McKie & Co

RUDGE REVENUE REVIEW

ISSUE VII

19th October 2010

McKie&Co

INDEX

SECTION I

"A SETTLED PURPOSE – INHERITANCE TAX PLANNING THROUGH TRUSTS"

This article considers using settlements to make effective gifts whilst maintaining control of the donated assets and how to maximise those gifts. All references are to the Inheritance Tax Act 1984 unless otherwise stated.

INTRODUCTION

An Unpopular Tax

Evelyn Waugh described taxes on the devolution of property on death as the means by which the State destroys property "by literally robbing the widow and the orphan by confiscating bequests" (commentary to 'the Private Man' by T A McInerny (Ivan Obanskey 1962)). It is reassuring evidence of the survival of the British sense of fair play that Inheritance Tax is unpopular even with those whose estates are unlikely ever to bear it, for it is a tax which falls only lightly on the very rich and is brutally confiscatory in respect of the merely prosperous.

There are many reasons for that. The very rich will often hold their assets in forms which qualify for Business and Agricultural Property Relief at 100%. They are often internationally mobile so that they can establish domiciles in other countries. They can afford to forego the benefit of a substantial proportion of their assets without it affecting the style in which they live. For the merely prosperous, however, this is not the case. It is rarely appropriate for them to hold a large proportion of their wealth in business assets once they have ceased to be involved in the day to day running of that business. Similarly, only a small minority will have the experience to take on the risks associated with substantial holdings of agricultural land. If they are based in only one country the decision to change domicile will often involve a complete change of life and a weakening of the familial and social ties built up during their lifetime. Their assets will often be in such a form that it is extremely difficult for them to forego the ability to benefit from them. The expenses of taking and implementing Inheritance Tax advice may be disproportionate to the savings which it offers yet a person who has built up total wealth of, say, £3m from income which has suffered Income Tax and capital gains which have suffered Capital Gains Tax will find that on his death he will pay well over £1m to the Chancellor. The members of each generation have to find out for themselves the waste and profligacy of Government in spending the money which it exacts from taxpayers. When they do, it is not surprising that they object to making the State their heir.

One could say flippantly, however, that Inheritance Tax is easily avoided. One has only to give all one's property away seven years before one's death except an amount sufficient to meet one's needs for the remaining period of one's life. The reasons people do not do so are that:-

(a) their time of death is uncertain;

(b) their needs during the rest of their life are uncertain;

(c) the persons whom they wish to benefit are not necessarily capable of exercising responsible ownership of assets at the stage in life which they have reached when the gift may best be made for tax planning purposes;

(d) they are concerned that the persons to whom they give their assets will be the targets of claims which will jeopardise those assets.

In order to solve these problems, taxpayers have sought means of making gifts of assets without giving up the ability to control those assets or to benefit from them after the gift.

Gifts with Benefit Retained

HMRC, of course, see structures which enable a donor to continue to benefit from his gift as tax avoidance which defeats the purpose of the tax and which threatens its yield. The Inheritance Tax legislation is designed to prevent such avoidance; in particular, the Gift with Reservation Provisions (Finance Act 1986 ss.102 – 104 and Sch 20) and the Pre-Owned Assets Charge to Income Tax (Finance Act 2001 s.84 and Sch 15) are designed to do so.

Gifts with Control Retained

Until quite recently, HMRC and the Government of the day were more relaxed about donors retaining control of assets. They had appeared to understand that children and young adults need to learn the skills of managing valuable assets gradually and to accept trusts as the appropriate mechanism by which this was done. In 2006, however, the Inheritance Tax regime for trusts was radically overhauled so that lifetime transfers into trust, except for a very restricted class, would create settlements within the relevant property regime which previously applied only to discretionary settlements (Inheritance Tax Act 1984 Part 3, Chapter 3).

Parents and grandparents who would like to set aside capital to help their children and grandchildren but do not wish to undermine their independence and sense of personal responsibility by giving them unfettered control of wealth at too early an age, now need to plan carefully and over a long period if they are to make substantial gifts into trust without triggering immediate Inheritance Tax charges.

This chapter looks at the mechanics of doing so and demonstrates that it is possible to settle quite substantial amounts in trust without triggering immediate Inheritance Tax charges and thus to make a substantial saving of Inheritance Tax.

THE RELEVANT PROPERTY REGIME

Transfers into Settlement

A transfer into a relevant property settlement will be a chargeable transfer. It is a disposition as a result of which the value of the transferor's estate immediately after the disposition is less than it would be but for the disposition (s.3). It is not a potentially exempt transfer because it does not constitute a gift to an individual or into a privileged trust (s.3A(1a)). If it is not an exempt transfer, it is, therefore, a chargeable transfer (s.2).

A gift into settlement of this sort, therefore, will only be free of an immediate Inheritance Tax charge to the extent that it is neither exempt nor exceeds the transferor's unused Nil-Rate Band. Even so, a husband and wife could transfer into a settlement, assets with an aggregate value of £650,000 plus their unused annual exemptions without creating an immediate charge to Inheritance Tax and they could do so every seven years because previous chargeable transfers fall out of accumulation after seven years. So a couple who have not previously made chargeable transfers could transfer £662,000 initially ((£325,000 + £3,000 + £3,000) x 2) and £6,000 per year thereafter and a further £650,000 every seven years without triggering an immediate charge to Inheritance Tax. After twenty eight years, a couple could have transferred £3,430,000 into trust in this way (being five pairs of Nil-Rate Bands and thirty pairs of annual allowances).

Inheritance Tax Charges on the Settlement

The Decennial Charge

Settlements are, in effect, treated as discrete taxable entities for Inheritance Tax purposes. The property in the settlement is subject to a charge (the Decennial Charge) on each tenth anniversary of the settlement being made. The rate of charge is calculated (s.66) by reference to a hypothetical transfer of value equal to the value of the property in the settlement, together with the value of property in any related settlement immediately after it commenced, made by an individual who had a cumulative total equal to:-

(a) the value of chargeable transfers made by the settlor in the seven years prior to the creation of the settlement; and

(b) the amounts upon which Inheritance Tax has been charged on 'exits' (see below) in the previous ten years.

It is accepted by HMRC that undistributed income retained by the trustees but not as yet accumulated does not fall within the charge (Statement of Practice SP8/86).

Other settlements made on the same day by the same settlor are 'related settlements' unless the property is held for charitable purposes only (IHTA 1984 s.62). Whether or not they are relevant property settlements, the property comprised in them immediately after they commence is therefore taken into account when calculating the decennial charge and the exit charge. Where property is added to a settlement the decennial charge for that settlement is subject to an alternative calculation. If the settlor's cumulative total of chargeable transfers is greater before the addition than it was before the settlement was made then the cumulative transfers immediately before the addition can be substituted in the calculation of the decennial charge (s.67).

