GOLDEN TRUSTS: ACTION PRIOR TO 6TH APRIL 1999

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1 Scope of Article

The UK Offshore Settlor Provisions[2] are being extended to certain non-UK resident trusts which were formerly "grandfathered in" and were colloquially referred to as "golden trusts". Although the changes were announced in the 1998 Budget Speech, they do not become fully effective until 6th April 1999, but will then usually apply with quasi-retrospective effect to gains realised by the trustees after16th March 1998. In this article, I discuss what tax planning steps can be taken before 6th April.

The Provisions can bite only if a "defined person" is capable of benefiting under the settlement. Before the 1998 Budget Speech, on 17th March, these were, broadly speaking, the settlor, his spouse and their children and their children's spouses. The categories now include their grandchildren and their spouses. These new categories will, however, be disregarded in the case of a settlement which was already non-UK resident before 17th March 1998, unless certain trigger conditions are fulfilled. A detailed discussion of these new rules is beyond the scope of this article. They are mentioned here as part of the background of the discussion.

2 Extension of "Qualifying Settlement"

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2 Taxation of Chargeable Gains Act 1992 section 86 and Schedule 5.

2.1 Prior to 17th March 1998

Prior to the Budget Speech on 17th March 1998, a settlement created before 19th March 1991 did not become a "qualifying settlement" until the beginning of the first year of assessment in which one of four "trigger" conditions was satisfied: Schedule 5 paragraph 9(2)-(6). A "qualifying settlement" is one which is potentially caught by the Offshore Settlor Provisions. A non-qualifying settlement could and can still become a qualifying settlement for 1997/98 or 1998/99 by virtue of one of those trigger conditions becoming satisfied.[3]

2.2 The New Rules

The general rule is that as from 1999/2000 all pre-19th March 1991 settlements will become "qualifying settlements": see Taxation of Chargeable Gains Act 1992 Schedule 5 paragraph 9(1A),[4] as inserted by FA 1998.

There is an exception in the case of a "protected settlement", contained in paragraph 9(1B), also added by FA 1998. A settlement which is a "protected settlement" immediately before the beginning of 1999/2000 will not automatically become a "qualifying settlement". It will, as before, become a qualifying settlement at the beginning of any year of assessment in which one of the four trigger conditions is first satisfied. It will also now become a qualifying settlement at the beginning of any year of assessment in which a fifth, new, trigger condition is fulfilled. The new condition is simply that the settlement ceases to be a protected settlement. The fact that a settlement ceases to be a protected settlement before 6th April 1999 will not cause it to become a qualifying settlement before that date. See paragraph 9(6A), inserted by FA 1998.

3 Protected Settlements

3.1 Advantage

Broadly, the advantage of a settlement being a protected settlement is that the settlor's grandchildren and minor children can benefit without its becoming a qualifying settlement.

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3 The four trigger conditions are discussed at 13.3 of my *Non-Resident Trusts* 7th edition, which is being published by Key Haven Publications PLC.

4 References in this article to paragraphs are in general, unless the context shows a contrary intention, references to paragraphs of Taxation of Chargeable Gains Act 1992 Schedule 5. In sections 4, 5 and 6, there are references to paragraphs of Finance Act 1998 Schedule 23.

3.2 The Test

3.2.1 The Statute

A settlement is a "protected settlement" at any time in a year of assessment if at that time the beneficiaries of that settlement are confined to persons falling within some or all of the following descriptions:

> "(a) children[5] of a settlor or of a spouse of a settlor who are under the age of eighteen at that time or who were under that age at the end of the immediately preceding year of assessment;
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> (b) unborn children of a settlor, of a spouse of a settlor, or of a future spouse of a settlor;
>
> (c) future spouses of any children or future children of a settlor, a spouse of a settlor or any future spouse of a settlor;[6]
>
> (d) a future spouse of a settlor;
>
> (e) persons outside the defined categories."[7]

3.2.2 "Beneficiaries"

For the purposes of the test, a person is a beneficiary of a settlement if:

> "(a) there are any circumstances whatever in which relevant property which is or may become comprised in the settlement is or will or may become applicable for his benefit or payable to him;
>
> (b) there are any circumstances whatever in which relevant income which arises or may arise under the settlement is or will or may become applicable for his benefit or payable to him;
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> (c) he enjoys a benefit directly or indirectly from any relevant property comprised in the settlement or any relevant income arising under the

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5 In this test, as in paragraph 9 generally, "child" includes a step-child: paragraph 9(11), as substituted by FA 1998.

