

BOARD OF INLAND REVENUE FINANCE (No. 2) BILL 2005
CLAUSES 23 - 45
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EXPLANATORY NOTE

**CLAUSES 23 - 45 AND SCHEDULE 1: TRUSTS WITH
VULNERABLE BENEFICIARY**

SUMMARY

1. Clauses 23 to 45, which together make up Chapter 4 of the Finance (No. 2) Bill, create a new tax regime for certain trusts with vulnerable beneficiaries. They determine which trusts and beneficiaries will be able to elect into the regime and, where a claim for special tax treatment is made for a tax year, provide for no more tax to be paid in respect of the relevant income and gains of the trust for that year than would be paid had the income and gains accrued directly to the beneficiary. The changes will take effect from 6th April 2004.

DETAILS OF THE CLAUSES

CLAUSE 23: INTRODUCTION

2. Clause 23 sets out how the legislation for the new tax regime for certain trusts with vulnerable beneficiaries will take effect.
3. Subsection (1) explains what income and gains will be subject to the new regime – that is income and gains arising from property held on qualifying trusts for the benefit of a vulnerable person.
4. Subsection (2) explains that Clause 24 sets out legislation for making claims for special treatment.
5. Subsection (3) explains that Clauses 25 to 29 contain the rules relating to income tax.
6. Subsection (4) explains that Clauses 30 to 33 contain the corresponding rules for capital gains tax.

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7. Subsection (5) explains that Clauses 34 to 36 contain the rules which determine whether trusts on which property is held are qualifying trusts for the purposes of the new regime.
8. Subsection (6) defines a “vulnerable person election” as one which is made under Clause 37.
9. Subsection (7) defines a “vulnerable person” as being a disabled person or relevant minor as defined in Clauses 38 and 39.

CLAUSE 24: ENTITLEMENT TO MAKE CLAIM FOR SPECIAL TAX TREATMENT

10. Clause 24 provides for trustees to be entitled to make a claim for special tax treatment for a tax year if, in that year, they hold property on qualifying trusts for a vulnerable person, and a vulnerable person election has effect at some time in the year in relation to those trusts and that person.

CLAUSE 25: QUALIFYING TRUSTS INCOME: SPECIAL INCOME TAX TREATMENT

11. Clause 25 makes provision for special income tax treatment under the new regime to apply.
12. Subsection (1) provides that the clause has effect for a tax year when income arises to the trustees from property held on qualifying trusts for the benefit of a vulnerable person (“qualifying trusts income”) and a claim for special tax treatment for the tax year has been made.
13. Subsection (2) provides that, where the clause has effect for a tax year, the special income tax treatment described in Clauses 26 to 29 applies for the tax year.
14. Subsection (3) provides that Clause 25 does not apply if the settlor is regarded as having an interest in the property from which the qualifying trusts income arose. “Settlor” is defined by reference to section 660G of the Income and Corporation Taxes Act 1988 (ICTA).

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CLAUSE 26: AMOUNT OF RELIEF

15. Clause 26 sets out how the amount of income tax relief under the new regime will be calculated.
16. It is the difference between two amounts. The first of those amounts is what (were it not for the provisions of Chapter 4 of the Finance (No. 2) Bill) the income tax liability of the trustees would be in respect of the qualifying trusts income for the tax year. This amount is determined in accordance with the rules in Clause 27 (“TQTI”). The second amount is the amount of extra tax to which the vulnerable person would be liable if the qualifying trusts income were that person’s own income. This amount is determined in accordance with the rules in Clause 28 (“VQTI”).

CLAUSE 27: TRUSTEES’ LIABILITY: TQTI

17. Clause 27 determines what the amount of the trustees’ income tax liability in respect of the qualifying trusts income would be for the tax year were it not for the provisions of Chapter 4 of the Finance (No. 2) Bill.
18. Subsection (1) explains that “TQTI” is the amount of income tax to which the trustees would be liable for the tax year in respect of the qualifying trusts income, disregarding any claim for special income tax treatment under Chapter 4.
19. Subsection (2) provides, in applicable cases, for an apportionment of trust management expenses to be made between qualifying trusts income and other income.
20. Subsection (3) provides that the clause is subject to Clause 29, which applies where a vulnerable person election has effect for part only of a tax year.