McKie&Co

The Exit Charge

Where the property comprised in the settlement or any part of that property ceases to be relevant property or where the trustees of the settlement make a disposition as a result of which the value of relevant property comprised in the settlement is less than it would be but for that disposition there will be an exit charge (s.65). Except before the first decennial (s.68), that exit charge will be at a rate which is a fraction of the rate at which tax was charged on the previous decennial (s.69).

Limitations on Settlement

The result of all this is that if one settles property equal to the Nil-Rate Band and that property grows in value at a rate which is greater than the rate of increase in the Nil-Rate Band then one will suffer a tax charge at the decennial of the making of the settlement and when there is an 'exit' under s.65.

One might think that one could easily deal with that problem by advancing, shortly before the decennial, an amount equal to the excess of the value of the relevant property over the then Nil-Rate Band. That is not the case, however, because, as we have seen (s.66(5) & (6) see above), the hypothetical transfer by reference to which the decennial charge is calculated, is a transfer by a transferor whose cumulative transfers are treated as including the amounts on which exit charges have arisen in the previous ten years in respect of the settlement concerned.

Nor can one simply set up a number of settlements with assets equal to the Nil-Rate Band divided amongst them. That is because, as we have seen above, the rate of tax on a decennial is calculated by reference to a hypothetical transfer of an aggregate amount which includes the value immediately after a related settlement commenced, of the property then comprised in it (s.66(4)(c)). One can, however, create a series of settlements with room to grow by careful regard to the rules for computing decennial charges. The following example shows how this may be done.

An Example

Mr Redstreak who has made no previous transfers of value establishes five relevant property settlements A, B, C, D and E at three monthly intervals, each with initial cash gifts of £5,000. He then makes further cash additions of £60,000 to each trust on the same day. Ignoring the availability of his annual exemptions, the margin for growth of each trust is as follows:-

	A	B	C	D	E
	£	**£**	**£**	**£**	**£**
Initial value	5,000	5,000	5,000	5,000	5,000
Added property	60,000	60,000	60,000	60,000	60,000
Trusts' 'clock'	–	5,000	10,000	15,000	20,000
	65,000	70,000	75,000	80,000	85,000
Margin for growth	260,000	255,000	250,000	245,000	240,000
Nil-Rate Band	**£325,000**	**£325,000**	**£325,000**	**£325,000**	**£325,000**

At the decennials of the settlements, the effect of s.67(3)(b)(i) is that each trust is looked at in isolation, ignoring the others. It is likely that these trusts will never be subject to inheritance tax either in respect of an 'exit' charge under s.65 or a decennial charge.

The total scope for future growth taking all of the trusts together is £1,250,000.

Discretionary v Fixed Interest Trusts

The form of the trusts used would depend on the assets in which the trustees were expected to invest. Other things being equal, it is normally best to provide trustees with the widest possible powers so as to preserve flexibility so one would normally establish discretionary trusts under which the trustees have a discretion as to whether to distribute income to the beneficiaries and, if distributed, to decide to whom it should be distributed coupled with a wide discretionary power over capital. Where discretionary trusts receive dividend income which is then distributed to beneficiaries, however, because the tax credit is not repayable, flowing the dividends through the trust substantially increases the total Income Tax charged on the dividend income. In that case one would use an interest in possession trust under which the beneficiaries would have a right to fixed shares in the income as it arises subject to broad powers of the trustees over capital and to defeat and restructure the income interests.

THE EXEMPTION FOR NORMAL EXPENDITURE OUT OF INCOME

Exempt Transfers

So creating a cascade of trusts enables one to make use of one's Nil-Rate Band and annual allowances so as to maximise the transfers into settlement which can be made without triggering an immediate Inheritance Tax charge. The reason that the annual exemption can be used in this way is both because the transfer of value by the settlor is, to the extent that it is an exempt transfer, not a chargeable transfer and because in the computation of the decennial charge, as we have seen, the added property provisions apply only where the settlor makes a chargeable transfer as a result of which the value of the property comprised in the settlement is increased. So if property is added by means of an exempt transfer, the added property provisions are not brought into play. Most exemptions are unlikely to be relevant to gifts into family settlements (for example, transfers between spouses (s.18), a gift in consideration of marriage to a child or remoter descendant (s.22) or gifts for national purposes (s.25)). One important exemption, however, which can be utilised so as to greatly increase the amount of property which may be settled without creating Inheritance Tax charges is the exemption for normal expenditure out of income.

<u>Section 21</u>

Section 21 provides that:-

> "A transfer of value is an exempt transfer if, or to the extent that, it is shown-
>
> (a) that it was made as part of the normal expenditure of the transferor; and
>
> (b) that (taking one year with another) it was made out of his income; and
>
> (c) that, after allowing for all transfers of value forming part of his normal expenditure, the transferor was left with sufficient income to maintain his usual standard of living."

Thus to fall within this exemption a payment must meet three conditions.

<u>Sub-section (1)(a) "Made as part of the normal expenditure of the transferor"</u>

There have been three decided cases on relief under s.21 (*Bennett & Others v Inland Revenue Commissioners* [1995] BTC 8003, *Nadin v Inland Revenue Commissioners* [1997] STC (SCD) 107 and *MacDowall and Others (Executors of MacDowall, Deceased) v Inland Revenue Commissioners and Related Appeal* [2004] STC (SCD) 2). The leading case is *Bennett & Others v Inland Revenue Commissioners* (*Bennett & Others v Inland Revenue Commissioners* [1995] BTC 8003). In that case it was said that normal expenditure "connotes expenditure which at the time it took place accorded with the settled pattern of expenditure adopted by the transferor" (at page 8008 ibid).

'The Settled Pattern'

That settled pattern may be:-

> "… established in two ways. First, an examination of the expenditure by the transferor over a period of time may throw into relief a pattern, e.g. a pattern each year of ten percent of all income to charity or members of the individual's family or a payment of a fixed sum or a sum rising with inflation as a pension to a former employee. Second, the individual may be shown to have assumed a commitment, or adopted a firm resolution, regarding his future expenditure and thereafter complied with it." (*Bennett & Others v Inland Revenue Commissioners* [1995] BTC 8003 @ p 8005)

Assuming a Commitment

As for the period over which the expenditure must be made Mr Justice Lightman explained in *Bennett* that:-

> "For an expenditure to be 'normal' there is no fixed minimum period during which the expenditure shall have occurred. All that is necessary is that on the totality of evidence the pattern of actual or intended regular payments shall have been established and that the item in question conforms with that pattern. If the prior commitment or resolution can be shown, a single payment implementing the commitment or resolution may be sufficient. On the other hand, if no such commitment or resolution can be shown, a series of payments may be required before the existence of the necessary pattern will emerge. The pattern need not be immutable; it must, however, be established that the pattern was intended to remain in place for more than a nominal period and indeed for a sufficient period (barring unforeseen circumstances) in order for any payment fairly to be regarded as a regular feature of the transferor's annual expenditure. Thus a 'death bed' resolution to make periodic payments 'for life' and a payment made in accordance with such a determination will not suffice." (at page 8008 ibid)

In their guidance on the exemption, HMRC say that "a reasonable span would normally be three to four years" (IHTM 14241).