6 A future spouse of the settlor would normally also fall under category (e). This exclusion may be important where there is more than one settlor. See 3.2.5 below.

7 Paragraph 9(10A), as inserted by FA 1998.

settlement."[8]

For the purposes of this definition, "relevant property" means property originating from a settlor; and "relevant income" means income originating from a settlor.[9]

3.2.3 Spouse of Children of the Settlor under 18

It is perhaps a little odd that whereas the inclusion of both children of the settlor under 18 and future spouses of any children (of whatever age) or future children of the settlor etc are permitted, the inclusion of the spouse of a child of the settlor or of the spouse of the settlor who is under 18 will cause the settlement not to be protected. The marriage of a child who is under 18 (or was under 18 on the previous 5th April) will thus cause the settlement to lose its protected status as from the beginning of the current year of assessment if the spouse can benefit.

3.2.4 Grandchildren and their Spouses

Grandchildren of the settlor or of the spouse of the settlor and their spouses are not permitted beneficiaries within categories 10A(a) to (d). Are they then within category (e), "persons outside the defined categories"? Since the amendment of Schedule 5 paragraph 2(3) by FA 1998, they are prima facie "defined persons" in relation to the settlor as they fall within categories (da) and (db). Given that the settlement in question will have been created before 19th March 1991, however, paragraph 2A will be in point. It provides that the references to grandchildren and their spouses are to be disregarded unless one of four trigger conditions is satisfied. If one of these conditions is satisfied, then one of the four trigger conditions in paragraph 9(2)-(6) will also be satisfied so that the settlement will have ceased to be a protected settlement in any event. Thus, the result is that the inclusion of grandchildren of the settlor or of the spouse of the settlor and their spouses as beneficiaries will not of itself cause the settlement to cease to be a protected settlement.

3.2.5 Two or More Settlors

For the purposes of paragraph 9 (10A), a person is outside the defined categories at any time if, and only if, there is no settlor by reference to whom he is at that time a defined person in relation to the settlement for the purposes of paragraph 2(1) of

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8 Paragraph 9(10C), as inserted by FA 1998.

9 Paragraph 9(10D), as inserted by FA 1998.

Schedule 5.[10] Where there is only one settlor, this provision will apply in a straightforward enough way. Where there are two or more settlors, it is deceptive. Suppose that when A and B were married to each other they settled property on the trusts of the same settlement to be held in different funds. The trusts are broad discretionary ones. The parties subsequently divorce. All defined persons in relation to each settlor other than those mentioned in categories (a) to (d) above are excluded in 1998/99 from benefiting from the fund established by that settlor. One would expect that the settlement would then become a protected settlement. Now suppose X is a defined person in relation to A, but not to B. He is therefore not excluded from benefiting from B's fund. Yet because there is a settlor, namely A, in relation to whom he is a defined person, he is not a "person outside the defined categories" and therefore the settlement is not a protected settlement at all. Whereas, in general, section 86 and Schedule 5 operate separately in relation to property originating from each settlor, there is here a potential tainting. My guess is that this is a drafting error, as there is no obvious reason for it. Whether or not the Revenue will insist on the strict letter of the law remains to be seen.

3.3 Planning

The conditions for qualifying as a protected settlement are not quite so restrictive as at first appears. Provided it is possible as a matter of trust law, beneficiaries can be cut out before they are in danger of tainting the settlement. There is in general no harm, so far as section 86 is concerned, in an appointment of capital being first made to or for their benefit. The appointment could be to them absolutely or to a trust for their benefit. The trust could be UK resident or non-UK resident. If it were non-UK resident, future gains could be caught by section 86, but previous trust gains would still escape. In each case, section 87 would have to be taken into account, which is why a transfer to a trust might be preferable to an absolute appointment. If there were a transfer to a trust, section 90 would need to be taken into account.

In general, a settlor, his present spouse, his children who are 18 or over (as at the beginning of the year of assessment in question) and the existing spouses of all his children, of whatever age, must be excluded. If the family is rich enough and the trust is seen as a vehicle to preserve assets long tem, this may be perfectly feasible, especially if only part of the family wealth is tied up in it. If a settlor is unmarried a future spouse can be included. She could be made an appointment of capital from the trust even the day before the wedding and then excluded from benefit. So too could future spouses of the settlor's children. As an alternative to an absolute appointment, the appointment could be to new settlements for their benefit (although care would need to be taken that the settlor or child in question could not benefit under the settlement).

