On Her Majesty's Service

FIRST REPORT (SETTLEMENTS) - FINAL VERSION

SPARES

PERSONAL AND CONFIDENTIAL

TAX REFORM COMMITTEE

I attach a copy of the final version of the First Report on Avoidance, dealing with Settlement, which is now being submitted to the Chancellor. Paragraph 18 has been revised to take account of comments received on the draft. The only other changes are minor drafting amendments to make it clear that the report represents the views of the Committee and not simply those of the Working Party.

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October 1972

Inland Revenue
Somerset House

TAX REFORM COMMITTEE

FIRST REPORT ON AVOIDANCE

CAPITAL SUMS PAID TO SETTLORS - SECTION 451, INCOME AND CORPORATION TAXES ACT 1970

History

1. Section 451 was introduced in 1938 (as Section 40, Finance Act 1938), to counter an avoidance device by which it was possible to settle assets and still enjoy the income without having to pay surtax (and perhaps income tax too). To take a simple example, the settlor made a settlement under which the income was wholly accumulated. The income ranked for tax purposes as the income of the trustees; if it was a UK trust, all the income bore UK standard-rate tax, but if it was a foreign trust there was no UK tax charged on overseas income of the trust. Payments were then made to the settlor in the form of capital, not subject to tax in his hands.

2. Briefly, the section dealt with this avoidance device by providing that any capital sum paid directly or indirectly by the trustees of a settlement to the settlor (or his or her spouse) should be treated as the settlor's income for tax purposes to the extent that there was undistributed income of the settlement available to meet the payment. The expression "capital sum" was defined to include "any sum paid by way of loan or repayment of a loan". If the undistributed income at the end of the year of assessment in which the payment was made was less than the amount of the payment, undistributed income in later years was to be treated as the settlor's income up to the amount of the payment. To counter attempts to get round the

legislation by indirect methods (by interposing a company between the settlor and the trustees) the income of the settlement was defined to include, in certain circumstances, undistributed income of a close company in which the trustees of the settlement held shares; and a loan or a repayment of a loan by such a company counts as a similar payment by the trustees.

3. The section has been judicially criticised; in particular in CIR v de Vigier, 42 TC 24, and CIR v Bates, 44 TC 225. The criticisms have been -

i. that the section is so drafted that the settlor could be charged to surtax several times over in respect of the same amount of income which was accumulated in a year of assessment;

ii. that the settlor could be charged to standard-rate tax on an amount equivalent to the capital sum grossed up at the standard rate, although the income of the settlement has already borne standard-rate income tax as income of the trust;

iii. that in some cases the section "creates unfairness", and is a "trap" which "inflicts a severe loss on the unwary person who acts with no dishonest intention" (for example, where the settlor makes a short term loan to the trustees to enable them to take up a rights issue).

On the other hand, in the Bates case Lord Reid commented unfavourably on the fact that the decision in Potts' Executors v CIR, 32 TC 211, had not been annulled; in brief, the decision in that case was that payment by the trustees of the settlor's bills did not amount to a payment directly or indirectly to the settlor.

whole basis of charge under Section 451 should not be radically altered. All are agreed that loans by the trustees to the settlor do not merit sympathetic consideration. With regard to the repayment by trustees of loans made to them by the settlor, three possible approaches have been considered. These may be summarised thus:

View 1

Unless the settlement contained a specific provision forbidding payments of any kind to the settlor or his wife (including payments for consideration in money or money's worth - see Section 451(8)(ii)), the settlor should be deemed to have an interest in the settlement for the purposes of Section 447 with the result that the undistributed income would be assessable on him. To avoid the necessity of going to Court to get existing settlements amended there should be a provision enabling trustees to make a formal declaration to the effect that they did not propose to make any such payments to the settlor. If, nevertheless, the trustees made such a payment, assessments should be made on the settlor in respect of the undistributed income for the previous six years (or possibly such longer period as might be necessary if the payment exceeded the undistributed income in those years).

Argument for: The objective should be to make it clear beyond doubt that once a settlor had made a settlement, he had parted with the funds for good, and they could not be paid to him or his wife in any circumstance whatever.

Objection: Section 451 only applies when a capital sum (as defined in the section) is paid to the settlor or his wife. Under this proposal, if any

payment was so made, the consequences would be very much as at present in relation to capital sums as so defined. For the majority of cases the settlement provisions are not in point and it is debatable whether it is necessary to amend the law so as to affect them.

