INHERITANCE TAX PLANNING

Presentation by Carl Islam, Barrister, TEP to the Thursday Club in Leicester 6 March 2014.

Structure and content of the presentation

- Tax planning and avoidance:
  - tax planning;
  - HMRC's armoury;
  - Ramsay principle;
  - climate;
  - GAAR; and
  - Mehjoo v Harben Barker.
- Don't leave it too late.
- Inheritance Tax:
  - characterisation of the tax;
  - the taxing statute;
  - the tax charge;
  - scope;
  - transfer of value;
  - computation of the tax and rates;
  - chargeable death estate;
  - exemptions and reliefs;
  - CLT's and PET's; and
  - time for payment.
- Planning process:
  - fact-finding;
  - do not plan in a vacuum; and
  - cost/benefit analysis.

Tax planning and avoidance

Tax planning

'Tax avoidance is not the same as tax planning. Tax planning involves using tax reliefs for the purpose for which they were intended [when] *Parliament…passed the relevant legislation.'* (HMRC Issue Briefing: Tackling tax avoidance September 2012). Prudent and careful planning therefore involves sensible use of the available exemptions and reliefs that are provided for in the tax legislation. This is known as lawful tax mitigation and = playing by and within the rules.

HMRC's armoury

HMRC's primary weapons in combating unacceptable tax avoidance are:

- anti-avoidance legislation aimed at a specific area of tax avoidance, for instance the gifts with reservation of benefit legislation which seeks to prevent *'having your cake and eating it'* arrangements;
- legislation aimed at general avoidance;
- the disclosure of tax avoidance schemes ('DOTAS') legislation designed to give HMRC early notice of marketed schemes, enabling them to respond, if necessary, with amending legislation;
- invoking the General Anti-Abuse Rule ('GAAR'); and
- taking cases before the courts arguing that the avoidance scheme failed under the relevant legislation or, more generally, is nullified as a matter of statutory construction under the Ramsay principle.

Ramsay principle

Planning that relies upon artificial technical loopholes is questionable, and where an arrangement appears to HMRC to be artificially engineered with the sole purpose of avoiding tax, and has no basis in reality, they are likely to challenge it under the ***Ramsay principle***. Aggressive and artificial tax-planning schemes are red rag to a bull to HMRC, and if they fail, intrinsically linked planning including for example, confidentiality and asset-protection planning, may collapse along with the rest of the house of cards. Such schemes are therefore not a solid foundation on which to plan for the preservation and effective management of family wealth.

In ***WT Ramsay Limited v IRC*** [1981] Lord Wilberforce expounded the Court's approach to avoidance schemes as follows, '*It is the task of the Court to ascertain the legal nature of any transaction to which it is sought to attach a tax, or a tax consequence, and if that emerges from a series, or combination of transactions, intended to operate as such, it is that series or combination which may be regarded.'* The application of the ***Ramsay*** or '*substance over form'* principle involves a realistic factual analysis of a transaction by the Judge. However, when deciding whether a particular transaction falls within the purpose of any provision of a taxing statute, the Court may apply a purposive approach instead of adopting a formulaic or atomistic approach.

The application of the principle involves:

(i) a realistic factual analysis of the transaction by Judge;

(ii) consideration of what the legislation means; and

(iii) deciding whether the transaction is of the sort that the statute has in mind i.e. whether it falls within the ambit of the statute.

'Nowadays…the Courts adopt a purposive construction of tax statutes in order to give to statutory expressions the meaning which Parliament intended, whether 'evidently' or 'not'. The Courts no longer cut down statutory expressions 'in the interest of precision'. Instead they tend to give statutory expressions a wide, practical meaning, even in legislation that is not directed at tax avoidance. That being so, the Courts will no longer adopt a 'different method' of interpretation of anti-avoidance legislation.' (Paragraph 1-008 of **Tax Avoidance**, by Rebecca Murray, published by Sweet & Maxwell.)

In ***MacNiven v Westmoreland Investments Ltd*** [2001], Lord Hoffmann reviewed the major cases decided since ***Ramsay***, and sought to explain the true basis of the case, which for him lay in statutory construction. The ***Ramsay*** principle involved consideration of what the legislation meant, and whether the particular event in question should properly fall within the statute. This involves deciding whether a transaction is the sort of transaction which the statute has in mind. Commenting on the distinction between *'tax avoidance'* and *'tax mitigation'* Lord Hoffmann said (obiter dictum), '*…when statutory provisions do not contain words like 'avoidance' or 'mitigation', I do not think that it helps to introduce them. The fact that steps taken for the avoidance of tax are acceptable or unacceptable is the conclusion at which one arrives by applying the statutory language to the facts of the case. It is not a test for deciding whether it applies or not.'* Any pre-arranged scheme which involves either tax avoidance, tax deferral or merely the preservation of an existing tax benefit is potentially within the scope of the ***Ramsay*** principle. However, the application of the principles developed by the ***Ramsay*** line of authorities depends upon the facts of the case and the wording of the relevant statutory provision in point.