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10 Paragraph 9(10B), as inserted by FA 1998.

4 Gains Realised in 1998/99: Transitional Provisions

4.1 Overview

At first blush, it would appear that Parliament has been extremely kind to non-qualifying settlements in not depriving them of their exempt status until 6th April 1999. The reality is that in general such settlements lost their exempt status with effect from 17th March 1998 since gains realised in the transitional period 17th March 1998 - 5th April 1999 will be visited on the settlor in 1999/2000.

The exceptions to this rule are:

where the trust has ceased to exist before 6th April 1999

where the settlor dies before 6th April 2000,[11] even though he was alive throughout 1997/98 and 1998/99

where the settlor is not domiciled in the UK in 1999/2000

where the settlor is neither resident nor ordinarily resident in the UK in 1999/2000[12]

where at no time after 5th April 1999 can the settled property or income become payable or applicable for the benefit of a defined person in relation to the settlor

where the settlement is a protected settlement

The fact that the trustees are UK resident or ordinarily resident for the whole or part of 1999/2000 does *not* stop gains of the transitional period being visited on the settlor in that year, although it will, of course, prevent gains realised by the trustees in 1999/2000 being so visited.

4.2 Anti-Avoidance

Finance Act 1998 Schedule 23 contains transitional provisions relating to a trust which was created before 19th March 1991, which was not a qualifying settlement in

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11 So that TCGA Sch 5 paragraph 3 comes into operation.

12 If the settlor is merely "temporarily" non-UK resident and ordinarily resident, TCGA s.10A may visit the trust gains on him in the year of his return.

the year 1998/99, which is a qualifying settlement in the year 1990/2000, yet which is not a "protected settlement" immediately after the beginning of 6th April 1999.[13]

The Schedule will apply only to trusts which have become qualifying settlements by virtue of the addition to Taxation of Chargeable Gains Act 1992 Schedule 5 of paragraph 9(1A), i.e. trusts which were previously "golden" trusts. It will not apply to pre-19th March 1991 trusts which became qualifying trusts by being tainted in one of the four ways set out in Schedule 5 paragraphs 9(3) - (6) inclusive.

Schedule 5 paragraph 9(1A) in principle comes into play only for the year 1999/2000 and subsequent years. Were it not for Schedule 23, it would thus be possible for trustees of trusts which would become qualifying on 6th April1999 to realise all trust gains in 1998/99 so that they would fall outside the scope of section 86. The aim of Schedule 23 is to remove the apparent "window" which would otherwise be available.

4.3 The Legislative Technique

The Schedule does not deem the settlement to be a qualifying settlement before 6th April 1999. Instead, it deems "relevant" gains (and losses) realised by the trustees in the transitional period from 17th March 1998 to 5th April 1999 to be gains (or losses) accruing to them on 6th April 1999.[14] One consequence of this anti-avoidance mechanism being used is that any gains caught will be taxed one or two years later than would have been the case if the settlement had simply been treated as a qualifying settlement from 17th March 1998.

4.4 Trustees Becoming UK Resident

If the trustees become UK resident or ordinarily resident in 1999/2000, then the gains can still be imputed to the settlor under section 86 in that year: Schedule 23 paragraph 1(2)(b) and (3).

If the trustees become UK resident or ordinarily resident at any time in 1998/99,[15] gains of that year cannot be imputed to the settlor under section 86 in 1999/2000.

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13 Schedule 9 paragraph 1.

14 Paragraph 1(2)(a).

15 Or in 1997/98, post 16th March.

Their gains and losses in a year are only relevant gains and losses if they fulfill the condition as to residence in that year, i.e. if they are not UK resident or ordinarily resident in any part of the year.[16] See Schedule 23 paragraph 1(4).

4.5 A Trap for Settlors with Changing Domicile or Residence Status

Although probably unintended, the fiction of deeming a gain in fact realised in the transitional period to be realised for section 86 purposes on 6th April 1999 can in fact result in a greater charge to tax than if "Golden Settlements" had simply been made qualifying settlements from 17th March 1998. Where a settlor is not both domiciled and resident or ordinarily resident in the UK in a year of assessment, section 86 does not apply to the trust gains of that year.[17] A settlor who was not both domiciled and resident or ordinarily resident in the UK in 1998/99 but was in 1999/2000 could find himself being charged to tax in that year on gains in fact realised by the trustees in 1998/99.