Where there is a commitment to make future expenditure the commitment must envisage that the payments will "remain in place … for a sufficient period (baring unforeseen circumstances) …" It need not be legally binding. Once that commitment has been made if, at a later time, the taxpayer changes his mind and resiles from the commitment that does not affect the application of the exemption to the payments previously made under the commitment.

Quantum

As to quantum, Mr Justice Brightman in *Bennett* quoted with approval the words of Mr Justice Lowry, in *Attorney General for Northern Ireland v Heron* (*Attorney General for Northern Ireland v Heron* (1959) 53 TR3) in which it was said in respect of the phrase "normal expenditure" in similar legislation under Estate Duty:-

> "To my mind the adjective in the sub-section is used in a qualitative not a quantitative sense. The adjective, therefore, seems to refer to type or kind, and not to size." (*Bennett & Others v Inland Revenue Commissioners* [1995] BTC 8003 @ pages 8005 and 8006)

In the case of *Nadin v IRC* one of the factors to which the Court referred as indicating that the expenditure under consideration was not 'normal' was its "irregularity both in point of time and in amount" (*Nadin v IRC* [1997] STC (SCD) 107 @ p 111).

Mr Justice Lightman in *Bennett* said:-

> "The amount of the expenditure need not be fixed in amount … As regards quantum, it is sufficient that a formula or standard has been adopted by application of which the payment (which may be of a fluctuating amount) can be quantified, e.g. ten per cent of any earnings whatever they may be or the costs of a sick or elderly dependant's residence at a nursing home. As regards the payees, it is sufficient that their general character or the qualification for benefit is established, e.g. members of the family or needy friends." (page 8008 ibid)

HMRC's guidance says:-

> "The gifts must be comparable in size but you need not query discrepancies unless the difference has the effect of placing a gift in a different category from those which are regarded as normal." (IHTM 14244)

HMRC accept, therefore, that gifts do not have to be of the same size for them to be regarded as part of the normal expenditure of the transferor but the fact that the gifts vary in size may indicate that they belong to different categories of expenditure, one or more of which is, or are, normal and one or more of which is, or are, not.

No Reasonableness Requirement

Finally, to fall within this head there is no requirement for the expenditure to be reasonable or of the type commonly made by people generally. Normality is judged in respect of the individual.

<u>Sub-section (1)(b) "That (taking one year with another) it was made out of his income"</u>

What does the phrase "made out of income" mean? First, it is accepted that 'income', here, means income under the general meaning of that word, that is, income determined under normal accountancy principles, rather than amounts assessable to Income Tax under the Taxes Act. Thus, it will not include amounts of capital such as gains arising on the surrender of life insurance policies or amounts received on the sale of Government securities treated as income under the accrued income scheme. HMRC's guidance says:-

> "Income is not defined but should be determined in accordance with normal accountancy rules; it does not necessarily coincide with income for Income Tax purposes." (IHTM 14250)

Does the requirement that the transfer be "made out of the [transferor's] income" require one to undertake a tracing exercise such as is required to determine whether there has been a remittance of foreign income or capital gains under the remittance basis? The decided cases do not specifically deal with the problem and indeed, none has been concerned with the construction of sub-section (1)(b).

Except where the remittance basis is in point, it is highly unusual for individuals to segregate their income from their capital and there is nothing in the decided cases which suggests that the individuals concerned in those cases did so. Does the fact that sub-section (1)(b) requires one to take 'one year with another' indicate that rather than tracing moneys from their source through the taxpayer's bank accounts to the payment one merely has to do an overall accounting exercise in which one identifies whether it is possible that a payment could be made out of income because there was a surplus of income over revenue expenditure?

HMRC guidance says that:-

> "… the transferor should have made the gift out of their income. Thus a gift of jewellery or securities does not qualify unless it was specifically purchased by the donor with the intention of making a gift.
>
> Repeated renunciations of bonus issues of shares do not qualify for exemption, although purchases of rights issues in the names of donees may do so.
>
> Income is considered to refer to current income. Gifts will not normally satisfy the second condition if made from a source which, although originally income, has by retention over a period of time acquired the nature of capital. The fact that the retained income has been invested or saved in a form that itself yields income will normally show that it has become capital. However, invested funds may remain income if the transferor was merely saving them temporarily in order to accumulate an amount sufficient for some expenditure specifically contemplated." (IHTM 14250)

This suggests that in HMRC's view a tracing exercise is required. It would be a logical corollary of the view expressed in the passage quoted above, for example, that, if the taxpayer held shares which were not merely a temporary investment and were capital assets which he then sold and applied to a gift, the exemption for normal expenditure out of income would not apply.

If that is HMRC's view, it goes beyond what is justified by the legislation or the case law. Nonetheless, the cost and uncertainty of challenging HMRC's view on any matter are so great that it is prudent to fall within their published views rather than outside them if one can. A counsel of perfection would be to segregate funds in the way in which, for example, a non-domiciliary segregates his offshore accounts, so as to clearly identify the regular payments as being amounts of income. In practice, few people would care to have their use of money restricted in this way. If there is a surplus of income over revenue expenditure it is unlikely that HMRC would be successful in asserting that a gift from a bank account which, although it also contained capital, contained sufficient income to make the gift, did not come wholly within sub-paragraph (b).

<u>Sub-section (c): "after allowing for all transfers of value forming part of his normal expenditure, the transferor was left with sufficient income to maintain his usual standard of living"</u>

What are "transfers of value forming part of his normal expenditure"? We have seen that a transfer of value is a disposition by which the value of the estate of the transferor is reduced. Two specific rules, however, provide that, loosely, dispositions not intended to confer gratuitous benefit and dispositions for the maintenance of a spouse or minor child are not transfers of value (ss.10 and 11). A transfer of value could be a capital transaction. Most investment transactions, however, will not be transfers of value either because they do not decrease the investor's estate or because they were not intended to confer a gratuitous benefit. A capital gift to charity, for example, will be a transfer of value.

The question is how one allows "for all transfers of value forming part of his normal expenditure" in considering whether "the transferor is left with sufficient income to maintain his usual standard of living." Arguably, if an amount of expenditure is capital expenditure it cannot affect the amount of income which is left to the payer after the expenditure has been made.

The transfers of value taken into account under sub-section (c) must form "part of [the transferor's] normal expenditure." There is nothing to suggest that this phrase in sub-section (c) is to be interpreted differently than the same phrase in sub-section (a). So unless there is a commitment to make the expenditure for a sufficiently long period or the expenditure of that type is actually made for a sufficiently long period it will not be normal expenditure of the transferor.

How does one determine whether the transferor was "left with sufficient income"? Of the three cases which have been decided on s.21, sub-section (c) was considered only in *Nadin* (this was a case before the Special Commissioners which did not proceed to the High Court). In that case, in respect of certain years, the Special Commissioner found that the condition in sub-section (c) was not satisfied because the taxpayer's annual nursing home costs, personal expenditure and Income Tax exceeded her annual income. The decision does not record any argument on the construction of sub-section (c) except that the Appellant argued that capital sums on the sale of investments were income. What was not argued was whether sub-section (c) allows one to take into account the extent to which capital is available to supplement income and is actually applied to doing so.

