Tax Representation

ICAEW TAX FACULTY

TAXREP 15/08

INHERITANCE TAX ON TRUSTS FOLLOWING FINANCE ACT 2006 CHANGES

Transitional period 22 March 2006 to 5 April 2008

Text of a letter dated 14 February 2008 to the Financial Secretary to the Treasury by the Tax Faculty of the Institute of Chartered Accountants in England and Wales

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TEXT OF LETTER

Introduction

Finance Act 2006 made major changes to the Inheritance tax ('IHT') treatment of trusts with effect from 22 March 2006. The Government, recognising that the changes were far-reaching, provided a transitional period, which ends on 5 April 2008, which was intended to allow time for trustees to rearrange their trusts, including the interests in possession of beneficiaries without necessarily changing the identity of the beneficiaries, to mitigate the impact of the changes without a charge to IHT arising.

We are concerned that statements made by HMRC as to how they interpret certain parts of the amended law, in particular section 53(2) and (2A) Inheritance Tax Act 1984 as amended by FA 2006, have given rise to so much doubt t hat even experienced advisers are unable to advise with certainty. The consequence is that trustees feel themselves currently unable to take action to mitigate the impact of the changes.

To illustrate this, we wrote to HMRC on 25 January 2007 and recei ved a reply on 11 May 2007 which touched upon this area and which we thought clarified the matter. We then became aware of other correspondence which cast some doubt on this, so on 25 September 2007 we wrote again to HMRC for clarification. No reply has been forthcoming pending their receiving counsel's opinion, and the transitional period has nearly ended.

We are therefore writing to you to request that you make a statement:

(i) confirming that the law in question, section 53(2A) IHT Act 1984, means what it says on a literal reading; and

(ii) extending the transitional period for a year.

These two steps would ensure that the intention of the Government in 2006 to provide a transitional period is achieved.

Explanation

Section 53(2A) Inheritance Tax Act 1984 (IHTA 1984) was inserted by section 156 and paragraph 14(3) Schedule 20 Finance Act 2006. Section 53(2A) says (cutting out words that are irrelevant to the point we are making here): 'Where … a person becomes beneficially entitled *on or after 22 March 2006 to an interest* in possession in settled property … subsection (2) …applies in relation to the coming to an end of *the interest* with the omission of the words "or to another interest in possession in the property".' (our italics).

Subsection (2) is a relieving provision which provides that IHT will not be chargeable under section 52 IHTA 1984 '… if the person whose interest in the property comes to an end becomes on the same occasion beneficially entitled to the property or to another interest in possession in the property.' This is because for IHT purposes the trust property remains in the estate of the individual with the interest in possession and so there is no reason for this occasion to produce an IHT charge.

In subsection (2A), giving the words their normal meaning, the words in italics '*the interest*' is the interest to which the person became beneficially entitled <u>on or after</u> 22 March 2006 referred to earlier in that same sentence. So the effect of subsection (2A) when read back into subsection (2) should be that tax is chargeable under section 52 where an interest which was created on or after 22 March 2006 comes to an end and is replaced by another interest in possession in the property. This follows the Government's objective, but HMRC are interpreting this subsection as applying also to interests created <u>before</u> 22 March 2006 which come to an end and are replaced by another interest in possession in the property for the same person. The prospect of HMRC claiming IHT in such cases, even though the wording of subsection (2A) appears to prevent it, is stopping trustees from doing what the Government intended they should be allowed to do during the transitional period.

Trustees are personally liable without limit for their mistakes. This makes trustees act cautiously, and if they are considering whether to make changes to the interests of beneficiaries or to the trust deed, they almost invariably consult with the settlors (if alive) or protectors (if any), have regard to the beneficiaries and any letter of wishes of the settlor, take professional advice, and even in some cases apply to the court to allow changes to trust deeds. This high level of care that trustees owe is presently making them feel unable to take advantage of the opportunity provided by the Government to rearrange the affairs of their trusts during the transitional period, despite the HMRC interpretation being disputed by tax experts outside of HMRC. Only reckless trustees are likely to take action without being satisfied that they will not end up in a potentially costly dispute with HMRC. HMRC pronouncements, even if they appear wrong, are taken very seriously and will prevent trustees taking actions that would otherwise be beneficial.

Conclusion

We should be grateful if you would clarify, at the first available opportunity, that the legislation should be interpreted literally (as set out above). If a different IHT result is felt necessary where the interest of a pre 22 March 2006 life tenant is varied after 5 April 2008 then we would suggest that this is done through an amendment in FA 2008. Furthermore, in the light of the paralysis that HMRC's silence has led to, we would also be grateful for an extension of the transitional period for a further year (that is until 5 April 2009).

PCB
15.2.08

ANNEX A

ICAEW AND THE TAX FACULTY: WHO WE ARE

1. The Institute of Chartered Accountants in England and Wales (ICAEW) is the largest accountancy body in Europe, with more than 128,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.

2. The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department for Business, Enterprise and Regulatory Reform through the Financial Reporting Council. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy, including taxation.

3. The Tax Faculty is the focus for tax within the Institute. It is responsible for tax representations on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter *TAXline* to more than 10,000 members of the ICAEW who pay an additional subscription.

4. To find our more about the Tax Faculty and ICAEW including how to become a member, please call us on 020 7920 8646 or email us at taxfac@icaew.com or write to us at Chartered Accountants' Hall, PO Box 433, Moorgate Place, London EC2P 2BJ.

ANNEX B

THE TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. **Statutory:** tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.

2. **Certain:** in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.

3. **Simple:** the tax rules should aim to be simple, understandable and clear in their objectives.

4. **Easy to collect and to calculate:** a person's tax liability should be easy to calculate and straightforward and cheap to collect.

5. **Properly targeted:** when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.

6. **Constant:** Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.

7. **Subject to proper consultation:** other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.

8. **Regularly reviewed:** the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.

9. **Fair and reasonable:** the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.

10. **Competitive:** tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as **TAXGUIDE 4/99**; see http://www.icaew.co.uk/index.cfm?route=128518.