One solution to this problem would be deliberately to taint the settlement before 6th April 1999 so that Schedule 23 paragraph 1 would no longer apply, as paragraph 1(1)(b) would not be satisfied. Section 86 would not apply to the gains of the trustees in that year on account of the settlor not being both UK domiciled and resident or ordinarily resident in that year.

5 Transfers to Another Settlement

5.1 The Mischief

It would be possible for the trustees of a golden settlement to transfer funds to another settlement before 6th April 1999 and to take steps to ensure that section 86 did not apply to the old settlement in 1999/2000, for example by putting an end to it or by excluding all defined persons from potential benefit. Finance Act 1998 Schedule 23 paragraph 2 aims to counter such a strategy by the mechanism of treating for section 86 purposes gains (and losses) realised by the trustees of the old settlement as realised, on 6th April 1999, by the trustees of the *new* settlement. Section 86 can then apply to these deemed gains of the transferee settlement. Just as liability cannot be evaded by the old settlement becoming UK resident or ordinarily resident at some time in 1999/2000, so too the residence status of the transferee settlement in that year is

16 TCGA section 86(1)(b) and (2)(a).

17 For the new exception in the case of certain temporarily non-UK resident settlors, see TCGA section 10A.

irrelevant.[18]

5.2. The Anti-Avoidance Provision

Schedule 23 paragraph 2(1) lays down the conditions for the application of paragraph 2:

> "(1) This paragraph applies, subject to sub-paragraph (5) below, to any chargeable gain or loss accruing on the disposal of any asset by the trustees of a settlement ("the transferor settlement") if:
>
> (a) that settlement was created before 19th March 1991;
>
> (b) the disposal on which the gain or loss accrues is one made:
>
> (i) on or after 17th March 1998 and before 6th April 1999; and
>
> (ii) in a year of assessment in which the trustees of the transferor settlement fulfil the condition as to residence but the settlement is not a qualifying settlement;[19]
>
> (c) a person who is a settlor in relation to the transferor settlement ("the chargeable settlor"):
>
> (i) is domiciled in the United Kingdom at some time in the year 1999-00 and in the year of assessment in which the disposal is made;
>
> (ii) is either resident in the United Kingdom during any part of each of those years or ordinarily resident in the United Kingdom during each of those years; and
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> (iii) is alive at the end of the year 1999-00;
>
> (d) the asset disposed of is property originating from the chargeable settlor;

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18 Unless a double taxation treaty can be relied on.

19 i.e. they are at no time resident or ordinarily resident in the UK.

(e) the property comprised in another settlement ("the transferee settlement") at any time after the disposal and before 6th April 1999 is or includes (whether in consequence of the disposal or otherwise) the asset disposed of or any relevant property;

(f) the transferor settlement has a relevant connection with the transferee settlement; and

(g) the gain or loss in question is not one treated under paragraph 1 above as accruing on 6th April 1999 to the trustees of the transferor settlement."

Conditions (a) to (d) and (g) are necessary simply to limit the application of paragraph 2 to those situations where it is needed.

5.3 Property Comprised in the Transferee Settlement

Condition (e) is designed to ensure that paragraph 2 will apply where value has been shifted from the transferor settlement to the transferee settlement. "Relevant property" is defined[20] to mean, in relation to any disposal made by the trustees of the transferor settlement, "any property (not being the asset disposed of) which:

(a) is or represents property or income originating from the chargeable settlor;

(b) has been comprised in, or has arisen to, the transferor settlement at any time after the time of that disposal; and

(c) is property or income of the trustees of the transferee settlement acquired or otherwise deriving, directly or indirectly, from the trustees of the transferor settlement."

5.4 Sphere of Application

Thus, paragraph 2 will apply in the following situations:

where a chargeable asset is transferred from Settlement A to Settlement B;

where a chargeable asset is sold by Settlement A to an unconnected third party and the proceeds or property representing the proceeds is transferred to

20 By paragraph 2(7).

Settlement B;

where a chargeable asset is sold by Settlement A and money or property *not* representing the proceeds is then transferred to Settlement B.[21]

Paragraph 2 will *not* apply where property is first transferred to Settlement B and then Settlement A disposes of a chargeable asset, even during the transitional period. This allows a "flip-flop" to be performed even during the year of assessment.[22] Money could be borrowed on the security of an asset of the transferor trust which is pregnant with gain and appointed to the transferee settlement. The asset could then be realised and the borrowings repaid. Steps could be taken to ensure that neither section 86 nor Schedule 23 paragraph 1 applied to the transferor settlement in1999/2000.[23]

It does not matter whether property is transferred directly or indirectly from the transferor settlement to the transferee settlement. Where Settlement A transfers property to Settlement B which then transfers it to Settlement C, the gain of Settlement A can still be caught by paragraph 2.