HMRC assume, in their guidance, that the exemption will not apply to the extent that "the transferor had to resort to capital for living expenses" (IHTM 14251). It is arguable, however, that if one had such a large amount of capital that, on the basis of the most conservative estimates, it would be sufficient to fund one's living expenses for one's lifetime even a small amount of income would be sufficient to maintain one's usual standard of living. People in that position, therefore, would have sufficient income to maintain their usual standard of living even if all but a minimal part of their income were expended in making gifts. Such a construction would not empty sub-section (c) of effect because less wealthy people would need to retain capital if they were not to jeopardise, in the long term, their ability to maintain their usual standard of living.

The following example shows how the normal expenditure out of income exemption can be used, over an extended period, to make very substantial transfers into settlement.

THE NORMAL EXPENDITURE OUT OF INCOME EXEMPTION: AN EXAMPLE

The Scope for Increased Gifts

Mr and Mrs Dabinett wish to settle funds on trusts for the benefit of their three sons, Harry, Dymock and Broxwood, to the maximum possible extent without suffering an immediate Inheritance Tax charge. Mr Dabinett's annual after-tax income fluctuates between £400,000 and £600,000. Mrs Dabinett's annual after-tax income fluctuates between £200,000 and £250,000. They make no other transfers of value. The amount they spend annually on maintaining their usual standard of living is as follows:-

	MIN £	**MAX £**
Mr Dabinett	400,000	450,000
Mrs Dabinett	190,000	210,000

Mrs Dabinett is a non-domiciliary and much of her income does not bear UK Income Tax. As we have seen, however, income for this purpose is not taxable income. So the fact that her income is not brought into charge to Income Tax because she is taxed on the remittance basis does not prevent her taking that income into account in determining whether the normal expenditure out of income exemption applies.

Variability

The fact that the excess of Mr and Mrs Dabinett's income over expenditure fluctuates significantly from year to year does not mean that they can only take advantage of the exemption in respect of the minimum annual excess. It would be possible for them both to record their intention for the foreseeable future to make gifts out of income in favour of their children equal to the excess of their income from year to year over the amount of that income which they expend on maintaining their usual standard of living. They could determine this excess after the end of each fiscal year and make settlements in their children's favour on a fixed date in the year thereafter.

That would be sufficient to conform to Mr Justice Lightman's analysis of the requirements of sub-section (1)(a). There would be a commitment covering a sufficient period for the payment fairly to be regarded as a regular feature of the transferor's annual expenditure. Although the payment would be a fluctuating amount it would be determined by reference to a formula which would not differ very greatly from the formula considered in *Bennett* in which a mother who was the beneficiary of an interest in possession trust instructed her trustees to distribute to her sons so much of the income arising in each accounting year as was surplus to her financial requirements.

An Established Pattern

Let us now assume that, over the period with which we are concerned, Mr Dabinett's average annual excess of income over expenditure is £100,000 and Mrs Dabinett's is £30,000. They might adopt the following strategy.

They both complete memoranda recording their intention to make annual gifts from their income on trust for their children equal to the excess of their income over the amount sufficient to maintain their usual standard of living.

Mr Dabinett sets up ten bank accounts and Mrs Dabinett sets up three bank accounts. They pay £10.00 into each bank account. The accounts set up by Mrs Dabinett are outside the United Kingdom and the moneys which she pays into the account are paid from an offshore income bank account. The moneys which Mr Dabinett pays are from the accounts into which his income is paid.

On each day from 1st to 5th December 2010 they each complete a deed per day declaring that they will hold the funds in a bank account which they have established on trusts for a class of beneficiaries which includes their children. Each trust deed provides that no child or grandchild of the settlor or the settlor's husband or civil partner may benefit under the settlement whilst they are under the age of eighteen. The trust deeds recite the existence of the memorandum made by the settlor of those trusts and that the settlements are intended to fulfill part of the settlor's intention to make gifts expressed in that memorandum.

On 1st January 2011 they add an amount to each settlement equal to the aggregate of the Nil-Rate Band and unused annual allowance for the prior year, divided by the number of settlements they have made, less £10.00. So Mr Dabinett adds £32,790 ((£325,000 + £3,000) ÷ 10) - £10) to each settlement which he has settled and Mrs Dabinett adds £109,323 ((£325,000 + £3,000) ÷ 3) - £10) to each settlement which she has settled.

In January of each year, as part of the work done to prepare their tax returns, the excess of their income over their living expenditure is determined. On 31st January in each year they enter into a deed of addition and pay an amount equal to the aggregate of their excess income and the annual exemption divided by the number of settlements they have settled by way of addition to each of the settlements which they have settled. Once again, the deed would recite the existence of the memorandum and that the settlements are intended to fulfil the settlor's intention to make gifts expressed in that memorandum. So Mr Dabinett would add an average £10,300 ((£100,000 + £3,000) ÷ 10) per settlement and Mrs Dabinett would add an average £11,000 ((£30,000 + £3,000) ÷ 3).

The rate of tax on future decennials of the trusts and on assets being withdrawn from the trusts will be nil per cent unless the value of the assets in the settlement grow to exceed the Nil-Rate Band by the tenth anniversary concerned. It is for that reason that both have set up a number of trusts, the number being chosen to leave plenty of room for growth.

At the end of the seven years Mr Dabinett would have settled £104,900 ((£10 + £32,790) + (£10,300 x 7) on each settlement. Mrs Dabinett would have settled £186,333 (£109,323 + 10)

+ (£11,000 x 7)) on each settlement. So they would have settled £1,607,999 ((£104,900 x 10) + (£186,333 x 3) in all divided between thirteen trusts.

The settled funds are unlikely to suffer any Inheritance Tax whilst they are in the settlement or on being distributed to the beneficiaries. The settlements could continue for 125 years if that was desired or even longer if they were written under a law with a longer perpetuity period.

What is more, this pattern could be continued every seven years until Mr and Mrs Dabinett judge that their children are sufficiently mature to receive outright gifts. Even then, there would still be advantages in creating settled funds which effectively are placed outside the scope of Inheritance Tax for 125 years.

Costs and Burdens

It might be objected that creating so many trusts would create a major administrative burden. It is obviously true that the trusts will require some administration but perhaps less than clients might think. The use of standard documentation and of nominees to hold trust assets would greatly reduce the administrative work required. Much of the work would be at a relatively routine level so that it should not be too expensive per hour. A degree of organisation on behalf of the client or his accountants and tax agents would contain costs within manageable proportions.

SECTION II

"TAX POLICY CONSULTATION"

INTRODUCTION

In this section we give the text of our submission on the Government's Consultation Paper 'Tax Policy Making: A New Approach' (the "Document").

