Chartered Institute of Taxation

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Inheritance Tax: Excluded property

Finance Bill 2019-20

Response by the Chartered Institute of Taxation

1 Introduction

1.1 The CIOT comments on draft Clauses 1 Inheritance tax: excluded property and 2 Inheritance tax: transfers between settlements, published for consultation on 11 July 2019[1].

1.2 As an educational charity, our primary purpose is to promote education in taxation. Our comments and recommendations on tax issues are made solely in order to achieve this aim; we are a non-party-political organisation.

1.3 Our stated objectives for the tax system include:

A legislative process which translates policy intentions into statute accurately and effectively, without unintended consequences.

Greater simplicity and clarity, so people can understand how much tax they should be paying and why.

Greater certainty, so businesses and individuals can plan ahead with confidence.

1.4 Clause 1 introduces legislation to provide that additions of assets by individuals domiciled in the United Kingdom to trusts made when they were non-domiciled cannot be excluded property and are therefore within the scope of Inheritance Tax. Clause 2 introduces legislation to provide that transfers between trusts are subject to additional excluded property tests.

2 Endorsement of the Society of Trust and Estate Practitioners' Comments

2.1 The CIOT have had sight of the comments made by the Society of Trust and Estate Practitioners (STEP) (attached) and endorse them.

[1] https://www.gov.uk/government/publications/inheritance-tax-and-excluded-property-added-to-and-transferred-between-trusts

3 Policy considerations on transfers between settlements or a resettlement

3.1 In the experience of our members, transfers between trusts are most commonly undertaken for family or related reasons and without any intention to avoid IHT or to circumvent the excluded property rules. Accordingly we believe that the main thrust of the legislation should be to limit additions by the settlor after s/he becomes deemed or actually UK domiciled.

3.2 The coherence of the IHT offshore settlements regime requires that additions of value by the settlor who is or has become UK domiciled should no longer be treated as excluded property, which is the aim of the draft legislation.

3.3 However the rationale for preventing transfers between settlements is much less apparent; it is often very convenient for trustees to be able to separate out assets into different trusts and there is no IHT avoidance in mind. Sub-fund elections do not always answer the problem as they have quite restrictive conditions.

3.4 Offshore trustees could inadvertently fall into the UK IHT code in the following circumstances: a trust is set up by a non-domiciled settlor who does not benefit, but later becomes deemed domiciled in the UK. The trustees take US advice on something which often involves an appointment, but in UK terms is treated as a resettlement or restatement. There is no question of IHT avoidance being attempted in such circumstances.

3.5 Accordingly, where trustees (not the settlor) are involved in transferring between two settlements both set up when the settlor foreign domiciled (or the second is set up by the trustees of the first) we think that, as a matter of policy, there should be no loss of excluded property status merely because of the change in status of the settlor. Thus if both trust A and trust B are excluded property trusts then there is no mischief and all the trust property should keep its excluded status; but if trust A is excluded property and trust B is not then, on any movement between trust A and trust B, each should retain its original status (and there should be no opportunity for trust B to 'piggy-back' on trust A's status by moving the B assets into A).

4 Acknowledgement of submission

4.1 We would be grateful if you could acknowledge safe receipt of this submission, and ensure that the Chartered Institute of Taxation is included in the List of Respondents when any outcome of the consultation is published.

5 The Chartered Institute of Taxation

5.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

The CIOT draws on our members' experience in private practice, commerce and industry, government and

academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT's comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

The CIOT's 18,700 members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

The Chartered Institute of Taxation

13 September 2019

STEP's Response to HMRC's Consultation on the Proposed amendments to the Inheritance Tax Act 1984 on excluded property added to and transferred between trusts published on 11 July 2019

About us

STEP is the worldwide professional association for those advising families across generations. We help people understand the issues families face in this area and promote best practice, professional integrity and education to our members.

Today we have over 20,000 members across 95 countries, with over 7,000 members in the UK. Our membership is drawn from a range of professions, including lawyers, accountants and other specialists. Our members help families plan for their futures: from drafting a will or advising family businesses, to helping international families and protecting vulnerable family members.

We take a leading role in explaining our members' views and expertise to governments, tax authorities, regulators and the public. We work with governments and regulatory authorities to examine the likely impact of any proposed changes, providing technical advice and support and responding to consultations.

STEP welcomes the opportunity to respond to this consultation.

