the purposes of computation under either of those sections or otherwise". (One may arguably also utilise such losses against gains of a later year during which the trustees are UK resident: see 10.9.3.)

This in itself is tolerably fair, although it does not cover the position as regards a year of assessment during no part of which the trustees are UK resident but for which section 87 did not apply to the settlement. In that case, the benefit of the losses is entirely wasted.

In the case of losses sustained in a year during at least some part of which the trustees were UK resident, there is prima facie nothing to stop the same losses being utilised time and time again in calculating trust gains for the purposes of section 87! Section 97(6) only prevents losses being utilised twice for the purposes of calculating trust gains under section 87 if there are losses accruing to the trustees in a year of assessment for which section 87 applied, i.e., losses which would not otherwise be allowable losses at all. Taxation of Chargeable Gains Act 1992 section 2(2) prevents losses being utilised only insofar as they have not been allowed as a deduction from chargeable gains accruing in any previous year of assessment. The Revenue would have to argue that where losses which were allowable losses quite apart from section 97(6) were deducted in computing trust gains for one year of assessment, then they had been "allowed as a deduction from chargeable gains accruing in" that year. This argument would succeed only a highly purposive construction of the provisions. In view of the modern trend towards such a construction of taxing statutes, the chance of the Revenue succeeding must be higher than at the time of publication of the sixth edition of this work, in which I expressed a more sceptical view.