The Document's Approach

Section 4 of the Document invites comments to be submitted on the overall approach which it adopts to reforming tax policy making and on the specific proposals that underpin the new approach and then summarises the proposals discussed elsewhere in the paper. In this submission we first consider the reform of tax policy making in general. We then consider the Document's approach to reform. We conclude that the existing situation is so bad that the Government needs to take steps which are considerably more far reaching than those proposed in the Document. Finally, we summarise those steps.

RECOGNISING THE SCALE AND NATURE OF THE PROBLEM

Recognising the Problem

The place to start is to recognise the precipitate decline in the integrity of our tax system and in our procedures for making, implementing and reviewing tax legislation which took place over the lifetime of the last Government.

Too Much Legislation

First, simply too much legislation was introduced.

Political Pressures for Unnecessary Change

The last Government continually changed tax legislation unnecessarily and then introduced further unnecessary changes to the legislation it enacted.

The major 'reforms' of Capital Gains Tax in FA 1998 and FA 2008 (which was reformed yet again with the advent of the new Government in FA (No.2) 2010) and the extremely damaging changes to the taxation of trusts in FA 2006 are good examples of such substantial unnecessary change. Largely this itch to change seems to be the result of two political pressures. First there is a general pressure for ministers to appear to have a grip of their departments and to be actively doing something useful. The easiest way of appearing to be so is to introduce legislative change in areas which are too complex for the detail of the change to engage the attention of the populist media. There is also a specific pressure for the Chancellor to have something to announce in the annual Budget Speech.

Abandonment of the Principle of Proportionality

Secondly, the last Government abandoned the principle that there should be proportionality in making tax changes; that tax changes should only be made if their introduction would confer a benefit on the Exchequer which exceeded the costs and other disadvantages which they imposed on taxpayers.

It introduced tax changes without any proper analysis of the balance between the advantages to be gained by the changes and their costs. As the Document acknowledges, the last Government's impact analyses of the effect of its tax changes were simply inadequate for the purpose for they did not take proper account of the wider costs of introducing tax changes. Those wider costs include the compliance costs of taxpayers and the economic cost of increased uncertainty in decision making which results from increased complexity in the tax system. In particular, because the last Government had an ideological commitment to preventing all tax planning, which it vilified as abusive tax avoidance, it introduced legislation the complexity and cost of which were wholly disproportionate to its benefits.

All Governments need to recognise that it is perfectly legitimate and morally unexceptionable for taxpayers to plan their transactions to minimise their taxation liabilities within the law and that, although Governments will naturally wish to ensure that their legislation is properly framed to tax those activities which they wish to tax, no system of tax laws can ever do so perfectly. The attempt to squeeze all tax planning out of the system can only have the result of creating a tax system which is unworkable. In the longer term, the use of a Government department to stigmatise and vilify a law abiding group of taxpayers has destroyed the respect of taxpayers for Government and will make the collection of tax more difficult in the future.

The last Government continually asserted that tax avoidance was a major threat to tax revenues without providing proper economic evidence to support its assertion.[1] HMRC was encouraged by the last Government to blame the increasing complexity of the tax system on taxpayers seeking to avoid tax liabilities instead of identifying the real cause of increased complexity. That cause was its failure to observe the principle of proportionality that tax changes should only be introduced if their economic benefits clearly outweigh their economic disadvantages including the disadvantages arising creating additional uncertainty and instability in the tax system.

[1] The recent paper "Measuring Tax Gaps 2010" continues to publish estimates of tax 'lost' from tax avoidance indicating a conceptual misunderstanding. Where tax is avoided a liability to the tax avoided never arises. Tax is not 'lost'. The Government has simply failed to frame laws to assess as much tax is it wished to do. The methods of estimation in the paper are so uncertain as to make the estimates worthless and yet they seem to be designed to be used by Government ministers to justify further attacks on specified groups of taxpayers and the expenditure of large sums of Government money on increasing the number of staff dedicated to 'anti-avoidance' activity

Failure to Consult Honestly

The pressure of the ever increasing quantity and complexity of tax legislation created pressures which led to a further decline. First, the legislation was introduced with insufficient scrutiny. Although the last Government paid lip service to the process of consultation it rarely listened to the results of the consultations it launched. In particular, it rarely listened to responses which addressed the overall policy of the proposed change or large strategic issues within the proposal. The only responses in which HMRC appeared to be interested were in respect of specific drafting points and then only in respect of those which prevented the Government exposing its incompetence by overlooking obvious howlers or of corrections which favoured the Government and not the taxpayer. In effect, the last Government and HMRC abused the consultation process, ignoring responses in relation to the most important issues involved in legislative change and creating an illusion, for public relations purposes, of taking account of outside views whilst exploiting the resources of the private sector to correct work which it had performed inadequately.

Publishing Legislation in Finance Bills before it was fit for Publication

It used to be accepted that legislation would not be published in a Bill if the Government (or, in effect, HMRC) were aware of flaws in it which required correction. Because it overburdened its legislative programme, the last Government formed the harmful habit of publishing legislation in Finance Bills which it knew to be inadequate. The most flagrant example of this deleterious departure from former practice was the introduction of the remittance basis rules in FA 2008. The result was that time had to be spent by the professional bodies, in effect, in doing the work of HMRC and the draftsman for them, instead of fine tuning legislation which was ready for public review.

Truncated Time for Parliamentary Debate

Having introduced inadequate legislation, the last Government truncated the time available for parliamentary debate on that legislation.

Widespread and Improper Use of Secondary Legislation

Wherever it could, the last Government avoided parliamentary scrutiny by enacting new tax rules in secondary legislation.

Refusal to Amend Legislation Where Faults were Identified

When faults were identified in the legislation by the professional bodies and through parliamentary debate, the Government often simply pretended that the faults did not exist or said that it would put them right by introducing "guidance".

Misleading and Dishonest Guidance

What HMRC then did was to publish guidance expressing an untenable construction of the new legislation which simply pretended that the identified weaknesses did not exist at all. A good example was the guidance on TCGA 1992 s.16A enacted in the Finance Act 2007.

The result of the Government's refusal to amend faulty legislation, coupled with a pretence that the legislation was not faulty, is that the Queen's subjects are now over-taxed by law and relieved by unacknowledged concession posing as guidance; a constitutionally improper situation.

The proliferation of 'guidance' in which HMRC (often deliberately) makes inaccurate statements of the law has had the result that much of the material published by HMRC, far from being useful to taxpayers, merely adds to their burdens. That is because taxpayers must now obtain advice not only on the law itself but also on whether HMRC's guidance on the matter in question is accurate and internally consistent and whether they should follow the law or HMRC's inaccurate gloss on the law.

Using the Decline of the Tax System to Justify Increased Powers

As the tax system became ever more unwieldy and unworkable, HMRC reacted by demanding ever more complex anti-avoidance provisions and ever greater powers to search premises, to obtain documents and to impose penalties; provisions and powers which there was no evidence to suggest were necessary.

