MODERNISING THE TAX SYSTEM FOR TRUSTS

Discussion paper – Definitions and tests

1. The Government recognises the important role trusts play in society and has said that as far as possible it wants a tax system for trusts that does not provide artificial incentives to set up a trust, but equally avoids artificial obstacles to the use of trusts where their use would bring significant non-tax benefits. It does not want a system that enables people to use trusts to avoid tax but neither, as far as is possible, does it want the tax system to penalise beneficiaries where a trust is imposed upon them by statute, such as the laws of intestacy, or where a trust exists to protect the vulnerable, such as a disabled person. Administration and compliance costs should also be kept as low as possible.

2. To keep administration and compliance costs down for trustees the tax system should be as easy as possible to comply with. At present there are many different definitions and tests for trusts and trustees across the Taxes Acts. This paper examines the scope for harmonising the main definitions used in the taxation of UK resident personal trusts, to see if this would help to make the tax system easier to navigate for trustees and beneficiaries.

3. We would welcome views as to the benefits that might flow from the ideas discussed below. We would also appreciate comments as to the pitfalls we should try to avoid if any new system is to work properly. The paper examines particular issues surrounding trusts, trustees and settlors, but does not go into detail on how any harmonised definitions or tests would cope with multiple settlors, or settlors with a fixed interest in a trust. We would like to examine the main principles first, but remain aware that these issues will have to be addressed as any new system is developed.

4. We believe that the use of common definitions as the starting point for taxing trustees should produce a simpler system with less scope for confusion. We think this will be of particular benefit to lay trustees. This paper is not concerned with the various categories of trusts for which special treatment is provided in the Taxes Acts, such as charitable trusts, pooled investment vehicles, and so on. Although the definition used for Stamp Duty Land Tax is essentially the same as for Capital Gains Tax (CGT), it again is not considered in this paper, and the position of non-resident trustees is not considered unless there is an explicit reference to them in the text.

A. Definition of settlement

5. We would like to explore the potential for harmonising the definition of “settlement” for Income Tax and CGT purposes (“trusts” are not defined in the Taxes Acts). We would like to hear views as to whether this is a good idea, and if so, whether we ought to base any harmonised definition of settlement on an existing statutory definition or design a new definition.

6. The approach taken to the taxation of trustees is different for Inheritance Tax, Income Tax and CGT. There is a comprehensive definition of what constitutes a “settlement” in the Inheritance Tax Act (IHTA) 1984 at Section 43 (2), and an alternative in Section 660G of the Income and Corporation Taxes Acts (ICTA) 1988. The latter definition is, however, very wide, and intentionally takes in arrangements or agreements that do not constitute trusts. The main definitions are set out in Appendix 1 to this discussion paper.

7. For normal Income Tax purposes the terms “trust” and “settlement” are not explicitly defined. Trustees are simply “persons” (though not individuals) and they are chargeable to tax as such. ICTA refers to “the trustees of a settlement” (Section 8A Taxes Management Act (TMA) 1970) and “income arising to trustees” (Section 686 ICTA 1988) without defining what exactly a trust or a trustee is. This approach is carried into the schedules so that for Schedule D, for example, Section 59 (1) ICTA 1988 charges tax on “the persons receiving or entitled to receive the income”. Trustees are therefore charged to tax on their income without the terms trust or settlement being explicitly defined.

8. For CGT, we rely on general and case law to define settlement in the light of the definitions in Section 69 and 68 of the Taxation of Chargeable Gains Act (TCGA) 1992. Trustees are again chargeable as “persons” and not individuals, though the position of bare trustees is covered in Section 60 TCGA 1992. The definition of settlement in Section 660G ICTA 1988 is borrowed for the purposes of certain CGT provisions by virtue of Section 97 (7) TCGA 1992.

Possible approaches

9. Although the idea of moving to just one definition of settlement for all tax purposes is attractive, many of the definitions in the Taxes Acts have arisen either as a response to particular tax avoidance schemes, or to meet the needs of particular taxes. We believe there is a risk that aiming for just one definition would open up loopholes for exploitation. For this reason, we think a more achievable objective might be to aim for a standardised definition for the purpose of taxing UK-resident personal trusts to Income Tax and CGT, but retaining relevant anti-avoidance definitions tailored to the particular needs of those provisions.