CLAUSE 28: VULNERABLE PERSON’S LIABILITY: VQTI

21. Clause 28 sets out how “VTQI” - the amount of extra tax for which the vulnerable person would be liable if the qualifying trusts income were that person’s own income – is to be calculated for the purposes of Clause 26.

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22. Subsection (1) provides that “VTQI” is equal to the difference between two amounts, “TLV1” and “TLV2”. TLV2 is determined in accordance with subsection (2) and, if it applies, subsection (4). TLV1 is determined in accordance with subsection (3) and, where applicable, subsection (4).
23. Subsection (2) provides that TLV2 is what the vulnerable person’s total income tax and capital gains tax liability for the tax year would be if his or her income tax liability were computed subject to subsections (5) and (6).
24. Subsection (3) provides that TLV1 is what TLV2 would be if the qualifying trusts income for the tax year in respect of which the trustees are liable to income tax were to be the vulnerable person’s own income.
25. Subsection (4) provides that, where the vulnerable person is “non-UK resident” during the tax year (see paragraph 28 below), his or her income tax liability for the purposes of determining TLV1 and TLV2 is to be calculated in accordance with the Income Tax Acts on the following basis. It is to be assumed that the person is resident and domiciled in the United Kingdom throughout the tax year, and that the person’s capital gains tax liability for the purposes of determining TLV1 and TLV2 is to be calculated on the assumption that his or her “taxable amount” (see paragraph 50 below) for the purposes of section 3 of the Taxation of Chargeable Gains Act 1992 (TCGA) for the tax year is equal to his or her “deemed CGT taxable amount” (see paragraph 28 below).
26. Subsection (5) excludes any income which arose to the trustees but which has been distributed to the vulnerable person in the tax year from the computation of the vulnerable person’s income tax liability for the year for the purposes of determining TLV1 and TLV2.
27. Subsection (6) excludes any relief which is given by way of an income tax reduction (for example married couple’s allowance or income tax relief under the Enterprise Investment Scheme) from the computation of the vulnerable person’s income tax liability for the year for the purposes of determining TLV1 and TLV2.
28. Subsection (7) provides for the question as to whether a vulnerable person is non-UK resident to be determined in accordance with subsection (2) of Clause 41 (see paragraph 89 below), and for a non-UK resident vulnerable person’s deemed CGT taxable amount

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to be determined in accordance with paragraph 3 of Schedule 1 (see paragraph 115 below).

29. Subsection (8) provides that Clause 28 is subject to Clause 29, which applies where the vulnerable person election has effect for just part of the tax year.

CLAUSE 29: PART YEARS

30. Clause 29 determines what happens if the vulnerable person election has effect for just part of the tax year.
31. Subsection (1) provides, in such circumstances, for the special income tax treatment in Clauses 26, 27 and 28 to apply with the modifications provided for by subsection (2).
32. Subsection (2) sets out those modifications. The references in those clauses to the qualifying trusts income arising (or treated as arising) to the trustees in the tax year are to be taken as references only to income so arising (or treated as so arising) in that part of the tax year for which the election is in force. And the provision made by subsection (2) of Clause 27 in relation to the apportionment of trust management expenses is correspondingly modified.

CLAUSE 30: QUALIFYING TRUSTS GAINS: SPECIAL CAPITAL GAINS TAX TREATMENT

33. Clause 30 provides for a special capital gains tax treatment to apply in relation to chargeable gains arising to the trustees of a settlement if certain conditions are met in relation to the tax year in question.
34. Subsection (1) determines the conditions which must be met for the clause to have effect. These are that—
- chargeable gains (“qualifying trusts gains”) arise in the tax year to the trustees on the disposal of settled property held on qualifying trusts for the benefit of a vulnerable person;
 - the trustees would be chargeable to capital gains tax in respect of those gains were it not for the application of Chapter 4 of the Finance (No. 2) Bill;