More recently in ***Andrew Berry v The Commissioners for Her Majesty's Revenue and Customs*** [2011] (Upper Tribunal), Judge Lewinson summarised

the principles governing the application of the Ramsay principle in practice, as follows:

> *'(i) The Ramsay principle is a general principle of statutory construction.*
>
> *(ii) The principle is twofold; and it applies to the interpretation of any statutory provision:*
>
> > *a) To decide on a purposive construction exactly what transaction will answer to the statutory description; and*
> >
> > *b) To decide whether the transaction in question does so.*
>
> *(iii) It does not matter in which order these two steps are taken; and it may be that the whole process is an iterative process.*
>
> *(iv) Although the interpreter should assume that a statutory provision has some purpose, the purpose must be found in the words of the statute itself. The Court must not infer a purpose without a proper foundation for doing so.*
>
> *(v) In seeking the purpose of a statutory provision, the interpreter is not confined to a literal interpretation of the words, but must have regard to the context and scheme of the relevant Act as a whole.*
>
> *(vi) However, the more comprehensively Parliament sets out the scope of a statutory provision or description, the less room there will be for an appeal to a purpose which is not the literal meaning of the words.*
>
> *(vii) In looking at particular words that Parliament uses what the interpreter is looking for is the relevant fiscal concept.*

(viii) Although one cannot classify all concepts a priori as 'commercial' or 'legal', it is not an unreasonable generalization to say that if Parliament refers to some commercial concept such as a gain or loss it is likely to mean a real gain or a real loss rather than one that is illusory in the sense of not changing the overall economic position of the parties to a transaction.

(ix) A provision granting relief from tax is generally (though not universally) to be taken to refer to transactions undertaken for a commercial purpose and not solely for the purpose of complying with the statutory requirements of tax relief. However, even if a transaction is carried out in order to avoid tax it may still be one that answers the statutory description. In other words, tax avoidance schemes sometimes work.

(x) In approaching the factual question whether the transaction in question answers the statutory description the facts must be viewed realistically.

(xi) A realistic view of the facts includes looking at the overall effect of a composite transaction, rather than considering each step individually.

(xii) A series of transactions may be viewed as a composite transaction where the series of transactions is expected to be carried through as a whole, either because there is an obligation to do so, or because there is an expectation that they will be carried through as a whole and no likelihood in practice that they will not.

(xiii) In considering the facts the fact finding tribunal should not be distracted by any peripheral steps inserted by the actors that are in

fact irrelevant to the way in which the scheme was intended to operate.

(xiv) In considering whether there is no practical likelihood that the whole series of transactions will be carried out, it is legitimate to ignore commercially irrelevant contingencies and to consider it without regard to the possibility that, contrary to the intention and expectation of the parties it might not work as planned.'

The Judge's review has since been adopted in ***James Albert McLaughlin v The Commissioners for Her Majesty's Revenue and Customs*** [2012] (First Tier Tribunal).

Climate

The climate remains enormously hostile to all forms of tax planning, and the new moral orthodoxy is illustrated by the following comments of Lord Walker in a recent case heard in the Supreme Court,

'The scheme adopted…was by no means at the extreme of artificiality…but it was hardly an exercise in good citizenship. In some cases of artificial tax avoidance the court might think it right to refuse relief, either on the ground that such claimants, acting on supposedly expert advice, must be taken to have accepted the risk that the scheme would prove ineffective, or on the ground that discretionary relief should be refused on grounds of public policy. Since the seminal decision of the House of Lords in ***WT Ramsay Ltd v IRC*** [1982] *there has been an increasingly strong and general recognition that artificial tax avoidance is a social evil which puts an unfair burden on the shoulders of those who do not adopt such measures.'*

Futter and another v The Commissioners for Her Majesty's Revenue and Customs, and Pitt and another v The Commissioners for Her Majesty's Revenue and Customs [2013] (Supreme Court).

The judicial attitude prevalent when I was a law student, that there is no morality in a tax or immorality in a tax avoidance scheme, has now been consigned to the history books.

GAAR

*'The **Finance Act 2013** has introduced a GAAR, but as a General Anti Abuse Rule not a General Anti Avoidance Rule as enacted in several foreign countries. It is aimed at countering abusive tax avoidance schemes, such as those where the tax allegedly saved is greater than the costs of entering the scheme. These schemes often involve the acquisition of assets which cannot reliably be valued such as film scripts of other intellectual property in the course of development, funded by soft loans secured only on the assets acquired and frequently backed by cash collateral arranged by the promoters. Many of these schemes have been struck down by the Courts but some have succeeded, such as **Mayes v HMRC**, where the tax legislation is prescriptive and there is no scope for a purposive interpretation of the tax statutes. The UK GAAR is not aimed at sensible tax planning such a lifetime giving, outright or into trust, or for example leaving assets in trust for a surviving spouse, as explained in* [Carl's] *book.'*

Nigel Eastaway OBE FCA CTA (Fellow) TEP, tax partner, MHA MacIntyre Hudson, in the City of London , extracted from the 4th edition of my book 'Tax-Efficient Wills Simplified 2013/2014.'