10. There might be benefits to using the existing IHT definition – which is in practice itself very similar to the CGT definition - as the starting point for a new definition, rather than the specialised Income Tax definition in Section 660G ICTA 1988. The latter forms part of the anti-avoidance settlements legislation, and intentionally catches arrangements other than trusts. We are aware however, of practical operational difficulties that might flow from such a change – these are discussed further below.

11. The other main option seems to be to pursue the Income Tax approach of taxing trustees/the trustees of a settlement, relying on trust law concepts

rather than a detailed Taxes Acts definition. This has the advantage of flexibility, though it could perhaps lead to continuing uncertainty as to what exactly it is that is being taxed. Again, we would like to hear views as to the merits of this approach.

Practical and operational issues

12. The current system can result in separate Self Assessment (SA) returns being issued to trusts which contain a number of separate funds within them. Often, these will be large and long-established family trusts, where the terms of the original deed have provided for the creation of separate funds for separate branches of the family. Sometimes the separate funds within the settlement will be administered by separate sets of trustees. Even though these may in strictness be one settlement, therefore, it has been convenient for both the trustees and the Inland Revenue to treat the funds as separate entities for Income Tax purposes and issue separate SA returns.

13. In practice our operational offices have permitted this, but when chargeable gains have been realised we have then insisted on receiving a single SA return covering all the gains realised within what we consider to be the one settlement. Adopting the IHT/CGT definition as the basis for any new single definition of settlement could upset this arrangement, and mean that the trustees responsible for managing different funds would have to work together to provide a single Self Assessment return. We would be interested to hear how people would view this aspect of our proposals.

Income Tax approach

14. The existing Income Tax legislation takes the approach of focussing on the income that is to be taxed, rather than persons who are taxable. That is not necessarily bad but it can make it quite involved to pick out the rules that apply to trustees.

15. To work out the appropriate rate of Income Tax for a trust, or more accurately trustees, it is necessary to go through each sub-section of Section 1A ICTA 1988 to see whether it refers to “persons” or “individuals”. As they are acting in a representative capacity, trustees are affected by the provisions that apply to persons, but not to those applying to individuals. So they have to work their way through sections to see if they are in, as persons, out, as non-individuals, or back in as trustees. Only then can they decide if they are caught by a particular section or not because, for example, the income in question is income over which they have discretion.

16. Trustees may be chargeable to Income Tax at basic rate, lower rate, or the Schedule F ordinary rate depending on the type of income received, but never at the starting rate or at higher rate, as these only apply to individuals. They may of course be liable at the Rate Applicable to Trusts (RAT) or the Schedule F Trust rate.

17. A further problem is in the balance between taxing settlors, beneficiaries and trustees. The present system relies heavily on taxing trustees, but the more tax that is levied at the trust level the greater are the chances of unfairness when those associated with trusts have widely differing incomes and wealth. We also think that the emphasis on distinguishing between different generic types of trusts - especially interest in possession (IIP) and discretionary trusts - for tax purposes, but generally adopting a "one size fits all" approach within these groups, can lead to unfairness when you factor in the variety of size, characteristics and purposes for trusts.

18. This summary over-simplifies the approach, mainly because it concentrates on resident trusts, settlors and beneficiaries. We would need to factor in various options for situations involving non-residence, non-domicile, mixed-residence and so on. None the less, we think it might be workable, and we would welcome views as to the benefits and of course drawbacks of such an approach.

Capital Gains Tax approach

19. Unlike the Income Tax approach, the CGT rules do start with the idea of taxing a specific person, though as for Income Tax the legislation uses the concept of the income or gains arising to persons.

20. However, unlike the Income Tax approach, for CGT the legislation treats the trustees as one single continuing body. Whilst this at first does not appear to matter, it is a further unwelcome discrepancy between the two taxes.

21. In trust law trustees are personally responsible for their actions. So if they do not make adequate provision within the trust for the tax due they are personally liable. So taxing the trust or the trustees does not affect the Revenue's ultimate ability to collect the tax.

Possible approach

22. We are considering adopting the CGT model of taxing the trustees as a single continuous body for Income Tax purposes. However the right to recover tax from relevant trustees where the circumstances warranted it would need to be retained.