View 2

To the extent of a loan made by the settlor to the trustees, the settlement should be regarded as revocable, with the result that the settlor would be assessed to tax (under Section 446) on the proportion of the income arising under the settlement which is attributable to the loan.

Argument for: The present provisions are wrong in principle. If a settlor makes a loan to his settlement the income generated within the trust by that loan is distributed to or accumulated for the benefit of the objects of the trust; on repayment of the loan the settlor does not either in an accounting sense or in reality "enjoy" the income but merely gets his money back. The income accumulated for beneficiaries in respect of the capital in the trust represented by the loan should not enjoy a favourable rate of taxation. The proportion of the income under the settlement which is attributable to the loan, but only that proportion, should be assessed for all purposes as the settlor's income, whether it is distributed or accumulated. Accordingly the repayment of the settlor's loan should be treated as capital in his hands and if the tax burden fell where the income benefit arises, eg, by right of recovery of higher rate taxes, against the trustees, it is not correct to treat such recovery as an additional benefit to the settlor.

Objection: This proposal would mean that the whole income of a settlement could be paid to the settlor and only a proportion of it would be liable to surtax. Instead of settling a fund out-and-out the settlor could lend part of it to the trustees and enjoy the whole income of the settlement, paying surtax on only part of it. It was to meet such devices that the 1938 legislation was introduced. To a lawyer, or an accountant, the payments would no doubt rank as capital in the settlor's hands; the substance of the position would however be that he was receiving the income. In the comparable case of an investment company which is a close company, any sum expended or available out of income in the repayment of any loan capital or debt in respect of which any person is a loan creditor of the company is to be regarded as available for distribution (Section 293(1)(c)). In other words, the repayment of a loan by such a company, whether out of income or capital, is not to affect the surtax apportionment.

View 3

Those who think that View 1 goes too far, and View 2 not far enough, recommend that Section 451 should continue, subject to the amendments suggested below which are designed to meet the more specific criticisms which have been made of it. The addition of a motive test to the section might, in theory, be a way out, but there are very strong practical arguments against such a test and without it, it is not practicable to devise legislation which would let out short-term loans; as the Bates case showed, a series of short-term loans may be scarcely distinguishable from a long-term loan.

Objection: In view of the criticisms of Section 451 it would be better to scrap it and start afresh.

5. The considered view of the majority of the Committee is that View 2 could lead to abuses and that the effective choice is between Views 1 and 3. They would have liked very much to adopt View 1 (that the whole of the undistributed income of the settlement should be taxed as the settlor's unless the settlement contained a provision specifically prohibiting all payments to him), but they doubted whether this would be politically acceptable. There would be no particular problem about settlements created in the future, but it might be regarded as onerous, and unnecessary, to require that trustees of all existing settlements should execute a declaration to the effect that they did not propose to make any payments to the settlor. The majority therefore favour View 3 - that Section 451 should be retained, but amended to meet the specific criticisms which have been made of it, and to correct some of the defects in the Section. In the paragraphs which follow, the suggested amendments are considered.

Right of Recovery

6. The suggestion was made that if a settlor was assessed to tax under Section 451, he

should be given a right to recover such tax from the trustees. There would be no objection in principle to giving such a right, but the corollary could be that any reimbursements would themselves be subject to surtax. They could be regarded as capital payments to the settlor. Elsewhere in the settlements legislation the settlor is given a right of recovery in respect of tax assessed on him and such reimbursements do not attract a liability to tax. These rights are however in respect of income which the settlor has not received; the position under Section 451 is not analogous. In view of this continuing liability, we had some doubt whether it was worthwhile introducing a right of reimbursement in such circumstances.

Loans by connected companies

7. Section 451(4) provides that any capital sum paid to the settlor by a body corporate connected with the settlement is to be treated as having been paid by the trustees of the settlement. But for some such provision, it would be possible to avoid the charge under Section 451 by accumulating income in a company in which the trustees held shares, instead of in the settlement, the company making loans to the settlor. We feel that, at least so far as trading companies are concerned, this provision goes too far and that the charge under the Section should be limited to so much of the income of the company as

has been apportioned to the trustees, but not paid to them. If this change were introduced, consideration would have to be given to cases where the company's assets included money belonging to or derived from the trustees, eg, dividends declared but not paid, or money lent by the trustees to the company.

When should the charge under Section 451 stop?

8. Under Section 451(1)(b), future undistributed income may be assessable on the settlor if the capital payment to him is more than the accumulated income in the settlement at the time of the payment. The provision was inserted to cover a case where the settlor makes a loan to the settlement and future income is used to repay the loans.
We consider that the charge under Section 451 should cease when the loan has been repaid by the trustees.