Whilst tax motivated transactions will not necessarily fall to be treated as part of an abusive arrangement, it is necessary to ensure that any tax planning advice is not caught by the GAAR.

The rule is aimed at tax advantages arising from tax arrangements that are abusive. For an arrangement to be abusive HMRC must show that it cannot reasonably be regarded as a reasonable course of action (the double reasonableness test). The test does not require the judge to give a view on whether the tax arrangements were a reasonable course of action. Instead the judge is required to consider the range of reasonable views that could be held in relation to the arrangements.

The received wisdom, is avoid doing anything that is likely to raise an eyebrow because it is too racey, including arrangements involving multiple planning steps and circular transactions.

Mehjoo v Harben Barker (a firm) & anor [2013]

'In an interesting twist to the tax avoidance debate, a High Court judge appeared to rule yesterday that a firm of accountants has a duty to advise wealthy clients to avoid tax. The judge said that the firm had a 'contractual duty to advise [their client] *that as a non-dom he had access to 'potentially significant tax advantages.' He likened the duty to refer a client to a tax specialist to the duty a doctor has to refer a patient. 'Surely' he said, 'if the GP knows there might be types of treatment known only to specialists…that should trigger a duty to advise.'* Harben Barker is to appeal the judgment. Julia Irvine, Economia, 06 June 2013.

In awarding damages in excess of £943.658.00 and costs, the judge stated*, 'I conclude that the Defendants had a contractual duty or concurrent tortious duty to advise the Claimant especially in the light of his large potential CGT liability that he should take advice from a firm of accountants or tax advisers who specialized in advising individuals* ***who had (or might have) non-dom status****. The duty flowed in the circumstances of the case (including the amounts of CGT involved) from the duty of the Defendants to exercise skill and care as was the*

duty in the Chartered Institute's Guidelines… if this was not the position, the client would be in the totally unsatisfactory position that he did not have the right to be told first that the professional who he consulted lacked the expertise to advise him; and second that somebody with the relevant expertise might be able to give this advice. I cannot see why the Chartered Institute of Taxation Rules and Practice Guidelines on referrals should not apply to all chartered accountants certainly where substantial sums of money are involved…[the practitioner in this case] *was an accomplished accountant…who was determined to help his clients to the best of his ability. Sadly, he erred by failing to advise the Claimant to take the advice of a non-dom specialist after many years of successfully helping the Claimant.'*

It would appear that accountants are under a professional duty to advise their wealthy non-dom clients to take the advice of a non-dom specialist, i.e. to enable a non-dom client to obtain proper professional advice about the planning opportunities that may exist to mitigate tax by reason of their non-dom status, which in this case was a substantial CGT liability on the sale of shares in a clothing company.

The legal principles expounded in ***Mehjoo*** also apply where a qualified financial adviser, a solicitor, or a will writer, has expressly or impliedly accepted a tax retainer.

'The situation today is further complicated by the fact that HMRC now has available a statutory general anti-abuse rule that will penalise clients and their advisors for 'abusive' tax planning. Thus practitioners must consider how they are to avoid being caught between the two stools of professional negligence litigation on the one hand and censure under the general anti-avoidance rule (GAAR) on the other. There is a danger that accountants are stuck between a rock and a hard place when it comes to advising on tax planning. Advisors need

to be very careful with engagement letters and not over-promise what advice they will giving, especially if a retainer is paid. Advisors should also recognise when they might need to seek a second opinion or more specialised advice. However, the introduction of the GAAR also gives tax advisors a powerful reason why taxpayers must not enter into the type of tax avoidance scheme referred to in the Mehjoo case.' Michael Izza, President of the Institute of Chartered Accountants of England and Wales.

'The moral of the tale for all paid professional advisors who give any tax planning advice is – know your limitations.' STEP Digest 10 June 2013.

Don't leave it too late

'Tens of thousands of families could be caught by inheritance tax in the next five years as the threshold fails to keep pace with rising house prices. The number of estates affected by the tax each year is due to double from 21,000 last year to 42,000 in 2016/17 - far beyond the previous peak of 34,000 under Labour in 2006/07, accountants predict. The allowance on inheritance tax was frozen at £325,000 in April 2011, a level that will remain until April 2018 - meaning its value is steadily declining. At the same time, house prices are rising far faster than the Treasury expected, and are due to rise by 25.2pc by the end of 2018. Mr Osborne's frozen rate will affect 176,000 estates in that time.' **('Steep increase in families caught by inheritance tax', the Telegraph 30 November 2013)**.

When effective IHT planning is not undertaken, there can only be one outcome. IHT is not philosophical. By analogy to the laws of physics it is more like the force of gravity, and a substantial amount of your accumulated wealth will end up in the coffers of HM Treasury, instead of being available to benefit your family and future generations.

