

A trust CGT trap – Crowe v Appleby (Lecture P1279 – 11.18 minutes)

Background

When the beneficiary of a trust becomes absolutely entitled to a trust asset, the trustees are generally treated as having disposed of the asset and reacquired it at market value for capital gains tax (CGT) purposes.

The trustees then hold the asset as bare trustees for the beneficiary, until the asset is appointed to that beneficiary (TCGA 1992, s 71(1)).

IHT and CGT charges

For inheritance tax (IHT) purposes, most lifetime trusts created these days are 'relevant property' (e.g., discretionary) trusts. When a beneficiary becomes absolutely entitled to relevant property, there is normally an immediate IHT ('exit') charge on the trustees (IHTA 1984, s 65).

To prevent simultaneous CGT and IHT charges arising on the same event, a CGT holdover relief claim is generally available (under TCGA 1992, s 260), subject to certain exceptions and alternative conditions. One of those conditions is that there is an immediately chargeable lifetime transfer for IHT purposes (section 260(2)(a)). This will normally be the case where a beneficiary becomes absolutely entitled to a discretionary trust asset.

For example, the trustees might appoint a buy-to-let property to a discretionary trust beneficiary. However, what is the CGT position if the trust holds a single asset such as a plot of land for several beneficiaries in undivided shares?

Crowe v Appleby

In *Crowe v Appleby* Ch D 1975, 51 TC 457, a parent died in 1938, leaving in his will the residue of his estate to trustees on trust in certain shares for the benefit of his five children. The share of each child was held on protective trusts for their benefit for life. One child ('G') died in August 1952. His 5/30ths share of residue devolved on his son. Another child ('C'), who was the life tenant of a further 5/30ths of residue, died in May 1968. Her share devolved on her two children as tenants-in-common in equal shares. The testator's other three children were alive and were life tenants of 9/30ths, 6/30ths and 5/30ths of residue respectively. The trust residue consisted of freehold property. The trustees sold the freehold property in 1969.

The Inland Revenue (as they were then) raised CGT assessments for the tax years 1968/69 and 1969/70. On appeal, there were potentially two issues for the Commissioners and ultimately the Courts to consider: (1) firstly, whether for CGT purposes on the death in 1968 of beneficiary C with a 5/30ths share of the testator's residuary estate, the trustees were deemed to have disposed of the whole of the assets or only a 5/30ths share of their sale proceeds; and (2) secondly, the amount of the chargeable gain for CGT purposes arising on the sale in 1969 of the freehold property.

In the High Court, the leading judgment was given by Goff J. Held: it was not possible to segregate a share in the notional proceeds of sale of unsold land; the son of beneficiary G and the children of beneficiary C were unable to direct the trustees how to deal with their respective shares, because they couldn't call for immediate payment of their respective shares, or interfere with the exercise of the trustees' discretion to postpone sale, and so they weren't absolutely entitled as against the trustees.

Holdover restriction?

The principle established by the judgment of Goff J in *Crowe v Appleby* gives rise to a potential CGT 'trap'.

Example: Industrial unit

A will trust holds an industrial unit in London for three children (Alison, Brian and Claire) to take in equal shares absolutely at age 25. Alison reached age 25 in May 2017; Brian was 25 in June 2019; and Claire was 25 in July 2021. The property is standing at a gain for CGT purposes.

The three beneficiaries reached age 25 in different tax years. However, it is only when Claire reaches 25 in the tax year 2021/22 that the beneficiaries can direct the trustees to transfer the property to them, and a CGT charge then arises under TCGA 1992, s 71.

Unfortunately, holdover relief under TCGA 1992, s 260 can only be claimed in respect of the gain attributable to Claire's interest, so the trustees are liable to CGT on the balance. This is because there is only a simultaneous IHT and CGT charge when the youngest beneficiary (Claire) reached age 25 in July 2021. The other two beneficiaries, Alison and Brian, became absolutely entitled for IHT purposes at age 25, in May 2017 and in June 2019 respectively. As there is no simultaneous IHT and CGT charge in respect of them, the condition for claiming CGT holdover relief is not met on their share of the gain.

Crowe v Appleby involved a legacy of freehold property in trust. However, in some cases an individual's will might leave the trust an undivided share in land, as opposed to (say) an entire plot of land. In such cases, according to HMRC's guidance the principle from *Crowe v Appleby* is not considered to apply, because that share is readily divisible (see HMRC's Capital Gains manual at CG37543).

Other assets

The *Crowe v Appleby* principle may apply to assets other than land if those assets are indivisible. For example, the trustees may hold a valuable antique, or an expensive item of jewelry. However, if the trustees sell the asset for cash before a beneficiary becomes absolutely entitled to an interest, the *Crowe v Appleby* principle will cease to apply, and the problem regarding holdover relief under TCGA 1992, s 260 disappears, as the cash is not a chargeable asset for CGT purposes.

If the trust has a controlling shareholding in a family or other owner-managed company, there is an argument that there is no disposal for CGT purposes on each occasion of absolute entitlement by the beneficiaries. This is on the basis that a pro-rata distribution of shares to beneficiaries would mean the value of the shares received by the first beneficiary is greater than the values received by the other beneficiaries, because the value of a majority holding would be greater than the value of the minority holdings per share (see CG37560).

However, in other cases where a trust holds a number of shares in a company, it should be possible to prevent the principle in *Crowe v Appleby* applying if the trustees have a power of appropriation over the shares, and actually exercise that power in favour of a beneficiary (or beneficiaries).

Note: The position in Scotland and Northern Ireland can differ in some respects, particularly where the trust asset is land (e.g., see CG37543).

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