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- the trustees are resident in the United Kingdom during any part of the tax year or ordinarily resident in the United Kingdom during the tax year; and
 - the trustees make a claim for special tax treatment for the tax year.
35. Subsection (2) provides for the special capital gains tax treatment to apply in any case where the clause has effect (but this is subject to the exclusion set out in subsection (3)). The treatment applies in accordance with Clause 31 if the vulnerable person is UK resident during the tax year. In any case where the vulnerable person is non-UK resident during the tax year, the special capital gains tax treatment applies in accordance with Clause 32.
36. Subsection (3) has effect to prevent the special capital gains tax treatment applying if the vulnerable person dies in the tax year.
37. Subsection (4) provides for chargeable gains which are treated as arising to the trustees by virtue of section 13 of the TCGA to be treated for the purposes of the first condition in subsection (1) as though they arose on the disposal of settled property. Section 13 has effect in certain circumstances where chargeable gains and losses arise to closely-controlled companies which have UK-based participators but which are resident in a country or territory outside the United Kingdom.
38. Subsection (5) provides that, for the purposes of this clause and Clauses 31 and 32, the question as to whether a vulnerable person is UK resident or non-UK resident is determined in accordance with the rule set out in paragraph 89 below.

CLAUSE 31: UK RESIDENT VULNERABLE PERSONS: SECTION 77 TREATMENT

39. Clause 31 determines the special capital gains tax treatment which applies where the vulnerable person is UK resident during the tax year.
40. Subsection (1) provides that the treatment is determined in accordance with the rule set out in subsection (2).

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41. Subsection (2) provides for sections 77(1), 78 and (most of) section 79 of the TCGA to apply in relation to the qualifying trusts gains (see paragraph 34 above) on the basis that—
- the vulnerable person is a settlor in relation to the settlement;
 - the settled property disposed of, and any other settled property disposed of at any time when it was “relevant settled property”, originated from that person; and
 - he or she has an interest in the settlement during the tax year.
42. Subsection (3) provides the meaning of “relevant settled property” for the purposes of subsection (2). Property comprised in the settlement is relevant settled property at any time when two conditions are satisfied. The first condition is that the property is held on qualifying trusts for the benefit of the vulnerable person. The second is that if there were to be a disposal of the property at that time, the trustees would be chargeable to capital gains tax in respect of any chargeable gains arising to them on the disposal. For the purposes of determining whether the second condition is satisfied in relation to any time falling in a tax year later than 2003-04, any special capital gains tax treatment provided by Chapter 4 of the Finance (No. 2) Bill in relation to the tax year concerned is to be disregarded.
43. The effects of subsection (2) are as follows. The trustees are not chargeable to capital gains tax in respect of the qualifying trusts gains. What happens instead is that chargeable gains of an amount calculated by reference to those gains are treated as arising to the vulnerable person in the tax year. (The amount in question is the amount of those gains, if any, which remains after deductions have been made in respect of qualifying allowable losses (see paragraph 44 below).) The vulnerable person is able to recover from the trustees the amount of any capital gains tax which consequently becomes chargeable on, and is paid by, him or her.
44. This treatment does not displace the corresponding capital gains tax provisions which apply in relation to settlements in which a UK-resident or ordinarily resident settlor has an interest. That is because a chargeable gain cannot be a qualifying trusts gain if those provisions have effect to provide that the trustees are not chargeable to tax in respect of it. Similarly, an allowable loss arising to the trustees cannot be a qualifying allowable loss unless it arises to them either on the disposal of property which is relevant settled property, or in accordance with section 13 TCGA by reference to such property (see paragraph 37 above).

