CHAPTER 20

OVERSEAS TRUSTS – CGT & IHT ISSUES

20.1 Capital gains & non-resident trusts – general principles

Trustees who are not resident in the UK are not generally chargeable to capital gains tax. However, in certain circumstances, capital gains of overseas trusts may instead be charged on the settlor or beneficiaries.

Trustees should compute gains as if they were resident in the UK. Any reliefs due to UK resident trustees are given, but no annual exemption is available.

Non-resident trustees must set allowable losses against gains of the same or later tax years. They cannot set them against gains for earlier tax years. Losses cannot be attributed to a beneficiary.

20.2 Capital gains "exit charges"

TCGA 1992, S.80

Where a trust becomes non-resident, **all trust assets are deemed to be disposed of then immediately reacquired at their market value**. This will give rise to capital gains tax in the year in which the trust is exported from the UK.

TCGA 1992, S.10

There is an exception to the exit charge where the trustees have assets in the UK that they use for the purposes of a trade. If the trustees trade through a branch or agency in the UK, these assets are chargeable to CGT in any event even if the Trustees are non-UK resident. Such gains are therefore excluded from the exit charge.

TCGA 1992, S.82

If the non-resident trustees do not pay the CGT due on an exit charge within six months from the normal due date, a former trustee may be required to pay the unpaid tax and interest. The former trustee must pay it within 30 days of the issue of a notice by HMRC. This trustee must have held office in the 12 months before the trustees became not resident.
The former trustee does not have to pay the tax and interest if he shows that:

- he ceased to be a trustee before the date the trustees became not resident; &
- there was no proposal for the trustees to become not resident when he ceased to be a trustee.

20.3 Capital gains chargeable on the settlor

TCGA 1992, S.86

A **settlor will be chargeable in respect of gains arising to a non-resident trust if the settlor has retained an "interest" in the trust** for capital gains tax purposes. This can happen even if he does not have an interest for income tax purposes. This is because the definition of a "settlor interest" for CGT is much wider than it is for income tax.

The "settlor charge" will only apply in tax years in which the **settlor is UK domiciled <u>and</u> is either resident or ordinarily resident in the UK**.

The charge will **cease to apply in the year of the settlor's death** and thereafter.

A settlor is treated as having an "interest" in the non-resident trust for CGT purposes if ANY of the following persons can benefit from the trust:

TCGA 1992, Sch 5 para 2

a) the settlor;
b) the settlor's spouse / civil partner;
c) the settlor's children / step-children;
d) spouses / civil partners of the settlor's children or step-children;
e) the settlor's grandchildren / spouse's of grandchildren (only for trusts set up on or after 17 March 1998).

The settlor charge will also apply to pre-1998 grandchildren's trusts where the trust became non-resident, or property is added or additional beneficiaries are added on or after 17 March 1998.

The settlor can set off any personal losses against trust gains attributed to him under S.86.

The settlor has a right to recover any CGT from the trustees.

TCGA 1992, Sch 5 para 6

Gains caught under S.86 for 2010/11 will be **deemed to arise before 23 June 2010 and will therefore be taxed at 18%**. There is no provision for applying different tax rates depending on when the trust gains arose (as there is for UK trusts). The rate will be 28% for 2011/12.

20.4 Capital gains chargeable on beneficiaries

TCGA 1992, S.87

Beneficiaries of non-resident trusts may be chargeable to capital gains tax in respect of gains realised by the trustees.

This will usually be the case where the settlor charge under S.86 does not apply to the trust gains, either because;

- the settlor is dead; or
- the settlor was either non-domiciled or not resident in the UK; or

- the trust is not "settlor interested" (for example, the trust was set up for persons other than the settlor and/or his spouse, children or grandchildren).

20.5 Capital gains – the "matching" rules

Payments or benefits received by beneficiaries ("capital payments") are matched with gains that the trustees have made. A charge to tax will usually arise when capital gains and capital payments are matched. The principle is similar to that used for income tax under S.731.

HMRC Residency issues forms 50(FS) to trustees who are not resident in the UK to help them monitor trust gains and capital payments.

If trust gains exceed capital payments, there are "unmatched" gains. A separate record is retained of "unmatched" gains for each tax year (they are not pooled).