The Bates case criticisms

9. The Section should be amended to meet the specific criticisms made in the Bates case about the possibility of a double charge referred to in paragraph 3 above. This would not involve any change in the Revenue's existing practice and although it would not be worth doing on its own, it should be done if any legislation is introduced to amend Section 451.

loans by the same settlement

10. If the settlor borrows say £5,000 from his settlement and there is accumulated income of that amount in the settlement, he is charged to surtax on the £5,000 grossed up at the standard rate. If he repays the loan, the surtax is not repayable and we do not recommend that there should be any change in the law on this point. If the settlor then borrows another £5,000 and there is further accumulated income sufficient to cover the loan, under the existing law he is again chargeable to surtax on that £5,000, grossed up. It should be provided that the loans should not be treated as cumulative, so that the assessment on the original £5,000 would cover subsequent loans up to that amount.

The Potts decision

11. As stated in paragraph 3 above, in the Bates case, Lord Reid said that in at least one respect Section 451 was too narrow and he referred to the decision of the House of Lords in Potts' Executors v CIR [1951 32 TC 211]. He drew attention to the "very unsatisfactory state in which the law has been allowed to remain since the decision" in that case. In the Potts' case the settlor had a current account with a body corporate connected with a settlement. This account was credited with amounts due to him from the company for remuneration and expenses and debited with various payments made by the company to him or to third parties at his request. Surtax assessments were made on Potts on the basis that the payments to third parties debited to the account constituted loans to the settlor. It was held that the sums in question were not paid "directly or indirectly" to the the settlor and that what is now Section 451 did not

therefore apply. It would be difficult to ignore Lord Reid's strictures if legislation to meet other criticisms of the Section was introduced. We recommend that the decision should be annulled. At the same time, it is considered that it would be necessary to deal with the decision in Ramsden v CIR [1957] 37 TC 619, in which it was held that a debt constituting the unpaid balance of purchase money could not be treated as a loan. This was a decision on what is now Section 478 of the 1970 Act (about the avoidance of tax by transfer of assets abroad). The devices with which these decisions are concerned have not been significantly exploited for the purposes of Section 451, but they have been annulled by the Finance Act 1969 for income tax purposes in relation to borrowings from close companies (see now Section 286(2) of the 1970 Consolidating Act).

Definition of "connected companies" and "income arising under a settlement"

12. These terms are defined in Section 454(4) and 454(1) respectively, but there are technical defects in both of them, arising in the main from the corporation tax legislation in 1965 which should in any event be corrected. In particular -

a. Under Section 454(4), a body corporate is deemed to be connected with a settlement for the purposes of the settlements legislation in any year of assessment if it is at any time in the year a close company (or only not a close company because it is not resident in the United Kingdom) and the participators then include the trustees of or a beneficiary under the settlement. In Section 286(9) there is an extended definition of "participators" in connection with loans by

close companies, but this extended definition applies only for the purposes of Section 286. It does not therefore apply to the settlements legislation. Consequently, if trustees hold shares in a close company, a loan to the settlor by a subsidiary of that company is not within Section 451, although a loan by the parent company would be.

b. "Income arising under a settlement" includes, where the income of a body corporate has been apportioned under Section 296 (close companies) or could have been so apportioned if the body corporate were incorporated in any part of the United Kingdom, "so much of the income of the body corporate which has been or could have been apportioned to the trustees of or a beneficiary under the settlement". However, deeming a company to be "incorporated" in the United Kingdom does not enable it to be treated as a close company.

It is recommended that the settlements legislation be amended so that -

i. A company should be treated as connected with a settlement if its income can be apportioned or sub-apportioned to the trustees.

ii. The apportionable part of the undistributed income of non-resident companies can be taken into account as income arising under the settlement.

Such amendments would, of course, apply for the purposes of the settlements legislation generally, and not only for the purposes of Section 451, and would remedy the defect disclosed by Lord Howard de Walden v CIR, 30 TC 345.

13. Section 451 is an attempt to deal with a particular problem of accumulation settlements. In the course of our review of it we have been obliged to consider whether the present basis of taxing accumulation settlements is satisfactory.

14. The undistributed income of settlements whose income is derived from annual payment covenants is treated as the income of the settlor for tax purposes, and was so treated before covenants were disallowed as a deduction for surtax purposes (Section 438(2)(a) in relation to parent/child settlements; Section 450 in relation to other settlements).

