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MBL SEMINAR

DOTAS AND IHT

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SECTION I

INTRODUCTION[1]

THE DISCLOSURE REGIME

1.1.1 FA 2004 introduced rules requiring the disclosure to the Revenue of tax planning strategies.[2] Originally, only arrangements which conferred Income Tax, Capital Gains Tax or Corporation Tax advantages and which were either connected to employment or involved financial products were required to be disclosed.[3] The rules were then amended so as to apply to arrangements which enabled a person to obtain an advantage in respect of Income Tax, Corporation Tax, Capital Gains Tax,[4] Stamp Duty Land Tax[5] and National Insurance[6] generally.[7] A separate but similar regime governs Value Added Tax.[8]

THE EXTENSION TO INHERITANCE TAX

1.2.1 This regime (the 'Disclosure Regime') was further extended, with effect from 6th April 2011, to certain classes of arrangement under which an advantage is obtained in relation to an Inheritance Tax charge. There will be many advisers to whom the Disclosure Regime did not apply, and many others who thought that it did not apply

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1 These notes are based on an article which appeared in Issue II of the *Rudge Revenue Review* and on Chapter 21 of *Tolley's Estate Planning 2011/2012* both by Sharon and Simon M^{c}Kie

2 Part VII. All references in these notes are to Finance Act 2004 unless otherwise stated

3 Tax Avoidance Schemes (Information) Regulations 2004 SI 2004/1863

4 The Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations 2006 (SI 2006/1543)

5 The Stamp Duty Land Tax Avoidance Schemes (Prescribed Description of Arrangements) Regulations 2005 (SI 2005/1868)

6 The National Insurance Contributions (Application of Part 7 of the Finance Act 2004) Regulations 2007 (SI 2007/785)

7 FA 2004 ss.306 and 319

8 VATA 1994 ss.58A & 58B and Sch 11A

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to them, who, since April of last year should have considered for the first time whether they have a duty to make a return under this Regime. In particular, large numbers of solicitors and financial advisers who give advice on what might seem very routine Inheritance Tax planning should carefully consider whether they have a duty to make a disclosure to HMRC. A flowchart designed to determine whether a disclosure needs to be made can be found at para 10 of the Guidance.[9] This chart, like all HMRC's guidance, should be used with caution for, as is explained below, the Guidance cannot be relied upon to be an accurate summary of the law.

1.2.2 HMRC have extensive powers to obtain information by way of an application to the tribunal. We shall not be looking at those powers in detail in this lecture but an adviser should be aware of them. HMRC can apply for an order that a scheme is to be treated as disclosable,[10] an order that a promoter provides further information and documents,[11] an order requiring a person to state whether in his opinion a proposal is notifiable and if not, the reasons for his opinion,[12] and an order enforcing disclosure.[13]

1.2.3 The extension of the Disclosure Regime to Inheritance Tax is restricted to certain classes of transactions involving trusts but the history of the Regime suggests that it will not be long before the Regime is extended to Inheritance Tax generally.

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9 The guidance on the Disclosure Rules is referred to in these notes as the 'Guidance'
10 FA 2004 s.306A
11 FA 2004 s.308A
12 FA 2004 s.313A
13 FA 2004 s.314A

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HOW THE DECISION WAS MADE

An Ill-Considered Development

1.3.1 When the Disclosure Rules were first introduced in 2004, I commented that:-

> "When one considers … [the] … financial and non-financial costs of the new rules, it is very surprising that the regulatory impact assessment does not contain any attempt to quantify the cost to the taxpayer of these measures. It refers throughout to returns made by 'promoters' without any real consideration of the extent to which compliance burdens will be placed on advisers who are not promoters of the schemes in the ordinary sense. It would be extraordinary if such a fundamental change to our tax system should have been introduced without any attempt to quantify the costs to taxpayers of the change.
>
> In reaching its decision to proceed with these provisions, the Government needed to balance the benefits of the change against these potential costs. That surely required the Government to have quantified the tax at risk from arrangements, which it regards as tax avoidance arrangements, and the extent to which these new rules will allow it to frustrate those arrangements and therefore increase the Government's tax yield. Indeed, the regulatory impact assessment does assert that 'tax avoidance costs the Exchequer substantial sums in lost taxes each year', yet the Financial Statement and Budget Report, … contains no estimates in relation to these disclosure provisions. Surely,

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before making such a fundamental change to the tax system, the Government must have quantified the benefit to the Exchequer of the change?

The Revenue seems to believe that there is a problem of non-disclosure in relation to tax avoidance planning, rather than just a time lag in disclosure between the tax planning arrangements being implemented and their being disclosed on the return of the taxpayer concerned. The regulatory impact assessment asserts that 'those who design new schemes go to considerable lengths to ensure that the scheme is not detected by the Revenue and, indeed in some cases, a tax advantage may depend on the scheme being successfully hidden'. That is nonsense. Tax avoidance is by definition avoiding incurring a tax penalty within the law. If the liability is legally avoided, its disclosure cannot prevent it from being effective.

Tax planning in the United Kingdom is primarily undertaken by those who belong to professional bodies who impose onerous ethical rules on their members backed by disciplinary procedures. A client who fails to make full and proper disclosure of his transactions in his tax return will expose himself to the risk of substantial penalties under section 95, Taxes Management Act 1970. No responsible professional adviser can advise his client to do anything other than make full disclosure of his transactions. Those who do not do so at the moment are a tiny minority who are either not subject to professional discipline or who deliberately breach the rules of their professional bodies and, it may be surmised, the criminal law and have managed to remain undetected. Such persons are unlikely to comply with these new disclosure requirements.

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> So the likely result of the new rules is to provide a competitive advantage to the dishonest, many of whom will be based in jurisdictions outside the United Kingdom, stimulating an offshore 'tax avoision' industry directed at the United Kingdom, which is not subject to professional ethical disciplines or effective legal restraints.[14]

1.3.2 My pessimistic forecast was amply justified. The breakdown in the relationship between HMRC and taxation advisers in the UK, to which the new regime has contributed, and the growth of the "tax avoision" industry which it has stimulated, has had the inevitable result that some less scrupulous promoters have not complied with the Disclosure Regime. This in turn allowed HMRC to obtain from Parliament extended powers and penalties in 2007[15] and again in 2010.[16]

Ignoring Expert Opinion

1.3.3 The extension of the Rules to Inheritance Tax similarly lacked any proper assessment and quantification of its advantages and disadvantages. A Consultation Document proposing the extension was issued on 27th July 2010.[17] That referred to "some informal discussions [which] were held with representative bodies and other interested parties in January 2010." Being an informal discussion there are of course no publically available records of it. The Consultation Document asserted however that the principle of extending the DOTAS regime "was generally accepted though there were concerns about how this might be implemented".[18]

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14 *Taxation Magazine* 20 May 2004 *"Big Brother Forces A Confidence – II"*
15 FA 2007 s.108
16 FA 2010 s.56
17 Referred to in the remainder of these notes as the "Consultation Document"
18 Consultation Document para 3.3

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1.3.4 In the Chartered Institute of Taxation's response to the Consultation Document, however,[19] it made the following comments which it described as "fundamental reservations":-

> "1.2 We suggest that a review of the overall policy of Inheritance Tax (IHT) and what it is trying to achieve would be a better way of dealing with perceived tax avoidance than imposing yet another layer of anti-avoidance legislation in the form of these disclosure requirements. Indeed, in the current financial climate, we would suggest that introducing a disclosure regime based on transfers into trust rather than avoidance of IHT *per se* is not a sensible use of HMRC's resources. …
>
> 2.1 **Misguided legislation**
>
> We have yet to be convinced that there is widespread avoidance of the IHT charge that arises when property is transferred into trust or, if there is, that it is in truth avoidance. The gift into trust provisions should be subjected to a policy review before the imposition of DOTAS system can be justified. In any event, correcting the Gift with Reservation provisions might be a more appropriate response to the perceived problem. The cost assumptions provided in the Impact Assessment lack credibility."

