

## CHAPTER 15

### CGT & UK TRUSTS - FURTHER ASPECTS

#### 15.1 Appointments of assets to beneficiaries

Assume that trustees of a UK Trust enter into a deed of appointment whereby **assets pass to a beneficiary**.

Under S.71 TCGA 1992, this is a **disposal of the assets by the trustees at market value**. In the absence of any claims to the contrary, a chargeable gain or allowable loss will arise to the trustees on the distribution. The beneficiary is deemed to have acquired the asset at the date of the appointment with a base cost equal to its market value.

[TCGA 1992, s. 71](#)

In certain instances, **gift relief can be claimed to defer the trustees' gain**. If the assets being appointed to the beneficiary are **business assets** within the definition of **s.165**, a gift relief claim can be made, and the trustees' gain may be rolled over against the base cost of the beneficiary.

Gift relief may also be claimed under **s.260**, if the gift to the beneficiary is a chargeable transfer for inheritance tax purposes. This will be the case if an asset is being appointed out of a **discretionary trust**, as the appointment to the beneficiary will give rise to an IHT exit charge. This treatment will also apply to post 22 March 2006 interest in possession trusts.

Note, **no gift relief** is available under s.260 if a distribution is made either **within the first 3 months of creating the trust or within 3 months of a principal charge**. On such occasions there is no transfer of value for IHT and therefore **no exit charge**.

Because the donee is an individual, gift relief must be claimed by way of a **joint election between the trustees and the beneficiary**. The time limit for a gift relief claim is 4 years from the end of the tax year in which the appointment took place.

[TCGA 1992, s.165\(1\)\(b\)](#)

[TCGA 1992, s.260\(1\)\(c\)](#)

Such deemed disposals by the trustees will generally take place in two circumstances. The trust deed will usually give the trustees authority to make **discretionary distributions** of capital assets to the beneficiaries. Under English law, the trustees have power, either under the trust deed or under S.32 Trustee Act 1925, to advance capital to a beneficiary who has a presumptive entitlement to a share of the capital of the trust. In trust law, such a distribution **cannot exceed 50% of the beneficiary's presumptive interest**.

[TA 1925, s.32](#)

A capital appointment by the trustees will also take place where a **beneficiary becomes entitled to the trust capital** (or a share of it), under the terms of the trust. This could happen, for example, where a life tenant of an interest in possession trust is entitled to the trust income until he reaches a specified age.

Once the life tenant has attained the specified age, the capital of the trust will usually pass to the reversionary beneficiary - i.e. the remainderman. This causes there to be a deemed disposal of those trust assets by the trustees.

If the IIP trust was created before 22 March 2006, gift relief will only be available under s.165 if the assets concerned are business assets. If the IIP trust was created on or after 22 March 2006, gift relief will be available under s.260, because the lifetime cessation of an interest in possession will generate an exit charge.

The trustees will also distribute capital on the occasion where a beneficiary of an accumulation and maintenance trust becomes absolutely entitled to a share of trust assets on attaining a specified age. For instance, in a typical A&M arrangement, assume a beneficiary became entitled to income at the age of 25 and capital at the age of 35. When the beneficiary reaches his or her 35<sup>th</sup> birthday, the trustees will distribute his or her share of the trust capital, and this will be an occasion of charge for CGT purposes.

## 15.2 Death of a life tenant

A deemed disposal by the trustees will also take place on the death of the life tenant of an interest in possession trust. This is **only** the case if the interest in possession is treated as a **"qualifying IIP"** for IHT purposes. It also applies on the **death of a bereaved minor** under the age of 18.

[TCGA 1992,  
s.72](#)

When the life tenant dies, under s.72 TCGA 1992, the trustees are deemed to have disposed of the **entire trust capital at its market value** at the date of the death of the life tenant. In most interest in possession arrangements, on the death of the life tenant, the trust capital thereafter passes to the remainderman. However, the trust deed could stipulate that a successive life interest is created on the death of the first life tenant.

This means that instead of the capital passing to the remainderman, a second person thereafter becomes entitled to the income of the trust. In either situation, there is a deemed disposal at market value by the trustees under s.72. Special rules apply to enable us to calculate the capital gains in this instance, and these are contained at s.73 TCGA 1992.