Public Loss of Trust and Respect for Government, HMRC and the Law

This combination of poor quality law, untruthful Government statements and expanded powers of interference in the lives of private citizens inevitably led to a decline in the trust and respect of the taxpayer for the Government, HMRC and the law.

PUTTING IT RIGHT

Introduction

Reversing this sorry tale of decline at a time when the Government's finances are in a worse position than they have ever been requires the new Government to stick firmly to the principles which lead to a successful tax system. Those principles and the method by which they could be embedded in the tax system are set out in this section.

A Presumption Against Change

There is little that can be done to remove the general political pressure for Government ministers to prove their worth which leads them to introduce unnecessary change, but one positive step would be for the Government to announce, perhaps after an initial period of one or two years to reverse the worst mistakes of the previous Government, a presumption against changes to the tax system. That is that changes will only be introduced if they are demonstrably an improvement on the current position judged in the light of the principle of proportionality.

Technical Finance Bills

To remove the political pressure to introduce complex technical changes in annual Finance Bills, it should be recognised that there is no need for every Budget Speech to announce technical tax changes and for such changes to feature in the annual Finance Act. No doubt it may be necessary to adjust tax allowances and rates from year to year and constitutionally, it is necessary to renew the Government's power to raise taxes but there is no good reason why technical changes should be introduced on an annual basis. By introducing technical changes in the same Bill as routine adjustments to rates etcetera, Chancellors of the Exchequer are subject to the temptation to spice up their annual Budget Speech with technical changes.

Technical changes should be enacted in Technical Finance Acts which are separate from the routine adjustment of rates and allowances enacted in annual Finance Bills. There should be a presumption that a Technical Finance Bill is not required annually so that the introduction of each bill would require particular justification.

Presumption against the use of Secondary Legislation

Secondary legislation can be useful where the provisions it contains are uncontroversial and of relatively minor significance both in respect of the amount of money involved and of the numbers of taxpayers affected. Secondary legislation was used by the last Government, however, as a means of avoiding proper scrutiny of its legislation. The use of secondary legislation should be greatly restricted. The Government should set out a presumption against the use of secondary legislation so that every decision to use secondary legislation would require justification.

An Overriding Principle of Proportionality

The Government must commit itself to a principle of proportionality. That is that changes to the tax system will only be introduced which can clearly be shown to confer a benefit which outweighs the direct and indirect disadvantages created by the change.

Objective and Independently Verified Quantification of Benefits and Costs

It is fundamental to applying this principle of proportionality that the assessment and estimate of those benefits and disadvantages is based on objective evidence in a realistic way which takes full account of the costs which creating uncertainty and instability in the tax system imposes on taxpayers.

So that all parties can have confidence in the process of quantification, the responsibility for the process should be taken away from the revenue departments and placed in the hands of an independent body. It may be that the Office of Budget Responsibility could properly oversee this process but only if it were provided with sufficient resources to do so. Such a body would, of course, make use of the resources of HMRC but it would require sufficient staff under its own control to challenge HMRC's assumptions and the basis of estimates provided by HMRC.[2]

Consultation

There should be a presumption that before any new tax legislation is introduced, it will be subject to wider public consultation. That consultation, as the Paper proposes, should be divided into three stages:-

- a broad consideration of the policy of the proposed change and of alternative strategies for implementing that policy;
- a more detailed consideration of the particular strategy for implementing the policy which is identified as best under the previous stage of consultation; and
- a consultation on draft legislation produced in the light of the results of the previous stage of consultation.

There should be a presumption that these processes should not be conflated. Sufficient time should be given not only to receiving representations but also to considering the representations.

There is no point consulting, if the results of the consultation are to be ignored. So it is important that there should be an examination of the results of the consultation and the extent to which those results have been reflected in changes to the proposed policy, strategy or draft legislation. There should also be a review, after the new legislation has been introduced to see to what extent the results predicted by HMRC and respondents have actually arisen, Such a review would help to identify errors in forecasting by HMRC and thus to improve the reliability of its forecasting.

Obviously, that review cannot be undertaken objectively by the department which has sponsored the proposal. Just like the process of producing reliable estimates, it is necessary that the process of consultation on legislation should be put under the control of a body which is independent of the department making the proposal which is the consultation's subject. Of course, much of the work of consultation must continue to be undertaken by HMRC, but deciding the scope of the process, controlling it and reviewing the results should be managed by an independent body.

The consultation on the Document to which this paper is a submission, itself demonstrates the inappropriateness of the department involved being in charge of the consultation process. Reforming tax policy making requires an objective view of the failings of HMRC and of HM Treasury particularly during the lifetime of the last Government. It is wholly inappropriate that

2 The recent paper "Measuring Tax Gaps 2010" shows how inappropriate it is to leave such estimation under the control of HMRC. This is not the place for a detailed criticism of that paper but it is an attempt to dress up wild and tendentious estimates of tax 'lost' through evasion and avoidance (a confusion of two entirely different concepts) with a veneer of methodological rigour

those two departments should be put in the position of reporting to Ministers on their own failings.

Simon M^{c}Kie recently attended (on 2nd September 2010) a meeting forming part of the consultation on the Document, which provided a forceful example of the inappropriateness of HMRC and the Treasury being in charge of this consultation. It was supposed to be a meeting, forming part of the consultation on para 2.15 of the Document, on whether or not the Government should introduce a General Anti-Avoidance Rule (a "GAAR") into the tax system. A large number of professionals attended. Only after the meeting commenced were the attendees informed that HMRC wanted the meeting to take place under Chatham House rules. Inviting a large number of members of the public to a meeting on a public consultation and attempting to impose a secrecy requirement on them only when they have arrived at the meeting is a strange way of conducting an open consultation on matters of such importance.

The meeting opened with a talk of some fifty minutes one of the few private sector partisans of a GAAR. The talk proceeded to set up a series of assertions which no commentator had ever made as Aunt Sallies to allow the speaker to present her highly controversial views as being the only alternative to plainly untenable positions. For example, the speaker said that opponents of a GAAR had suggested that it would introduce uncertainty into the tax system and answered that 'point' with the truism that the system already contained uncertainty. Of course, no informed commentator on a GAAR has ever suggested that it does not. Most commentators say, not that a GAAR would introduce uncertainty into the tax system, but, rather, that it would significantly increase it.

There was no other speaker at the meeting to provide balance.

Having so unsubtly tried to direct the meeting's views, the first question the meeting was asked to debate was not what the effects of introducing a GAAR would be or whether a GAAR should be introduced, but rather "which taxes should a GAAR cover", thus begging the very question which was the subject of the consultation!

One cannot envisage any respectable market research agency conducting its research in such a biased fashion.

No mechanism was provided for participants to check the accuracy of the summaries of their responses which were to be submitted to ministers.

Worthy though the sentiments of the consultation Paper in respect of the conduct of consultations may be, it is clear that the consultation process cannot command public trust unless it is overseen by a body independent of the departments whose activities or proposals are the subject of the consultation.

