DISCLOSURE OF TAX AVOIDANCE SCHEMES AND INHERITANCE TAX

ARRANGEMENTS: PRESCRIBED DESCRIPTIONS

PART TWO
SIMON McKIE

In part one of this article, which is online at bit.ly/pwTLtZ, the author looked at the background to the extension of the disclosure rules to inheritance tax. In this concluding article, he discusses the detail of the provisions and guidance.

The actual description of the arrangements that fall within s306(1) of the *Finance Act 2004* 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 (IHT) is prescribed by, and only by, the *Inheritance Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations 2011* (SI 2011/170) (IHT Regulations).

Regulation 2(2) and (3)[1] 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:

- "relevant property" has the meaning given by s58(1) of the *Inheritance Tax Act 1984*
- "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...'

Because these arrangements are prescribed in relation to IHT, arrangements will only be notifiable if they enable a person to obtain an advantage in relation to IHT and not, for example, if property becomes relevant property for the purposes of IHT, and in so doing confers an income tax advantage[2].

ANY ELEMENT OF THE ARRANGEMENTS

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 I give property to my 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 I make up my mind to make the gift we plan together that my son should make the settlement
(b) we do not plan my 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,
(c) we do not plan my 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?

The answer is by no means clear. Tentatively I 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

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 'a relevant property entry charge' means 'the charge to IHT 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 achieving the same result under which such a charge would arise.

It does not appear that HMRC accept that this is the case. Paragraph 9B.4.3 of the guidance says: 'Where there are arrangements that result in property becoming relevant property, where 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.'

Paragraph 9B.6.2 of the guidance says under 'Examples of arrangements not exempted from disclosure': 'Examples of arrangements which would not 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'[3].

So it seems, 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. It may be that HMRC reached this view because it has overlooked the significance of the indefinite article in regulation 2(2)(b). In the passage quoted above from para 9B.4.3 and in the following passage from para 9B.4.1, for example, it substitutes 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 <u>the</u> "relevant property entry charge" (see 9B.4.2. below). Where a scheme provides a tax advantage but that advantage is not in respect of <u>the</u> "relevant property entry charge" then disclosure will not be required under the regulations.'

If that is HMRC's view, it is incorrect. If it was correct in its 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 was 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 9B.4.3: '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.'

GRANDFATHERING

Regulation 3 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 the guidance the aim of this regulation is to restrict disclosure to those schemes that are new by exempting schemes that are the same or substantially the same as arrangements made available before 6 April 2011[4]. The guidance refers to this as 'grandfathering'[5]. To understand the scope of this exclusion we need to understand the meaning of the following words and phrases: '...substantially the same... description', 'made available for implementation', 'promoter' and 'made a firm approach'.

'SUBSTANTIALLY THE SAME… DESCRIPTION'

In the guidance, HMRC states: '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[6].' 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 the 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 to take account of changes in financial services legislation, it 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 the *Finance Act 2006* to the inheritance taxation of trusts[7] 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 that 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? You would not think so. The guidance contains no useful commentary on such matters.

'MADE AVAILABLE FOR IMPLEMENTATION'

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 6 April 2011. The guidance in respect of IHT arrangements simply incorporates HMRC's general material as to when arrangements are made available for implementation. That material is obviously designed to draw the date back as early as possible.

HMRC's guidance states:

'**General**

A scheme is regarded as being made available for implementation by another person when it:

(a) has been developed to such a stage that the promoter has a high degree of confidence in the tax analysis applying to it, and
(b) is communicated to a potential user in sufficient detail that he could be expected to:
  - understand the expected tax advantages, and
  - decide whether or not to enter into it[8].'

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 they lack 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. HMRC's guidance goes on to consider the application of this mistaken view of the general principle to marketed schemes, bespoke schemes, schemes that must go through an internal approval process and the communication of schemes to non-users.

'PROMOTER'

A 'promoter' is defined in s307. In respect of a notifiable proposal, a person is a promoter '...if, in the course of a relevant business, the person (P):

(a) is to any extent responsible for the design of the proposed arrangements
(b) 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
(c) makes the notifiable proposal available for implementation by other persons.'

This is, of course, an extremely wide definition. The width of the definition is restricted by regulations[9], 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 apply to persons who would otherwise be promoters under s307(1)(a)(i) or (b)(i). Those restrictions are designed to exclude advisors who are not responsible for the design of the arrangements but merely advise on some part of them (the 'benign test'), those who do not provide tax advice in respect of the arrangement, (the 'non-advisor test') and those whose knowledge of the arrangements is so small that they cannot know whether there is a notifiable arrangement or a notifiable purpose or not (the 'ignorance test'). Without examining the detail of these tests, it should be noted that the summary of them in the guidance is not entirely reliable.

'A FIRM APPROACH'

A firm approach is defined in s307(4A).

THE GUIDANCE

Paragraph 9B.6.1 of the guidance is headed as a 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 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 that 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. The guidance also states: 'If there is any doubt as to whether a scheme ought to be disclosed then a disclosure should be made[10].'

It will be apparent from the analysis in this article that, in relation to much, possibly most, IHT 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 advisors follow the advice in the guidance, HMRC will be inundated with disclosures in respect of perfectly routine IHT 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[11].'