5.5 Relevant Connection

Condition (f) requires that the transferor settlement should have a "relevant connection" with the transferee settlement. This is defined by paragraph 2(8):

> "For the purposes of this paragraph the transferor settlement has, in relation to a disposal by its trustees, a relevant connection with the transferee settlement if:
>
> (a) immediately before the time of the disposal, the beneficiaries of the transferor settlement are or include persons who are defined persons in relation to that settlement at that time;
>
> (b) the transferor settlement is not a protected settlement at that time in relation to the chargeable settlor;
>
> (c) at the beginning of 6th April 1999, the beneficiaries of the

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21 Provided all the property emanated from the same chargeable settlor.

22 It may be preferable for the flip-flop to be performed over two years of assessment, to prevent or restrict trust gains being transferred to the transferee settlement under Taxation of Chargeable Gains Act 1992 section 90.

23 The Offshore Beneficiary Provisions, and especially TCGA section 90, would need to be borne in mind.

transferee settlement are or include persons who:

(i) have attained the age of eighteen; and

(ii) have been defined persons in relation to the transferor settlement;[24]

and

(d) the property comprised in the transferee settlement in respect of which some or all of the persons mentioned in paragraph (c) above are beneficiaries of that settlement at the beginning of 6th April 1999 is or includes anything which, in relation to either that settlement or the transferor settlement, is property or income originating from the chargeable settlor."

Conditions (a) and (b) simply limit the scope of paragraph 2 to situations where it is needed. Condition (c) is obviously aimed at preventing section 86 being avoided by assets being decanted to another settlement which has as its beneficiaries persons who are defined persons in relation to the transferor settlement. It does not entirely achieve that aim. Suppose, for example, the settlor is about to marry a lady who is not a defined person in relation to the transferor settlement. The trustees of the transferor settlement transfer all the trust assets to a new settlement for her benefit under which no person who is currently a defined person in relation to the settlor can benefit. The old settlement thus ceases to exist. She then marries the settlor. If the marriage is after 6th April 1999, paragraph 2(8)(c)(ii) is clearly not satisfied. Nor it is satisfied, in my view, if she marries him before that date, but at a time when the old settlement has ceased to exist.

Condition (d) appears at first blush to offer scope for avoidance. If property provided by a settlor has been transferred from the transferor settlement to the transferee settlement, then the transferee settlement will contain property or income originating from that settlor. Condition (d) will fail to be satisfied only if the property has left the transferee settlement by 6th April 1999. In that case, the Revenue are not unduly concerned. It could as easily have left the transferor settlement directly and the tax consequences will in general be the same as if it had done so.

5.6 Exemption in Case of Death

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24 Paragraph 2(9) provides: "For the purposes of this paragraph a person is a defined person in relation to a settlement at a time if he would fall at that time to be treated, by reference to the chargeable settlor, as a defined person in relation to that settlement for the purposes of paragraph 2 of Schedule 5 to the 1992 Act."

The application of paragraph 2 is subject to the exemption contained in paragraph 2(5):

> "(5) This paragraph does not apply to any chargeable gain or loss accruing on any disposal if, for the year of assessment in which that disposal is made, section 86 of the 1992 Act would, on the relevant assumption, have been prevented by virtue of paragraph 3, 4 or 5 of Schedule 5 to that Act:
>
> (a) from applying in the case of the chargeable settlor in relation to the transferor settlement; or
>
> (b) from applying in his case in relation to the transferee settlement."

The relevant assumption for the purposes of sub-paragraph (5) is that section 86 of the 1992 Act would have applied in the case of the chargeable settlor apart from paragraphs 3 to 5 of Schedule 5 to that Act: see paragraph 2(6).

TCGA Schedule 5 paras 3, 4 and 5 provide that section 86 is not to apply for a year of assessment where certain persons die during the year.[25] Given that gains of the transferor settlement would not have been attributed to the settlor even if that settlement had been a qualifying settlement, there is no need for paragraph 2 to apply. Nor is there if by the end of 1998/99 all defined persons who might have benefited under the transferee settlement have died.