15. On the other hand, income accumulated under capital settlements is in general liable only to standard rate income tax. The law thus gives better treatment to those with capital to put into a settlement than to those who have only income out of which to provide for their families. This power to save up income from settled capital free of surtax runs counter to the general policy of the tax system under which tax relief is not due in respect of savings. The tax law admittedly makes available certain special reliefs, eg, life assurance relief, but this is available to tax-payers generally and is regulated in amount. It is quite a different matter from the surtax saving which is available without limit to any family with sufficient reserves of capital. Sometimes the accumulated income is very large indeed, running into hundreds of thousands of pounds a year. This line of argument points to the conclusion that some form of tax over and above standard rate income tax should be levied upon this income.

16. We have considered various bases on which accumulated income could be taxed and we can say no more than that, in our view, there are insuperable difficulties in the way of taxing such income as income of the settlor, or of the potential beneficiaries.

17. When the new unified system of tax takes effect in 1973-74, the income of trustees will be subject only to basic rate tax, ie, the lowest rate appropriate primarily to earned income. We recommend that income of a trust which is not immediately distributable to beneficiaries should be subject to the investment surcharge (without abatement). If the income is subsequently distributed, the beneficiary should be given credit for the basic rate tax and investment surcharge paid by the trustees.

18. This would mean that accumulated income would bear tax at 45 per cent, compared with the present standard rate of 38¾ per cent. It will not be subject to the higher rates of tax in the hands of the trustees, whatever its amount. One view expressed was that in principle accumulated income should not be subject to tax at a higher rate than the average rate which would be levied if all the income were distributed. Many beneficiaries would not be liable to tax at more than 30 per cent, and the proposed 45 per cent (compared with the present 38¾ per cent)

was high enough to meet any arguments about the taxation of accumulated income. To impose any higher charge would be unnecessary and oppressive, especially where the beneficiary was incapacitated. On the other hand, it was felt that in practice income would not normally be accumulated unless there was some tax advantage in doing so. Accordingly, the majority of the Committee suggest that, subject to the exceptions mentioned below, accumulated income should be subject to an additional accumulation charge of (say) 10 per cent which, unlike basic rate tax and investment surcharge, would not be taken into account if the income was subsequently distributed, for either repayment or grossing up purposes. In this respect the charge might be regarded as comparable with the flat rate profits tax, which applied before the introduction of corporation tax. Great complications would arise in dealing with repayments of tax in respect of, and the grossing up of, distributions made from a fund part only of which has borne the accumulation charge.

19. It is envisaged that -

a. the tax would be imposed on the undistributed income arising to the trust in the tax year;

b. there should be a period of grace of say three months after the end of the tax year within which trustees might make distributions;

c. the charge should extend to income apportioned to the trust from a company connected with the settlement (the trustees being given a power to recover from the company the amount of the charge).

It would be necessary to examine the information provisions in the tax laws; for example, the trust statements R59 and 59(a) should be made statutory.

20. The charge would not apply to charitable trusts, or to approved superannuation funds, and it is suggested that income accumulated for the benefit of a specified child of the settlor contingently on attaining an age not later than 25 should also be excepted, on the ground that such trusts might be regarded as socially desirable. If the contingency failed to happen, the accumulation charge would be imposed at that point. It is doubtful whether it would be practicable to exclude trusts for the benefit of incapacitated persons, since it would be difficult to find a workable definition of "incapacity".

21. It is envisaged that any exceptions would apply equally to income accumulated under wills or intestacies.

Releases from trust funds

22. Where income which has been accumulated is subsequently distributed, difficult questions sometimes arise as to the nature of the payment in the hands of the beneficiary. In the parent/child settlements legislation, Section 438(2)(b) provides, in effect, that all payments to or for the benefit of a child of the settlor are to be deemed to be paid as income to the extent that there is accumulated income in the settlement. Moreover, all payments out of a trust are taken into account under Section 37(3)(b) of the Finance Act 1969 in determining the measure of the charge to estate duty on the death of a beneficiary under a discretionary trust. It is recommended that the provision in the parent/child settlements legislation should be adapted so as to apply to all payments out of accumulations trusts during the subsistence of the trust, but not so as to impose an unfair burden on the eldest child who might receive accumulated income first. An exception might be made for isolated payments made for purely capital purposes out of the original capital of the trust.

