Blurred boundaries

MALCOLM GUNN examines the newly widened scope of the inheritance tax disclosure of avoidance scheme provisions. There is some doubt as to how effective these will be.

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Do you market tax avoidance schemes? My guess is that most readers of this magazine would say no, but would admit that they have occasionally been involved in a fairly artificial or aggressive arrangement, perhaps recommended by tax counsel. In that case, stand by for a completely new regime for the disclosure of inheritance tax avoidance schemes. New regulations that came into effect from 1 April 2018 (The Inheritance Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations SI 2017/1172) will force all sorts of inheritance tax planning to be disclosed under the DOTAS (disclosure of tax avoidance scheme) provisions, even if HMRC is already well aware of such planning steps.

It is a classic example of mission creep. The regulations originally set out to eradicate artificial tax avoidance and, as the regime is extended, that objective is lost and we will now be required to disclose inheritance tax planning arrangements that we would regard as nothing more than legitimate tax mitigation.

The 2011 regulations

Originally, when inheritance tax was brought within the scope of DOTAS, HMRC was concerned only with novel or innovative schemes for avoiding the entry charge when property becomes relevant property (IHTA 1984, s 58). As an example, this might be in a discretionary trust. Further, arrangements that were largely similar to those already in place before 6 April 2011 did not need to be notified. It was of course too much to hope that this narrow regime would last.

KEY POINTS

- A new regime for the disclosure of inheritance tax avoidance schemes came into effect from 1 April 2018.
- The disclosure provisions for inheritance tax have been widened significantly.
- A disclosure is required if an 'informed observer' would conclude that specific conditions are met.
- The 'grandfathering' provisions of the 2011 regulations cease to apply. All schemes must now be tested.
- HMRC provides examples of arrangements that need not be disclosed.
- An arrangement may not be avoidance but may be disclosable.

The 2018 regulations

From 1 April 2018, the disclosure provisions for inheritance tax have been widened significantly (SI 2017/1172, reg 4(2)). Any arrangements whose main purpose, with or without other main purposes, is the avoidance or reduction of inheritance tax in circumstances as below will need to be disclosed, subject to specific exceptions. Note how these days tax avoidance is mentioned in the same breath as the simple reduction of tax due. Disclosure must be made within five days of making the arrangements available. The circumstances are:

- the entry charge into a trust and the other charges on trusts;
- charges on participators;
- the avoidance of the reservation of benefit provisions without a pre-owned asset charge arising; and
- any reduction in a person's estate without a chargeable transfer or a potentially exempt transfer (PET) arising.

Apart from the 'main purpose' test, there is a further test that the arrangements must involve one or more contrived or abnormal steps. All this is vague and ill defined. To help clear the fog, the regulations go on to provide that disclosure must be made if an 'informed observer' who has studied the arrangements and had regard to all the relevant circumstances would conclude that the above conditions are met (SI 2017/1172, reg 4(1)).

What this means in practice is that the adviser must consider whether an imaginary person, who cannot be consulted, would tell them that the main purpose test and the contrived or abnormal steps test are both present in the arrangements that they have in mind. This is little help because one person's opinion about something is likely to be different from another person's. If you ask some newspapers whether paying a substantial dividend to a non-resident spouse is tax avoidance I suspect you will get a much different view on it from that of most readers of this magazine.

HMRC's guidance (tinyurl.com/yddjh4na) at 7.6.5 attempts to deal with the problem of different opinions by setting out the skills one can expect the informed observer to have: 'The informed observer is to be contrasted with an uninformed observer, but is not an expert or necessarily a tax practitioner. An informed observer is independent, has all the relevant information about the scheme and has sufficient knowledge to understand both the scheme and the relevant statutory context. The informed observer is assumed to have the appropriate knowledge and skillset to reach the conclusion the hallmark requires.'

Personally, I find this unhelpful and I do not think the introduction of this imaginary observer helps anybody.

Schemes and grandfathering

Arrangements that involve premium fees or confidentiality arrangements are also disclosable under DOTAS and this continues to apply to inheritance tax planning. Under this heading, the informed observer does not get involved at all.

The 2011 regulations included 'grandfathering' provisions, but these cease to apply from 1 April 2018 and all schemes must be tested afresh under the new provisions. Note also that there is no grandfathering arrangement in relation to the confidentiality and premium fee hallmarks.

Under SI 2017/1172, reg 5, any inheritance tax planning implemented after 1 April 2018 does not need to be disclosed in two circumstances.

(1) The arrangements implement a proposal that has been effected by 'related arrangements' and which is substantially the same as the related arrangements.
(2) The related arrangements must have been entered into before 1 April 2018 and at the time it was known they accorded with established practice of which HMRC had indicated acceptance.