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*CLAUSE 32: NON-UK RESIDENT VULNERABLE PERSONS:
AMOUNT OF RELIEF*

45. Clause 32 determines the special capital gains tax treatment which applies where the vulnerable person is non-UK resident during the tax year.
46. Subsection (1) provides that the treatment is determined in accordance with the rule set out in subsection (2).
47. Subsection (2) provides for the trustees' liability to capital gains tax for the tax year to be reduced by an amount determined as follows. The amount is equal to the difference between two quantities. The first quantity, which is called "TQTG", is the capital gains tax liability that the trustees would have in respect of the qualifying trusts gains were it not for Chapter 4 of the Finance (No. 2) Bill. The second quantity, "VQTG", is an amount determined in accordance with Clause 33. This is the amount of extra tax to which the vulnerable person would be liable if Clause 31 were to apply in relation to the qualifying trusts gains and certain assumptions were to be made.

CLAUSE 33: VULNERABLE PERSON'S LIABILITY: VQTG

48. Clause 33 determines how the amount VQTG referred to in Clause 32 is calculated.
49. Subsection (1) provides that VQTG is an amount equal to the difference between the amounts "TLVA" and "TLVB" which are determined by subsections (2) and (3).
50. Subsection (2) provides that TLVB is the total amount of income tax and capital gains tax to which the vulnerable person would be liable for the tax year if two assumptions were to be made. The first assumption is that the vulnerable person's income for the tax year is the sum of his or her "actual income" for the tax year and the "trustees' specially taxed income" for the tax year. The second assumption is that the vulnerable person's taxable amount for the tax year for the purposes of section 3 of the TCGA is his or her "deemed CGT taxable amount" for the tax year. An individual's "taxable amount" for the purposes of section 3 of the TCGA is

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what remains of the total amount of chargeable gains arising to him or her in the year after deductions have been made for any available allowable losses and any taper relief has been applied.

51. Subsection (3) provides that TLVA is the amount that TLVB would be if the vulnerable person's taxable amount for the tax year for the purposes of section 3 of the TCGA were to be the sum of two quantities. These quantities are the vulnerable person's deemed CGT taxable amount for the year and his or her "notional section 77 gains" for the year.
52. Subsection (4) provides interpretation for the references to expressions mentioned in paragraphs 50 and 51 above.
53. In broad terms, the quantity VQTG is the amount of extra tax liability for the tax year which the vulnerable person would have if chargeable gains were to be treated as arising to him or her under section 77(1) TCGA in respect of the qualifying trusts gains in accordance with Clause 31 on the assumption that he or she was resident and domiciled in the United Kingdom throughout the tax year.

CLAUSE 34: DISABLED PERSONS

54. Clause 34 determines whether property which is held on trusts for the benefit of a disabled person is held on qualifying trusts for the purposes of Chapter 4 of the Finance (No. 2) Bill.
55. Subsection (1) provides that the trusts are qualifying trusts if they secure that the conditions set out in subsection (2) are met throughout the lifetime of the disabled person or, if sooner, until the trusts terminate.
56. Subsection (2) states that the first condition is that any of the relevant property which is applied must be applied for the benefit of the disabled person. The second condition is that either the disabled person must be entitled to all the income (if there is any) arising from that property, or no such income may be applied for the benefit of any other person.
57. Subsection (3) provides that the trusts on which property is held are not to be taken to fail to meet the conditions set out at subsection (2) solely by reason of the fact that powers of

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advancement are conferred on the trustees by section 32 of the Trustee Act 1925 or section 33 of the Trustee Act (Northern Ireland) 1958.

58. Subsection (4) explains that the “lifetime of a disabled person” referred to in subsection (1) is to be interpreted as the length of time the property is held on trust for the disabled person if it is held on trusts of the kind described in section 33 of the Trustee Act 1925 (protective trusts).