"Unmatched" gains can be matched against capital payments in subsequent years. **Matching is on a "last-in-first-out" (LIFO) basis.** Therefore (say), a capital payment in 2011/12 will match first with any gains in 2011/12, then with "unmatched" gains of 2010/11, then with "unmatched" gains of 2009/10 and so on.

TCGA 1992, S.87A

If capital payments exceed trust gains, these "unmatched payments" are carried forward and matched with trust gains made in future years.

Personal capital losses made by a beneficiary are not available to be set against a beneficiary's trust gains attributed to him under S.87. This is different to settlor interested trusts where attributed gains under S.86 can be offset by personal capital losses.

A capital payment is any payment that is not chargeable to income tax on the beneficiary and will include:

- The transfer of an asset (cash or otherwise);
- The conferring of any benefit (e.g., low interest loans, rent-free occupation of trust property);
- Occasions when a beneficiary becomes absolutely entitled to trust assets.

Where the capital payment is not an outright transfer of money or the transfer of an asset, the value of the capital payment for CGT purposes is the value of the benefit conferred.

In the case of a low interest loan, the value of the benefit is calculated using the notional interest rules, with interest computed using the HMRC official rate. In the case of rent-free occupation of trust property, the value is the "arms- length" rent that would be charged to a third party tenant.

For S.87 purposes, the **rate of CGT depends on when the capital payment is made**. Matched gains are taxed at;

- 18% if the capital payment was made before 23 June 2010; and
- 28% if the capital payment was made on or after 23 June 2010.

The date the Trustees made the gain is irrelevant as the "match" creates the charge.

Illustration 1

The Brown Family discretionary trust was established by Arthur Brown in 2007 for the benefit of his god-daughter Jessica. Jessica is resident and domiciled in the UK.

The trust has 2 Trustees, both of whom are resident outside the UK. The Trust has no income.

The trust has the following gains / (losses):

Year	Gains	Losses
	£	£
2008/09	40,000	(10,000)
2009/10	10,000	NIL
2010/11	48,000	(60,000)
2011/12	120,000	(18,000)

The trustees have made the following capital payments:

Year	To Jessica
	£
2008/09	NIL
2009/10	NIL
2010/11	50,000
2011/12	110,000

S.86 TCGA 1992 will not apply to the trust as the trust is not "settlor interested". Instead, trust gains will be attributed to the beneficiary under S.87.

The position for each year is as follows:

2008/09

The trust gains are £(40,000 - 10,000) = £30,000.
There are no capital payments to beneficiaries, so these gains are "unmatched".

2009/10

The trust gains are £10,000.

Again there are no capital payments to beneficiaries, so these gains are "unmatched".

These 2 unmatched gains are kept separate. They are not pooled together.

2010/11

There is a net trust loss in the year of £12,000 (£48,000 - £60,000). This loss must be carried forward to reduce trust gains of later years (i.e. 2011/12 onwards). It cannot offset gains from 2008/09 or 2009/10.

The trustees made a capital payment in 2010/11 of £50,000. This is matched with gains on a LIFO basis. There are no gains in 2010/11, so we first match with gains from 2009/10 (£10,000) before those from 2008/09 (£30,000).

Jessica is therefore chargeable on a capital gain of £(30,000 + 10,000) = £40,000 in 2010/11 and she must disclose this on her 2010/11 SA return and pay CGT accordingly. She can use her annual exemption against the gain, but she cannot offset any personal capital losses.

The process has not used up all the capital payment, so some of the capital payment is "unmatched". The unmatched balance goes forward to 2011/12.

	£
Capital payment	50,000
Less: matched with capital gains	(40,000)
Unmatched capital payment c/f	10,000

2011/12

The trust gains are £(120,000 - 18,000 - 12,000 b/f) = £90,000
The capital payment is £(110,000 + 10,000 b/f) = £120,000

Capital payments exceed trust gains, so the gains of £90,000 will be "matched" and the excess capital payments will be carried forward to 2012/13.

Jessica is chargeable on a capital gain of £90,000 in 2011/12 and she must disclose this on her 2011/12 SA return.