Response

Accumulations

Our understanding is that accumulated income is capitalised (so that it becomes comprised in the settlement) when trustees make the decision to accumulate it. If they do not make any such decision in respect of income arising before a period of five years ending immediately before a 10 year anniversary, then, for the purposes of the 10 yearly anniversary charge, that income is nevertheless treated by s64(1A) as relevant property comprised in the settlement.

However, by the proposed amended s64(1B) where the settlor of property comprised in a settlement was non-UK domiciled "when the property became comprised in the settlement" (and not a formerly domiciled resident for the tax year in which the 10

year charge falls) income that arose directly or indirectly from the property is not to be regarded as relevant property comprised in the settlement as a result of s64(1A) if the income is situated outside UK. A change in the domicile status of the settlor after making the settlement will not affect the position.

In contrast, on the basis that accumulated income becomes comprised in the settlement when it is accumulated, a change in the domicile status of the settlor from non-UK domiciled to UK domiciled between the date of the settlement and the date when income is accumulated would seemingly result in the accumulations becoming relevant property comprised in the settlement at a time when the settlor is UK domiciled even though arising from excluded property.

Example:
Giovanni made a settlement on 5.4. 2018 whilst non-UK domiciled and not a formerly domiciled resident.

The 10 year anniversary will be 5.4.28.

The five years ending immediately before 5.4.28 will start on 4.4.23.

All income is retained offshore pending a trustee decision.

Income arising before 4.4.23. is deemed to be comprised in the settlement at the 10 year anniversary being unaccumulated immediately before 5.4. 28 (s 64(1A)) but for Giovanni the rule is disapplied under the amended s64(1B).

If however the income had been accumulated by the time of the 10 year anniversary it becomes actual trust capital rather than deemed trust capital and loses the protection of s64(1B). If Giovanni is UK domiciled by the time of the accumulation there is nothing to prevent the accumulated income from being non excluded property while the capital remains excluded property.

In view of clause 1 (5) we assume that the policy is that income arising from excluded property should not be relevant property for 10 yearly charge purposes. One way of dealing with this would be to insert a new sub-section after s48(3) which reads something along the following lines:

"48(3AA) Where income from property to which s48(3) applies is accumulated, that income is treated for the purposes of this Act as becoming comprised in the settlement at the same date as the property in question."

Alternatively, you may wish to include this in new s271B.

S 48(3): an unintended consequence

Our reading of the effect of the proposed amendments to s48(3) is as follows.

If a settlor, of any domicile, dies he will not meet a condition, for example relating to excluded property, which requires the settlor to be UK domiciled at a time later than his death.

It follows that if there is a trust to trust transfer after the settlor's death, property he originally settled will, if non UK situate, be excluded property from the time of the transfer, unless s 81 applies bringing into play s 82A. Most cases will be within s 81, but a few may involve a transferee settlement which has a qualifying interest in possession and so falls outside s 81.

S 82A

The proposed new s82A (and its interaction with s81 and s48) is difficult to follow especially in view of the heading which would perhaps be more helpful if it read "Excluded property: qualifying transfers". The concept of "qualifying transfers" was presumably devised to reverse the decision in Barclays Wealth Trustees (Jersey) Ltd/Dreelan v RCC [2017] EWCA Civ 1512.

Our view is that there should be a freestanding section which does not refer to ss80 or 81 and is not confined to relevant property and deals comprehensively with the question as to which settlor's domicile needs to be tested and at what point in time in different circumstances where there have been trust to trust transfers (including multiple transfers). We should be happy to submit a specimen draft.

Qualifying Transfers

The words "to any extent as a result of" in s82A(5) and (6) are unclear and potentially open to abuse. The words "to any extent" suggest at first glance that a distinction is capable of being drawn between cases where the whole of the property indirectly referred to in s82A(4)(b) becomes comprised in the new settlement and cases where only part of the property becomes so comprised. It would be preferable if the scenarios intended to be governed by these words were more precisely set out. For example, we assume that they are intended to clarify which event is to be regarded as resulting in a transfer of property from one settlement to another where a reversioner of settlement 1 has settled his interest and it subsequently falls into possession with a resultant transfer of property to settlement 2. Are there other scenarios in which this new subsection is intended to be engaged?

Section 82A(6)(a)(ii)

This paragraph does not seem necessary as a formerly domiciled resident is (deemed) domiciled in the UK.

Submitted by the STEP Technical Committee on 5 September 2019

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