For you to do nothing is to leave a time-bomb ticking quietly away in the background until your death, which is when it will blow up. The problem is

compounded because a large part of the IHT planning exercise involves the assembly, maintenance, and safe-keeping of accurate and intelligible documentary records. Without satisfactory records, those who are left behind to pick up the pieces after the bomb has gone off, will be shocked, confused, and quite possibly unable to resist a revenue claim or challenge. The best advice I can give is:

1. to make your family IHT planning a personal priority;
2. do not procrastinate or delay, act now rather than postponing the decision to take proper professional advice until a later date (by which time the opportunity to instigate optimal tax planning may have passed you by); and
3. consider whether your technical knowledge of IHT is actually complete and accurate, as a gifted amateur is likely to end up in an elephant trap.

In other words, recognize your limitations, and invest in your family IHT planning process by paying for timely professional advice from a knowledgeable and clever advisor. This requires the disclosure of sufficient information to the advisor to enable him to see both the big picture, and to understand the underlying family and business dynamics, which in the particular circumstances of the client, limit the practical options available to lawfully mitigate IHT. That means the advisor has to be trusted not only by yourself but also by the other stakeholders, i.e. your wife and adult children. He will therefore have to spend time getting to know you all, whilst earning confidence and respect, without actually being regarded as a partisan advisor who promotes the interests of a particular beneficiary, for example a son who succeeds to your business, where for example a daughter does not wish to be actively involved. This requires openness, candor, and the demarcation of boundaries when the advisor is taking your instructions, which need to be recorded in writing.

As you are about to discover, Inheritance Tax is notoriously complex and volatile and even tax practitioners regard it as one of the most difficult taxes to comprehend. There are no short-cuts. Which is why, for an estate of any size or complexity, the development and implementation of an effective plan, is a bespoke holistic and continuing process that involves a team of specialists managed by a trusted family advisor (for example the family accountant or solicitor).

As Nigel Eastaway OBE, Tax partner at MHA MacIntyre Hudson in the City of London states in the foreword to my book 'Tax-Efficient Wills Simplified 2013/2014',

'The drafting of tax-efficient wills are a critical component in the structural planning of the financial affairs of clients. Ideally they should be the end product of comprehensive inheritance planning undertaken at an early stage. To maximize the available inheritance tax reliefs and exemptions, lifetime wealth structuring needs to be undertaken at least 7 years before death. This requires forward planning, and the assembly of accurate and intelligible documentary records required by the client's accountant for probate, and by his executors, as it is not uncommon for HMRC queries to arise after assets have been appropriated to beneficiaries. Because a client's wealth and personal circumstances may change, and the tax landscape can be altered suddenly with retrospective effect, their will also needs to be periodically reviewed.'

IHT planning is like look after your teeth. If you want to preserve them, it is an ongoing and pro-active process, and you get what you pay for.

Inheritance Tax

- Characterisation of the tax.
- The taxing statute.

- The tax charge.
- Scope.
- Transfer of value.
- Computation of the tax and rates.
- Chargeable death estate.
- Exemptions and reliefs.
- CLT's and PET's.
- Time for payment.

Characterisation of the tax

- IHT is a direct tax on transfers of capital.
- It is a cumulative charge on transfers made over any seven year period during your lifetime, and on death.
- It is a charge on the whole of the value transferred.

The taxing statute

- The primary IHT legislation is contained in the **Inheritance Tax Act 1984** ('IHTA 1984'), as amended by subsequent **Finance Acts**.
- The main charging provisions of the Act are set out in **sections 1-6** (contained in **Part I of the Act**), which also apply to certain limited settled property in which an individual has an interest in possession, i.e. an entitlement to income from trust property.
- '*Special charging provisions'* confined to dealing with property held on trust (known as *'Relevant Property'*) are contained in **Part III of the Act**.
- Provisions contained in **Part IV of the Act** deal with '*transfers by close companies'*.

- Historically, IHT replaced **Capital Transfer Tax ('CTT')**, which in 1975 took the place of death duty.

- **CTT** was an integrated lifetime transfer and estates tax.
- As a result the IHT charge is based on taxing lifetime transfers.
- As HMRC's Inheritance Tax Manual (the '**IHTM**') explains, *'These provisions are then adapted to charge tax on other events such as:*

  (i) death;

  (ii) gifts with reservation (GWRs); and

  (iii) transactions involving settled property in which an interest in possession subsists.'

  Under Capital Transfer Tax, all lifetime transfers were charged to tax when they were made. Under IHT, certain types of lifetime transfer remain taxable when made. Most are only taxable if the transferor dies within seven years of making the transfer. These transfers are known as potentially exempt transfers, (PETs) because they will become exempt transfers if the transferor survives for seven years.

  There is separate legislation for charging inheritance tax on settled property that is held on non-interest in possession trusts, otherwise gathered together under the term discretionary trusts.'