There are unmatched capital payments to carry forward to 2012/13 as follows:

	£
Capital payment	120,000
Less: matched with capital gains	(90,000)
Unmatched capital payment c/f	30,000

Summary of taxable gains:

	£
2008/09	NIL
2008/10	NIL
2010/11	40,000
2011/12	90,000

20.6 Non-resident beneficiaries

"Matched" gains are not necessarily chargeable on all beneficiaries. To be chargeable to UK CGT, **a beneficiary must be resident or ordinarily resident in the UK.**

If a beneficiary is non-UK resident, gains are still "matched" with capital payments (and thereby reduce trust gains), but **those matched gains are not charged to CGT**.

Therefore, for tax planning purposes, it can be a sensible course of action for non-resident trustees to make capital payments to non chargeable beneficiaries first, as this will reduce the "stockpile" of capital gains on which chargeable beneficiaries will pay tax in subsequent years.

Illustration 2

The Smith Family discretionary trust was established by Charles Smith on his death in 1999 for the benefit of his two sons, Adam and Ben. Adam is resident and domiciled in the UK. Ben is domiciled in the UK but has been resident in Australia for the last 5 years.

The trust has 2 Trustees, both of whom are resident outside the UK. The Trust assets are a collection of valuable paintings and antiques. The Trust has no income.

The trust has the following gains / (losses):

Year	Gains	Losses
	£	£
2008/09	40,000	(10,000)
2009/10	10,000	NIL
2010/11	48,000	(60,000)
2011/12	120,000	(18,000)

The trustees have made the following capital payments:

Year	Adam	Ben
	£	£
2008/09	NIL	NIL
2009/10	NIL	NIL
2010/11 (both December 2010)	30,000	20,000
2011/12	55,000	55,000

S.86 TCGA 1992 will not apply to the trust as the settlor is dead. Instead, trust gains will be attributed to the beneficiaries under S.87.

The position for each year is as follows:

2008/09

The trust gains are £(40,000 - 10,000) = £30,000.
There are no capital payments to beneficiaries, so these gains are "unmatched".

2009/10

The trust gains are £10,000.
Again there are no capital payments to beneficiaries, so these gains are "unmatched".

2010/11

There is a net trust loss in the year of £12,000 (£48,000 - £60,000). This loss must be carried forward to reduce trust gains of later years (i.e. 2011/12 onwards). It cannot offset gains from 2008/09 or 2009/10.

The trustees made capital payments totalling £50,000. These are matched with gains on a LIFO basis. There are no gains in 2010/11, so we first match with gains from 2009/10 before those from 2008/09.

These gains are attributed to beneficiaries in proportion to the capital payments received.

2009/10 gains - £10,000:

	Adam	Ben
	£	£
£10,000 x 30,000/50,000	6,000	
£10,000 x 20,000/50,000		4,000

2008/09 gains - £30,000:

	Adam	Ben
	£	£
£30,000 x 30,000/50,000	18,000	
£30,000 x 20,000/50,000		12,000

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Adam is chargeable on a capital gain of £(6,000 + 18,000) = £24,000 in 2010/11 and he must disclose this on his 2010/11 SA return and pay CGT accordingly.

As the capital payment was after 22 June 2010, the gain will be taxed at 28%.

Ben is not chargeable on the £(4,000 + 12,000) = £16,000 attributed to him. This is because he is not resident in the UK.

The process has not used up all the capital payments, so some of the capital payments are "unmatched". The unmatched balance goes forward to 2011/12.

	Adam	Ben
	£	£
Capital payment	30,000	20,000
Less: matched with capital gains	(24,000)	(16,000)
Unmatched capital payment c/f	6,000	4,000

2011/12

The trust gains are £(120,000 - 18,000 - 12,000 b/f) = £90,000
The capital payments are £(110,000 + 10,000 b/f) = £120,000

Capital payments exceed trust gains, so all gains will be "matched" and the excess capital payments will be carried forward to 2012/13. The matching is as follows:

Capital payments	Adam	Ben
	£	£
£(55,000 + 6,000)	61,000	
£(55,000 + 4,000)		59,000
Matched with gains:		
£90,000 x 61,000 / (61,000 + 59,000)	£45,750	
£90,000 x 59,000 / (61,000 + 59,000)		£44,250

Adam is chargeable on a capital gain of £45,750 in 2011/12 and he must disclose this on his 2011/12 SA return.

Ben is not chargeable on the £44,250 attributed to him because he was not resident in the UK throughout the tax year.