CLAUSE 35: RELEVANT MINORS

59. Clause 35 determines where property which is held on trusts for the benefit of a child is held on qualifying trusts for the purposes of Chapter 4 of the Finance (No. 2) Bill. The child must be a “relevant minor” (see paragraph 78 below).
60. Subsection (1) provides that the trusts are qualifying trusts if they are statutory trusts for the minor set up under sections 46 and 47(1) of the Administration of Estates Act 1925 (rules relating to intestacy), or if they are trusts to which subsection (2) applies.
61. Subsection (2) applies to trusts which secure that the conditions in subsection (3) are met and which were established either under the will of a deceased parent of the child in question or under the Criminal Injuries Compensation Scheme.
62. Subsection (3) sets out the conditions which must be secured by the trusts. The first condition is that the minor will, on reaching the age of 18, become absolutely entitled to the property, any income arising from it, and any income from property held on the trusts for his or her benefit that has been accumulated before that time. The second condition is that, until that time, any of the property that is applied during the minor’s lifetime must be applied for his or her benefit. The third condition is that, until that time and while the minor is alive, either the minor must be entitled to all the income (if there is any) arising from any of the property, or no such income may be applied for the benefit of any other person.
63. Subsection (4) provides that trusts to which subsection (2) applies are not to be taken to fail the conditions set out at subsection (3) solely by reason of the fact that powers of advancement are

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conferred on the trustees by section 32 of the Trustee Act 1925 or section 33 of the Trustee Act (Northern Ireland) 1958.

64. Subsection (5) defines what is meant by “the Criminal Injuries Compensation Scheme”.

CLAUSE 36: PARTS OF ASSETS

65. Clause 36 provides that, for the purposes of Chapter 4 of the Finance (No. 2) Bill, references in the Chapter to property being held on trusts include reference to a part of an asset being held on trusts if that part and any income arising from it can be identified for the purpose of determining whether the trusts on which it is held are qualifying trusts.

CLAUSE 37: VULNERABLE PERSON ELECTION

66. Clause 37 contains the rules relating to the election which must be made jointly by trustees and a vulnerable beneficiary if the trustees are to be eligible to make claims for the special tax treatment under Chapter 4 of the Finance (No. 2) Bill to apply in relation to tax years for which the election is in force.
67. Subsection (1) provides that where trustees hold property on trusts for the benefit of a person, the trustees may make an election (in relation to the person and the trusts) jointly with him or her if the trusts in question are qualifying trusts and the person is a vulnerable person. The election is referred to in Chapter 4 as a “vulnerable person election”.
68. Subsection (2) provides that the election must be made by notice to an officer of the Board of Inland Revenue in such form as is required by the Board, that it must specify the date from which it is to have effect (“the effective date”), that it must be made no later than 12 months after the 31st January next following the tax year in which that date falls, and that it must contain the items specified in subsection (3). The time limit may be extended by discretion of the Board.
69. Subsection (3) sets out the information and declarations that the election must contain.

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70. Subsection (4) provides that a vulnerable person election is irrevocable.
71. Subsection (5) provides that an election has effect from the effective date until the earliest date on which one or more of certain specified events occurs.
72. Subsection (6) requires the trustees to inform an officer of the Board of Inland Revenue if the election ceases to have effect, and to do so within 90 days of first becoming aware of the occurrence of an event mentioned in subsection (5) which has caused it to cease to have effect. The information must be given by notice in writing and must contain particulars of the event concerned.

CLAUSE 38: MEANING OF “DISABLED PERSON”

73. Clause 38 defines “disabled person” for the purposes of Chapter 4 of the Finance (No. 2) Bill.
74. Subsection (1) provides that “disabled person” means a person who by reason of mental disorder within the meaning of the Mental Health Act 1983 is incapable of administering his or her property or managing his or her affairs, or a person in receipt of attendance allowance or disability living allowance at the highest or middle rate.
75. Subsection (2) provides that a person is to be treated as a person in receipt of attendance allowance or disability living allowance at the highest or middle rate if he or she satisfies an officer of the Board of Inland Revenue that a condition is met. The condition is that the person would be entitled to receive the relevant allowance if he or she were to meet the necessary residence requirements.
76. Subsection (3) provides that a person who is regarded as being a disabled person for the purposes of Chapter 4 of the Finance (No. 2) Bill because he or she is in receipt of attendance allowance or disability living allowance at the appropriate rate (or is treated by virtue of subsection (2) as being a disabled person for such purposes), does not cease to fall within the definition of “disabled person” if the sole reason that he or she is no longer in receipt of the allowance in question (or would no longer be in receipt of it if the relevant residence requirements were to be met) is that he or

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she is undergoing treatment for renal failure in a hospital or is being provided with certain accommodation.