[TCGA 1992,  
s.73](#)

On the death of the life tenant, the trustees are deemed to have disposed of all of the trust assets at their market value, and a chargeable gain - or allowable loss - will arise. **Under general principles, death is not treated as an occasion of charge** for CGT purposes. Therefore the gain accruing to the trustees on this deemed disposal will be exempt from CGT.

[TCGA 1992,  
s.62\(1\)](#)

However, s.74 tells us that **full exemption will not be available if a capital gain was deferred when the trust asset was originally transferred into the settlement**. Therefore, when a life tenant of an interest in possession trust dies, the first question we must ask is "were any gains deferred when the trust assets were originally transferred into the trust".

[TCGA 1992,  
s.74\(1\)](#)

If the answer to this question is "no" i.e. gift relief was not available to the settlor when he created the trust - no gain will arise to the trustees on the death of the life tenant. If the answer to this question is "yes" - i.e. when the settlor transferred the asset to the trust, gift relief was claimed - the death of the life tenant will give rise to a chargeable gain.

In this case, we calculate the gain arising to the trustees assuming that all trust assets were disposed of at their market value. However, the **gain that is chargeable** to capital gains tax, is **restricted to the amount of any previous gains which were held-over**. In effect, the maximum gain on the death of the life tenant is limited to any gift relief previously claimed.

### Illustration 1

A settlor transferred unlisted shares to an interest in possession trust in September 2005. The shares had a market value of £200,000 at that date. The capital gain is:

	£
Market value (September 2005)	200,000
Less: base cost (say)	<u>(120,000)</u>
Gain	80,000
Less: deferred under s. 165	<u>(80,000)</u>
Chargeable	<u>Nil</u>
Trustees' base cost	£
Market value	200,000
Less: rolled-over gain	<u>(80,000)</u>
Base cost (September 2005)	<u>120,000</u>

The life tenant of the interest in possession trust dies in July 2010, at which point the shares were worth £350,000. The death of the life tenant causes there to be a **deemed disposal by the trustees of all trust assets at market value**. The only asset in the trust in July 2010 was shares with a market value of £350,000. The deemed gain is therefore:

	£
Market value (July 2010)	350,000
Less: base cost	<u>(120,000)</u>
Deemed gain	<u>230,000</u>

This gain is normally exempt, however, we must ask ourselves whether a gain was deferred when the settlor transferred the shares into the trust. In this instance, the answer is "yes".

Therefore on the death of the life tenant, the chargeable gain arising to the trustees is the gain on the deemed disposal, but **restricted to the amount of the capital gains previously held over**.

We therefore treat the trustees as having disposed of all of the trust assets at market value, but the total chargeable gains in this instance cannot exceed £80,000. **The trustees therefore have a capital gain of £80,000.**

Capital gains tax is payable by the trustees on this gain as below;

	£
Gain	80,000
Less AE 2010/11	<u>(5,050)</u>
Taxable	<u>£74,950</u>
 CGT @ 28% (payable by trustees)	 <u>£20,986</u>

Note that a chargeable gain has only arisen because the settlor originally deferred a gain of £80,000 when he transferred the shares to the trust. If no gift relief had been available on the initial settlement - for example if the shares had been in a quoted company - no chargeable gain would have arisen on the death of the life tenant. This is simply because the gain of £80,000 would have been charged to tax in the hands of the settlor at the time that he created the trust in September 2005.

### 15.3 Availability of gift relief

Whenever the trustees have made a chargeable gain on a **deemed disposal**, we should always consider the availability of **gift relief**.

In the previous illustration we calculated the chargeable gain arising to the trustees on the death of the life tenant. When the life tenant died in July 2010, the trustees were deemed to have disposed of all of the trust assets - in this case the shares - at their market value, and this produced a gain of £80,000.

On the death of the life tenant, the shares will pass to the remainderman. The remainderman is deemed to have acquired the shares with a base cost equal to their market value in July 2010, being £350,000.

As the trustees have a gain of £80,000 on a deemed disposal, we will next consider the availability of gift relief. Gift relief will be available to defer the gain, if the assets being transferred to the remainderman are **business assets** under s. 165. Gift relief will also be available under s. 260 if the transfer to the remainderman is a **chargeable transfer for IHT purposes**.

