Section 80 TCGA 1992: in Breach of Community Law?

by Claire Simpson

The Scenario

A trust with United Kingdom resident trustees has assets in the United Kingdom and/or abroad. For whatever reason, it is desirable to appoint non-resident (and not ordinarily resident) trustees.

The Problem

Section 80, Taxation of Chargeable Gains Act 1992 ("TCGA 1992") provides:

> "(1) This section applies if the trustees of a settlement become at any time ("the relevant time") neither resident nor ordinarily resident in the United Kingdom.
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> (2) The trustees shall be deemed for all purposes of this Act-
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> (a) to have disposed of the defined assets immediately before the relevant time, and
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> (b) immediately to have reacquired them,
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> at their market value at that time.
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> (3) Subject to sections (4) and (5) below[1], the defined assets are all assets constituting settled property of the settlement immediately before the relevant time..."

Thus, a deemed disposal of trust assets is trigged, purely as a consequence of the trustees becoming neither resident nor ordinarily resident in the United Kingdom.

The Solution?

Many of us are familiar with the judgment of the European Court of Justice in Case C-9/02 *de Lasteyrie du Saillant* [2004] ECR I-2409. The case concerned the compatibility with Community law of exit charges levied on an individual who leaves one Member State for another. Under Article 167 *bis* of the French Code Général des Impôts, a tax charge was levied on individuals with substantial shareholdings who left France and became resident elsewhere. The charge was calculated by reference to accrued but unrealised gains. The tax charge could be deferred (and in some cases avoided), but only after a series of burdensome administrative requirements were met and guarantees given.

M. de Lasteyrie left France to live in Belgium and was taxed accordingly. He challenged the French legislation under Article 43 EC (freedom of establishment). The ECJ ruled that, while the measure did not prevent a taxpayer from exercising his freedom of establishment, it had, at the very least, a dissuasive effect on taxpayers wishing to leave France: they either had to pay up, or put up property as a guarantee, which in itself deprived the taxpayer of the enjoyment of that property. Such a measure therefore hindered the freedom of establishment, contrary to Article 43 EC.

A number of justifications were advanced by France (and other intervening Member States, although - somewhat surprisingly - the United Kingdom did not intervene): the fight against tax avoidance together with the efficiency of fiscal controls; the need to prevent erosion of the tax base; the cohesion/coherence of the tax system; and the distribution of the power to tax between the Member State of departure and that of destination.

None of the justifications was accepted by the ECJ. In particular, in agreement with Advocate General Mischo, it noted that there were less restrictive means of combating tax avoidance. For example, the exit charge could be levied if individuals left France, sold their assets, and shortly thereafter returned to France – in such a case it might more legitimately be presumed that avoidance was key.

The case has already had a big impact.

France has amended its legislation in the light of *de Lasteyrie*. The Netherlands has a similar exit tax system to the French. It has sought to apply its legislation more in line with *de Lasteyrie*, and has referred a case on the compatibility of its own exit tax with Articles 18 and 43 EC: Case C-470/04 *N. v Inspecteur van de Belastingdienst Oost*.

The Commission has sent a reasoned opinion under Article 226 EC to Germany, requesting it to abolish the German income tax levied on the unrealised capital gains of emigrating shareholders[2]. It is also examining the exit tax rules of other Member States with a view to ensuring their compliance with the EC Treaty. Commission Working Party IV on Direct Taxation has produced a working paper on Exit Taxes. This proposes a number of solutions to the exit tax problem, including the Member States sharing taxing rights once the relevant assets are finally disposed of – by reference either to the holding periods in each State, or the gains which accrued in each of the States.

It takes little imagination to see how the principles espoused by the ECJ in *de Lasteyrie* might be applied to challenge the legality of a s.80 charge. Article 49 EC (freedom to provide services) is the most obvious ground of challenge, for s.80 clearly acts as a hindrance to the supply of services of trustees from other Member States. Depending on the factual circumstances, Article 39 EC (free movement of workers) or Article 43 EC might also provide grounds of challenge – for example, where the newly-appointed trustees are resident in another Member State and the settlor of the trust wishes to leave the United Kingdom to work or establish himself in that (or another) Member State[3].

Article 56 EC prohibits restrictions on the free movement of capital, which of course includes restrictions in respect of third, non-EU countries. Could Article 56 EC be relied upon to challenge a s.80 charge on the appointment of, say, Jersey trustees?

There are in my view a number of problems with such an argument. First, Article 56 EC only applies in relation to fiscal measures introduced after 31 December 1993: Article 57(1) EC. This would prevent any "third country" challenge to s.80, which was introduced prior to that date. Second, it is difficult, in the average case, to see that any "capital movement" occurs on the mere appointment of non-resident trustees. Finally, the ECJ may be more sympathetic to the concerns of Member States to prevent tax avoidance where third countries are involved.

Following *de Lasteyrie* it remains however the case that natural (and, perhaps, legal[4]) persons should be able to establish themselves or work in other Member States, and trustees should be able to provide services from other Member States, without facing a charge to tax simply because of a change of residence. The opportunities which present themselves are obvious – taxpayers may migrate from high to low tax jurisdictions without incurring immediate exit penalties. This is likely to be particularly attractive given the arrival of new Member States with low rates of tax..

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[1] Broadly speaking, UK situs assets used for the purposes of a UK trade carried on by trustees through a UK permanent establishment are not "defined assets", nor are assets specified in any double taxation relief arrangements and on which the trustees would not have been liable to capital gains tax (under such arrangements), had the assets been disposed of before the trustees became non-resident.

[2] More details can be found in press release IP/04/493, which can be accessed at http://europa.eu.int/rapid/

[3] Within the EU, Cyprus, Gibraltar, Estonia, Poland and Madeira are all fiscally attractive jurisdictions.

[4] It is a moot point – and the subject of another article - whether the Daily Mail jurisprudence (Case 81/87) should now be re-visited and there should be no taxes on capital gains in respect of companies 'emigrating' from the United Kingdom. This topic will be examined by a future Commission Working Party, with no doubt interesting results.