77. Subsections (4) and (5) define “attendance allowance” and “disability living allowance”, and subsection (6) provides further interpretation.

CLAUSE 39: MEANING OF “RELEVANT MINOR”

78. Clause 39 defines “relevant minor”, for the purposes of Chapter 4 of the Finance (No. 2) Bill, as a person who satisfies two requirements. The person must not yet have attained the age of 18, and at least one of his or her parents must have died.

CLAUSE 40: POWER TO MAKE ENQUIRIES

79. Clause 40 contains provisions allowing officers of the Board of Inland Revenue to obtain information where a vulnerable person election has been made, and makes provision in cases where the Board of Inland Revenue declare that such an election is void or is no longer valid.
80. Subsection (1) provides for any officer of the Board of Inland Revenue to issue a notice to the trustees or the vulnerable person to provide such particulars as may reasonably be required to determine whether the conditions for the election to be made were met at the time it was made, or whether an event has occurred which has caused the election to cease to have effect.
81. Subsection (2) provides for the notice to specify a time limit of not less than 60 days for providing the information.
82. Subsection (3) provides that if the Board of Inland Revenue determines that any of the relevant requirements were not met at the time the vulnerable person election was made, or that an event as mentioned in subsection (5) of Clause 37 has occurred since the effective date of the election, they may determine, by giving notice to the trustees and the vulnerable person, that the election never had effect or, as the case may be, has ceased to have effect from a specified date.

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83. Subsection (4) provides that a person aggrieved by any determination of the Board under subsection (3) may appeal to the General Commissioners.
84. Subsection (5) provides that the notice of appeal must be given to the Board within 30 days after the relevant notice of determination.
85. Subsection (6) provides for all such adjustments to be made, by discharge or repayment of tax, the making of assessments etc, as are required to give effect to any determination under subsection (3).
86. Subsection (7) defines “tax” in subsection (6) to mean income tax or capital gains tax.

CLAUSE 41: INTERPRETATION

87. Clause 41 provides interpretation for Chapter 4 of the Finance (No. 2) Bill.
88. Subsection (1) provides the meaning of various expressions used in the Chapter.
89. Subsection (2) explains what is meant by a vulnerable person being UK resident, or UK non-resident, during a tax year. A vulnerable person is UK resident during a tax year if he or she is resident in the United Kingdom during any part of the tax year or ordinarily resident in the United Kingdom during the tax year. A vulnerable person is non-UK resident during a tax year if he or she is neither resident in the United Kingdom during any part of the tax year nor ordinarily resident in the United Kingdom during the tax year.
90. Subsection (3) provides for Clauses 30 to 33 and Schedule 1 to be construed as one with the TCGA. This secures that certain expressions used in those provisions have the same meaning as they have for TCGA purposes. It also has effect to provide for the time at which, for the purposes of those provisions, a disposal is made to be the time determined by that Act.
91. Subsection (4) provides that where any provision of Chapter 4 of the Finance (No. 2) Bill would not otherwise form part of the Income Tax Acts, the provisions of the Income Tax Acts are to apply for the purposes of any references in the provision to income

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arising (or treated as arising) to a person or the income tax liability of a person.