As the transfer of shares to the remainderman will take place on the **death of the life tenant, there will be a charge to inheritance tax**, because the shares will be deemed to form part of the life tenant's estate for IHT purposes. Remember, assets in a trust created before 22 March 2006 in which the deceased had an interest in possession form part of the death estate for IHT purposes. Therefore in the majority of instances, the **deemed gain that arises to the trustees on the death of the life tenant, can be held over under s.260 TCGA 1992.**

[TCGA 1992,  
s.260](#)

S.260 gift relief will not be available if the remainderman is the **spouse** of the life tenant. If a life tenant dies and the capital of the trust thereafter **passes to the spouse**, this is an **exempt** transfer for IHT purposes and is not therefore chargeable to inheritance tax. In this instance, **gift relief would only be available if the assets transferred qualified under s.165**. Finally remember that under general principles of gift relief, if a gift qualifies for relief under both s.260 and s.165, s.260 will take priority.

Assuming that gift relief can be claimed, the trustees' capital gain will be rolled over and reduces the base cost of the remainderman.

	£
Market value at death of life tenant	350,000
Less: rolled-over gain (s. 260)	<u>(80,000)</u>
Base cost (July 2010)	<u>£270,000</u>

Note that for a valid gift relief claim to be made, it must be a joint election between the trustees and the remainderman.

#### 15.4 Accumulation and maintenance trusts

Let us consider distributions from accumulation and maintenance trusts, starting by looking at the tax case of *Crowe v Appleby*. This case involved beneficiaries of an A&M trust becoming absolutely entitled to a share of the trust capital, where the trust assets included land and buildings.

Following *Crowe v Appleby*, where a **beneficiary only has an "undivided" share in land** - effectively a right to sale proceeds when the land is sold - there is **no deemed disposal by the trustees until such time that all of the beneficiaries become entitled to the land** as against the trustees.

##### Illustration 2

An accumulation and maintenance trust has two beneficiaries, Amy and Ben. Under the terms of the trust, Amy becomes entitled to a share of the trust capital on reaching a specified age. Ben is younger than Amy, and does not have an entitlement to capital. At the date that Amy becomes entitled to capital, the trust assets are 10,000 shares and an investment property. On reaching the specified age, Amy is therefore entitled to 50% of the shares and 50% of the property.

As shares are a "divisible" asset, the trustees will appoint 5,000 of the shares to Amy. This will give rise to a deemed disposal by the trustees at the date of the appointment. However, following the case of *Crowe v Appleby*, as Amy has an undivided share of the land (i.e. the trustees still hold the property on trust for Ben) the trustees will **not be deemed to have disposed of a 50% share in the property**. Instead a deemed disposal of the entire property will take place when Ben becomes entitled to his 50% share.

### 15.5 Gift relief and bereaved minors trusts / "Age 18-to-25" trusts

In a bereaved minors trust, when the beneficiary attains 18 he/she will thereafter become entitled to the trust capital. This is a deemed disposal by the trustees, potentially giving rise to a capital gain. However, **gift relief is available under Section 260** even though there is no IHT charge.

[TCGA 1992, s.260\(2\)\(da\)](#)

Where a beneficiary of an "Age 18-to-25" trust becomes entitled to trust capital - for example, at the age of 25 -an IHT exit charge arises. Therefore any gains on transfers of assets to the beneficiary will be **eligible for gift relief under Section 260**.

S.260 relief is also available where assets are appointed from an old A&M trust after April 2008, as such distributions give rise to an IHT exit charge.

### 15.6 Capital losses on appointments from trusts

In October 2010 a trust distributed an asset to a beneficiary. The asset had cost the trustees £100,000. At the time of the distribution, the asset was worth £80,000. This deemed disposal by the trustees gives rise to a loss of £20,000.

	£
Market value at appointment	80,000
Less: cost	<u>(100,000)</u>
Trustees' loss	<u>(20,000)</u>

The next question is "what can the trustees do with this loss"?

The **trustees must first set this loss against any trust gains** in 2010/11, which arise before the appointment to the beneficiary. There is no restriction to the way that the losses can be used, because the trustees and the beneficiary are not connected persons for CGT purposes. However, this loss on the deemed disposal must be used **in priority to any other trust losses in the year** up to the date of the appointment.