1.3.5 In a similar vein, the Society of Trust and Estate Practitioners responded:-

[19] "Disclosure of Inheritance Tax Avoidance, Response by the Chartered Institute of Taxation 22nd October 2010

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"We would suggest that DOTAS represents a fundamentally flawed response to the real issue that arose out of a misconceived Inheritance Tax policy introduced in 2006. There is no logical policy reason why lifetime transfers into trust should be taxed more severely than outright transfers to individuals. There is indeed plenty of anti-avoidance legislation to prevent trusts being used as vehicles for tax avoidance (including s.102, s.102ZA and schedule 20 para 5 FA 1986). The desire of many people to settle assets into trust for their issue is not prompted by tax avoidance but reflects their very natural wish to ensure that children do not have unfettered control over assets of significant value until they reach a responsible age. Many clients see no logic in the idea that lifetime gifts into trust are significantly more severely taxed than lifetime gifts to individuals. If this misconceived policy was reversed then we suggest that much of the impetus for the sort of schemes the DOTAS aims to catch would fall away anyway … . The DOTAS regime should target avoidance. Many of the *Melville* arrangements [a tax planning strategy already negated by blocking legislation[20] and which might be thought to be the sort of strategy which HMRC would wish to frustrate] were not set up to avoid Inheritance Tax on the death of the person but to avoid an entry charge that was not payable before 2006 and is not due on outright lifetime gifts even now. There was no intention to avoid the reservation of benefit rules or circumvent other anti-avoidance legislation …

The nature of IHT means that the majority of advice on IHT planning is given by advisers who may not be familiar with the DOTAS regime anyway and who

[20] See IHTA 1984 s.55A & s.81A

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are not always abreast of which planning ideas are in the public domain. We are concerned that, given the breadth of the draft regulation, much time and effort will be expended by such practitioners (giving rise to increased costs to their clients) establishing whether or not the strategy they are advising needs to be reported or not."[21]

1.3.6 HMRC published a summary of the responses to the consultation on 6th December 2010 in which these fundamental criticisms by two professional bodies, who between them represent the combined expertise of over 30,000 taxation and trust practitioners were dismissed as, "Two respondents [who] felt that the proposed legislation is 'misguided' and a fundamentally flawed' response to what they perceive as misconceived policy changes in 2006".[22] The document went on to ignore these criticisms on the basis that they were "… beyond the scope of this consultation" there being "no plans for such a reform of IHT at this stage".[23]

The Impact Assessment: A Failure to Accurately Assess the Financial Impact

1.3.7 An Impact Assessment of the proposals was published on 22nd July 2010[24] under the signature of David Gauke, Exchequer Secretary to the Treasury. He stated:-

… "I am satisfied that, given the available evidence, it [the Impact Assessment] represents a reasonable view of the likely costs, benefits and impact of the leading options".

[21] STEP Response to the Consultation Document issued on 27 July 2010 made on 25th October 2010
[22] "Disclosure of Inheritance Tax Avoidance: Summary of Responses – 6th December 2010
[23] Section 2 ibid
[24] Referred to in the remainder of these notes as the "Impact Assessment"

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No proper quantification of costs

1.3.8 The Impact Assessment estimated the administrative burden on "promoters" at £90,000 per year. This was based on a cost of each notification of £3,700 per scheme on the assumption that 25 schemes will be notified to HMRC in each year. The Impact Assessment said:-

> "many promoters are likely to be familiar with the DOTAS regime already as it applies to other taxes. Those likely to promote IHT schemes will also be familiar with the IHT regime and have processes in place to comply with the new rules. However [sic] there may be a few promoters who have no experience of the DOTAS regime. They would have to familiarise themselves with the regime and draft guidance for their staff."[25]

1.3.9 As we shall see the use of the word 'promoter' is misleading. It is a term used in the legislation where it is given a special meaning[26] very different from the meaning it bears in ordinary English usage. It is clear that any firm or individual advising on Inheritance Tax planning which includes property becoming relevant property may be a promoter under the Disclosure Rules and will have to review their advice to see whether or not it must be disclosed. Many solicitors and financial advisers will have to consider the Disclosure Rules for the first time. Indeed in its summary of responses to the consultation document HMRC, admitted as much saying: "… in relation to IHT there is likely to be a higher proportion of lawyers among tax practitioners than may be the case for many other taxes. These practitioners may not have had to deal with DOTAS previously."

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[25] Page 5 ibid
[26] Section 307

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1.3.10 It is clear from the operation of the Disclosure Rules in relation to other taxes, that large numbers of arrangements are not disclosed which fall within the letter of the Rules. No doubt it will be the same with Inheritance Tax. Nonetheless, prudent firms will institute a general procedure of reviewing all of their advice and that will impose costs on clients hugely in excess of £90,000 per annum.

No quantification of yield

1.3.11 What is more the Impact Assessment also made no attempt to quantify the likely savings from this extension of the Disclosure Regime.

Only two options considered

1.3.12 Finally the Impact Assessment revealed that only two options were considered: first, the proposed extension of the Disclosure Regime and, the second, doing nothing.

The TIAN: further failure

1.3.13 As can be seen from the quotations given above, the professional bodies' responses to the Impact Assessment were scathing. When the Regulations were laid before the House of Commons, they were accompanied by Explanatory Notes and a Tax Information and Impact Note[27] ("TIAN"). That revealed that the introduction of the scheme was not forecast to have any effect on Government revenues and yet it was stated that "the change is expected to reduce the future use of IHT avoidance schemes [sic], which currently present a risk to the Exchequer." So one presumes that either the use of such arrangements does not reduce overall Government

[27] A newly expanded version of Tax Impact Assessments introduced by the Coalition Government in an attempt to make the reasons for introducing tax charges more transparent

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revenues or the effects of the Disclosure Rules are either so minor or so unpredictable that they cannot be taken into account in Government forecasting.

1.3.14 The TIAN does show signs of having taken some account of the professional bodies' criticisms of the Impact Assessment. It says for example:-

> "... on the basis of representative body estimates that up to 10,000 practitioners will need three hours training, this will be in the region of £3 million.[28] Although not directly chargeable on individuals, these initial costs will ultimately influence fee charging policies."[29]

1.3.15 Having acknowledged that this new burden will be imposed by the change, the TIAN makes no attempt to make any use of this assessment in its quantification of the cost of the compliance regime. In making that quantification it maintains the method of the Impact Assessment assuming that twenty five schemes will be notified in a year, increases the estimated cost of each notification from £3,700 to £4,400 without explaining how that figure is calculated and thus arrives at an annual cost of £110,000. It placed great weight on the fact that HMRC was "… developing a list of existing schemes and arrangements that do not have to be reported which should reduce the number of unnecessary disclosures."

[28] This implies an average charge out rate of £100. As the individuals being trained will need to fully understand the relevant IHT provisions and have the capacity to understand the complex Disclosure Rules that is unrealistically low

[29] TIAN, 'Impact on individuals and households'

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1.3.16 As we shall see, the list produced by HMRC is confused, imprecise, inaccurate and heavily caveated and is unlikely to be of any material use to a practitioner in deciding whether or not a disclosure should be made.

1.3.17 It is clear that the major cost for practitioners will not be of making returns required under the Disclosure Rules but that of reviewing advice to determine whether or not a disclosure is required. If we assume, for example, that the 10,000 practitioners to which the TIAN refers give on average ten pieces of advice per year[30] and spend one hour reviewing each piece of advice,[31] and if we adopt the Revenue's assumption that the average charge out rate is £100 per hour, that would give an annual cost which will ultimately be borne by the clients of the advisers, that is by taxpayers, of £10 million. So a relief, the benefits of which are so unpredictable that they have no effect on the Government's forecasts of its income, is likely to impose an annual cost on this body of taxpayers of £10 million. That is small beer in comparison with the total burdens imposed on taxpayers but not, surely, a burden which should be imposed without some commensurate quantification of its benefits.

1.3.18 One other claim of the TIAN is also significant. It is that the IHT Disclosure Rules will have no effect on 'privacy'.[32] The introduction of the Disclosure Rules in 2004, however, was a fundamental change in the relationship between Revenue Departments and the taxpayer and his adviser. For the first time, taxpayers generally were required to submit information about their transactions to a Revenue Department, whether or not those transactions gave rise to a tax liability[33] and their

[30] Surely a very modest estimate
[31] Considering the complexity of the issues this is a very low estimate of the time involved
[32] TIAN "Other impacts"
[33] Section 313

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advisers were required to provide details of their advice whether or not their advice was acted upon.[34] It is difficult to see how the extension of these requirements to another class of transactions and another tax involving a new population of advisers and taxpayers cannot have some effect on privacy issues.

1.3.19 So the extension of the Disclosure Rules to IHT cannot be justified on financial grounds. As STEP's representations made clear, the increase in tax motivated transactions, if indeed there was such an increase, to which the new rules are claimed to be a response was merely a symptom of a more fundamental problem. That more fundamental problem is the conceptual incoherence of the rules governing the Inheritance Taxation of trusts which resulted from the changes made in the Finance Act 2006.

[34] Section 308(2)(a)

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SECTION II

THE FORM OF THE LEGISLATION

AN OJBECT LESSON IN FAULTY DRAFTING

2.1.1 The legislation governing the Disclosure Rules is an example of many of the worst features of modern tax legislation.

2.1.2 The primary legislation provides only a framework for the Disclosure Regime and a series of powers for the Treasury to make secondary legislation by way of statutory instrument. That ensures that the disclosure rules mostly escape detailed parliamentary scrutiny. The bulk of the legislation is, therefore, found in Regulations which have been amended piecemeal and now require consolidation.

2.1.3 The Regulations governing Inheritance Tax[35] are very poorly drafted so that their scope is uncertain. The Coalition Government has followed the deleterious practice of its predecessor in allowing HMRC to sponsor poor legislation the faults of which they then attempt to correct through inaccurate and inadequate guidance. The practitioner is, therefore, placed in the position of having to decide to what extent he can rely on HMRC's statements as to the effect of the law where many of those statements are inaccurate and, where they are not, present what is only one tenable view amongst many as if it were the only possible view. The Guidance is often so imprecise that the practitioner will not know whether or not he falls within its terms.