CLAUSE 42: APPLICATION IN RELATION TO SCOTLAND

92. Clause 42 provides the modifications to Chapter 4 of the Finance (No. 2) Bill that are required for the purposes of its application in relation to Scotland.
93. Subsection (1) explains that the clause sets out how the provisions of the Chapter are modified in order to apply to Scotland.
94. Subsection (2) provides for a modification to Clause 23(5), so that the reference to property held on qualifying trusts is read as a reference to property held in qualifying trusts in Scotland.
95. Subsection (3) provides for a modification to Clause 31, so that the reference to property held on qualifying trusts is read as a reference to property held in qualifying trusts in Scotland.
96. Subsection (4) provides for modifications to Clause 34, so that the references to property held on qualifying trusts and to property held on trusts are read as references to property held in qualifying trusts and to property held in trust in Scotland.
97. Subsection (5) provides for modifications to Clause 35, so that the reference in subsection (1) to property held on qualifying trusts is read as a reference to property held in qualifying trusts, the reference to statutory trusts established under the intestacy rules in subsection (1)(a) is replaced by a reference in subsection to comparable trusts established in Scotland, and the reference to trusts in subsection (2) is replaced by a reference to trust purposes in Scotland.
98. Subsection (6) provides for a modification to Clause 36, so that the reference to property held on trusts is read as a reference to property held in trust in Scotland.
99. Subsection (7) provides for modifications to Clause 37, subsections (1), (3)(b) and (5)(b), so that the references to property held on qualifying trusts and to property held on trusts are read as references to property held in qualifying trusts and to property held in trust in Scotland.

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100. Subsection (8) provides that Clause 34(3) and Clause 35(4) do not apply in Scotland.
101. Subsection (9) provides a general rule that any references to anything being held on trusts in the Chapter is, unless modified by the section, to be construed in Scotland as a reference to that thing being held in trust.
102. Subsection (10) provides a general rule that any reference to trusts is to be construed as a reference to “a trust” or “the trust” as appropriate.

CLAUSE 43: PENALTIES UNDER TMA 1970

103. Clause 43 provides for amendments to be made to section 98 of the Taxes Management Act 1970 (TMA) so as to make provision for penalties in relation to notices under subsection (1) of Clause 40 and information requirements under Clause 37. The clause also provides that, for the purposes of section 98, any information, statements or declarations made jointly by trustees and a vulnerable person are to be treated as given or made by the trustees.
104. Subsection (1) provides for amendments to section 98 TMA.
105. Subsection (2) provides for Clause 40(1) of this Act to be inserted in the first column of section 98 TMA, with the effect that any person who fails to comply with a notice under Clause 40(1) will be liable to penalties under section 98 TMA.
106. Subsection (3) provides for Clauses 37(3) and 37(6) to be inserted in the second column of section 98 TMA with the effect that any person who fails to furnish the information required under those provisions will be liable to penalties under section 98 TMA.
107. Subsection (4) provides that, for the purposes of section 98 TMA, information, statements or declarations provided jointly by the trustees and vulnerable person will be treated as made by the trustees.

CLAUSE 44: CONSEQUENTIAL AMENDMENTS

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108. Clause 44 makes some minor amendments to ICTA and the TCGA which are needed as a result of the introduction of the provisions for trusts with vulnerable beneficiaries.
109. Subsection (1) sets out that an amendment should be made to section 687(3) of ICTA, which relates to the calculation of payments out of discretionary trusts, to include relief under this Chapter in the amounts to be set off as part of the relevant calculation under section 687 ICTA.
110. Subsection (2) sets out that an amendment should be made to Schedule 4B of TCGA 1992, which relates to transfers of value by trustees and trustee borrowing, to prevent the changes made by this Chapter extending the scope of Schedule 4B.

CLAUSE 45: COMMENCEMENT

111. Clause 45 provides for the provisions in Chapter 4 of the Finance (No. 2) Bill to have effect for the tax year 2004-05 onwards.

DETAILS OF THE SCHEDULE

112. The Schedule provides interpretation for various terms used in Clauses 28 and 33.
113. Paragraph 1 provides the meaning of the “vulnerable person’s actual income” for the tax year to which the claim for special tax treatment relates. This is the income which, on the assumption that the vulnerable person was resident and domiciled in the United Kingdom throughout the tax year, would be his or her income for that year for the purposes of the Income Tax Acts.
114. Paragraph 2 provides the meaning of the “trustees’ specially taxed income” for the tax year to which the claim for special tax treatment relates. This is the income of the trustees relating to the vulnerable person in connection with which special income tax treatment applies for the tax year.
115. Paragraph 3 provides the meaning of the “vulnerable person’s deemed CGT taxable amount” for the tax year. Sub-paragraph (1) provides that this is the sum of the person’s “taxable amount” for that year for the purposes of section 3 of the TCGA (see paragraph