There are unmatched capital payments to carry forward to 2012/13 as follows:

	Adam	Ben
	£	£
Capital payment	61,000	59,000
Less: matched with capital gains	(45,750)	(44,250)
Unmatched capital payment c/f	15,250	14,750

Summary of taxable gains:

	Adam	Ben
	£	£
2008/09	NIL	NIL
2009/10	NIL	NIL
2010/11	24,000	NIL
2011/12	45,750	NIL

20.7 The "supplementary charge"

TCGA 1992, S.91

S.91 TCGA 1992 imposes an increase in the tax due under S.87.

The increase (the "supplementary charge") is intended to penalise beneficiaries where there is a delay between the trustees making capital gains and distributing those gains to beneficiaries by means of capital payments. The supplementary charge is intended to encourage overseas trusts to repatriate their capital gains without too much delay.

The "supplementary charge" is levied where gains are not distributed to beneficiaries in either the tax year in which they are made or the following tax year.

The supplementary charge is an amount of tax. It is not an interest charge (despite the fact that it is calculated as if it was interest).

There are 4 steps in the supplementary charge computation:

Step 1 - Match capital payments to trust gains on a "last in first out" basis (as in illustrations 1 & 2 above).

Step 2 - Compute the beneficiary's CGT liability on attributed gains. To do so we assume that the S.87 gains represent the lowest slice of the beneficiary's total gains (and hence qualify for the annual exemption).

Step 3 - If appropriate, apportion the tax between different years (for example, if gains of more than one year are "matched" with capital payments). This will not always be necessary. The split is based on the gains of each year.

Step 4 – Increase the CGT on attributed gains by a "supplementary charge" where gains are not distributed to beneficiaries in either the tax year in which they are made or the following tax year.

The supplementary charge is at a rate of 10% of the tax on the capital payment, multiplied by the number of years in the "chargeable period". The "chargeable period" runs from 1 December following the tax year in which the gain arose to 30 November in the tax year after that in which the gain is distributed. The chargeable period cannot exceed 6 years (therefore the supplementary charge cannot exceed 60% of the tax).

The supplementary charge will therefore be at 20%, 30%, 40%, 50% or 60% of the CGT. It will never be at 10% because the chargeable period cannot be one year – if the trustees distribute gains in the tax year following that in which the gains were made, there is no supplementary charge.

Illustration 3

Adam (in illustration 3) has no personal capital gains. He is chargeable to CGT under S.87 TCGA 1992 as follows:

	2010/11	2011/12
	£	£
Attributed gains	24,000	45,750
Less; AE	(10,100)	(10,100)
Taxable gains	13,900	35,650
CGT @ 28%	3,892	9,982

2010/11

The tax of £2,502 relates to trust gains made in 2008/09 and 2009/10, split as follows:

	2008/09 trust gains	2009/10 trust gains
	£	£
£3,892 x 18,000 / 24,000	£2,919	
£3,892 x 6,000 / 24,000		£973

The supplementary charge applies where trust gains are not distributed to beneficiaries in either the tax year in which they are made or the following tax year.

Some of the trust gains made in 2008/09 were distributed to Adam in 2010/11, therefore a supplementary charge will apply.

The "chargeable period" runs from 1.12.09 to 30.11.11 being 2 years.

The supplementary charge will therefore be £2,919 x 2 x 10% = £584.

There is no supplementary charge in respect of the 2009/10 gains as these were matched with capital payments made in the following tax year, 2010/11.

2011/12

There is no supplementary charge in relation to the 2011/12 CGT as all gains in 2011/12 are matched with capital payments in the same year.

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	2010/11	2011/12
	£	£
CGT	3,892	9,982
Add: supplementary charge	584	NIL
Total tax payable	4,476	9,982

20.8 Non-domiciled beneficiaries

Prior to 6 April 2008, the beneficiary must have been both domiciled and resident or ordinarily resident in the UK for S.87 to apply.

With effect from April 2008, where a beneficiary is UK resident but not UK domiciled and he receives a capital payment from a trust, **any attributed gain is only taxable to the extent that the capital payment is remitted to the UK**.

TCGA 1992, S.87B

This remittance basis will only apply if a claim has been made under S.809B ITA 2007 (or if the remittance basis applies automatically – i.e. where unremitted foreign income or gains are less than £2,000).