23. Section 43 (2) IHTA 1984 provides a comprehensive definition of settlement for Inheritance Tax purposes (see Appendix 1 below). We think that this might be the best starting place for a harmonised standard definition for Income Tax and CGT (and might also have the incidental benefit of bringing the definition into line for all three taxes).

24. A possible approach to taxing trusts for both income Tax and CGT would be to define the different sorts of trust we would seek to tax, or not, and then set out how the tax rules apply to those different sorts of trust. So for example:

- We could define settlements in which the settlor retains an interest. That is wider than trusts and brings in arrangements etc.

- For settlements in which the settlor does not retain an interest, we could then separate out trusts.

- From these we could identify the bare trusts where the beneficiary has to return all the income and gains.

- If necessary we could then separate out interest in possession trusts and define how they are to be taxed.

- We would then be left with discretionary and accumulation trusts, and the taxation treatment of them could then be defined.

25. We could allocate all trusts (excluding the specialist trusts) to one of three main categories for tax purposes: bare trusts, where we would tax the beneficiary on the basis that they owned the assets in the trust; settlor-interested trusts, where we would tax the settlor as though they owned the assets in the trust; and general trusts, where the new tax rules for trusts would apply.

26. We will have to ensure that any new definitions will still allow us to treat charities, approved pension schemes, and pooled investment vehicles as appropriate and outside any new regime for ordinary trusts, but as these are already provided for in the Taxes Acts that should not be a problem.

Lack of trust tax legislation

27. It may seem unnecessary to further add to tax legislation by, in effect, legislating again what is already there, albeit in an unclear way. But we think there would be real benefits for all trustees if we could make our legislation clearer and easier to use - trust tax law could be codified and brought together.

28. We think the main benefits from bringing the standard definitions into line with each other will be for smaller trusts. We would welcome views as to the benefits of also harmonising the other definitions of settlement in the Taxes Acts.

B. Definition of settlor/settlor-interested

29. At present there are several separate tests for whether a trust is settlor-interested within the Taxes Acts. The tests in turn depend on defining what a settlor is, and the circumstances in which they have an interest. Again, we believe that the use of common definitions and tests for taxing trustees should produce a simpler system with less scope for confusion

30. The approach taken for Income Tax is slightly different from that for CGT, but for both taxes the legislation provides for income and gains arising to trustees of certain settlements to be treated, in effect, as belonging to the settlor. (The approach taken for Income Tax on chargeable event gains on life insurance policies is different again.) The differences between the basic definitions for Income Tax and CGT are not large, which suggests that harmonising the approach for these taxes would be beneficial without having a huge impact in terms of either bringing into charge or excluding from charge a large number of trusts.

31. Such a change would, however, make it easier to address obvious inconsistencies, for example where the Income Tax settlements legislation deems the income of a bare trust established for the settlor's child to be assessable on the settlor, whilst gains arising to the same trustees are assessable on the child. We would like to know if there would be support for using the same definitions and tests for both taxes.

32. An alternative approach would be to deem a trust to be settlor-interested if any of the existing settlor-interest tests for resident trusts applied to it. This would generally cause relatively little disruption to the current system, though it would mean that trustees would have to look at all of the separate tests in order to decide whether or not their trust fell within the terms of any of them. It does not sit well with the aim of improving consistency in the system.

33. One potential problem is that the effort put into harmonising the tests could be disproportionate to any benefits obtained. However, one of the aims of modernising the tax system for trusts is to make it simpler for trustees, settlors and beneficiaries to comply with their obligations, and we believe that bringing the definitions used into line with each other ought to help achieve this.

Purpose of tests

34. The principal purpose of the tests for whether a trust is deemed to be settlor-interested is to discourage a settlor from passing income or capital to another individual, or to trustees, in order to get the income or gains taxed at a lower rate than his or her own, or not suffer any tax at all.

35. The settlements rules for Income Tax and CGT operate by treating income and gains arising under a settlement as the income or gains of the settlor for tax purposes. We believe that there is a general consensus that the principles behind the settlor-interested tests are fair. It seems only right that where a person, or their specified relatives, still enjoys the benefits of income or gains or assets that they are taxed on them accordingly.

Current inconsistencies

36. However, there are inconsistencies in the way the system works at present. For Income Tax purposes, the settlements legislation taxes income

arising to the trustees on the settlor under Case VI of Schedule D, unless the income consists of dividends or other similar income when the Schedule F rates apply. That inconsistency means the actual tax paid is not always the same as if the settlor had received the income direct.