23.. Where, following Pilkington v CIR, 40 TC 416, trustees advance capital from one settlement to another, the same principle should apply, viz, the advance to the trustees of the subsidiary settlement should be deemed to be income to the extent that there is accumulated income in the primary trust and should retain its quality in the hands of the trustees of the subsidiary settlement. Payments by these trustees to beneficiaries, if not otherwise chargeable to tax, would accordingly be treated as income in the beneficiary's hands.

FOREIGN TRUSTS

24. The approach to foreign trusts adopted by the present law (Section 478 of the Taxes Act) is unsatisfactory in many respects. When it bites it can have inequitable results imposing very substantial liabilities on those who neither have, nor will, receive any income (although the Revenue ensure by administrative means that in practice it does not have such unreasonable consequences). On the other hand the Section is by no means adequate to deal with all the carefully planned avoidance schemes of the large scale operators. The field in which it operates, however, is difficult to tackle because of the mobility of the assets concerned and the assumption for fiscal reasons of legal forms behind which reality can be very well concealed.

25. The possibility which we have examined is to tax foreign trusts on the same basis as we have discussed in the previous section of this paper for domestic trusts. We have recognised however that any attempt to equate their treatment must entail some modification of the rules for domestic trusts to take into account the fact that the trustees are out of jurisdiction. Hence in the proposals which follow we seek to provide in all circumstances for someone to function as do the trustees of a resident trust - in different circumstances this may be the foreign trustees, the settlor or the beneficiaries. These proposals would go a long way to replace the provisions of Section 478 since the approach is a new one, but in residual cases some of the concepts behind that Section may have to be applied. However, because they will be residual cases, and because our proposed scheme generally will ensure that any reasonable purpose can be served without attracting undue liability, our proposals should have the public acceptability which may now be lacking.

Information

26. As a first step, the Revenue must obtain information from resident taxpayers at the time they make a settlement on a foreign trust rather than, as now, after the crucial events have taken place. There should be a general requirement on anyone who makes a settlement to notify the Revenue, and the latter should have power to ask taxpayers likely to be affected if they have made any settlements which they have not previously notified to the Revenue.

The simplest way of achieving this would be to include in the annual return form a question on the lines of "Have you made a foreign settlement?" Such a question may however be difficult to frame to cover all possibilities and might have to be supplemented by a questionnaire at periodic intervals to a controlled class of recipient. In addition to this requirement on settlors, beneficiaries would have to report (in so far as they are not required to do so already) the receipt of trust money, whether income or capital, and the sale of any interest under a trust.

Basis of charge

27. The settlements which would be caught would be

(i) those made by a settlor domiciled in the United Kingdom at the time he made the settlement, whatever the situs of the assets concerned; and

(ii) those made by a settlor domiciled outside the United Kingdom from assets connected with the United Kingdom.

The basis of the charge would be that once a settlor had made a foreign settlement the beneficiaries of which could include United Kingdom residents, there would be a liability to pay tax of that amount which the trustees would have paid had the trust been resident, ie basic rate income tax, investment surcharge and accumulation charge where appropriate as proposed in paragraphs 16 to 20 above, less any tax actually borne by the trustees on any income of the trust derived from the United Kingdom. Since domestic trustees will be entitled to a tax credit in respect of qualifying distributions, there would also be such entitlement in the case of foreign trusts.

28. There are alternative ways of fixing liability for the tax. The first would provide that it falls on the foreign trustees with recourse in the absence of payment to the settlor and beneficiaries. This would follow our proposals for domestic trusts as closely as possible and would provide the simplest scheme if the trustees wished to pay the tax falling due. But it would be going beyond anything we now do to charge foreign residents with United Kingdom tax on the income from such of the settled assets as they chose to invest abroad.

The second course, and the one we prefer, is to provide that the liability is that of the settlor (with recourse to the beneficiaries in the absence of payment). This would be a realistic approach if the object of the action is to counter avoidance of tax: it would have to be framed in such a way that, if the trustees chose to reimburse the settlor or a beneficiary for the tax, the outlay would be recognised in their country as a payment of tax in respect of which double taxation relief in that country should be given.

The position of the settlor

29. Whichever of these courses were adopted the measure of the charge on the settlor would be that which would have been due from the trustees had the trust been resident in the United Kingdom. This would be due from him even though he had divested himself of the assets or any control over them. If, as a result of this lack of control, he was unable to get the necessary information from the trustees, the assessment would have to be estimated on the basis of the amount of the assets settled: there would therefore have to be provision for the Board (subject to appeal to the Special Commissioners) to make estimated assessments. If any payment was subsequently made to a resident beneficiary on which he was liable to tax, the basic rate tax and investment surcharge would be repaid to the settlor pro rata to the distribution as a parallel to what would be done in the domestic field. The settlor would however remain liable for the accumulation charge.