As non-domiciled beneficiaries are brought within the S.87 charge for the first time from 6 April 2008, there are transitional rules to prevent such beneficiaries from being charged to CGT either in respect of trust gains made before 6 April 2008 or capital payments made before 6 April 2008.

FA 2008, Sch 7 para 124

In effect, **a non-domiciled beneficiary of an overseas trust will only be charged under S.87 TCGA if the trust gains arise after April 2008 and the capital payment is made after April 2008.**

Even if this is the case, a CGT liability can be avoided by the beneficiary claiming the remittance basis and keeping the capital payment offshore.

Where an overseas trust is subject to the provisions of S.87 TCGA for 2008/09 onwards, the **trustees can make an election to "rebase" the trust assets to their market value at 6 April 2008** for the purpose of calculating trust gains to be attributed to non-domiciled beneficiaries.

FA 2008, Sch 7 para 126

The effect of the election is that trust gains made in 2008/09 onwards will be **apportioned between pre-6 April 2008 and post-6 April 2008 elements**. The pre-6 April 2008 element of the gain will not be taxed if matched with capital payments made to non-domiciled beneficiaries.

The **post 6 April 2008** element is the gain that would have arisen had the asset been bought for **market value at 6.4.08**.

The election is irrevocable and must be made by the trustees no later than the 31 January following the first tax year in which a capital payment is made to a UK resident beneficiary. The first elections will therefore have been made by 31 January 2010.

Illustration 4

John is the beneficiary of a trust set up in 2008 which is resident in the Cayman Islands. He is UK resident but non-UK domiciled. In December 2010 he received a capital payment of £100,000 from the trustees. The trust has no income.

The trust gains are as follows:

	£
2007/08	40,000
2008/09	50,000
2009/10	NIL
2010/11	36,000

The gain made in 2008/09 was in respect of an investment property bought in January 2007 for £100,000 and sold in March 2009 for £150,000. The property was valued at £135,000 at 6 April 2008.

The gain made in 2010/11 was in respect of quoted shares bought in June 2008 for £180,000 and sold in January 2011 for £216,000.

The trustees made an election under Sch 7 para 126 FA 2008.

Solution

2010/11

£36,000 of the capital payment is matched with the gain in 2010/11. The whole of the 2010/11 gain arises after 5 April 2008, so the gain is fully attributed.

John is non-domiciled. Therefore this £36,000 is a foreign capital gain. This gain will either be:

- charged to UK CGT if John is not a remittance basis user; or
- charged to UK CGT if John claims the remittance basis under S.809B and if the capital payment is brought into the UK.

2009/10

There are no gains in this year so there is no "match".

2008/09

£50,000 of the capital payment is matched with the gain in 2008/09.

A rebasing election has been made, so the trust gains of £50,000 are apportioned into pre and post 6 April 2008 elements using the MV of the asset at 6 April 2008.

Post 6 April 2008 element:

	Post April 2008
	£
Proceeds	150,000
MV @ 6 April 2008	(135,000)
Post 6.4.08 gain	15,000

The post April 2008 element is chargeable. The foreign chargeable gain under S.87 is therefore £15,000.

Again this will either be:

- charged to UK CGT if John is not a remittance basis user; or
- charged to UK CGT if John claims the remittance basis under S.809B and if the capital payment is brought into the UK.

2007/08

We still have an unmatched capital payment of £14,000. This £14,000 is matched with part of the gain in 2007/08. However, trust gains made prior to 6 April 2008 are not charged on a non-domiciled beneficiary.

The balance of the gain in 2007/08 of £26,000 will be carried forward to be matched with a later capital payment. However these gains will not be charged as they arose pre April 2008.

20.9 S.10A TCGA 1992

S.10A TCGA 1992 provides that, where an individual leaves the UK and becomes resident abroad, gains made in the period in which he is not resident will not be charged to CGT unless he returns to the UK and resumes residence within 5 tax years.

There is an interaction between S.10A and the attribution of gains to beneficiaries rules in S.87.

Assume a UK domiciled individual leaves the UK and becomes non-resident. Gains attributed to him from an offshore trust in a year of non residence will not be charged to UK CGT unless the individual resumes residence within 5 tax years. In this case, the attributed gains will be charged in the year he returns to the UK.

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20.10 Interaction between S.731 ITA 2007 and S.87 TCGA 1992

There is an interaction between the "transfer of assets abroad" rules in S.731 ITA 2007 and the "capital payments to beneficiaries" rules in S.87 TCGA 1992.