37. Savings income arising directly to an individual liable at basic rate is taxed at 20%, and this satisfies the individual's basic rate liability on that income. But if the income arises to trustees of a settlor-interested trust and the settlor is a basic rate taxpayer, the income is assessed on the settlor at 22%.

38. Any payment to a beneficiary out of the income of a discretionary trust is an annual payment even where the trust is settlor-interested, and so is taxed on the beneficiary. The settlor is also taxable on the trust income in that capacity. To avoid this double charge we treat payments of income out of the trust to beneficiaries, though not of course to the settlor themselves, as a gift by the settlor to the beneficiary.

39. It is possible to get around the Income Tax settlor-interested test by using a company to settle the assets. In many close companies the director/ shareholders can manipulate this fact to avoid tax. Where a company can be so easily controlled by a few people it seems obvious that the anti-avoidance legislation should apply.

40. As outlined above, parents can transfer assets to their minor children in trust and avoid CGT in circumstances where the trust's income would be assessable on the parents. And certain savings schemes exploit this by providing products for people to invest in non-income producing assets such as second hand qualifying life insurance policies. The child's CGT annual exempt amount can in effect be used by the parent to cover investment income.

41. Another inconsistency is that the settlor-interested test for offshore trusts is much wider than for resident trusts, including, for example, grandchildren of the settlor, and companies controlled by them. The tests for resident trusts, whether for Income Tax or CGT purposes, do not. However the former's purpose is to determine those cases where it is considered appropriate to charge the settlor now, instead of deferring liability until gains are distributed. There is also a further rule for chargeable event gains from life insurance policies. These are generally taxed on the settlor where the latter lives in the UK.

42. There are perceived anomalies with the operation of taper relief in relation to trusts and settlors. These sometimes, but not always, may have an adverse effect on the settlor's CG liability. This is mentioned in more detail in the separate discussion paper on CGT issues.

Fairness

43. Not all settlors are higher rate taxpayers. We think a key outcome of the test for settlor-interested trusts should be that the income and gains of such a trust should be taxed as closely as possible as if the settlor had received the income or gains direct.

Possible approach

44. We think there should perhaps be a clearer separation between the treatment of settlor-interested and non settlor-interested trusts. Gains and income in settlor-interested trusts could be treated as far as possible as the settlor's for all tax purposes. However if settlors truly divest themselves of the assets then that should be treated as a clean break, just like it would be if they gave the assets to a complete stranger.

45. To achieve this for income, we think we could assess the settlor on an amount equal to the trust income, with all the normal individual reliefs and allowances being available. We think it would be preferable to drop the Case VI charge for Income Tax, and replace it with the original case and/or schedule of charge. For CGT purposes, we think the settlor's trust-derived losses or gains would have to be ring-fenced to prevent abuse of the system.

46. On the problem of payments out of a settlor-interested discretionary trust (see paragraph 38), the best solution seems to be to continue to treat payments out of settlor-interested trusts as gifts from the settlor to the beneficiary. This avoids the double charge to Income Tax, and clarifies the position for CGT. It also fits with the logic of taxing settlor-interested trusts as if gains and income of the trust are treated as the gains and income of the settlor.

47. There could be a common definition of "settlor-interested" which applied to Income Tax and CGT. This would, in effect, be the existing tests added together so that a trust that was caught by at least one of the existing tests would be caught by the new test. This might mean extending the CGT test to Income Tax, so that participators in a close company caught by the CGT test would also be caught for Income Tax purposes.

48. The new test for settlor-interested trusts would need to include bare trusts for children. To improve consistency, we think the rules for Income Tax would have to be expanded, in line with those for CGT, to apply to any trust from which the minor child of the settlor could benefit, rather than just a trust from which they do benefit. We also think it might usefully bring in the wider class of beneficiaries currently used for non-resident trust purposes.

Electing to be settlor-interested

49. It is already easy for a living settlor to make a trust settlor-interested - they just make themselves a potential beneficiary. Therefore it is easy to opt into settlor-interested status if that would be beneficial. However it may also be desirable to allow certain sorts of trusts to elect to be treated as settlor-interested, for example where the settlor is not alive. This is explored in the

discussion paper on Income Tax issues and so the arguments are not repeated here, but basically certain trusts created on death for orphaned children and certain trusts for disabled persons could elect, on a once and for all basis, for treatment similar to that of settlor-interested trusts.