[35] The Inheritance Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations 2011 (SI 2011/170) (referred to in the remainder of these notes as the "Regulations") and the Tax Avoidance Schemes (Information) (Amendment) Regulations 2011 (SI 2011/171)

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Even if he does fall within the terms of the Guidance, where the Guidance conflicts with the law he will only be able to rely on it to the extent that he can anticipate establishing, in Judicial Review proceedings, that he has a legitimate expectation that the Guidance will be applied.

2.1.4 Because the IHT Disclosure Regime is an extension of the existing regime, it fits within an extensive compliance system which has been developed since 2004. In this lecture the general provisions are discussed by way of background and a more detailed discussion is made of the Regulations dealing with Inheritance Tax.

NOTIFIABLE PROPOSALS

2.2.1 Sections 308–310 impose a duty of disclosure on promoters of notifiable proposals and on persons entering into transactions forming part of notifiable arrangements. It will be seen that the term 'promoter' is very widely defined and will include most providers of taxation advice in respect of notifiable proposals.

2.2.2 A notifiable proposal is '…a proposal for arrangements which, if entered into, would be notifiable arrangements (whether the proposal relates to a particular person or to any person who may seek to take advantage of it)'.[36]

[36] FA 2004 s.306(2)

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NOTIFIABLE ARRANGEMENTS

2.3.1 Notifiable arrangements are central to the duty of disclosure, as it is only such arrangements which can give rise to a notifiable proposal. Notifiable arrangements are any arrangements which:-

(a) fall within any description prescribed by the Treasury by regulations (the hallmarks);

(b) enable, or might be expected to enable, any person to obtain an advantage in relation to any tax that is so prescribed in relation to arrangements of that description; and

(c) are such that the main benefit, or one of the main benefits, that might be expected to arise from the arrangements is the obtaining of that advantage.[37]

2.3.2 Before looking at those elements of this definition which are prescribed by regulation, the meanings of 'arrangements', 'advantage' and 'main benefit' will be considered.

Arrangements

2.3.3 FA 2004 s.318(1) provides that the meaning of 'arrangements' for this purpose 'includes any scheme, transaction or series of transactions'. It will be noticed that the definition is inclusive rather than exhaustive. In the context of the definition of a settlement for the Income Tax provisions found in ITTOIA 2005 Pt 5 Ch 5 the term

[37] FA 2004 s.306(1)

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'arrangement' has been held to be a wide one.[38] It is likely that the courts will take a similarly wide view of the meaning of 'arrangements' in the Disclosure Regime. Certainly it is clear from s.318(1) that 'arrangements' can include a single transaction. As we shall see, however, HMRC seem to assume, erroneously, that a single transaction cannot be within the meaning of 'arrangements' for this purpose.

Tax Advantage

2.3.4 For the Disclosure Regime to apply, the arrangements must enable or be expected to enable an advantage to be obtained and such an advantage must be either the main, or one of the main, benefits expected to arise'.[39] An 'advantage' in relation to any tax is defined in s.318(1) as:-

> "(a) relief or increased relief from, or repayment or increased repayment of, that tax, or the avoidance or reduction of a charge to that tax or an assessment to that tax or the avoidance of a possible assessment to that tax,
>
> (b) the deferral of any payment of tax or the advancement of any repayment of tax, or
>
> (c) the avoidance of any obligation to deduct or account for any tax;"

2.3.5 This definition is based on the definition in the transactions in securities legislation[40] which has been considered by the courts in a number of cases. Although the exact

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38 See for example *Burston v CIR* (Number 1); *Halperin v CIR* [1945] 2 All ER 61 (KB); *CIR v Prince-Smith* [1943] 1 All ER 434 (KB); *Young v Pearce: Young v Scrutton* [1996] STC 743 (ChD); *CIR v Pay* [1955] 36 TC 109 (ChD); *Crossland v Hawkins* [1961] 2 All ER 812 (CA); *Vandervell v CIR* [1967] 2 AC 291 (HL); *CIR v Wachtel* [1971] 1 All ER 296 (ChD)

39 FA 2004 s.306(1)

40 Found in ITA 2007 Part 13, Chap 1

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meaning of that definition is uncertain, its scope is certainly extremely broad. In the Guidance, HMRC say:-

> "where the scheme is expected to result in tax being avoided or reduced then the long-standing judgment of Lord Wilberforce in *CIR v Parker* [1966] AC 141 applies and the existence of a tax advantage is tested on a comparative basis."[41]

2.3.6 *CIR v Parker* concerned the transactions in securities provisions. It is perhaps a reasonable assumption that the courts will have regard to the case law on the meaning of 'tax advantage' in that legislation in construing the phrase in the Disclosure Regime.

2.3.7 In another transactions in securities case, *Emery v CIR*,[42] it was held that a tax advantage is obtained where a person receives something in a non-taxable form which, if received in another way, would have been taxable even though it might also have been received in a third way which was non-taxable. By extension, the view might be taken that a tax advantage arises where a result might have been obtained by a route which results in a tax charge but is actually obtained by another route which results in no, or a lesser, tax charge.

2.3.8 What is more, in respect of the transactions in securities rules, the courts have applied a wide latitude in identifying a hypothetical receipt to which to compare the

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41 Guidance para 11.4.1
42 *Emery v CIR* [1981] STC 150 (ChD)

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actual receipt. In *Cleary v IRC*[43] a company repurchased its own shares. In determining whether there was a tax advantage, a comparison was made with the situation which would have ruled had the company paid a cash dividend equal to the purchase consideration. Of course, a shareholder who sells shares suffers a diminution in his rights over the company whereas one who receives a dividend does not. In spite of that, the court was able to regard the receipt of sale proceeds as being the same receipt for the purpose of the comparison as a hypothetical receipt of a dividend.

2.3.9 There is a very great difference between the sort of transactions which are subject to the transactions in securities rules and those which are undertaken for Inheritance Tax planning purposes. Where a transfer into trust is made, the transfer will not be a benefit to the transferor except in an intangible manner by satisfying his wish to provide for those whom he loves and for whom he feels responsibility. If we look at all of the parties concerned, the settlor and the beneficiaries, there will not be any net change in their wealth.

2.3.10 How will the courts decide which hypothetical transactions they are to regard as comparable to the actual transactions taking place in the arrangements? If the end result of two alternative sets of transactions is exactly the same and the actual and hypothetical transactions are only differentiated by the inclusion of intermediate steps in the actual transaction, it is likely that the courts will find the two sets of transactions, actual and hypothetical, to be equivalent.

[43] *Cleary v IRC* (1967) 44 TC 399 (HL)

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Example One

If a father who wishes to make a discretionary settlement for his daughters instead gives money to his wife in the hope and expectation that she will settle the money on discretionary trusts on identical terms to those on which he would have settled it, it would be easy for the court to decide that the hypothetical arrangements to which the actual arrangements is to be compared is the direct settlement. Even here, however, the effects of the two are not exactly the same. For example, if the wife were to become insolvent within two years of the settlement being made, it could be set aside whereas, in such circumstances, a settlement made directly by the husband could not (Insolvency Act 1986 s.339).

What, however, if the wife is subject to gift and succession taxes in another state and, by reference to the taxation laws in that state, makes a significantly different settlement from the one which the husband would have made? Will the courts then still see the actual and hypothetical transactions as equivalent? If they were to follow the wider approach adopted in the transactions in securities cases no doubt they would but would they do so in relation to the very different provisions relating to the disclosure of Inheritance Tax arrangements?

2.3.11 So it will often be difficult to determine what hypothetical transaction should be the comparator with which the taxpayer's actual transaction is to be compared.

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Example Two

A father is contemplating settling shares in an investment company on discretionary trusts for his daughters. Because the shares are worth more than his unused Nil-Rate Band he decides first to reorganise the share capital of the company so as to create preference shares with a market value equal to his unused Nil-Rate Band and ordinary shares whose value is equal to the value of the whole company in excess of that amount. He then settles the preference shares on discretionary trusts and makes an outright gift of the ordinary shares. In determining whether a main benefit of the arrangements consisting of the re-organisation, gift and settlement is the obtaining of a benefit in relation to a relevant property entry charge, does one compare his actual transactions with a simple settlement of the original shares on discretionary trusts? The effect of the actual transactions will be very different from that of the transactions which the father originally contemplated which might be taken to be the appropriate comparator.

2.3.12 The Guidance provides no useful commentary at all on these difficult issues.

Main benefit

2.3.13 Condition (c) of s.306(1) raises the difficult question of when a benefit is a ‘‘main benefit’’. The Oxford English Dictionary defines ‘‘main’’ as ‘‘principal, chief, pre-eminent’’ and specifically in relation to ‘‘a quality, condition, action, etcetera’’ as

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meaning ‘‘very great in degree, value etcetera; highly remarkable for a specified quality, very great or considerable of its kind.”