The interaction will apply where;

1) a beneficiary receives a benefit from an overseas trust in a tax year;
2) the benefit takes the form of a capital payment to which S.87 TCGA 1992 applies;
3) the trust has relevant income for the year.

In this case, the benefit will fall to be taxed under both S.731 (income tax) and S.87 (CGT).

S.731 will take priority and will tax the benefit up to the amount of the relevant income pool. If the capital payment exceeds the relevant income pool, the excess benefit will be charged to CGT under S.87.

ITA 2007, S.734

ITA 2007, S.734(3)

For future years any excess benefits for income tax are reduced by matched S.87 gains.

Illustration 5

Mr Daniels (a widower with no children) is resident, ordinarily resident and domiciled in the UK. On 6 April 2007 he transferred £600,000 to a discretionary trust for the benefit of his nephews (all resident and domiciled in the UK). The trustees of the trust are resident in the Channel Islands. Mr Daniels is excluded from benefit and has no influence over the decisions of the Trustees.

The Trustees invested the settled property into equities and bonds. Income, capital gains and distributions have thus far been as follows;

Year	Income	Gains	Payments to beneficiaries
	£	£	£
2008/09	25,000	nil	£10,000 income distribution
2009/10	26,500	nil	nil
2010/11	22,500	58,000	£80,000 capital proceeds
2011/12	18,800	nil	£6,000 income distribution

S.731 ITA 2007 will apply. There was a transfer of assets to a person not resident in the UK as a result of which income becomes payable to a person abroad. S.720 will not apply as the settlor is excluded from benefit.

S.87 TCGA 1992 will also apply. The trust is not "settlor interested", so gains are only attributed to beneficiaries when capital payments are made.

Taking each year in turn:

2008/09

The £10,000 income distribution is matched with relevant income pool of £25,000. The £10,000 is charged to income tax in the hands of the recipient in 2008/09. A balance of £15,000 in the relevant income pool is carried forward.

2009/10

No payments are made to beneficiaries so no charges arise. A further £26,500 is added to the pool. The relevant income pool carried forward is £41,500.

2010/11

A capital payment of £80,000 is made to a beneficiary. In the first instance, this is a benefit to which S.731 will apply. The benefit is matched with the relevant income pool;

	£
2008/09 income	25,000
Less: distribution	(10,000)
Pool c/fwd	15,000
2009/10 income	26,500
	41,500
Less: distribution	(NIL)
Pool c/fwd	41,500
2010/11 income	22,500
	64,000
Less: distribution	(80,000)
Pool c/fwd	NIL

The excess capital payment £(80,000 – 64,000) = £16,000 is matched with capital gains and taxed under S.87 TCGA 1992. This leaves unmatched capital gains of £(58,000 – 16,000) = £42,000 which are available for matching with future capital payments.

The beneficiary receiving the £80,000 will therefore have the following SA reporting in 2010/11:

S.731 income	£64,000
S.87 gains	£16,000

An annual exemption will be available to reduce the gains. There is no supplementary charge as the gain is matched with a payment of the same tax year.

2011/12

Excess benefits for income tax purposes are reduced by matched S.87 gains (to avoid future double taxation). A S.731 charge therefore arises in 2011/12 as follows;

	£
Excess benefits for income tax £(80,000 – 64,000)	16,000
Less: matched under S.87	(16,000)
	NIL
Relevant income 2011/12	18,800
Less: matched benefits	(6,000)
Relevant income pool c/fwd	12,800

20.11 Inheritance tax

For inheritance tax purposes, **trusts are domiciled where the settlor was domiciled at the time he made the settlement**. This will not change even if the settlor later changes his domicile.

The domicile of the trust is different to its residence status. For example, a trust established by a non-domiciled settlor with trustees resident in the UK will be UK resident but non-UK domiciled.

Assets held by a non-domiciled trust are excluded property if such assets are situated outside the UK. Therefore any transfers of such assets will be ignored for IHT purposes, even if the settlor subsequently becomes actually domiciled or deemed domiciled in the UK.

TCGA 1992, S.48(3)

For this reason, "excluded property trusts" have become popular vehicles for non-UK domiciliaries who have been long-term resident in the UK and who are shortly to become deemed domiciled by virtue of the 17-year rule in S.267 IHTA 1984.