50. Finally, one radical option we are considering is that of deeming any trust with a living settlor to be settlor-interested for Income Tax and CGT purposes. This would be a significant step towards simplifying the tax system for trusts, and would also be useful in preventing the use of trusts in avoidance schemes. However, we are aware that it could also be seen as unfair when an individual had genuinely put their assets beyond their control for the benefit of others. We would like to know how people would view such a radical change.

C. Residence test

51. Again when deciding on the residence status of a trust or settlement there are different tests for Income Tax and CGT. We would like to explore the possible benefits of bringing these into line with each other.

Income Tax

52. For Income Tax, where all the trustees are UK resident the trust is treated as UK resident, and where all the trustees are non-resident the trust is treated as non-resident. There is then a set of rules for cases where some, but not all, of the trustees are not resident (mixed residence trustees) in Section 110 FA 1989 (see Appendix 2 below). Broadly speaking, such mixed residence trustees are treated as wholly resident for Income Tax purposes if the settlor (or any one of the settlors, if there is more than one) was either resident, or ordinarily resident, or domiciled in the United Kingdom at the time either he made the settlement or later provided funds for it.

53. On the other hand, if the settlor was not resident, not ordinarily resident and not domiciled in the United Kingdom at all times when he provided funds for the settlement, such mixed residence trustees are treated as wholly non-resident for Income Tax purposes. However if that same settlor used all resident trustees they would end up with a UK resident trust.

Capital gains tax

54. For CGT purposes, the starting point in Section 9 TCGA 1992 (see Appendix 2 below) is the Income Tax rules. There is then some detailed provision for temporary UK residents, non-residents carrying on a trade in the UK through a branch or agency, gains accruing to members of non-resident companies, and so on.

55. As set out above, the trustees of a settlement are treated as being a single and continuing body of persons, distinct from the persons who may from time to time be the trustees. Hence whilst individual trustees come and go the trustees as a body remain the same for CGT purposes. The trustees

are treated as being resident and ordinarily resident in the United Kingdom unless the general administration of the trusts is ordinarily carried on outside the United Kingdom and the trustees, or a majority of them, are not resident or not ordinarily resident in the United Kingdom.

56. This concept of a single and continuing body of persons is useful. It prevents problems over who exactly should be assessed and who is responsible for paying the tax. Although there is legislation in Section 107A TMA 1970 to improve the situation for Income Tax purposes, we think there would be benefits to bringing the idea of trustees as "a single and continuing body of persons" into the Income Tax code.

57. For CGT there are special rules for professional trustees which state that a person carrying on a business which consists of or includes the management of trusts, and acting as trustee of a trust in the course of that business, shall be treated in relation to that trust as not resident in the United Kingdom if the whole of the settled property consists of or derives from property provided by a person not at the time (or, in the case of a trust arising under a testamentary disposition or on an intestacy or partial intestacy, at his death) domiciled, resident or ordinarily resident in the United Kingdom.

58. The purpose of this rule is to encourage the use of professional trustees and lawyers in the UK. We have been told that the rule can be too restrictive and sometimes gives the wrong result. We would like to take views as to the benefits of permitting an election to be treated either as UK resident or non-resident by such professional trustees.

59. The general administration of a trust is treated as being carried on at the place where the trustees carry out their general duties as trustees, though we take account of all the circumstances of the trust when determining the location of its "place of effective management". General administration is not the same as the concept of place of effective management used in Double Taxation Agreements.

Practical issues

60. In practice the different residence tests appear to create few problems. Trustees tend to be resident or non-resident for both Income Tax and Capital Gains Tax purposes. However the differences are not helpful and can lead to avoidance opportunities. We believe that a common test for Income Tax and Capital Gains Tax would be sensible and would like to know if this is supported by trust professionals.

Possible approach

61. There seem to be three possibilities for simplifying the residence tests; either moving towards the Income Tax test for residence, the CGT test or a completely new test based on say, effective management or control and management. We would like to hear people's views as to which of these

would seem the best approach, or indeed whether they think the drawbacks of making such changes would outweigh any benefits.