- Capital Transfer Tax was renamed Inheritance Tax with effect from 25 July 1986 and from that date the **Capital Transfer Tax Act 1984** is cited as the **Inheritance Tax Act 1984**. Please note that unless otherwise stated all statutory references in these notes are to the **IHTA 1984**.

The tax charge

- IHT is charged whenever there is a chargeable transfer of value, i.e. a disposition causing loss to a person's estate, which is not an exempt transfer.
- IHT is also charged in certain other situations where transfers are treated as transfers of value but are not deemed to be dispositions.

Scope

- Under the **IHTA 1984**:

  (i) an individual legally domiciled in the UK is liable to IHT on their entire chargeable worldwide estate wherever property is located; and

  (ii) a foreign domiciliary (a '*Non-dom'*) who is not yet deemed to be domiciled for IHT, is only liable to IHT on their chargeable UK property (**s.6(1)**).

Transfer of value

- A transfer of value is any disposition by which the value of a person's estate is reduced.
- *'The legislation divides transfers of value into those which are immediately chargeable and those which are only potentially chargeable, which the Act chooses to call potentially exempt transfers (PET's). Immediately chargeable transfers enter the transferor's cumulative total of transfers at once; as soon as the total goes over the nil rate band, tax becomes due. By contrast, PET's do not give rise to tax straight away and do not enter the transferor's cumulative total of transfers unless and until the donor dies within a period of seven years from the date of the*

transfer, whereupon they become chargeable as lifetime transfers but at death rates, with reductions if the donor dies more than three years after the gift. Most types of gift are PET's, however the system now draws a distinction between outright gifts, which may often be PET's and many gifts through trusts which are not. It will usually be advantageous to create a PET rather than an immediately chargeable transfer.'
(Paragraph 44.3.1.1 of Revenue Law by John Tiley and Glen Loutzenhiser).

Computation of the tax and rates

- The threshold above which IHT is payable is known as the nil rate band *('NRB')*.
- This is frozen at the rate of £325K until April 2018.
- An individual's NRB can become fully replenished after 7 years.
- Where an individual's chargeable lifetime transfers and death estate do not exceed his available NRB they are taxed at the rate of 0% and no IHT is payable.
- The available NRB of the first spouse / civil partner to die is transferable to the surviving spouse.
- IHT is payable at the rate of 20% on life-time chargeable transfers above the NRB, and on death at 40% above the testator's remaining (i.e. unused) NRB.
- For deaths on or after 6 April 2012 a reduced rate of IHT at 36% applies where an individual leaves at least 10% of his net estate to charity.
- Computation is complex.

- In calculating IHT due on an individual's chargeable transfers of value, his available NRB must be ascertained.

- This requires aggregation of a transfer on death or during that individual's lifetime, with all chargeable transfers made by him within the previous seven years.

<u>Chargeable death estate</u>

- IHT on death is charged on an individual's estate as if immediately before his death he had made a transfer of value.

- The value transferred is deemed to be equal to the value of his estate immediately before his death, which is known as the *'loss to estate principle'*.

- An individual's' chargeable or *'death'* estate for IHT purposes includes:

  (i) the aggregate of all property to which he was beneficially entitled (not counting any *'excluded property'*, which is known as his *'free'* estate); and

  (ii) certain *'settled'* property in which he was beneficially entitled to a life interest, however beneficial entitlement does not include property held in a fiduciary capacity.

- In valuing an individual's estate a liability may be taken into account provided it is legally enforceable.

- In particular, a mortgage can be deducted from property, if it is charged on it.

- Note however that the liability reduces the value of the encumbered property, and not of the individual's estate generally.

- This is significant where:

  (i) an exemption, such as the spouse exemption is available, and

  (ii) an individual's estate includes property that is eligible for 100% relief, for example business property relief ('BPR').

<u>Exemptions and reliefs</u>

- The amount of IHT chargeable on death:

  (i) is subject to all available IHT *'exemptions'* and *'reliefs'*; and

  (ii) depends upon:

    a. the aggregate chargeable life-time transfers *('CLT's')* and potentially exempt transfers *('PET's')* made by an individual within the previous seven years, which is known as the *'principle of cumulation';* and

    b. whether the donee of the gift (i.e. the beneficiary), is an *'exempt'* beneficiary (for example a spouse / civil partner), or a *'non-exempt'* beneficiary (for example a child or grandchild).

- Note that:

  (i) an *'exempt transfer'* is not liable to IHT (and therefore does not affect the rate of IHT charged on later transfers made by an individual);

  (ii) a transfer of value may be treated as exempt under more than one category, and it is possible for part of a transfer of value to be partially exempt under one category, and for part of it to be partially exempt under another category;

(iii) a *'PET'* is a life-time transfer of value (of any amount) made by an individual to another individual or into a trust for a disabled person, which is assumed to be exempt when made;

(iv) if an individual survives the making of a PET by seven years or more, it becomes completely exempt;

(v) however if an individual dies within the seven year period, the PET becomes chargeable at that time, **s.3A**;

(vi) *'taper relief'* applies where a failed PET was made more than three years before an individual's death (which operates to reduce the IHT payable on the PET but not the value of the transfer);

(vii) a life-time transfer that does not qualify as a PET will give rise to an immediate charge to IHT; and

(viii) a transfer which benefits from the application of *'relief'* is within the charge to IHT, however the value of the transfer is removed from the charge to the extent that the applicable relief is available, which can be up to 100%.