5.7 The Consequences of Paragraph 2(2) Applying

If section 86 applies to the transferee settlement for 1999/2000, then the relevant gain or loss which in fact accrued to the trustees of the transferor settlement in 1998/99[26] is deemed for section 86 purposes to be a gain or loss accruing on 6th April 1999 to the trustees of the *transferee* settlement and to have accrued to them on the disposal by those trustees of any asset that was property originating from the chargeable settlor.

If section 86 does not apply to the transferee settlement for 1999/2000 only because the trustees are resident or ordinarily resident in the UK for at least part of that year, then section 86 is similarly deemed to apply to the transferee settlement for that year as if the only gains and losses of that settlement from property originating from the

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25 The reference to Schedule 5 paragraph 3 is otiose. If the settlor dies in the transitional period, there is no question of section 86 applying in 1999/2000.

26 Or between 17th March and 5th April 1998.

chargeable settlor were the relevant ones of the transferor settlement.[27]

5.8 Apportionments

Paragraph 2(4) provides for apportionment of the gains and losses of the transferor settlement:

> "(4) Where (but for this sub-paragraph) the same gain or loss would fall to be treated by virtue of sub-paragraph (2) or (3) above as a gain or loss accruing to the trustees of more than one settlement:
>
> (a) that gain or loss shall be apportioned between those settlements in such manner as may be just and reasonable; and
>
> (b) only such part of the gain or loss as on that apportionment is attributable to a particular settlement shall be treated in accordance with that sub-paragraph as accruing to that settlement."

5.9 Settlors with Changing Domicile and Residence Status

I have pointed out at 4.5 above a trap under Schedule 23 paragraph 1 where a settlor who is not both domiciled and resident or ordinarily resident in the UK in, say, 1998/99 but is in 1999/2000 could unexpectedly find himself being charged to tax in that year on gains in fact realised by the trustees in 1998/99.

There is no similar trap in relation to paragraph 2, as it is differently worded: see paragraph 2(1)(c)(i) and (ii).

6 Transfers to Foreign Institutions

6.1 The Mischief

It would be similarly possible for the trustees of a golden settlement to transfer funds to a foreign company or other non-natural person before 6th April 1999 and to take steps to ensure that section 86 did not apply to the old settlement in 1999/2000. Finance Act 1998 Schedule 23 paragraph 3 aims to counter such a strategy by the mechanism of treating gains (and losses) realised by the trustees of the settlement in

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27 This is the effect of paragraph 2(3), although it is worded somewhat differently. For the construction of paragraph 2(3), see also paragraph 2(10).

the transitional period as realised by them for section 86 purposes on 6th April 1999. Paragraph 3 is drafted in a very similar way to paragraph 2. In the following discussion, I shall concentrate on the differences.

6.2 Foreign Institution

Paragraph 3 applies to a transfer to a "foreign institution". This is defined, somewhat unhelpfully, by paragraph 3(12) to mean "any company or other institution resident outside the United Kingdom". No doubt by "institution" the draftsman had in mind entities such as Liechtenstein Anstalts and Stiftungs which are perhaps not companies.[28]

6.3 Conditions for Application

Paragraph 3(1) mirrors paragraph 2(1),[29] with the substitution of references to "foreign institution" for "transferee settlement". Paragraph 3(4) confers an exemption corresponding to that conferred by paragraph 2(5).[30] Indeed, the general intention is that paragraph 3 shall apply in precisely the same circumstances, *mutatis mutandis*, as paragraph 2. The effect of the application is, however, different. Nor are there any express apportionment provisions.

6.4 Effect of Application

If section 86 applies for the year 1999/2000 in relation to the transferor settlement, that section is to apply for that year in relation to that settlement as if any chargeable gain or loss to which paragraph 3 applies:

> "(a) were a gain or loss accruing on 6th April 1999 to the trustees of the *transferor* settlement; and
>
> (b) so accrued on the disposal by them of an asset that was property originating from the chargeable settlor."

It is not immediately obvious what this adds to paragraph 1(2).

More importantly, where section 86 would not otherwise apply to the transferor settlement for 1999/2000, then it is to apply in relation to the chargeable settlor as if:

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28 See my article 'The Liechtenstein Foundation and United Kingdom Tax Avoidance' in *The Offshore Tax Planning Review* Volume 4, Issue 3, at page 185.