30. Thus even though the settlor had no interest in the trust whatsoever and had not set it up for avoidance purposes, an ill-advised man could find himself liable to meet the tax falling due from his own resources. Although this is an extreme and improbable case, provision would therefore have to be made should he not be able to pay. Even if such measures did not always appear to work equitably they would be essential if the principle that the treatment of foreign and domestic trusts should be equated is to be followed. The principles to be adopted would be

a. so that a settlor should not be able to escape liability by divesting himself of his assets it would pass to the trustees of any other settlement he had made if he could not meet the liability himself or had died;

b. any liability still remaining would pass to the potential beneficiaries of the settlement.

After the settlor had died it would be unreasonable to expect the beneficiaries of his estate to meet the subsequent liability; there would have to be provision for the potential beneficiaries of the settlement then to assume complete responsibility for the tax.

<u>The position of the beneficiaries</u>

31. In principle it would be possible to give a potential beneficiary who found himself accountable for the tax as described a statutory right to recover it from the foreign trustees. But this would be of doubtful value since it would not be enforceable in the country of residence of the trustees. Hence while in practice one would normally expect trustees to ensure that no hardship arose from payment of the tax - and where they did pay the tax it should not be treated as income in the hands of the beneficiaries - nevertheless payment by the potential beneficiaries - even though a matter of last resort - presents some difficulties in theory.

32. One possibility would be to wait until any beneficiary received a payment (income or capital, direct or indirect) and then seek to collect the accumulated liability from that beneficiary together with interest to cover the years of tax-free accumulation up to the full amount of the payment received. If payment was made to a non-resident beneficiary, he would become accountable if he subsequently became resident. Obviously, such an arrangement would be easy to circumvent and for that reason the majority of us do not favour it.

33. The alternative would be to seek to collect the tax from potential beneficiaries as the income was accumulated. This would be in keeping with the general scheme of seeking someone to assume the responsibilities of domestic trustees, but its application would introduce into the new scheme some of the difficulties now inherent in Section 478. One solution would be to make any potential resident beneficiary who was a connected person within the meaning of Section 533, liable to the tax in full (so however that the total tax due from all such beneficiaries should not exceed the total tax arising). Another, which we prefer because it is more specific, would be to list the potential resident beneficiaries in accordance with the laws of intestacy and seek the tax from them in that order. If a payment was subsequently made to a resident beneficiary other than the one who had paid the tax, the basic rate tax and investment surcharge which would normally be credited to the recipient of the payment might be repaid instead to the beneficiary charged (once the recipient had paid the corresponding tax), although the person originally charged would have to bear the accumulation charge.

Arrangements

34. When a foreign trust is set up it is often part of a web of foreign companies and subsidiary trusts. Power would be needed to enable the substance of the arrangements to be looked at as a whole, so that foreign companies controlled by United Kingdom or foreign trustees would be treated on the same lines as United Kingdom close companies or as though they were trusts. Thus the definitions of settlor, settlement etc would have to be drawn very widely. Any artificial limitation on the application of the provisions would quickly be exploited.

Existing trusts

35. Apart from that relating to the provision of information, the above proposals would relate only to settlements made after the introduction of the new system. However, the trustees of a foreign trust set up before that date would be able, if they so wished, to change its residence and bring it into the United Kingdom. If they did not do so, the settlor could be given the option to pay tax under the new provisions in respect of the current and subsequent years or for the trust to remain within the ambit of Section 478. If the trust had been set up for non-avoidance reasons clearly the latter would be chosen.

36. Existing trusts would be brought within the proposal designed to obtain information. On the first occasion that the questionnaire was issued it would seek information about any settlement a taxpayer had set up still in being.

Conclusion

37. We had hoped that it would have been possible to have reached a conclusion providing for the repeal of Section 478. Apart, however, from the need to retain it for existing trusts which do not change their residence or opt for the new scheme, there will be some cases, such as transfers to foreign investment companies, which would not be covered by our proposals on foreign trusts. After a few years' experience of the legislation we propose on foreign trusts, it might be possible to add extra provisions to cover these other cases as well but in the meantime our proposals should take priority so that Section 478 should apply only to the residue. There are some defects in the Section, in particular in relation to foreign partnerships, which will need

remedying in the course of reshaping the provisions and the power to enable arrangements to be looked at as a whole, mentioned in paragraph 33, should apply to Section 478 as to our proposed scheme.