If some of the loss is still remaining, **the excess losses may be transferred by the trustees to the beneficiary**. For example, in this instance, if the trustees had no other gains in the year, the loss of £20,000 would pass to the beneficiary. However, the beneficiary is **only allowed to use** this loss of £20,000, **against gains on the disposal of this particular asset only**. The beneficiary cannot use the loss against general capital gains.

[TCGA 1992, s.71\(2\)](#)

Assume that in the future, the beneficiary sells the asset for £150,000. The gain would be:

	£
Proceeds	150,000
Less: base cost (MV at date of appointment)	(80,000)
Less: losses transferred to beneficiary	<u>(20,000)</u>
Capital gain	<u>£50,000</u>

Note that the loss can only be used to reduce a future gain made by the beneficiary on the **same asset**. Therefore if the asset had continued to fall in value, no relief would have been available for the trustees' capital loss.

### 15.7 Disposal of an interest in possession

[TCGA 1992, s. 76](#)

If an individual has a right to income from a trust, he or she has a valuable asset for CGT purposes. The life tenant (assuming he is not prohibited from doing so within the trust instrument) may then be free to **sell his right to income**. After the sale, the new purchaser will thereafter be entitled to the annual income of the trust.

Certain settlements - called "protective trusts" - are created in such a way that a life tenant is prohibited from trying to dispose of his right to income. Under a protective trust arrangement, if a life tenant makes an attempt to sell their interest in possession, the trust thereafter becomes a discretionary trust.

Under s.76 TCGA 1992, if a life tenant disposes of his interest in possession, **any gain is not chargeable to CGT**. This general rule will **not apply** where the original interest in possession was **acquired by the life tenant for "money or money's worth"**. Therefore, a life tenant will only have a capital gain on the sale of an interest in possession if he or she had bought the interest, for valuable consideration, in the first place.

[TCGA 1992, s.76\(1\)](#)

Anti-avoidance rules were introduced in Finance Act 2000 to block elaborate avoidance schemes which relied on the application of s.76. Consequently the **exemption** for disposals of interests in possession **does not apply if the trust is, or ever has been, non UK resident**.

[TCGA 1992, Sch 4A](#)

**Example 1**

Robert set up an interest in possession trust for his son James in March 2000 with shares in XYZ Ltd worth £220,000. A gain of £160,000 was held over on creation. James died in November 2010. The XYZ Ltd shares were worth £200,000 and passed to James' son Michael as remainderman.

**Assuming all appropriate claims are made, calculate the base cost of the XYZ Ltd shares for Michael.**

**Example 2**

**Indicate whether gift relief is available in respect of the following disposals.**

**Assume none of the trusts is a settlor-interested trust.**

	Yes	No
	✓	X
1. Gift of quoted shares by a discretionary trust to a beneficiary		
2. Gift of farmland to an interest in possession Trust created in 2004		
3. Transfer of quoted shares by a bereaved minors' trust to a beneficiary		
4. Death of a life tenant of a trust created in 2000 with trust assets passing to his son as remainderman		
5. Gift of unquoted trading company shares to an overseas trust		

**Answer 1**

Lower of:

	£
Market value at death	200,000
Less: cost £(220,000 - 160,000)	<u>(60,000)</u>
Gain	<u>140,000</u>

or

Gain held over on creation	<u>£160,000</u>
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i.e. £140,000

Base cost for Michael:	£
Market value @ James' death	200,000
Less: gain deferred (s. 260)	<u>(140,000)</u>
Michael's base cost	<u>60,000</u>

**Answer 2**

	Gift Relief	
	Yes	No
1. Gift of quoted shares by a discretionary trust to a beneficiary	✓ (s. 260)	
2. Gift of farmland to an interest in possession trust created in 2004	✓ (s. 165)	
3. Transfer of quoted shares by a bereaved minors trust to a beneficiary	✓ (s. 260(2)(da))	
4. Death of a life tenant of a trust created in 2000 with trust assets passing to his son as remainderman	✓ (s. 260)	
5. Gift of unquoted trading company shares to an overseas trust		X (Non resident donee)