This would seem to allow many inheritance tax planning arrangements to escape disclosure because, to some extent, there is nothing new under the sun. Unfortunately, HMRC says otherwise in its guidance at 13.3.4. This states that, if different companies are offering their own versions of a tax-saving scheme (for example, a discounted gift trust), each must be considered to be a separate proposal, a proposal being a step or series of steps with an inheritance tax saving purpose in mind. Further, if any one company adds a new feature to its marketed arrangements and this slightly alters the tax treatment, this makes it a new, different proposal and it must therefore be disclosed under DOTAS, even though the informed observer would say that it is substantially the same as the pre-2018 proposal.

Advisers will glean none of this from the wording of the regulations. True to modern form, the regulations are lacking in crucial definitions so that HMRC believes it can fill in the gaps with its own ideas. HMRC's explanation (at 13.3.7) is as follows:

> 'It is important to bear in mind that the "substantially the same" requirement relates to the arrangements being implemented and the related arrangements, not the proposal that the arrangements are implementing. For the exception to apply the current arrangements have to implement the same proposal as was implemented by the "related arrangements".'

Non-notifiable arrangements

HMRC's guidance (at 13.4) goes on to give examples of arrangements that are not notifiable. On my reading, many of them fall within the subject suggested by Basil for Sybil Fawlty if she were to enter BBC's *Mastermind*. They include arrangements such as a lifetime gift to a spouse or regular gifts out of income. It is ludicrous that HMRC thinks it needs to tell professional tax advisers that a husband giving something to his wife is not a disclosable tax avoidance scheme.

There are, however, one or two items in the examples (at 13.4) that are helpful. One is that a will leaving property to an exempt beneficiary is never disclosable. The guidance (13.4.2) says: 'Executing a will does not meet any of the elements of condition one'.

Thus, if a testator wants his estate to benefit from the spouse exemption but also wishes to leave it to children, they could execute a will leaving the estate on immediate post-death interest (IPDI) trust for the spouse, which the trustees terminate soon after their death and then appoint the funds out to the children. This is not disclosable in keeping with general principle that death is not step in a tax avoidance scheme nor an associated operation.

Another interesting example is the gift of a share in a property that is used later by both donor and donee. The guidance (at 13.4.3, example 10) refers to this and says: 'It is likely that an informed observer would conclude that obtaining the inheritance tax advantage was the main reason' for the gift. So much for the imaginary informed observer having any experience of life in the real world. Fortunately, the guidance says the gift could not be seen to be contrived or abnormal except that 'where the donor only retained a very small proportion of the property in comparison to the level of occupation' the analysis might be different. You have been warned.

Grey areas

The guidance admits that there will be cases when it is difficult to be definitive about whether they are notifiable. It seems entirely wrong to me to have a tax system under which it is difficult to tell what is caught and what is not.

An example we are given of arrangements that may have to be disclosed is when shares qualifying for 100% business property relief are transferred into a trust with the intention that they will be sold back to the settlor at some stage after the trust is created (13.5, example 16). The broad effect is that cash is put into the trust free of the normal inheritance tax entry charge. Fine, so now we know and obviously in future there will be no such intention; any sale back to the settlor will be decided on later.

Notifiable arrangements

The guidance gives two examples of arrangements that must now be disclosed under DOTAS, one being the creation of a reversionary lease over a residence, after which the lease is given away to a trust or to children (13.6, example 17). This is considered to be a contrived or abnormal arrangement and must therefore be disclosed. Note that HMRC knows perfectly well that such arrangements exist, so disclosure is no longer about giving the department information about new ideas that are being marketed, but is more about notifying the Revenue what the taxpayer is up to in any particular case.

The second example in the guidance is the creation of an employee benefit trust into which shares in a family investment trust are transferred free of inheritance tax (13.6, example 18).

What we still don't know

Despite all this guidance, there are all sorts of standard inheritance tax planning arrangements that are hard to test against the new disclosure hallmarks. For example, an elderly lady may be advised to live in her holiday home abroad and take the opportunity to invest her entire estate in gilts that are inheritance tax-exempt to those not ordinarily resident in the UK. She then gives the gilts to her children who sell them.

One might say that this is an abnormal arrangement, but on the other hand this is squarely within the relevant inheritance tax legislation. It is not therefore tax avoidance but it may be disclosable, or do we assume that the statutory exemption is the end of the story?

What if something similar is done by a younger person, such as an expatriate working overseas?

The owner of a property investment company may enter into share freezing arrangements whereby new B shares carrying the growth value in the company over the existing value may be issued and then given away to a trust. This might be regarded as contrived or abnormal but it should not reduce the estate and so is not disclosable.

On divorce, the parties might agree that a property is transferred into trust for the other party as an exempt transfer under a court order, with the embellishment that the title is spread over a number of trusts to reduce or eliminate inheritance tax charges in future. This may be contrived, but is it disclosable? Since *CIR v Rysaffe Trustee Company (CI) Ltd* [2003] STC 536, HMRC has made it clear that it accepts trust fragmentation schemes. But any particular case will not be identical to a past one (an earlier 'proposal') so I imagine this must now be disclosed.

I have to say that I find it hard, perhaps even impossible, to identify the boundaries of this regime, so whether it will work in practice seems doubtful to me.

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