Don't just lend or gift it – document it

Julie Butler explains recent HMRC guidance on the importance of documentation of all estates

ABOUT THE AUTHOR

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HM Revenue & Customs (HMRC) guidance, which applies from 31 March 2008, states that there will be greater scrutiny of lifetime transfers. In *IHT and Trusts Newsletter,* HMRC included a note that it intended to pay close attention to such transfers. The HMRC theme for the documentation of all estates above and below the nil rate band is similar to the record keeping of the self-employed. There was further indication of this need to document with both the transfer of the unused nil rate band and jointly owned property.

Lifetime transfers

The HMRC August 2007 *IHT and Trusts Newsletter* states:

'From now until 31 March 2008, when looking at forms IHT200 received on a death, we will be paying particularly close attention to lifetime transfers. Not only will we be looking at estates where a form D3 has been completed giving details of gifts or other transfers of value but we will be reviewing other aspects of estates which we know can give rise to a lifetime transfers.

'These may include:

Joint assets – gifts can arise on a transfer into joint names or where a joint owner receives the benefit of withdrawals from accounts funded wholly by the deceased;

Loans – gifts can arise on the forgiveness of a debt or part of a debt;

Movement of funds between multiple bank accounts – this can lead to gifts being overlooked (see below);

Inheritance – gifts can arise if there have been redistributions of property inherited by the deceased;

Business or partnership – transfers from a business or partnership will not necessarily qualify for business relief;

Rights under a pension scheme – a gift may arise if acts or omissions by a member of a pension scheme have the effect of increasing the value of benefits passing outside the member's estate at the expense of his own estate.

'Where the information provided about these aspects is unclear, or incomplete, there is an increased likelihood that we will ask for further information or seek an explanation of what has occurred.

'In appropriate cases we will open an enquiry and ask you for further information to satisfy ourselves that all gifts have been included. We will tell you if the estate is one that has been selected for enquiry in this way. Where it appears that the accountable persons have been negligent in not disclosing a gift in the IHT200, we will consider whether a penalty is appropriate.'

So is this HMRC behaviour potentially (please excuse the pun) intimidating or just HMRC doing what they should be doing, which is checking information submitted and collecting the correct amount of tax?

The self-employed taxpayer realises they have to keep business records, so too must the taxpayer whether the estate falls below the nil rate band or above. Clearly incorrectly recorded transfers could place the estate above the nil rate band and hence cause a need for review and now there are games to be played with two nil rate bands.

Estates below the nil rate band

It will be necessary to keep records of estates below the Inheritance Tax (IHT) threshold so that the appropriate relief may be claimed when the surviving spouse dies.

HMRC have confirmed that:

'Where someone dies after 9 October 2007 with a nil rate band discretionary trust in their will, an appointment of the trust assets in favour of the surviving spouse or civil partner (before the second anniversary of the death, but not within the three months immediately following the death) would normally be treated for IHT purposes as if the assets had simply been left to the surviving spouse of civil partner outright. Ending the trust in this way could mean that the nil rate band was not used in the first death, and so the amount available for eventual transfer to the surviving spouse of civil partner would be increased accordingly.' (Inheritance Tax: Transfer of Unused Nil Rate Band from *www.hmrc.gov.uk/pbr2007/supplementary.htm*)

> "The self-employed taxpayer realises they have to keep business records, so too must the taxpayer whether the estate falls below the nil rate band or above"

So from 9 October 2007 were all those 'nil rate band protection wills' thrown away and started again?

The answer is that all wills should be looked at in a timely (but unrushed) manner and the need to revise the wills and a look at basic angles of loans, gifts and joint property reviewed.

HMRC's Brief 71/07 announces that henceforth, when valuing land or building jointly owned by husband and wife (or by civil

partners), HMRC will assume that section 161(4), *Inheritance Tax Act 1984 (IHTA 1984)* applies. This means that the shares of the husband and wife will no longer be separately valued; instead, the overall value of the shares of both spouses will be determined (the value of the whole property, if they are the only joint owners), and then divided between them, accordingly to their fractional shares. This change of practice follows a review of the decision in *Arkwright* v *Inland Revenue Commissioners* [2004] STC 1323 since when it has been assumed that section 161(4) applies only to assets held as a number of separate units (for example shares in a company). The background to *Arkwright* was that a Special Commissioner has held that section 161(4) did not apply to jointly owned land or buildings. That decision was not challenged in the High Court, either by the Revenue or the judge. However, the judge allowed the Revenue's appeal 'to the limited extent' that the Special Commissioner should not have gone on to consider questions of fact – rather, she should have remitted such questions to the Land Tribunal. HMRC has now received 'legal advice' that section 161(4) does apply to jointly owned land and buildings.

The new practice will apply where Inheritance Tax Account is received by HMRC on or after 29 November 2007 (the day after the Brief was published).

There may be cases where section 161(4) treatment is advantageous to the taxpayer (for example, to establish a higher base cost for capital gains tax purposes). HMRC state that they will, at the taxpayer's request, re-open any valuation concluded on or 16 July 2004 (the date of the decision in the *Arkwright*), on the basis that section 161(4) did not apply.

Loans

As mentioned in the section on lifetime transfers, making or receiving a commercial or family loan can have implications with regard to wills and IHT. Not all loans can be deducted from a person's estate.

It is common for an individual to either loan money or to receive money as a loan and there are complicated rules in notifying HMRC that judge whether that the loan is allowable as a deduction against the value of the estate or not. In family situations where a loan is made or received it is often done on an informal basis with little or no documentation.

Section 162 and 164 of *IHTA 1984* broadly provide that a debt is to be valued for IHT purposes on the assumption that the obligation will be discharged and this would include any accrued interest.

In the case of a mortgage or bank loan, HMRC will normally accept the deduction claim on Form D16 (part of the IHT 200) and it will be first set against the property against which it is charged, but where the property is being passed on to a spouse or civil partner and is exempt the loan will not be allowed as a deduction against the deceased estate.

The family loan and the commercial loan secured against family assets must clearly be reviewed as what it seems 'a good idea at the time' might cause problems with the calculation of the net estate, the IHT liability and family entitlement.

A meeting with the family's tax advisor and lawyer beckons.

The answer is don't just lend it or gift it, document it!

The same applies to jointly owned assets and lifetime transfers – is documentation robust enough? ■