2.3.14 It should be clear from this definition that there can only be more than one main benefit of a thing where those main benefits may all be fairly described as chief or as very great in degree or highly remarkable, etc. Where one benefit is of greatly more importance than all the others, the absolute pre-eminence of one benefit precludes any other benefit from being a main benefit.

Snell v HMRC

2.3.15 One must, however, be cautious in the light of the Special Commissioner’s decision in *Snell v HMRC* SpC [2008] SSCD 1094 which concerned the meaning of ‘main benefit’ in the transfer of assets abroad legislation. The Special Commissioner found that, although a sale was undertaken for a bona fide commercial purpose, it also had another main purpose of conferring a tax advantage. This, in spite of the fact that the tax benefit of the transaction was just seven percent of the total transaction value.

Expected benefits of actual arrangements

2.3.16 It should also be noted that in contrast to FA 2004 s.306(1)(b), s.306(1)(c) looks at the expected benefits of the actual arrangements concerned. So in deciding whether the benefit consisting of the advantage is a main benefit one is making a comparison with the other benefits expected to arise under the actual arrangements rather than arising from another set of hypothetical arrangements.

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2.3.17 The Guidance gives no help in understanding the ambit of condition (c). It makes the point that the test is objective rather than subjective which is only partially true: as we have seen, although condition (c) does not look at an actual person's expectation it is still concerned with expectation, that of an hypothetical person. Apart from that, all it says is:-

> "In our experience those who plan tax arrangements fully understand the tax advantage such schemes are intended to achieve. Therefore we expect it will be obvious (with or without detailed explanation) to any potential client what the relationship is between the tax advantage and any other benefits of the product they are buying ..."[44]

Whose expectation?

2.3.18 It will be noticed that in sub-sections (b) and (c), the definition is not concerned with actual benefits but rather with benefits which might be expected to arise. The use of the conditional 'might' implies a hypothetical person whose likely expectations are to be considered. One presumes that this is a hypothetical reasonable man. The question of whether the condition in FA 2004 s.306(1)(c) applies, therefore, must depend upon whether a reasonable man would consider one of the main benefits of the arrangements to be the obtaining of a tax advantage. It will often be the case that the 'promoter' of the arrangements asserts that they will have the desired taxation effects whereas HMRC, when they become aware of them, assert that they do not. In considering whether s.306(1)(c) is satisfied, however, it is the probable expectations

[44] Guidance para 11.5

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of the reasonable man that matter and he may share the opinion of either the 'promoter' or of HMRC.

ARRANGEMENTS: PRESCRIBED DESCRIPTIONS

2.4.1 The actual description of the arrangements which fall within FA 2004 s.306(1) are prescribed by the Treasury in Regulations. Each set of regulations prescribes one or more descriptions in respect of particular taxes. A description in respect of Inheritance Tax is prescribed by, and only by, the Inheritance Tax Avoidance Schemes.[45]

Regulation 2

2.4.2 Regulation 2(2) & (3) of the IHT Regulations provides:-

> "(2) Arrangements are prescribed if -
>
> (a) as a result of any element of the arrangements property becomes relevant property; and
>
> (b) a main benefit of the arrangements is that an advantage is obtained in relation to a relevant property entry charge.
>
> (3) In this regulation -
>
> 'property' shall be construed in accordance with section 272 of the Inheritance Tax Act 1984;
>
> 'relevant property' has the meaning given by section 58(1) of the Inheritance Tax Act 1984;

[45] Prescribed Descriptions of Arrangements Regulations 2011 (SI 2011/170) referred to in these notes as the "IHT Regulations"

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'relevant property entry charge' means the charge to Inheritance Tax which arises on a transfer of value made by an individual during that individual's life as a result of which property becomes relevant property;

'transfer of value' has the meaning given by section 3(1) of the Inheritance Tax Act 1984."

2.4.3 Because these arrangements are prescribed in relation to Inheritance Tax, arrangements will only be notifiable arrangements under this description if they enable a person to obtain an advantage in relation to Inheritance Tax and not, for example, if property becomes relevant property for the purposes of Inheritance Tax and in so doing confers an Income Tax advantage.[46] Of course, it is also possible in such a case that the arrangements may fall within one of the descriptions prescribed in relation to Income Tax.

Any element of the arrangements

2.4.4 It will be seen that arrangements will not be prescribed unless 'as a result of any element of the arrangements property becomes relevant property'. What is an 'element' of the arrangements? If a father gives property to his son and he in turn settles the property on trust for his daughter, is the settlement a result of an element of the arrangements if:-

(a) at the time when the father makes up his mind to make the gift, he and his son plan together that the son should make the settlement; or

[46] FA 2004 s.306(1)(b)

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(b) they do not plan the son's settlement but he is enabled to make the settlement by the gift because he has no other assets with which to do so; or

(c) they do not plan the son's settlement and he would have been able to make the settlement whether or not the gift proceeded but he feels morally obligated to share his good fortune with his daughter?

2.4.5 The answer is by no means clear. Tentatively, we should expect a Court to find Regulation 2(2)(a) satisfied in relation to (a) and, possibly, (b) but not in respect of (c).

A Relevant Property Entry Charge

2.4.6 It can be seen that for the condition in regulation 2(2)(b) to be satisfied, the advantage must be obtained 'in relation to a relevant property entry charge' and that 'a relevant property entry charge' means 'the charge to Inheritance Tax which arises on a transfer of value made by an individual during that individual's life as a result of which the property becomes relevant property.' What is the effect of the opening indefinite article? It surely requires there to be an actual relevant property entry charge arising under the arrangements rather than merely referring to the abstract concept of the relevant property entry charge. So, under this construction, if no benefit is obtained in relation to an actual relevant property entry charge the arrangements will not be prescribed. So, if it were possible to place property in a relevant property settlement without giving rise to a relevant property entry charge, regulation 2(2)(b) would not be satisfied even if there were an alternative way of

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achieving the same result under which such a charge would arise. It does not appear that HMRC accept that this is the case.

2.4.7 Paragraph 11.4.3 of the Guidance says:-

> "Where there are:-
>
> - arrangements which result in property becoming relevant property;
> - there is no transfer of value; but,
> - in the absence of other intervening steps in the arrangements there would have been a transfer of value;
>
> disclosure may be required. This is because the arrangements, have, by definition [sic], resulted in an advantage in respect of the relevant property entry charge."

2.4.8 Paragraph 11.8 of the Guidance says under the heading 'Examples of arrangements not exempted from disclosure':-

> "Examples of arrangements which would <u>not</u> be excluded from disclosure include arrangements where property becomes relevant property and an advantage is obtained in respect of the relevant property entry charge:-
>
> - where the claim that there is no transfer of value relies on a series of transactions where, in the absence of all other intervening steps, there would have been a transfer of value and a relevant property entry charge;"

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2.4.9 So it seems that, in HMRC's view, a benefit may be obtained where no relevant property entry charge actually arises but one would have arisen had the same result been obtained by different transactions.

2.4.10 It may be that HMRC have reached this view because they have overlooked the significance of the indefinite article in regulation 2(2)(b). In the passage quoted above from para 11.4.3 and in the following passage from para 11.4.1, for example, they substitute the definite for the indefinite article:-

> "It is important to note that under the Regulations a scheme is only disclosable if there is a tax advantage in respect of *the* [emphasis added] 'relevant property entry charge' (see 11.4.2 below). Where a scheme provides a tax advantage but that advantage is not in respect of *the* [emphasis added] "relevant property entry charge" then disclosure will not be required under the Regulations."

2.4.11 If that is HMRC's view, they are incorrect. If they were correct in their view, however, it would not be necessary for arrangements to include a transfer of value for them to be notifiable arrangements. That is because, if that view were correct, it would be sufficient for property to have become relevant property as a result of the arrangements and that a relevant property entry charge would have arisen on alternative transactions even if one did not actually arise. The Guidance, however, says at para 11.4.3:-

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"Where there is no transfer of value and no wider arrangements then no advantage can be obtained in respect of a transaction which results in property becoming relevant property."

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SECTION III

GRANDFATHERING

REGULATION 3

3.1.1 Regulation 3 of the Regulations provides that:-

> "Arrangements are excepted from disclosure under these Regulations if they are of the same, or substantially the same, description as arrangements -
>
> (a) which were first made available for implementation before 6th April 2011; or
>
> (b) in relation to which the date of any transaction forming part of the arrangements falls before 6th April 2011; or
>
> (c) in relation to which a promoter first made a firm approach to another person before 6th April 2011."

Restriction

3.1.2 According to the Guidance this regulation is designed to restrict disclosure to those schemes which are new or innovative by exempting schemes which are the same or substantially the same as arrangements made available before 6th April 2011.[47]

3.1.3 The Guidance refers to this as 'grandfathering'. In order to understand the scope of this exclusion, the meaning of the following words and phrases must be understood:-

[47] Guidance para 11.6

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(a) '… substantially the same … description';

(b) 'made available for implementation';

(c) 'promoter' ;

(d) 'made a firm approach'.

