Private Client Business

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The purpose of this journal is to draw the attention of all those advising private clients to possible tax planning strategies, tactics, opportunities, traps and relevant legal developments generally. The views offered are intended only to stimulate readers, who will need to evaluate them independently.

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Inheritance Tax

The Background to the Extension of the Disclosure Rules to Inheritance Tax Part 2

Simon Mckie[*]
McKie & Co

Disclosure; HMRC guidance; Inheritance tax; Tax avoidance

Simon McKie continues his examination of the extension of the Disclosure of Tax Avoidance Schemes (DOTAS) rules to certain arrangements conferring Inheritance Tax advantages. In this second part he examines the Grandfathering provisions and HMRC's Guidance on them.

Grandfathering

Regulation 3[1] 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."

According to HMRC's Guidance on the IHT Regulations[2] the aim of this Regulation is 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 April 6, 2011.[3] The Guidance refers to this as "grandfathering".[4] In order to understand the scope of this exclusion we need to understand the meaning of the phrase: "… substantially the same … description".

In the Guidance, HMRC states:

> "[I]n 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."[5]

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[1] All references to regulations in this article are to regulations contained in the Inheritance Tax Avoidance Schemes (Prescribed Description of Arrangements) Regulations 2011 (SII 2011/170) (the "IHT Regulations").

[2] Referred to in this article as the "Guidance".

[3] Guidance para.9B.6.

[4] Guidance para.9B.6.

[5] Guidance para.10.2.5.

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 the two sets of arrangements. 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 (notice the Guidance does not use the statutory language 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 not prevent those arrangements being regarded as substantially the same as the arrangements before the alterations were made.

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[6] had been made shortly after the time when the IHT Disclosure Rules 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 IHT Disclosure Rules? One would not have thought so. The Guidance contains no useful commentary on such matters.

The Guidance on grandfathered arrangements

Paragraph 9B.6.1 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."

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 reg.2. How a list of grandfathered arrangements can be made "as 'extensive' as possible" by mixing it with other sorts of arrangements is not immediately apparent.

The Guidance also says "[i]f there is any doubt as to whether a scheme ought to be disclosed then a disclosure should be made".[7]

It will be apparent from the analysis in this article, 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."[8]

[6] FA 2006 s.156 and Sch.20.
[7] Guidance para.9B.6.1.
[8] Guidance para.9B.6.

Of course, a liability to disclose can only arise in respect of arrangements which fall within the statutory definition. No doubt it will be prudent for advisers to err strongly on the side of caution in deciding whether or not to make disclosures. A failure to make a disclosure under s.308 (which governs the duties of "promoters") carries a penalty of £600 per day in the period between, loosely, the day when the disclosure should have been made in accordance with the relevant Regulation and the time at which the penalty is determined.[9] Where a busy practice is delivering many pieces of advice to a large number 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.

Guidance under paragraph 9B6.1 in respect of arrangements which HMRC say do not fall within regulation 2

Anodyne examples

Some of the items on this list are merely anodyne. For example the Guidance says at Item A:

> "If arrangements do not result in any property becoming relevant property at any stage then the arrangements are not disclosable as the Regulations will not apply."

Single step transactions

Others are obscure, inaccurate and contradictory. At Item B, the Guidance says:

> "[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."

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

Example

Consider the following example:

> Mr A, 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.[10] The arrangements satisfy the condition of reg.(2)(a) because as a result of them, property becomes relevant property. There is an alternative way of achieving the same result or substantially the same result under which Mr A would have suffered a relevant property entry charge. If HMRC's apparent view that reg.2(2)(b) can be satisfied without an actual relevant property entry charge arising were correct, Mr B would have gained an advantage in relation to such a charge and reg.2(2)(b) would be satisfied. So the settlement would be a notifiable arrangement unless it were "grandfathered" by reg.3.

Rather puzzlingly item B goes on:

> "(b) Where the arrangements lead to qualification for:
>
> - Multiple reliefs or exemptions;

[9] TMA 1970 s.98C(1).
[10] Section 318(1).

> - 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."

The listed bullet points must be alternative rather than cumulative so the implication is that where arrangements consisting of a single transaction lead to qualification for multiple reliefs or exemptions (the first bullet point) there does 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 Mr A 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 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.

Transfers on death

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."

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

Example

Consider the following example.

> Mr A 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 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 s.318. As a result of an element of the arrangements, property becomes relevant property. So reg.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 reg.2(2)(b) can be satisfied without an actual relevant property entry charge arising, then reg.2(2) is satisfied in respect of the arrangements consisting of the settling of property under a Will.

Transfer of pension death benefits

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."

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.

Changes in the distribution of a deceased's estate

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

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

If it is correct, as HMRC appear to think, that reg.2(2)(b) can be satisfied where there is no actual relevant property entry charge, it is not clear why arrangements to which s.17 applies would not satisfy the criteria set in reg.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

Consider the following example:

> Mr A is left a legacy of £300,000 under Mr B's Will. He has been considering settling £300,000 of cash on trust for his daughters. 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 B's will (containing a statement under s.142(2)) under which the executors are to transfer the legacy to trustees on trust for his daughters.
>
> It seems clear that there is an alternative transaction with the same result as the actual transaction which would give rise to higher relevant property entry charge.[11]

[11] It is not clear, however, that the same point would apply to transfers under ss.143 and 144 because, crucially, those sections apply automatically where such transfers are made.

Items in section 9B.6.1 which HMRC consider are not disclosable because they fall within the grandfathering provisions

Business and agricultural property

In respect of business and agricultural property,[12] 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 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."

That at least is moderately helpful except, 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 lazy drafting.

Discounted gift trusts

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."[13]

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 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.

Transfers of the nil-rate band every seven years

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."

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

Loans into trust

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

[12] The Guidance uses the term "assets" rather than the word used in the legislation "property" for no apparent reason.
[13] Guidance para.9B.6.1, Item F.

> "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."

Presumably a "transfer into a relevant property trust by way of loan" actually means a payment of money by way of loan 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 I lend 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 reg.3 whether HMRC agree that that is the case or not.

Insurance policy trusts

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."

A chargeable transfer followed by a potentially exempt transfer (PET)

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".[14]

Deferred shares

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

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

Reversionary interests

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."

[14] Guidance para.9B.6.1.M.

Not much use at all

So all in all, the list in the Guidance of arrangements which HMRC accept fall within the grandfathering provisions of reg.3 is only of the most minor use to advisers trying to decide whether a disclosure is required.

Self-reliance

The adviser therefore will have to rely on collecting evidence that the grandfathering provisions of reg.3 will apply. Prudent advisers will review each piece of inheritance tax planning advice wherever property will become relevant property as a result of any part of the arrangements considered in the advice, in order to determine whether a disclosure is required. They will record their reasoning and they will 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.

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 smaller taxpayers from obtaining inheritance tax planning advice so as to make such advice the preserve of the rich?

This article is based on a longer article which first appeared in the Rudge Revenue Review.