62. One option we would like to explore is that of making all trusts with a UK resident trustee UK resident, whatever the status of the settlor. That would certainly make it easier to decide whether or not a trust was UK resident, especially where there is a company settlor, or the status of the settlor is not known. Using a UK resident trustee brings the trust certain benefits, such as access to the UK legal system and access to undoubted trust expertise, so it might seem only right that tax liability should flow from that.

63. We would like to hear views as to whether that proposal, if coupled with the election referred to in paragraph 59 above, would be helpful, or if aspects of it would be detrimental to trust professionals operating in the UK.

64. To address this, would an ability to elect for non-residence status but with an information power attached be seen as an acceptable compromise? In such a system, professional trustees might have to inform the Inland Revenue of all trusts where they had elected to be treated as non-resident and the Revenue would retain the right to issue SA returns to such trusts, along with our usual enquiry powers. The Revenue already has that right anyway as we have the right to check on the residence status of any trust and under SA that has to be done through an enquiry.

65. A residence test that made any trust resident where there was one resident trustee would have to be subject to a Double Taxation Agreement (DTA) override as now. (DTAs provide rules for deciding which fiscal authority will have taxing rights where the normal rules will make the trustees resident in both territories.) This might cause additional work for trustees and the Revenue, though as most DTA tiebreakers use the concept of the place of effective management, something we are already familiar with (in DTAs and the CGT test), that should not pose insuperable problems.

66. One other possible common residence test would be to treat any trust with a UK resident settlor as a UK resident trust whatever the residence of the trustees. Clearly this would have compliance implications where all the trustees were in fact non-resident, and we would like to hear views as to whether this approach would be workable. We are aware that some other countries, such as Canada, have adopted this system.

67. In summary, we would like to hear views as to the best way forward. It is clear a common residence test would be desirable and sensible, but we recognise that moving to it may cause problems. In the end we think a more consistent system would be fairer and might even attract more business to the UK, but the views of trust professionals will clearly be important in deciding how to take this aspect of modernising the tax system for trusts forward.

Inland Revenue Trusts

17 December 2003

APPENDIX 1 - Definitions

Definitions of settlement

Inheritance Tax

Section 43 (2) IHTA 1984

"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-

(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

(b) 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.

Income Tax

Section 660G ICTA 1988

(1) In this Chapter-

"settlement" includes any disposition, trust, covenant, agreement, arrangement or transfer of assets, and

"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) References in this Chapter to income arising under a settlement include, subject to subsection (4) below, any income chargeable to income tax by deduction or otherwise, and any income which would have been so chargeable if it had been received in the United Kingdom by a person domiciled, resident and ordinarily resident in the United Kingdom.

(4) Where the settlor is not domiciled, or not resident, or not ordinarily resident, in the United Kingdom in a year of assessment, references in this Chapter to income arising under a settlement do not include income arising under the settlement in that year in respect of which the settlor, if he were actually entitled thereto, would not be chargeable to income tax by deduction or otherwise by reason of his not being so domiciled, resident or ordinarily resident.

But where such income is remitted to the United Kingdom in circumstances such that, if the settlor were actually entitled to that income when remitted, he would be chargeable to income tax by reason of his residence in the United Kingdom, it shall be treated for the purposes of this Chapter as arising under the settlement in the year in which it is remitted.

Capital Gains Tax

Section 68 TCGA 1992

In this Act, unless the context otherwise requires, "settled property" means any property held in trust other than property to which section 60 applies.

Section 60 TCGA 1992

(1) In relation to assets held by a person as nominee for another person, or as trustee for another person absolutely entitled as against the trustee, or for any person who would be so entitled but for being an infant or other person under disability (or for 2 or more persons who are or would be jointly so entitled), this Act shall apply as if the property were vested in, and the acts of the nominee or trustee in relation to the assets were the acts of, the person or persons for whom he is the nominee or trustee (acquisitions from or disposals to him by that person or persons being disregarded accordingly).

(2) It is hereby declared that references in this Act to any asset held by a person as trustee for another person absolutely entitled as against the trustee are references to a case where that other person has the exclusive right, subject only to satisfying any outstanding charge, lien or other right of the trustees to resort to the asset for payment of duty, taxes, costs or other outgoings, to direct how that asset shall be dealt with.