'<u>… Substantially the same … description</u>'

3.1.4 In the Guidance, HMRC say:-

> "in our view a scheme is no longer substantially the same if the effect of any change would be to make any previous disclosure misleading in relation to the second (or subsequent) client."[48]

3.1.5 It is tentatively suggested that the key to deciding whether arrangements are substantially the same as other arrangements is whether tax would be charged in the same manner on two sets of arrangements which have the same end result. That would seem to follow both from the purpose of the provisions and from their concentration on whether a tax advantage is obtained. If that is the case, HMRC's assertion that arrangements (it should be noted that the Guidance does not use the statutory word 'arrangements' but substitutes the pejorative word 'scheme') will not be substantially the same if they have been adjusted to take account of 'changes in the law or accounting treatment' is only an approximation to the true position. For example, if the strategy involves the acquisition by trustees of shares qualifying for business property relief and the contractual terms of the acquisition are altered in order to take account of changes in Financial Services legislation, that would surely

[48] Guidance para 12.2.3

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not prevent those arrangements being regarded as substantially the same as the arrangements before the alterations were made.

3.1.6 Determining when arrangements are substantially the same as grandfathered arrangements will often be difficult. Consider for example, if the changes made by FA 2006 to the Inheritance Taxation of trusts had been made shortly after the time when the IHT Disclosure Regime came into effect. Before the change, arrangements often involved using a discretionary trust because the designer wished the trust to be within the relevant property regime. After the change, arrangements which were otherwise the same often used interest-in-possession trusts because such trusts were for the first time, within the relevant property regime and beneficiaries usually prefer to have a vested interest in income. Would that change have resulted in the arrangements being not substantially the same as arrangements prior to the introduction of the Inheritance Tax Disclosure Regime? One would not have thought so. The Guidance contains no useful commentary on such matters.

'Made available for implementation'

3.1.7 The date when a promoter makes a notifiable proposal available for implementation is important in determining when a disclosure must be made to HMRC. It is obviously generally in the promoter's interest for that date to be as late as possible. In respect of the grandfathering provisions, however, it is in the promoter's and the client's interests for the date at which the same or substantially the same arrangements have been made available to be before 6th April 2011. The Guidance in respect of Inheritance Tax arrangements simply incorporates HMRC's general

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material as to when arrangements are made available for implementation. That material is obviously designed to draw the date back as early as possible.

3.1.8 The Concise Oxford English Dictionary defines available as 'able to be used, unoccupied'. If a plan is available when it is 'able to be used', a person to whom it is available must be able to implement it and that must mean that he has all of the information available to him to allow him to do so. A tax planning scheme which has been described in sufficient detail to allow the client to decide whether or not he wishes to enter into it will not have been made available for implementation, if, for example, the client has not been given the documents which will enable him to implement it. The Guidance, however, says that:-

> "A scheme is made available for implementation at the point when all the elements necessary for implementation of the scheme are in place and a communication is made to a client suggesting the client might consider entering into transactions forming part of the scheme, but it does not matter whether full details of the scheme are communicated at that time."[49]

3.1.9 It is difficult to see how arrangements can be made available for implementation to a person who is in fact incapable of implementing them because he lacks some essential information such as the wording of an appropriate document. Yet such a person would be quite capable of understanding the expected tax advantages of an arrangement and of deciding whether or not to enter into it.

[49] Guidance para 12.3.2

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'Promoter'

3.1.10 A 'promoter' is defined in FA 2004 s.307. The definition of promoter is not only important in respect of determining whether arrangements are grandfathered. More fundamentally, the duty to make a disclosure imposed by FA 2004 s.308, which is the duty under the disclosure rules which is most likely to apply to advisers on estate planning, is imposed on promoters. In respect of a notifiable proposal, a person is a promoter:-

> "…if, in the course of a relevant business, the person ('P') -
>
> (i) is to any extent responsible for the design of the proposed arrangements,
>
> (ii) makes a firm approach to another person ('C') in relation to the notifiable proposal with a view to P making the notifiable proposal available for implementation by C or any other person, or
>
> (iii) makes the notifiable proposal available for implementation by other persons."

The Promoter Exclusions

3.1.11 This is, of course, an extremely wide definition. Barristers, solicitors, accountants, chartered tax advisers, financial advisers and other advisers whose work includes an element of tax advice fall within the scope of it. The width of the definition is, however, restricted by the Regulations[50] which exclude certain classes of persons who would otherwise be promoters. There are exclusions for employees and for companies within corporate groups. There are also three general exclusions which

[50] Tax Avoidance Schemes (Promoters and Prescribed Circumstances) Regulations 2004 SI 2004/1965 [hereafter referred to in this lecture as the "Promoter Regulations] Regulation 2

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apply to persons who would otherwise be promoters under FA 2004 ss.307(1)(a)(i) or (b)(i). Those three exclusions are given labels in the Revenue's Guidance. In spite of the rather misleading nature of those labels we shall use them here because they are commonly used as a shorthand. They are:-

(a) the Benign Test;

(b) the Non-adviser Test;

(c) the Ignorance Test.

'The Benign Test'

3.1.12 The Benign Test is satisfied:-

> "… where, in the course of providing tax advice, a person is not responsible for the design of any element of the proposed arrangements or arrangements (including the way in which they are structured) from which the tax advantage expected to be obtained arises."[51]

3.1.13 In respect of this the Guidance says:-

> "for example, a promoter marketing or designing a scheme may consult a second firm to provide advice in relation to a particular element of it. This second firm will not be a promoter, despite being involved in the design of the overall scheme, so long as any tax (or National Insurance Contributions) advice does not

[51] The Promoter Regulations, reg 4

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contribute to the tax (or National Insurance Contributions) advantage element of it."[52]

3.1.14 But it is not the advice which has to contribute to the tax advantage but rather the element on which the advice is given. So if, for example, it is essential to the tax advantage of arrangements that an investment should qualify as an authorised unit trust, a financial services specialist who provides advice to ensure that that is the case, will not, in spite of the apparent meaning of the Guidance's example, be exempt under the Benign Test. The Guidance seems to recognise that because it goes on to provide a very much narrower view of the scope of the Benign Test:-

> "For example, a promoter may seek advice from an accounting or law firm on whether two companies are 'connected' for any purposes of the Taxes Act. Provided the advice goes no further than explaining the interpretation of words used in tax legislation, it would be benign; as would advice on general compliance requirements and so on."[53]

3.1.15 It is true that mere advice on the construction of legislation will not make a person a promoter in respect of a notifiable person. It would not fall within the basic provisions of FA 2004 s.307(1)(a).

The Non-adviser Test

3.1.16 The Non-adviser Test is satisfied where:-

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[52] Guidance para 3.4.1
[53] Guidance para 3.4.1

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"(a) a person, in the course of a business that is a relevant business for the purposes of section 307 by virtue of subsection (2)(a) of that section, is to any extent responsible for the design of the proposed arrangements or arrangements; but

(b) does not provide tax advice in the course of carrying out his responsibilities in relation to the proposed arrangements or arrangements."[54]

3.1.17 FA 2004 s.307(2)(a) provides:-

"In this section 'relevant business' means any trade, profession or business which -

(a) involves the provision to other persons of services relating to taxation ..."

The Ignorance Test

3.1.18 A person will not be a promoter where he:-

"(a) is not responsible for the design of all the elements of the proposed arrangements or arrangements (including the way in which they are structured) from which the tax advantage expected to be obtained arises; and

(b) could not reasonably be expected to have -

[54] The Promoter Regulations reg 4(3)

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(i) sufficient information as would enable him to know whether or not the proposal is a notifiable proposal or the arrangements are notifiable arrangements; or

(ii) sufficient information as would enable him to comply with section 308(1) or (3)."[55]

3.1.19 This will absolve from being a promoter those firms which provide tax advice in respect of some limited part of the arrangements but are not responsible for the overall design of the arrangements and do not make the arrangements available for implementation by others. It will only do so, however, if they are acting in circumstances where they cannot be expected to understand the nature of the overall arrangements governing the elements on which they are giving advice. That must be a very limited class of advisers, particularly in view of the modern professional's need to guard against becoming involved in money laundering arrangements.

'Made a firm approach'

3.1.20 A firm approach Is defined in FA 2004 s.307(4A) as follows:-

"(4A) For the purposes of this Part a person makes a firm approach to another person in relation to a notifiable proposal if the person makes a marketing contact with the other person in relation to the notifiable proposal at a time when the proposed arrangements have been substantially designed.

[55] The Promoter Regulations reg 4(4)

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(4B) For the purposes of this Part a person makes a marketing contact with another person in relation to a notifiable proposal if -

(a) the person communicates information about the notifiable proposal to the other person,

(b) the communication is made with a view to that other person, or any other person, entering into transactions forming part of the proposed arrangements, and

(c) the information communicated includes an explanation of the advantage in relation to any tax that might be expected to be obtained from the proposed arrangements.