Foreign assets can be settled on trust by a non-UK domiciliary for the benefit of the settlor (and his family if appropriate) and **those assets will be outside the scope of IHT on his death** (or in the event of a subsequent transfer).

If a settlor adds property to an excluded property trust after he has become UK domiciled, HMRC treat the addition as a separate trust and the added property will be within the charge to IHT.

The initial transfer of assets to the trust can however result in a CGT charge with no possibility of gift relief, as the trust will be settlor interested.

It is common practice for excluded property trusts to be resident outside the UK, but this is not essential to secure IHT protection.

20.12 Exit and principal charges

Where a non-resident trust is created by a UK domiciled settlor (and therefore has UK domicile status), **the worldwide trust assets are "relevant property" and are thereby still subject to exit and principal charges** as for UK trusts. The fact that the assets may be foreign assets held by non-resident trustees is irrelevant.

Where a non-resident trust is created by a non-UK domiciled settlor (and therefore has non-UK domicile status), **any trust assets held outside the UK are "excluded property". These assets are therefore not subject to exit and principal charges**.

Non-domiciled trustees can therefore exchange UK assets for non-UK assets prior to a 10-year anniversary in order to avoid a principal charge. For example, switching cash from a UK bank to an offshore account will reduce IHT the exposure.

Example 1

The Broccoli Family trust was established by Alberto Broccoli on his death in 1998 for the benefit of his two grandchildren, Bella and Christina. Alberto was Italian and the Trustees are all resident in Switzerland. Both Bella and Christina were born in Italy, but in 2006 Bella married David (a UK citizen) and has since settled permanently in the UK. Christina still lives in Italy.

The trust has the following gains / (losses) and has made the following capital payments in recent years:

	Trustees		Capital payments	
Year	Gains	Losses	Bella	Christina
	£	£	£	£
2009/10	100,000	(20,000)		30,000
2010/11	NIL	(30,000)	60,000	20,000
2011/12	97,500		20,000	15,000

Trust income is small and is covered by management expenses.

Show the amounts chargeable to capital gains tax on Bella and Christina for 2009/10 to 2011/12 inclusive and identify any unmatched gains or unmatched capital payments at 6 April 2012.

Answer 1

2009/10

The trust gains are £80,000.

The trustees made a capital payment to Christina of £30,000. This is matched with the capital gains leaving "unmatched" gains of £50,000.

Christina is not chargeable on the £30,000 attributed to her because she is not resident in the UK.

2010/11

There is a trust loss in the year of £30,000. This loss must be carried forward to reduce trust gains in 2011/12 (it cannot offset the unmatched gains £50,000 from 2009/10).

The trustees made capital payments totalling £80,000. There are no gains in 2010/11, so these payments are matched with the £50,000 of unmatched gains from 2009/10.

Trust gains are attributed to the beneficiaries in proportion to the payment each received.

	Bella	Christina
	£	£
£50,000 x 60,000/80,000	37,500	
£50,000 x 20,000/80,000		12,500

Bella is chargeable on a capital gain of £37,500 in 2010/11 and she must disclose this on her 2010/11 SA return.

Christina is not chargeable on the £12,500 attributed to her.

Excess capital payments are "unmatched" and are carried forward to 2011/12.

	Bella	Christina
	£	£
Capital payment	60,000	20,000
Less: matched with capital gains	(37,500)	(12,500)
Unmatched capital payment c/f	22,500	7,500

2011/12

The trust gains are £(97,500 – 30,000 loss b/f) = £67,500

The capital payments are £(35,000 + 30,000 b/f) = £65,000

Capital gains exceed capital payments, so all payments will be "matched".

	£
Trust gains	67,500
Less: matched with capital payments	
Bella £(22,500 + 20,000)	(42,500)
Christina £(7,500 + 15,000)	(22,500)
Unmatched gains	2,500

Summary of taxable gains;

	Bella	Christina
	£	£
2009/10	NIL	NIL
2010/11	37,500	NIL
2011/12	42,500	NIL

Note:

Bella has settled permanently in the UK and consequently will be treated as both resident and domiciled in the UK. If she had not acquired a UK domicile, the "matched" gains would be foreign chargeable gains and would be taxed on the remittance basis (if she elected under S.809B ITA 2007).