An Independent Body to Oversee Consultation

There should, therefore be an independent body charged with overseeing consultation, reviewing the results of consultations and challenging HMRC over any failure to accept and implement the results of those consultations.

Proper Time for Parliamentary Debate

The Government needs to ensure that legislation is published sufficiently far in advance to allow proper consultation and for MPs to be properly informed of the relevant issues. The Parliamentary schedule should allow sufficient time for proper debate. The Document has much to say about allowing a proper review of draft legislation but not about allowing sufficient Parliamentary time for the detail of tax legislation to be properly debated as it was under the Governments of the 1980s. A reduction in the volume and frequency of new technical tax legislation would allow proper Parliamentary scrutiny to be restored.

An Independent Body to Review Existing Legislation

With time, tax legislation often becomes unnecessary either because economic conditions change or because new legislation makes the old redundant. HMRC are very reluctant to allow the repeal of anti-avoidance provisions and administrative powers which have become redundant. There is a ratchet effect. Once anti-avoidance provisions have been introduced or powers conferred on HMRC, they are almost never repealed, so that the tax system is gradually submerged under an ever-increasing accretion of unnecessary anti-avoidance provisions and administrative powers.

Existing legislation, therefore, needs regular review and pruning. There should be a presumption that legislation which cannot be demonstrated to have a continuing and necessary use should be repealed. Again it is plainly inappropriate for HMRC to be the department which oversees that process. The new Office of Tax Simplification might undertake that procedure but only if it becomes a much more substantial body than appears to be planned.

Restricting and Improving HMRC Guidance

HMRC's publications should be restricted in scope so that they may be improved in quality.

There should be a process of reviewing HMRC publications and retaining only those which are of proven usefulness. A recent example of a highly unnecessary development which simply increases the taxpayer's costs, is the issue of "toolkits". If they were of any practical use, they would be produced by commercial publishers. As they are not, they are merely one more source of information about HMRC's views which will have to be checked for accuracy at the expense of the taxpayer.

A Healthy Scepticism concerning the Need for Increased HMRC Powers

Governments need to be advised by Civil Service Departments; they should not accept that advice uncritically. The Conservative Governments of the 1980s subjected the Revenue's departments' requests for new administrative powers and avoidance provisions to sceptical scrutiny. The last Government utterly failed to do so. It is important that the Government should resume its function of governing HMRC and not merely accepting its demands.

Acceptance that all Healthy Tax Systems have some level of Tax Planning Activity

None of this will reverse the precipitate decline in the standard of our tax legislation and tax system unless the Government recognises that its task is to make less tax legislation of better quality and that a certain level of tax planning activity is natural to any tax system. Tax avoidance activity is not a sign of ill health in a tax system; far from it, it is a sign of a healthy tax system. Tax avoidance involves arranging one's transactions so that the law will impose a lower tax liability than it would do if one undertook alternative transactions and therefore involves a scrupulous respect for the law. Healthy tax systems have tax avoidance activity, unhealthy tax systems have tax evasion activity. The last Government made considerable progress towards creating an unhealthy tax system and in stimulating tax evasion at the expense of tax avoidance.

ARE THE DOCUMENT'S PROPOSALS SUFFICIENT TO ADDRESS THE PROBLEMS?

In this section we comment on the adequacy of the Document's proposals contained in the Paper.

Insufficient Appreciation of the Extent of the Problem

The Paper shows some awareness of the need to identify steps to improve tax policy making. It does not display, however, a sufficient sense of the truly appalling state to which the last Government brought our tax system.

Insufficient appreciation of the radical action which is necessary

Nor does it show an appreciation of the radical change of attitude which will be necessary if the Government is to reverse this decline. In particular the Paper does not identify the fact that HMRC is, in effect, allowed by the present system to be its' own judge and jury in respect of estimation, the justification of new and existing legislation and in the conduct of consultations.

HOW TO IMPROVE TAX POLICY MAKING

Eight Steps

The most important steps which the Government could take to improve the tax system are summarised below.

Presumption against Tax Changes

Introducing a presumption against changing the tax system unless the benefits of the proposed change can be clearly shown to be likely to exceed the cost and disadvantages which it will impose on taxpayers.

Technical Finance Bill

Routine Budget changes in respect of such matters as tax rates and levels of allowances should be enacted in an annual Tax Bill which is separate from the enactment of more wide-ranging or technical matters. Such matters would be introduced in Technical Finance Bills and announced otherwise than at the time of the Budget Speech. The Government should publicly state a presumption that these more wide-ranging technical changes would not be made every year and that the introduction of a Technical Finance Bill would require substantial justification.

An Independent Body to Oversee Tax Estimation

An independent body should have responsibility for tax estimates both for testing the validity of the estimates made of tax yield and of the wide costs of proposals for tax changes before they are implemented and for checking the accuracy of the estimates against the actual out-turn after implementation.

An Independent Body to Oversee Consultation

An independent body should have responsibility for the process of consultation to ensure that consultations are properly undertaken and that proper account is taken of their results.

Sufficient Parliamentary Time to Debate Tax Legislation in Detail

The Government should create a series of presumptions and procedures ensuring that sufficient Parliamentary time is given to allow proper debate on the detail of tax legislation.

Restricting and Improving Revenue Guidance

HMRC's publications should be reviewed for accuracy and usefulness. Only those publications which can be demonstrated to fulfill a useful function which could not be performed by commercial publishers should be continued.

An Independent Body to Review Existing Legislation

An independent body should be given the task of reviewing existing tax legislation to identify legislation which has become redundant or disproportionate.

An Acceptance that Tax Planning Activity is Natural to a Tax System

The Government should accept the principal that tax planning activity is natural in a tax system and that attempts to squeeze it out of the system entirely have resulted in the over-complex and unworkable system which it has inherited from the last Government.

SECTION III

"IT SOOTHES ALL MY TROUBLES AWAY"

In the dying days of the last Government, in his desperate search for additional tax revenue, Alistair Darling announced in his March Budget that he was raising cider duty rates by 10% above inflation giving an overall rise of over 13%. The spin put on the proposal by the Government was that the rise was designed to combat teenage binge drinking which was associated with 'white ciders'; drinks with only minimal apple juice content and a high proportion of alcohol derived from glucose. In his Budget Speech, the then Chancellor said:-

> "There is a long-standing anomaly which has meant cider has been under-taxed in comparison to other alcoholic drinks.
>
> I intend to correct this. So duty on cider will increase by 10 per cent above inflation from midnight on Sunday.
>
> In September changes will be made to the definition of cider to ensure specific strong ciders are taxed more appropriately."

It became apparent that what was proposed by the final sentence was an across the board increase in duty on cider with an alcohol content above a limit which was still to be decided.

In fact, the differential rates of duty applied to cider and other alcoholic drinks was a long standing arrangement and reflected the importance of cider making to the rural economies of the South West and of the three counties of Herefordshire, Worcestershire and Gloucestershire and to the tourist industry in those areas.