<u>CLT's and PET's</u>

- A chargeable lifetime transfer of value made between individuals is not a CLT but is a PET.
- Most lifetime transfers are PET's.
- A PET has three elements:

(i) the transfer must be a transfer of value made by an individual;

(ii) it must otherwise be a chargeable transfer (in whole or in part), so if the transfer is exempt under other rules it remains fully exempt and is not made potentially chargeable; and

(iii) it must, in broad terms, be either a gift to another individual (including, where appropriate, a settled gift under which the individual has an interest in possession) or a gift into an appropriate form of trust.

- Transfers into most forms of trust are CLT's.
- The IHT treatment of '*settled property'* depends upon whether a *'qualifying interest in possession'* exists in the property or not.
- The only *'qualifying interests in possession'* that can now be created by a testator under his will are:

  (i) an immediate post-death interest *('IPDI')* within **s.49A**; and

  (ii) a disabled person's interest *('DPT')* as defined in **s.89B**.

- Where what is known as a *'relevant property trust'* is created (for example a discretionary trust), no *'qualifying interest in possession'* subsists (see **sections 58** and **59**).
- IHT is charged on *'Relevant property trusts*' on:

  (i) creation;

  (ii) every ten years; and

  (iii) when property leaves the trust.

- The settlement of property on a relevant property trust is a CLT, precipitating an IHT charge on the date that the property is settled.

- In the case of a lifetime trust the charge is levied on the value transferred by a chargeable transfer of value (that exceeds the settlor's available NRB) at the rate of 20%.

- All lifetime trusts created after 22nd March 2006 are subject to the IHT rules contained in **Part III, Chapter 3** applicable to the taxation of relevant property (known as the *'relevant property regime'*).

- Where an individual has not made any CLT's within seven years of the creation of a relevant property trust (and provided the amount settled did not exceed his unused NRB), no exit charge can arise on any appointment made out of the trust within the first ten years, because the effective rate at which IHT will be charged is 0%, due to the application of 100% of the full amount of his NRB.

- If no appointments are subsequently made out of the trusts prior to the first ten year anniversary, and the amount initially settled in the trust equalled his NRB at the time of creation, no IHT charge arises on the first tenth anniversary, provided that the growth in the value of the trust assets does not exceed the increase in his NRB over that period.

- In which case the charge can be avoided if growth is stripped out before the first decennial anniversary.

- Where a *'qualifying interest'* exists:

  (i) property settled on the trust qualifies as a PET (and is not a CLT), therefore where a settlor survives for at least seven years after settling the property, no IHT charge arises on the gift into trust;

  (ii) decennial and exit charges do not apply; and

(iii) under what is known as the *'interest in possession principle'* the life-tenant is treated as owning the underlying trust property, which forms part of their estate for IHT.

- Where a qualifying interest is created by the testator's trustees appointing property to his surviving spouse more than two years after his death:

  (i) the appointment cannot be *'read back'* as a *'spouse-exempt gift'* under **s.144**;

  (ii) an immediate IHT entry charge will be precipitated; and

  (iii) the *'beneficiary principle'* will not apply (therefore the underlying trust property will not fall into the surviving spouse's estate for IHT when she dies).

- In two cases the transferor will be deemed to be beneficially entitled to property which he does not actually own as a matter of general law:

  (i) if he has an *'interest in possession'* in *'settled property'* that property is included in his estate; and

  (ii) if during his lifetime he gave away property it may nevertheless be regarded as comprised in his estate immediately before he died if the property is caught by the gifts with reservation of benefit anti-avoidance rules (the *'GWR'* rules).

- IHT does not apply to transactions effected at fair market value (i.e. where no gratuitous intent or element of bounty is involved).

- A transaction affected by an individual which it transpires is a *'bad'* deal does not precipitate an IHT charge where he can demonstrate that no donative intent or gratuitous benefit was intended (**s.10**).

Time for payment

- IHT is payable according to the timing of a chargeable event.
- Subject to exceptions provided for by **s.226** IHT is due and payable six months after the end of the month in which a charge arose on either a lifetime gift or on death.
- IHT must be paid before an estate is distributed and HMRC impose penalties for late payment.

The planning process

- Fact-finding.
- Do not plan in a vacuum.
- Cost/benefit analysis.

Fact finding

A tax-efficient will is a component of your IHT planning, which includes lifetime and testamentary planning driven by your planning imperatives, and practical circumstances. Before a holistic plan can be developed and implemented the following need to be analyzed:

- your planning objectives, needs, and resources;
- the assets comprising your estate, your interest in each asset, and approximate current values (for probate) [‘**A**’];
- your relationships with family members and any dependants [‘**B**’].
- approximate calculation of the IHT payable on your death if no planning is undertaken (which involves preliminary analysis of your domicile, available transferable Nil Rate Band and the IHT exemptions and reliefs that appear to be available) [‘**C**’].