(4C) For the purposes of subsection (4A) proposed arrangements have been substantially designed at any time if by that time the nature of the transactions to form part of them has been sufficiently developed for it to be reasonable to believe that a person who wished to obtain the advantage mentioned in subsection (4B)(c) might enter into -

(a) transactions of the nature developed, or

(b) transactions not substantially different from transactions of that nature."

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SECTION IV

THE GUIDANCE ON THE GRANDFATHERING RULE

GENERAL

4.1.1 Paragraph 11.7 of the Guidance is headed 'list of grandfathered schemes and schemes that are not within the Regulations'. The Guidance explains:-

> "A list of schemes which HMRC regards as being 'grandfathered' may be found below … To be as extensive as possible, the list includes arrangements which do not fall within the regulations because, for example, property does not become relevant property."

4.1.2 The Guidance again refers to 'schemes', a term which is not used in the legislation which is concerned with 'arrangements'. As the Guidance explains, the list does not just include grandfathered arrangements but also other arrangements which do not fall within the basic provisions of regulation 2. How a list of grandfathered arrangements can be made 'as "extensive" as possible' by mixing it up with other sorts of arrangements is not immediately apparent.

4.1.3 The Guidance also says:-

> "If there is any doubt as to whether a scheme ought to be disclosed then a disclosure should be made."[56]

[56] Guidance para 11.7

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4.1.4 It will be apparent from the analysis in this lecture that in relation to much, possibly most, Inheritance Tax advice in respect of arrangements under which any property becomes relevant property there will be uncertainty as to whether or not the scheme ought to be disclosed. If advisers follow the advice in the Guidance, HMRC will be inundated with disclosures in respect of perfectly routine Inheritance Tax planning. It is difficult to see how that is consistent with the Guidance's statement that:-

> "One of the aims of the extension of the disclosure rules to Inheritance Tax is to restrict disclosure to those schemes which are new or innovative."[57]

4.1.5 Of course, a liability to disclose can only arise in respect of arrangements which fall within the statutory definition but it will be prudent for advisers to err strongly on the side of caution in deciding whether or not to make disclosures, particularly because of the penalties that can be imposed where there is a failure to make a required disclosure.

LIST OF GRANDFATHERED SCHEMES AND SCHEMES THAT ARE NOT WITHIN THE REGULATIONS

HMRC's List

4.2.1 The list of grandfathered schemes and schemes which HMRC consider not to be within the regulations includes:-

[57] Guidance para 11.6

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(a) Arrangements where property does not become relevant property;

(b) Arrangements that qualify for relief/exemptions;

(c) The purchase of business assets with a view to transferring the assets into a relevant property trust after two years;

(d) The purchase of agricultural assets with a view to transferring the assets into a relevant property trust after the appropriate period;

(e) Pilot Settlements;

(f) Discounted Gift Trusts/Schemes;

(g) Excluded property trusts; disabled trusts; employee benefit trusts which satisfy s 86 and a qualifying interest in possession trust;

(h) Transfers on death into relevant property trusts;

(i) Changes in distribution of deceased's estates;

(j) Transfers of the Nil-Rate Band every seven years;

(k) Loan into trust;

(l) Insurance Policy trusts;

(m) Making a chargeable transfer followed by a potentially exempt transfer;

(n) Deferred shares;

(o) Items of national importance;

(p) Pension death benefits;

(q) Reversionary interests;

(r) Transfers of value;

(s) Gifts to Companies.

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GUIDANCE IN RESPECT OF ARRANGEMENTS WHICH, HMRC SAY, DO NOT FALL WITHIN REGULATION 2

4.3.1 Some of the items on this list are merely anodyne, for example, Item A, whereas others, Item B for example, are obscure, inaccurate and contradictory.

Item B: Arrangements that qualify for relief/exemptions

4.3.2 The Guidance says at Item B that:-

> "(a) A single step that qualifies for a relief or exemption (where there are no other steps in order to gain an advantage) will not require disclosure.
>
> (b) Where the arrangements lead to qualification for:-
>
> - multiple reliefs or exemptions;
> - more than one application of the same relief or exemption;
> - a single relief or exemption where there are further steps in order to gain an advantage;
>
> then disclosure will not be required where the arrangements can be shown to be covered by the grandfathering rule.
>
> When considering whether arrangements which qualify for a relief or exemption require disclosure, it is important to remember that the arrangements must result in property becoming relevant property for the Regulations to apply."

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4.3.3 If HMRC's apparent view is correct that regulation 2(2)(b) may be satisfied when no actual relevant property entry charge arises but one might have arisen in an alternative transaction, the statement is clearly incorrect.

Example Three

Luke, who has utilised his entire Nil-Rate Band, wishes to settle property worth £100,000 on discretionary trusts. Rather than settling £100,000 from his bank account he settles £100,000 of property qualifying for business property relief.

This settlement is an arrangement because it is a transaction (FA 2004 s.318(1)). The arrangements satisfy the condition of regulation (2)(a) because as a result of the transfer, property becomes relevant property. There is an alternative way of achieving the same result or substantially the same result under which Luke would have suffered a relevant property entry charge. If HMRC's apparent view that regulation 2(2)(b) can be satisfied without an actual relevant property entry charge arising were correct, Luke would have gained an advantage in relation to such a charge and 2(2)(b) would be satisfied. So the settlement would be a notifiable arrangement unless it were 'grandfathered' by regulation 3.

4.3.4 The bullet points given in the Guidance in Item B, quoted at para 4.3.2 above, must be alternative rather than cumulative so the implication is that where arrangements

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consisting of a single transaction lead to qualification for multiple reliefs or exemptions (the first bullet point) there do not need to be further steps in order for the arrangements to be disclosable. That implies that HMRC thinks that arrangements consisting of a single step can be disclosable in which case there appears to be a contradiction between Item A and Item B. So, for example, if Luke had not used his annual exemption in our example above, the settlement would have qualified for relief under IHTA 1984 s.19 as well as for relief under IHTA 1984 s.104. It would seem to fall within HMRC's first bullet point and, under the view of the law set out in the Guidance, would have been disclosable had it not been clearly covered by the grandfathering rule.

Item H: Transfers on death

4.3.5 The Guidance says at Item H:-

> "A transfer into a relevant property trust made under the terms of a person's Will or paid into a relevant property trust on a person's death will not require disclosure."

4.3.6 This is true if the arrangements have to involve an actual relevant property entry charge but is not true if they do not.

Example Four

Septimus is considering setting up a relevant property settlement. He could do so during his lifetime or under his will. He decides to do so under his will

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because he has made previous chargeable transfers which are likely to drop out of cumulation if the settlement is not made until his death. It is clear that the creation of a settlement under the Will constitutes arrangements under the definition in FA 2004 s.318. As a result of an element of the arrangements, property becomes relevant property. So regulation 2(2)(a) is satisfied. It appears that there is a tax advantage in respect of a relevant property entry charge because there is an alternative way of achieving the same result which would result in an Inheritance Tax charge. If regulation 2(2)(b) can be satisfied without an actual relevant property entry charge arising, then regulation 2(2) is satisfied in respect of the arrangements consisting of the settling of property under a will.

Item I: Changes in the distribution of a deceased's estate

4.3.7 In respect of changes in the distribution of a deceased's estates, the Guidance says at Item I:-

"Section 17 prevents there from being a transfer of value where there is:-

(i) a variation or disclaimer to which s.142(1) applies;

(ii) a transfer to which s.143 applies;

(iii) an election by a surviving spouse or civil partner under s.47A of the Administration of Estates Act 1925;

(iv) the renunciation of a claim to legitim or rights under s.131 of the Civil Partnership Act 2004 within the period mentioned in s.147(6)

Where property becomes relevant property but s.17 applies to the transaction then disclosure will not be required.

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In addition, where distributions are made from property settled by Will to which s.144 applies then disclosure will not be required."

4.3.8 If it is correct, as HMRC appear to think, that regulation 2(2)(b) can be satisfied where there is no actual relevant property entry charge, it is not clear why arrangements to which IHTA 1984 s.17 applies would not satisfy the criteria set in regulation 2(2). They will have resulted in property becoming relevant property and there are alternative transactions under which the same result could have been achieved which would have incurred a relevant property entry charge.

Example Five

Luke is left a legacy of £300,000 under Mr Tumble's will. Luke has been considering settling £300,000 of cash on trust for his sister and brother. He has previous chargeable transfers exceeding the Nil-Rate Band so were he to do so he would suffer a relevant property entry charge. Instead he enters into a Deed of Variation of Mr Tumble's will (containing a statement under s.142(2)) under which the executors are to transfer the legacy to trustees on trust for his siblings.

It seems clear that there is an alternative transaction with the same result as the actual transaction which would give rise to a higher relevant property entry charge. It is not clear, however, that the same point would apply to transfers under IHTA 1984 ss.143 and 144 because, crucially, those sections apply automatically where such transfers are made.