There is no exhaustive statutory definition of cider, for the Excise Duty definition is restrictive, referring to cider and perry and then excluding certain drinks which would otherwise fall into the term under its ordinary English definition. The Oxford English Dictionary defines cider as *"a drink made from the juice of apples … expressed and fermented".* It may come as some surprise, therefore, for the reader to learn that most commercial cider consists mainly of water rather than apple juice. A research paper published in 2004 by the Food Standards Agency calculated from published data that the mean juice content of cider produced in the UK was just 31% and revealed that the lowest proportion of apple juice found in the ciders analysed by the authors was just 7%.

Over the last ten to fifteen years there has been a remarkable revival in England and Wales of the making of 'fine' or 'craft cider' by small and medium sized cider makers competing with the large industrial producers on quality rather than price. Craft cider, by contrast to most cider made by the largest producers ("industrial cider"), is made from undiluted apple juice or with only minimal dilution. The final alcohol content of craft cider is normally determined by the naturally occurring sugar in the apple juice and will usually be in the range of 6% - 8.4%. That is higher than most industrial cider. Cider with an alcoholic strength exceeding 5.5% already bears a higher rate of duty than weaker cider and cider of a strength exceeding 7.5%, a higher rate again. Cider with strength of 8.5% or more, is charged at the higher rates applicable to ‘made wine’. Craft cider making requires a larger proportion of apples and is more labour intensive than industrial cider making and, because it is carried on on a smaller scale, cannot benefit from the economies enjoyed by the industrial cider producers. A 13% rise in cider duties coupled with the proposal for a further increase on ‘strong’ cider threatened to make much commercial craft cider making economically unviable. High alcohol cider will only be bought by teenage binge drinkers if it is cheap. It can only be made sufficiently cheaply if its apple juice content is even lower than that of normal industrial cider. Craft cider is not a drink for binge drinkers and, therefore, imposing penal duties in this way would not have achieved their declared aim. Doing so risked destroying an increasingly successful craft industry which makes a high quality product in an environmentally friendly way.

The Conservative Party immediately announced that it would rescind the additional 10% rise in duty and would review the definition of cider so as to impose a higher duty on those types associated with binge drinking whilst protecting ordinary and craft cider. On 27th July 2010, the Government fulfilled the Conservatives’ pledge by making the ‘Alcoholic Liquor Duties (Definition of Cider) Order 2010’, ironically under a power conferred by s.65 of Mr Darling’s last Finance Act, providing a new definition of cider for Excise Duty purposes. Any cider which does not fall within this definition will fall within the definition of made wine and thus suffer the higher rate of duty.

At first sight, the new definition appears to be designed to ensure that, to be cider, a liquor must have been made from ingredients which are at least thirty five percent apple and/or pear juice. In fact, at least under HMRC’s gloss on the definition given in amendments to Customs Notice 162, it will be fairly easy to fall within the new definition with an apple (or pear) juice content of just twenty three percent and it is theoretically possible to do so with a juice content of just twelve percent. The major industrial producers can continue to sell cider which is mostly water, which many people appear to like, without suffering a duty penalty and many craft cidermakers have been saved from ruin. The Government deserves at least two cheers for stepping back from its predecessors’ ill-judged attack.

Simon McKie’s book, *“Making Craft Cider: A Ciderist’s Guide”* will be available from Shire Publications Limited www.shirebooks.co.uk, telephone 01206 256002, and from good bookshops early next year.

SECTION IV

"A DUBIOUS APPROACH"

We recently received an email from a very kind gentleman in Nigeria. He explained that he was a Government Minister and that he had a large sum of money which he did not wish to disclose to the Nigerian Finance Ministry. For the mere use of our bank account he would allow us to keep US$30m of the money. All we had to do was to send him our bank details. In spite of the generosity of his offer, we decided not to accept it.

One would not expect to receive similar communications from HMRC even though HMRC have not always been wholly reliable in regard to their customers' financial information. On 12th August they issued a press release "warning taxpayers to be vigilant" because there are:-

> "fraudsters [who] inform taxpayers they are due [sic] a tax rebate and ask for their bank card details over the phone. They then attempt to take money from the account using the details provided…"

Chris Hodgson, Director of Customer Contact at HMRC said:-

> "We only ever contact customers who are due [sic] a tax refund in writing by post. We never use telephone calls, emails or external companies in these circumstances. We strongly urge anyone receiving such a phone call not to give any information to the caller, but report it to the police straight away."'

Our experience is rather different to Mr Hodgson's. On 11th June we were telephoned by a woman who said she was from HMRC and was working on our company's tax affairs and that she had noticed that a repayment of some £3,000 in respect of a prior year had been returned to HMRC marked 'Account Details Unknown'. She went on to say that she needed new bank details so that the repayment could be made. She was asked to read out the bank details which she had on her file which bore no relationship to the details which had been included on the company's last return. We asked her for a telephone number where we could verify her identity but she said that she was working remotely at home on secondment to an office at which she was not usually based. She could give me the office number but explained that, if we were to ring it, nobody there would know who she was. As we were not willing to give the company's bank details over the telephone, she asked that we fax the details to her on our company's headed writing paper. As an alternative to the fax, she gave an email address to which we could send the details.

We were not aware that a repayment was due and, in any event, the woman's story sounded pretty thin. Rather than fax the details to her, we rang the Tax Office dealing with the company's affairs and asked them if they knew who the caller was. The person to whom we spoke said that they had no record of her and so, assuming that we had been the target of an attempted fraud, we sent details of the incident to the company's normal inspector and asked to be informed of what steps HMRC were taking in respect of scams such as this.

We were amazed to receive a letter on 5th July confirming that the caller did indeed work for HMRC, denying that she had said that she was working from home but admitting that she had said that she was working 'remotely' and asking us to send the company's bank details to her by fax. We wrote back on 29th July 2010 expressing our astonishment at HMRC's insouciant attitude to the security of taxpayer's information particularly in view of the many public scandals which there have been over the last few years concerning HMRC's control of confidential information. Our caller wrote on the 20th August 2010 to say she was arranging for the repayment. We telephoned her on 24th August 2010 and she turned out to be a very pleasant and polite woman who expressed her hope that we were now reassured as to her bona fides. We were grateful for her help but were still surprised that HMRC were asking by telephone for taxpayers to send bank account details to them by email. We referred her to the Press Release of the 8th August 2010 of which she did not seem to be aware. She said that HMRC were contacting taxpayers by telephone to ask them for their bank details because there was a very large backlog of repayments and HMRC were trying to clear them.

We remain, however, rather bemused. For HMRC to ask taxpayers by telephone to send their bank details by email provides an obvious opportunity to fraudsters. How can a responsible organisation of any sort, let alone a major department of Government, behave in this way? Then there is the matter of the conflict between HMRC's practice and the 8th August Press Release. We have grown accustomed in recent years to HMRC's press releases reflecting a fantasy world which bears little relationship to reality, but this experience of the Department's double-speak still surprised us.

Should we take Mr Hodgson's advice and report HMRC to the police for investigation?