It is an over-simplification, but **A - C** approximately = what you have available to give to **B** (including your spouse/civil partner).

The development of an effective and sustainable plan requires the client to place his/her cards on the table, however unpalatable.

'Getting as full a picture as possible is essential in relation, not only to the assets currently held – or indeed in prospect – but also to those which have been given away. Assets in prospect might include an expectation under a Will where the testator is alive or perhaps the likelihood of receiving assets from a settlement. The assets underlying either interest may be considered 'surplus to requirements'. If so, a testator might be encouraged to leave them down a generation perhaps.

In relation to gifts made in the past, the reservation of benefit regime for IHT and pre-owned assets regime for income tax can ensure unwelcome tax consequences for gifts going back as far as 18 March 1986. So it may not be enough for the initial enquiry to go back just seven years. Indeed the 7+7 = 14 trap for chargeable transfers may mean that in that context alone a 14 years gifts history is required. In a case where the trap might rear its ugly head, a delay in making a new PET by a month or two could save significant amounts of tax if death were to follow within the seven year period.' Paragraph 21.2 of Hutton on Estate Planning (6th edition) by Matthew Hutton and Ian Maston.

A testator (i.e. a person who makes a will) (**'T'**)**,** and his/her spouse/civil partner ('**S'**), should both make appropriate wills. Taking instructions usually commences with the completion by **T** and **S**, of a separate fact-finding questionnaire about their own: personal circumstances; family and dependants; assets; and liabilities. This forms the basis of subsequent investigations and the separate discussion with **T** and **S** of the planning of their respective estates, until key issues (including the following) have been identified, investigated, evaluated / determined:

1. the domicile of **T** and **S** (and their future plans);
2. the composition, nature, ownership, value, and location of **T**'s / **S**'s assets (including any life-insurance policies, death in-service benefits, and sums payable under retirement, annuity, and pension policies);
3. debts and liabilities;
4. the couple's life-style, needs, and income;
5. family members and dependants (including their age and domicile, needs, plans, resources, and the state of their relationships with **T**, **S** and with each other);
6. how **T** and **S** wish their respective estates to devolve on death, including any personal legacies, particularly of chattels (which should include consideration of the incidence of IHT and potential grossing-up);
7. the making of any absolute gifts;
8. the creation of beneficial interests in property subject to a trust of residue, including the creation of any special trusts, and in particular any life interests;
9. **T**'s / **S**'s choice of executors, trustees, guardians (if **T** / **S** have children under the age of 18);
10. approximate calculation of **T**'s / **S**'s unused NRB – which requires tracing each individual's history of giving within the last seven years (and sometimes further back);
11. any excluded property;
12. approximate calculation of the amount of IHT payable on death if **T** / **S** dies intestate (as a bench-mark for comparison);
13. the availability of IHT exemptions and reliefs; and
14. approximate calculation of **T**'s / **S**'s net residuary estate available for distribution.

- **T** and **S** should also be advised separately:
  1. about the extent of testamentary freedom under English law, and the potential for a claim being made by a dependant (which can in certain circumstances include for example a mistress), and certain relatives, within six months of death, under the **Inheritance (Provision for Family and Dependants) Act 1975** ('Inheritance Act');
  2. that jointly-held property will pass outside **T**'s / **S**'s estate by survivorship;
  3. that unless specific provision is made in the will, a gift of a specific item will adeem if during the testator's lifetime it: (i) is sold; or (ii) changes in substance;
  4. that unless his/her will provides otherwise, in the event that the recipient predeceases **T** / **S**, most gifts made in **T**'s / **S**'s will to that person will lapse, and either: (i) fall into residue; or (ii) pass under the **Intestacy Rules**, with unintended consequences;
  5. about provision for the making of a *'gift over'* (or *'substitutional gift'*);
  6. the *'incidence'* of taxation; *'grossing-up'*; and that unless the will provides otherwise, a beneficiary who takes property subject to a debt, will take it subject to that debt (and that particular care is required where life assurance is linked to debt);
  7. that payments from pension funds and insurance policies written in trust for beneficiaries, will pass outside the will; and
  8. about the scope of **s.142** and **s.144** (variations and automatic reading-back).

The assembly and keeping of records for probate is a key output of the planning process. This is critical because '[the] *absence of records can be a major headache for personal representatives. Specific instances arise where the*

executors have a duty to notify HMRC of events of which they have had no personal knowledge. It is good practice for any person who has an estate that may on his death become taxable to maintain personal records of gifts etc in a form that will be intelligible to the personal representatives. That has become more important as many more transfers have been treated as chargeable since 22 March 2006.' (**Ray & McLaughlin's Practical Inheritance Tax Planning**, paragraph 2.72).