'Practices delivering IHT planning advice involving trusts should have procedures under which advice is reviewed to consider whether a disclosure is required'

Of course, a liability to disclose can only arise in respect of arrangements that fall within the statutory definition. No doubt it will be prudent for advisors to err strongly on the side of caution in deciding whether or not to make disclosures. A failure to make a disclosure under s308, which governs the duties of 'promoters', carries a penalty of GBP600 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[12]. 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 IHT planning advice involving trusts should have procedures under which every piece of advice is reviewed to consider whether a disclosure is required.

GUIDANCE UNDER PARA 9B6.1

Some of the items on this list are merely anodyne. For example, the guidance states 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.'

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 regulation (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.

Consider the following example: Ms A, who has used her entire nil rate band, wishes to settle property worth GBP100,000 on discretionary trusts. Rather than settling GBP100,000 from her bank account, she settles GBP100,000 of property qualifying for business property relief.

This settlement is an arrangement because it is a transaction[13]. 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 Ms A 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, Mr B 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 was 'grandfathered' by regulation 3.

Rather puzzlingly item B goes on: 'Where the arrangements lead to qualification for multiple reliefs or exemptions, more than one application of the same relief or exemption, or 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 point), there do not need to be further steps for the arrangements to be disclosable. That implies HMRC thinks arrangements consisting of a single step can be disclosable, in which case there appears to be a contradiction between items A and B. So, for example, if Ms A had not used her annual exemption in the example above, the settlement would have qualified for relief under the *Inheritance Tax Act 1984* (IHT Act) s19 as well as for relief under s104. It would seem to fall within HMRC's first 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.

Consider the following example. Ms A is considering setting up a relevant property settlement. She could do so during her lifetime or under her will. She decides to do so under her will because she has made previous chargeable transfers, which are likely to drop out of cumulation if the settlement is not made until this death. It is clear that the creation of a settlement under the will constitutes arrangements under the definition in s318. 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 IHT 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.

Transfer of pension death benefits

At item P the guidance states: '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: 'Section 17 prevents there from being a transfer of value where there is:

(i) a variation or disclaimer to which s142(1) applies
(ii) a transfer to which s143 applies
(iii) an election by a surviving spouse or civil partner under s47A of the *Administration of Estates Act 1925,*
(iv) the renunciation of a claim to legitim or rights under s131 of the *Civil Partnership Act 2004* within the period mentioned in s147(6).

'Where property becomes relevant property but s17 applies to the transaction then disclosure will not be required. In addition, where distributions are made from property settled by will to which s144 applies then disclosure is not required.'

If it is correct 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 s17 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.

Consider the following example: Ms A is left a legacy of GBP300,000 under Mr B's will. She has been considering settling GBP300,000 of cash on trust for her daughters. She has previous chargeable transfers exceeding the nil rate band so were she to do so, she would suffer a relevant property entry charge. Instead she enters into a deed of variation of Mr B's will (containing a statement under s142(2)) under which the executors are to transfer the legacy to trustees on trust for her 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[14].

ITEMS IN S9B.6.1

In respect of business and agricultural property[15], 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 IHT Act s105 or s116) '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, in due course, the purchaser will want to actually transfer the assets into the trust. That is a further step. Read literally, the guidance does not cover arrangements that include this further step, although you may infer this is only the result of inaccurate 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[16].'

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 was referring to such arrangements, but it does not in words say so, and the term 'discounted gift schemes/trusts' (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 advisor who relied on this item to refrain from disclosure.

Transfers of the nil rate band

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.' This seems to be unequivocal, but you would not have thought such arrangements required disclosure.

Loans into trust

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.' 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 that the monies 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 regulation 3 whether HMRC agree 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

> 'The term "discounted gift schemes/trusts" is insufficiently precise to indicate the arrangements to which it refers'

which a settlor makes a chargeable transfer prior to a PET 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[17].'

Deferred shares

At item N the guidance states: 'The transfer of deferred shares into a relevant property trust in itself is not disclosable.' It goes on, however, to say '...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.'

CONCLUSION

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 advisors trying to decide whether a disclosure is required.

The advisor, therefore, will have to rely on collecting evidence that the grandfathering provisions of regulation 3 will apply. Prudent advisors will review each piece of IHT planning advice wherever property will become relevant property as a result of part of the arrangements considered in the advice, 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 IHT planning will now bear a significant additional cost, at the margin that may well make some IHT planning uneconomic. Is it the government's true intention to prevent smaller taxpayers from obtaining IHT planning advice to make it the preserve of the rich?

Simon McKie TEP is the Chairman and a designated member of McKie & Co (Advisory Services) LLP

This article, parts one and two, is based on a longer article, which first appeared in the *Rudge Revenue Review*

[1]All references to regulations in this article are to the IHT Regulations unless otherwise stated
[2]Section 306(1)(b)
[3]Guidance para 9B.6.2
[4]Guidance para 9B.6
[5]Guidance para 9B.6
[6]Guidance para 10.2.5
[7]*Finance Act 2006* s156 and Sch 20
[8]Guidance para 10.3.1
[9]*Tax Avoidance Schemes (Promoters and Prescribed Circumstances) Regulations 2004* SI 2004/1965 (hereafter referred to in this article as the Promoter Regulations) regulation 2
[10]Guidance para 9B.6.1
[11]Guidance para 9B.6
[12]*Taxes Management Act 1970* s98C(1)
[13]Section 318(1)
[14]It is not clear, however, that the same point would apply to transfers under s143 and s144 because, crucially, those sections apply automatically where such transfers are made
[15]The guidance uses the term 'assets' rather than the word used in the legislation, 'property', for no apparent reason
[16]Guidance para 9B.6.1 item F
[17]Guidance para 9B.6.1.M