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Item P: Transfer of pension death benefits

4.3.9 At item P the Guidance says:-

> "The transfer of pension scheme death benefits into a relevant property trust where the scheme member retains the retirement benefits will not in itself require disclosure. However, where the transfer is part of arrangements which enable an advantage to be obtained in respect of the relevant property entry charge then disclosure may be required. This will depend on whether it can be shown that the arrangements are within the exceptions to disclosure outlined in Regulation 3."

4.3.10 Presumably HMRC's view in the first sentence is based on the proposition that if the pension scheme death benefits are of value they will give rise to a relevant property entry charge on their value. If such a charge does not arise, it is because any diminution in the settlor's estate will be covered by the combination of the annual exemption and the settlor's unused Nil-Rate Band. The succeeding sentences make the Guidance here all but valueless.

GUIDANCE IN RESPECT OF ARRANGEMENTS WHICH HMRC CONSIDER ARE NOT DISCLOSABLE BECAUSE THEY FALL WITHIN THE GRANDFATHERING PROVISIONS

Items C and D: Business and agricultural property

4.4.1 In respect of business and agricultural property, it is stated in Items C and D that the purchase of such property with a view to holding it for two years prior to transferring

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it to a trust (and thereby qualifying for relief under IHTA 1984 s.105 or s.116) 'is not disclosable provided that there are no further steps in the arrangements as the grandfathering rules will apply' and this is so 'whether or not they are insurance backed.'

4.4.2 That at least is moderately helpful but what is the force of the proviso? Obviously, the purchaser will want in due course to actually transfer the assets into the trust. That is a further step. Read literally the Guidance does not cover arrangements which include that further step although one might infer that this is only the result of inaccurate drafting.

Item F: Discounted Gift Trusts

4.4.3 The Guidance says at Item F:-

> "Discounted gift schemes/trusts where the residual trust is a bare trust would not require disclosure as there is no property becoming relevant property.
>
> Where, in relation to a discounted gift trust/scheme, property becomes relevant property then disclosure will not be required where the grandfathering provisions apply."

4.4.4 Arrangements involving insurance often involve making settlements of death benefits arising under insurance policies, the market value of which is conventionally arrived at by applying a discount, determined actuarially, to the expected amount of the benefit payable on death. It is to be supposed that the Guidance here refers to such arrangements but it does not in words say so and the term discounted gift

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schemes/trusts (which is reversed in the second paragraph which refers to 'a discounted gift trust/scheme') is insufficiently precise to indicate the arrangements to which it refers. It would be a brave adviser who relied on this item to refrain from disclosure.

Item J: Transfers of the Nil-Rate Band every seven years

4.4.5 In respect of transfers equal to the Nil-Rate Band made at seven-year intervals, the Guidance says at Item J:-

> "The transfer of the settlor's Nil-Rate Band into a relevant property trust every seven years (provided there is no other step or steps to the arrangements which enable an advantage to be obtained in respect of the relevant property entry charge) will not be disclosable as the grandfathering provisions will apply."

4.4.6 At least that seems to be unequivocal but then one would hardly have thought that such arrangements would require disclosure.

Item K: Loans into trust

4.4.7 In respect of loans and trusts the Guidance says at Item K:-

> "A transfer into a relevant property trust by way of loan where, other than the establishment of the trust, it is a single step transaction, will not be disclosable as the grandfathering provisions will apply."

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4.4.8 Presumably a 'transfer into a relevant property trust by way of loan' actually means a payment of money by way of loan to trustees of a relevant property trust, but the Guidance is, perhaps, useful here subject to that. It is surely unusual for a payment under a loan to be a single step transaction, however, because the loan would normally be made in order that the moneys lent should be expended on something. If one lends money to the trustees of a relevant property trust for them to acquire a property to be occupied by a beneficiary, for example, and they do so, are the arrangements within HMRC's statement? It appears that they are not. Of course, it is likely that they will actually fall within regulation 3 whether HMRC agree that that is the case or not.

Item L: Insurance Policy trusts

4.4.9 In respect of insurance policy trusts the Guidance says at Item L:-

> "A transfer of the rights to the benefits payable on death into a relevant property trust will not be disclosable even where other benefits, for example, critical illness benefits are payable to the settlor as the grandfathering provisions will apply.
>
> The payment of premiums on a policy settled into a relevant property trust paid by the settlor or other person will not be disclosable as the grandfathering provisions will apply."

Item M: A chargeable transfer followed by a PET

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4.4.10 The Guidance also says at Item M that, because the grandfathering provisions will apply, arrangements under which a settlor makes a chargeable transfer prior to a potentially exempt transfer to ensure that the full Nil-Rate Band is available on the chargeable transfer are not disclosable 'unless there are further arrangements so as to allow an advantage to be obtained in respect of the relevant property entry charge.'

Item N Deferred shares

4.4.11 At Item N the Guidance says that 'the transfer of deferred shares into a relevant property trust in itself is not disclosable.'

4.4.12 It goes on, however, to say that:-

> "… where the transfer is part of arrangements which enable an advantage to be obtained in respect of the relevant property entry charge then disclosure may be required. This will depend on whether it can be shown that the grandfathering provisions will apply."

4.4.13 So the initial, apparently useful statement, is so caveated as to be of no use at all.

Item Q: Reversionary interests

4.4.14 At Item Q there is a similarly valueless comment in respect of reversionary interests:-

> "Where property is transferred into a relevant property trust and the settlor retains a reversionary interest then the transfer will not require disclosure as long as it can be shown that the grandfathering rule applies."

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NOT MUCH USE AT ALL

4.5.1 So, all in all, the list in the Guidance of arrangements which HMRC accept fall within the grandfathering provisions of regulation 3 is only of the most minor use to advisers trying to decide whether a disclosure is required. The adviser, therefore, will have to rely on collecting evidence that the grandfathering provisions of regulation 3 do apply.

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SECTION V

THE DUTY OF DISCLOSURE

INTRODUCTION

Duties of a Promoter

5.1.1 A person who is a promoter in relation to a notifiable proposal or notifiable arrangements must provide the Board with prescribed information relating to the notifiable proposal within the prescribed period.[58]

Dealing with Non-UK Promoters

5.1.2 Non-UK promoters fall within the scope of the Disclosure Regime but it may be difficult for HMRC to enforce their compliance. Where a person enters into a transaction forming part of notifiable arrangements where the promoter is resident outside the UK and there is no promoter resident in the UK, therefore, it is the person entering into the arrangements who must make a disclosure unless the promoter has made a disclosure previously.[59]

Duties of Parties to Notifiable Arrangements not Involving a Promoter

5.1.3 Any person who enters into any transaction forming part of notifiable arrangements as respects which neither he nor any other person in the UK is liable to comply with the duties of a promoter, or of a person dealing with a promoter outside the UK, must give prescribed information to HMRC within the prescribed time.[60]

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[58] FA 2004 s.308
[59] FA 2004 s.309
[60] FA 2004 s.310

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Legal Professional Privilege

5.1.4 A person who is prevented by reason of legal professional privilege from disclosing information which he would otherwise be required to give, is not treated as a promoter.[61] In such cases, the obligation to make a disclosure becomes the obligation of the client.[62]

DISCLOSURE BY PROMOTERS

5.2.1 Once a decision has been taken that a disclosure should be made, it is usually the promoter who has to make the disclosure although, as we have seen, in certain circumstances it is the client's duty to do so.

Time Limits

5.2.2 A promoter must make a disclosure within five days beginning with the day after he:-

(i) makes a firm approach to another person with a view to making the scheme available for implementation by that person or others; or

(ii) makes a scheme available for implementation by another person; or

(iii) becomes aware of a transaction forming part of the scheme (FA 2004 s.308).

5.2.3 Weekends and bank holidays are not counted in calculating the five days.

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61 FA 2004 s.314 and SI 2004/1865 reg 6

62 SI 2004/1864 reg 4(5A)

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5.2.4 That is obviously a very short period in which a return is required so the product adviser will now build into his advisory procedures, a procedure for a view of whether a disclosure is required as soon as the advice is rendered.

Co-Promoters

5.2.5 Special provisions found in FA 2004 s.308(4)–(4C) apply to co-promoters. Where two or more persons are promoters in respect of the same, or substantially the same, scheme, whether or not it is made available to the same person, a single disclosure can be made. Use of these rules is optional by the parties.

5.2.6 A promoter is only required to disclose the same scheme once.[63] The Guidance says that minor changes need not be disclosed 'providing the revised proposal remains substantially the same'.[64] As we have seen, it is HMRC's view that a scheme is no longer substantially the same 'if the effect of any change would be to make any previous disclosure misleading in relation to the second (or subsequent client)'.[65]

Making the Disclosure

5.2.7 A disclosure must be made on the relevant Anti Avoidance Group ("AAG") form. The disclosure can be made online or by completing the hard copy version of the relevant form and sending it to HMRC.