29 See 5.2 above.

30 See 5.6 above.

"(a) (where it is not the case) the transferor settlement existed in the year 1999-00;

(b) that settlement were a settlement in relation to which all the conditions specified in paragraphs (a) to (d) and (f) of subsection (1) of that section were fulfilled in the case of the chargeable settlor in that year;

(c) any gain or loss to which this paragraph applies:

(i) were a gain or loss accruing on 6th April 1999 to the trustees of the transferor settlement; and

(ii) so accrued on the disposal by them of an asset that was property originating from the chargeable settlor;

and

(d) any chargeable gains and losses which are not gains or losses to which this paragraph applies were to be disregarded for the purposes of that section."[31]

In other words, the settlor is in principle to be taxable under section 86 in 1999/2000 on the gain realised by the transfer.

7 Conclusion

7.1 Trust Gains from 1999/2000

Section 86 can be prevented from applying to gains realised by the trustees of a settlement in a year from 1999/2000 onwards by ensuring:

(a) that during the whole of the year:

(i) the settlement is a protected settlement, which may involve exercising their dispositive powers before the beginning of the year;

(ii) it is not the case that some defined person might at some time benefit from the settlement, which again may involve

31 Paragraph 3(3).

exercising their dispositive powers before the beginning of the year;

(iii) the settlor is not domiciled in the UK;

(iv) the settlor is neither resident nor ordinarily resident in the UK;

or

(b) that during part of the year:

(i) the trustees are resident or ordinarily resident in the UK, in which case they will be normally be taxable, after allowing for their annual exemption, at the rate of 34%, unless the UK Settlor Provisions apply and/or the trustees can claim treaty protection (in which case a potential liability of the settlor under TCGA section 86 might arise by virtue of section 86(2)(b)); or

(ii) the settlor or some other relevant person dies.

The trustees can also make sure that the provisions do not apply by putting an end to the trust before the beginning of the relevant year. This need not involve absolute vesting of assets in beneficiaries.

The trustees can also postpone realising any gains until a year in which the provisions will not apply.

More aggressive tax planning involving a "flip-flop" under which cash will be appointed out and beneficiaries excluded from benefit in one year, while gains will not be realised until a later year.

7.2 Trust Gains 16th March 1998 - 5th April 1999

7.2.1 Gains Realised at any Time 16th March 1998 - 5th April 1999

Section 86 can be prevented from applying to gains realised by the trustees of a settlement in the above period by:

(a) the settlor not being in 1999/2000

(i) alive, or

(ii) domiciled in the UK, or

(iii) either resident or ordinarily resident in the UK;[32]

(b) at any time in 1990/2000

(i) the settlement not existing;

(ii) the settlement being a protected settlement; or

(iii) no defined person being capable of benefiting under the settlement.

In considering whether beneficiaries should be excluded from benefiting, it should be borne in mind that a disposal by a beneficiary of his interest under the settlement is not exempt from capital gains tax where the trustees are non-UK resident.[33] Moreover, it is no longer a solution to import the settlement prior to 6th April 1999 and for the beneficiary then to dispose of his interest.[34]

If the settlement is no longer to exist, the trustees will necessarily have to dispose of the settled property. If it is to individual beneficiaries, then section 86 will not apply, although section 87 will have to be borne in mind. It may be possible to avoid or mitigate the section 87 problem by other means. If the disposal is to the trustees of another settlement, Finance Act 1998 Schedule 23 paragraph 2 must be borne in mind. If the disposal is to a foreign institution, Finance Act 1998 Schedule 23 paragraph 3 must be borne in mind.

7.2.2 Gains Realised 1998/99

Section 86 can additionally be prevented from applying to gains realised by the trustees of a settlement in 1998/99 by the trustees becoming UK resident or ordinarily resident for part of the year. If they are dual resident and are relieved from UK capital gains tax by a double taxation convention, Taxation of Chargeable Gains Act 1992 section 86(2)(b) should not normally be a problem.

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32 And not being merely temporarily non-UK resident: see Taxation of Chargeable Gains Act 1992 sections 10A and 86A, inserted by Finance Act 1998.

33 Taxation of Chargeable Gains Act 1992 section 85(1).

34 Taxation of Chargeable Gains Act 1992 section 76(1A) and (1B), inserted by Finance Act 1998.