APPENDIX 2 – Residence tests

Residence test – income tax

Section 110 FA 1989

(1) Where the trustees of a settlement include at least one who is not resident in the United Kingdom as well as at least one who is, then for all the purposes of the Income Tax Acts –

(a) if the condition in subsection (2) below is satisfied, the trustee or trustees not resident in the United Kingdom shall be treated as resident there, and

(b) otherwise, the trustee or trustees resident in the United Kingdom shall be treated as not resident there (but as resident outside the United Kingdom).

(2) The condition referred to in subsection (1) above 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.

(3) 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.

(4) For the purposes of this section "settlor", in relation to a settlement, includes any person who has provided or undertaken to provide funds directly or indirectly for the purposes of the settlement.

(5) In section 824(9) of the Taxes Act 1988 (repayment supplements), for the words "or a United Kingdom trust (as defined in section 231)," there shall be substituted the words "the trustees of a settlement".

(6) Subject to subsections (7) to (9) below, this section shall apply for the year 1989-90 and subsequent years of assessment.

(7) For the purpose of determining the residence of trustees at any time during the year 1989-90, the condition in subsection (2) above shall be regarded as not having been satisfied if none of the trustees of the settlement is resident in the United Kingdom at any time during the period beginning with 1st October 1989 and ending with 5th April 1990.

(8) This section shall not apply for any of the purposes of section 739 of the Taxes Act 1988 in relation to income payable before 15th June 1989, or for the purposes of subsection (3) of that section in relation to income payable on or after that date if –

(a) the capital sum there referred to is received, or the right to receive it is acquired, before that date, and

(b) that sum is wholly repaid, or the right to it waived, before 1st October 1989.

(9) This section shall not apply for any of the purposes of section 740 of the Taxes Act 1988 in relation to benefits received before 15th June 1989; and, in relation to benefits received on or after that date, "relevant income" for those purposes shall include income arising to trustees before 6th April 1989 notwithstanding that one or more of them was not resident outside the United Kingdom, unless they have been charged to tax in respect of it.

Residence test – CGT

Section 9 TCGA 1992

(1) In this Act "resident" and "ordinarily resident" have the same meanings as in the Income Tax Acts.

(2) Section 207 of the Taxes Act (disputes as to domicile or ordinary residence) shall apply in relation to capital gains tax as it applies for the purposes mentioned in that section.

(3) Subject to [sections 10(1) and 10A], an individual who is in the United Kingdom for some temporary purpose only and not with any view or intent to establish his residence in the United Kingdom shall be charged to capital gains tax on chargeable gains accruing in any year of assessment if and only if the period (or the sum of the periods) for which he is resident in the United Kingdom in that year of assessment exceeds 6 months.

[(4) The question whether for the purposes of subsection (3) above an individual is in the United Kingdom for some temporary purpose only and not with any view or intent to establish his residence there shall be decided without regard to any living accommodation available in the United Kingdom for his use

APPENDIX 3

Types of trust for tax purposes

Income tax

- Bare trusts where tax not collected from the trustees.
- Bare trusts where tax is collected from the trustees. (1)
- “Baker” interest in possession trusts. (3)
- “Garland” interest in possession trusts.
- Discretionary and accumulation trusts. (3)
- Employee Benefit Trusts (EBTs)
- FURBS.
- Any of the above can be settlor interested under section 660A (not bare trusts) or section 660B ICTA 1988.
- Approved pension schemes.
- Charities. (3)
- Heritage Maintenance Funds

CGT

- Bare trusts – CGT is not collected from these. (1)
- Interest in possession trusts. (3)
- Discretionary and accumulation trusts. (3)
- Disabled trusts. (2)
- Offshore trusts where special CGT rules apply
- Settlor interested trusts.

IHT

- Interest in possession (3)
- Relevant Property (Discretionary) (3)
- Accumulation and Maintenance
- Employee benefit
- Pension funds
- Charities (3)
- Compensation funds
- Newspaper trusts
- Protective trusts
- Disabled trusts (2)
- Heritage Maintenance Funds (4)
- Foreign trusts set up by a non-domicile – exempt from IHT.

Notes:

(1) – The same definition in effect applies for income tax and CGT.
(2) – The same definition in effect applies for CGT and IHT.
(3) – The same definition in effect applies for income tax, CGT and IHT.
(4) – The same definition in effect applies for income tax and IHT.