5.2.8 Regulations found in SI 2004/1864 reg 3 sets out the information required, including:-

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63 FA 2004 s.308(3)
64 Guidance para 12.2.3
65 Guidance para 12.2.3

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- a summary of the proposal;
- the name by which it is known;
- information explaining the elements of the proposal and how the expected tax advantage arises;
- the statutory provisions on which the tax advantage is based.

5.2.9 When making a disclosure, a promoter may also provide HMRC with details of a co-promoter of the same or substantially the same scheme thus exempting him from having to make a disclosure.

The Scheme Reference Number

5.2.10 Having submitted a disclosure HMRC may issue a scheme reference number (which is an eight digit number). They do not always do so, particularly if HMRC considers that the set of arrangements and associated tax advantage would only apply to a very limited group of individuals.

5.2.11 If a scheme reference number is issued, it is given to the person who made the disclosure; for example, the promoter or the scheme user. Where a promoter receives such a number he must provide it to any person to whom he provides, or has provided, services in connection with the disclosed arrangements.[66] This must be done on a form AAG6(IHT) within 30 days of being provided with the number or becoming aware of any transactions forming part of the scheme. The promoter may provide the number directly to the party who implemented the arrangements or to a person who in turn notifies the person who implemented the arrangements.

[66] FA 2004 s.312

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5.2.12 The person who enters into any such arrangements must include the scheme reference number on his form IHT100 or on a form AAG4(IHT) and also state the tax year in which or the date on which the advantage is expected to be obtained.[67] The relevant forms must be submitted within 12 months of the end of the month in which the first transaction forming part of the notifiable arrangements was entered into.

Client Lists

5.2.13 Promoters are required to provide to the Revenue lists of their clients to whom they have issued a scheme reference number during that calendar quarter.[68] The information must be provided within thirty days of the end of the calendar quarter (counting weekends and Bank Holidays). A promoter should also include details of clients who take a first step to implement the arrangements but later withdraw.

PENALTIES

5.3.1 The penalties imposed under the DOTAS Regime fall into three categories:-

(a) disclosure penalties which apply where a scheme has not been disclosed;

(b) user penalties which apply where there has been a failure by a scheme user to report a scheme reference number to HMRC;

(c) information penalties which relate to all other failures to comply, with the exception of those mentioned above.

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[67] FA 2004 s.313
[68] FA 2004 s.313ZA

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Disclosure Penalties

5.3.2 A Tribunal may impose a penalty of an amount not exceeding £600 per day during the initial period for the following failures:-

(i) a failure by a promoter to notify a scheme under FA 2004 s.308(1) & (3);

(ii) a failure by a scheme user to notify a scheme under FA 2004 ss.309(1) and 310 (TMA 1970 ss.98C and 100(2)(F).

5.3.3 It should be noted that it is only a Tribunal that can impose these penalties and not HMRC.

5.3.4 The 'initial period' begins with the 'relevant day' which effectively is the first day following the end of the period prescribed in which the scheme should have been disclosed.[69] In each case the initial period ends with the earlier of:-

- the day on which the Tribunal determines the penalty; or
- the last day before the day on which the scheme is disclosed, thereby ending the failure.

5.3.5 In determining the amount of the penalty, the Tribunal must take into account all relevant considerations including the desirability of its being set at a level which appears appropriate for deterring a person from similar failures to comply on future occasions having regard to:-

[69] TMA 1970 s.98C(2ZA)

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- in the case of a failure to disclose by a promoter, the amount of fees received, or likely to have been received by the promoter in connection with the scheme;
- in the case of a failure to disclose by any other person, the amount of the tax advantage gained, or sought to be gained.[70]

5.3.6 The Tribunal has the power to impose a higher penalty than the maximum penalty imposed under s.98C(I)(a) where that penalty 'appears inappropriately low after taking account of those considerations'.[71] The Tribunal can impose a penalty of up to £1 million under this provision.

5.3.7 In addition, where the failure continues after a penalty has been imposed by the Tribunal, the Revenue may impose a daily penalty of up to £600 for each day after the day on which the Tribunal imposed a penalty until the failure is remedied.[72] HMRC states that:-

> "in such cases we will normally begin by imposing a daily amount that is proportionate to the amount imposed by the Tribunal, compared to the maximum. If the failure continues, HMRC will consider increasing the amount, up to the maximum."[73]

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70 TMA 1970 s.98C(2ZB)
71 TMA 1970 s.98C(2ZC)
72 TMA 1970 s.98C(I)(b)
73 Guidance para 19.5.2

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5.3.8 Penalties can also be imposed where the Tribunal has made orders determining that a scheme is notifiable.

5.3.9 There is a right of appeal to the Tribunal against penalties imposed by HMRC.[74]

The User Penalties

5.3.10 Where a scheme user fails to report a scheme reference number and related information to HMRC, he is liable to a penalty of the 'relevant sum'.[75] The relevant sum is:-

(i) £100 for each scheme to which the failure relates for a first occasion;

(ii) £500 per scheme on the second occasion within three years;

(iii) £1,000 per scheme on the third and subsequent occasions.[76]

5.3.11 These penalties are imposed by HMRC[77] but, again, there is a right for the penalised person to appeal to the First Tier Tribunal under TMA 1970 s.100B.

Information Penalties

5.3.12 Penalties may be imposed where information has not been provided by the due date and in the form and manner specified. The Tribunal may impose an initial penalty of up to £5,000.[78] In addition, the Revenue may impose a daily penalty not exceeding £600 for each day the failure continues.

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74 TMA 1970 s.100B
75 TMA 1970 s.98C(3)
76 TMA 1970 s.98C(4)
77 TMA 1970 s.100
78 TMA 1970 s.98C(1)(a)(ii)

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5.3.13 Where a notification order has been made by the Tribunal under FA 2004 s.306A or a disclosure order has been made, the maximum daily penalty increases to £5,000 per day.

Reasonable Excuse

5.3.14 Where a person has a reasonable excuse, they have no liability to a penalty.[79] The Revenue do not consider that the fact that a person has obtained legal advice stating that a scheme is not disclosable 'in itself' provides a reasonable excuse.[80] The Revenue consider that 'the proper test ... is whether it was reasonable for a particular person to rely upon the particular advice received in relation to the particular facts of the case'. The Revenue have produced a list of factors that they will consider.[81]

5.3.15 The Revenue's position on the ambit of reasonable excuse in respect of penalties generally was recently criticised by the First Tier Tribunal in *N A Dudey Electrical Contractors Ltd v R & C Commissioners* [2011] UKFTT 260 (TC) and in *Buxton Rugby Football Club v R & C Commissioners* [2011] UKFTT 428 (TC). In *Buxton* the Tribunal Judge said:-

> **"34.** In the recent decision of *N A Dudley Electrical Contractors Ltd v R&C Commrs* [2011] UKFTT 260 (TC) ('*Dudley'*), the Tribunal explicitly rejects HMRC's formulation of the 'reasonable excuse' defence, saying:-

[79] TMA 1970 s.118(2)
[80] Guidance para 19.5.3
[81] Guidance para 19.5.3

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> ‘HMRC argues that a ‘reasonable excuse’ must be some exceptional circumstance which prevented timeous filing. That, as a matter of law, is wrong. Parliament has provided that the penalty will not be due if an appellant can show that it has a ‘reasonable excuse’. If Parliament had intended to say that the penalty would not be due only in exceptional circumstances, it would have said so in those terms. The phrase ‘reasonable excuse’ uses ordinary English words in everyday usage which must be given their plain and ordinary meaning.’
>
> **35.** I too consider that HMRC's formulation of the ‘reasonable excuse’ defence is too narrow and reflects neither the normal and natural meaning of the term (per *Dudley*), nor the earlier *dicta* of this Tribunal quoted above.”

CONCLUSION

5.4.1 The costs of non-disclosure are substantial and cannot be ignored.

5.4.2 Where a busy practice is delivering many pieces of advice to large numbers of clients they could, inadvertently, incur daily penalties of many thousands of pounds. It is essential, therefore, that practices delivering Inheritance Tax planning advice involving trusts should have procedures under which every piece of advice is reviewed in order to consider whether a disclosure is required.

5.4.3 Prudent advisers should review each piece of Inheritance Tax planning advice wherever property will become relevant property as a result of any part of the

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arrangements considered in the advice, in order to determine whether a disclosure is required. They should record their reasoning and append to this record the evidence on which they have relied in reaching that conclusion which will be drawn from published material, or from their own client files or from both. When recommending a strategy created by a third party, the adviser should make enquiries as to whether a disclosure has been made to the Revenue and ask for a copy of that disclosure.

5.4.4 It is clear that most Inheritance Tax planning will now bear a significant additional cost. At the margin, that may well make some Inheritance Tax planning uneconomic. Is it the Government's true intention to prevent all but the wealthiest taxpayers from obtaining Inheritance Tax planning advice so as to make such advice the sole preserve of the rich?

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