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50 above), calculated by reference only to “actual gains” and “actual losses”, and his or her taxable amount for the year for those purposes calculated by reference only to “assumed gains” and “assumed losses”. Sub-paragraph (2) provides that, for the purposes of determining the second of these taxable amounts, no deduction is to be made for assumed losses of any year other than the tax year in question. Sub-paragraph (3) provides that any claims and elections made in respect of assumed gains are to be disregarded in determining the vulnerable person’s deemed CGT taxable amount for the tax year. Sub-paragraph (4) provides interpretation.

116. Paragraph 4 provides the meaning of the “vulnerable person’s notional section 77 gains”. These are the gains that, if the “relevant assumptions” were to be made (see paragraph 119 below) would be treated as arising to the person in the tax year in accordance with Clause 31.
117. Paragraph 5 provides the meaning of “actual gains” and “actual losses”. “Actual gains” are chargeable gains arising to the vulnerable person in respect of which he or she is actually liable to capital gains tax for the tax year. “Actual losses” are allowable losses arising to the vulnerable person in the tax year in question, and any unused allowable losses carried forward from earlier tax years.
118. Paragraph 6 provides the meaning of “assumed gains” and “assumed losses”. “Assumed gains” are those chargeable gains (other than actual gains) which, on the relevant assumptions, would arise to the vulnerable person in the tax year and in respect of which he or she would be chargeable to capital gains tax for that year. “Assumed losses” are those allowable losses (other than actual losses) which, on the relevant assumptions, would arise to the vulnerable person in the tax year.
119. Paragraph 7 describes the “relevant assumptions”. The first is that the vulnerable person is resident and domiciled in the United Kingdom throughout the tax year. The second is that the vulnerable person has given the necessary notice for any capital losses which arose to him or her in the tax year, but which are excluded from being allowable losses owing to the person’s actual residence status, to be allowable losses. The assumption as to residence and domicile does not apply for the purposes of section 10A of the TCGA (which provides for an individual returning from

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a period of temporary residence outside the United Kingdom to be chargeable to capital gains tax in the tax year of return in respect of certain chargeable gains that arose to him or her during the period of absence from the United Kingdom).

BACKGROUND NOTES

120. The rate applicable to trusts (40%) and the dividend trust rate (32.5%) were raised in the Finance Act 2004 with effect for the tax year 2004-05 onwards to reduce opportunities for people to use trusts for tax avoidance purposes. However, the Government recognised that this could have an adverse impact on trusts with vulnerable beneficiaries, particularly trusts for disabled people and for children who have lost a parent.
121. The provisions in Chapter 4 of the Finance (No. 2) Bill are designed to benefit trusts having such vulnerable beneficiaries. The trustees of relevant trusts will be able to make a joint election with a vulnerable beneficiary which will have effect, for any tax year for which the election is in force, to allow the trustees to make a claim for the special tax treatment provided by Chapter 4 to apply for that year.
122. For trust income, the trustees' tax liability will be brought into line with what the vulnerable beneficiary's tax liability in respect of the income would have been had he or she received the income directly. The trustees will be able to take account of the vulnerable beneficiary's personal allowances and starting and basic rate income tax bands to reduce the amount of income tax paid.
123. For chargeable gains arising to UK-resident or ordinarily resident trustees, the beneficiary, rather than the trustees, will be chargeable to capital gains tax if the beneficiary is UK-resident for the tax year for the purposes of Chapter 4 of the Finance (No. 2) Bill (see paragraph 89 above). Where the beneficiary is non-UK resident for the tax year for the purposes of Chapter 4, the trustees' tax liability in respect of the gains will be brought into line with what the vulnerable beneficiary's tax liability in respect of the gains would have been had the gains arisen to him or her directly.
124. The special capital gains tax regime does not apply in any case where, in the tax year in question, the trustees are not, for TCGA

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purposes, resident in the United Kingdom during part of the year,
or ordinarily resident in the United Kingdom during the year.