Do not plan in a vacuum

Other taxes may also need to be considered including Capital Gains Tax ('CGT') and Stamp Duty Land Tax ('SDLT').

For CGT, with the exception of a disposal between **T** and **S**, the disposal of an asset, otherwise than by way of a bargain at arm's length, is treated as a disposal at open market value. If **T** makes a lifetime gift e.g. to a child, he is deemed to receive the market value of the property he has given away even though he has in fact received nothing. A disposal between connected persons (other than **T** and **S**) is always treated as a transaction otherwise than by way of bargain at arm's length, irrespective of any consideration paid and hence is taxed at market value. In addition to being treated as a disposal at market value for CGT purposes, a gift of assets may be chargeable to IHT, and limited relief is available against this double charge. In certain situations, CGT on a lifetime gift may be postponed if a hold-over election is made. CGT is not payable on a gift of cash.

The purchase or lease of land or a building will attract an SDLT liability for the purchaser. Generally, no SDLT is charged on a gift, however a gift of an asset which is subject to a mortgage where the liability for that mortgage is taken on by the donee may attract SDLT.

Where land or buildings are transferred by **T** to a company with which he is connected, the taxable consideration is taken to be not less than the market value of the land.

Cost/benefit analysis

When you pay for the planning and drafting of a tax-efficient will, what you get in return is the preservation and effective management of your personal wealth for the benefit of a surviving spouse / civil partner, descendants, and future generations. This can save substantial amounts of IHT and result in some degree of asset protection.

The planning process is labour intensive, and the provision of professional advice involves high standards of client care (including the making and keeping of accurate and detailed attendance notes) and technical expertise, all of which comes at a cost.

Rule 2.1 of the **Code of Professional Conduct of the Society of Trust and Estate Practitioners** (see www.step.org) requires that, *'a member shall at all times perform competent work for his or her client. Competent work requires the knowledge, skill, thoroughness and preparation reasonably necessary to perform the work, as well as performing the work conscientiously and diligently in a timely and cost-effective manner.'* **Rule 2.3** further states that *'a member should not undertake work for a client if he or she is not competent to handle the work, or is not able to become competent to perform the work without undue delay, risk or expense to the client. Where a member feels he or she is not competent to handle the work, the member should either decline to act, or obtain instructions from his or her client to retain or consult with a practitioner or other advisor who is competent to perform the work.'*

Mandatory Money Laundering due diligence must also be fully complied with. Failure to comply by a solicitor is professional misconduct, and the imposition of criminal sanctions may follow in addition to disciplinary proceedings.

Compliance requires thorough due diligence to be completed before legal advice is provided.

Given that a comprehensive estate planning exercise resulting in the execution of tax-efficient wills for yourself and your spouse/civil partner is likely to save substantial amounts of IHT, the cost of obtaining proper professional advice can be viewed as an investment.

For the taxpayer who thinks that he is getting a bargain by obtaining the cheapest advice, it is sobering to reflect that the ultimate beneficiary of this economy is likely to be HM Treasury, and not his heirs and beneficiaries.

Want to learn more about IHT planning (including strategies)?

If you would like to know more about planning a tax-efficient will, three hours of podcasts and videos on the following subjects (with accompanying notes), will be available to view and download from July at www.wealthplanning.tv:

1. The planning environment.
2. The planning process.
3. Inheritance Tax (including gifts with reservation of benefit).
4. Domicile.
5. Bare trusts.
6. Deduction of liabilities.
7. Discounted gift trusts.
8. Discretionary trusts.
9. Flexible reversionary trusts.
10. Gifts of chattels.
11. Gifts of excluded property.
12. Incidence of IHT.

13. Jointly owned-property.

14. Legacies and devises.

15. Loan trusts.

16. Options to purchase.

17. Special trusts.

18. Specific gifts of property qualifying for APR/BPR.

19. Survivorship clauses.

20. Taxation of trusts.

21. Transferable NRB.

22. Traps for the unwary.

23. Trustee's powers and duties (including overriding powers of appointment).

24. Will structures and strategies.

The 5th edition of my book 'Tax-Efficient Wills Simplified 2014/2015' is scheduled for publication in October.

The presenter

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of the Society of Trust and Estate Practitioners (www.step.org), belonging to the STEP Contentious Trusts and Estates Special Interest Group.

I am a registered Public Access practitioner who can be instructed directly by members of the public (including executors and trustees) without the involvement of a solicitor. I am licensed to exercise rights of audience in all courts and proceedings in England and Wales, and specialise in:

- estate planning and drafting wills and trusts (which I jointly undertake with specialist tax advisors in the UK and other jurisdictions);
- probate, inheritance, trust, professional negligence, and tax disputes (including mediation advocacy); and
- construction and rectification of wills.

To arrange an initial fixed fee meeting with me to discuss your case please send an email to carl@ihtbar.com

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Disclaimer

The information set out above is only intended as a general guide, and is provided on the basis of no liability for the information given. If you want advice about English law upon which legal reliance may be placed you can instruct Carl Islam to provide it.