

TAX PLANNING BULLETIN

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Introduction

“O what a tangled web we weave
when first we practise to deceive!”

Tax professionals of all political persuasions were shocked to find, buried amongst the Budget Notes, a fundamental change to Inheritance Tax. The change will affect hundreds of thousands of taxpayers and yet no reference was made to it in the Chancellor's speech. It was the most outrageous introduction of tax by stealth since the Chancellor's smash and grab raid on pension funds in his very first Finance Act.

Since Capital Transfer Tax was introduced in 1974 a fundamental conceptual element of the tax has been that holders of interests in possession (IIP) are treated as if they are the beneficial owners of the assets in which their interests subsist. Now most interest in possession trusts will be brought within the special rules which previously applied only to a residual class of discretionary trusts. Because it is rarely appropriate to make unfettered outright gifts of substantial capital, most lifetime IHT planning involves the use of trusts. In practice, the change therefore represents the reimposition of Capital Transfer Tax which subjected to tax all lifetime gifts; but a Capital Transfer Tax strengthened by the gifts with reservation and pre-owned asset rules.

No doubt the Government calculated that such a change was too complex to be of interest to any but technical specialists but the initial storm of protest from tax professionals has spread into the wider news media as it has become apparent how large is the number of people who will be affected.

Will the Government withdraw or significantly modify the changes? The Sunday Times has announced that the Government has already given in to vociferous representations and modified the proposals in relation to existing trusts of insurance policies. Unfortunately, the journalists were misled by Government spin. So far, no changes have been announced to the original proposals in relation to insurance policies or to any other matters. The Government may make some concessions but it has said that it is committed to the policy of subjecting IIP trusts to the discretionary trust regime.

If part or all of these changes remain there is hardly an existing trust or Will which will not require a thorough review. We shall be following the legislation through its parliamentary stages and explaining its implications for all sorts of testamentary and inter vivos trusts.

Tax planning techniques to mitigate or expunge Inheritance Tax liabilities will become all the more valuable because so many traditional approaches will no longer work. When Denis Healey introduced Capital Transfer Tax he promised to “squeeze the rich till the pips squeaked”. Gordon Brown has decided to squeeze the merely prosperous. If you want to avoid the Chancellor’s embrace you should contact us.

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A. INHERITANCE TAX

1. Trusts – ‘Aligning the IHT Treatment’: Budget 2006

Context

This proposed change announced by way of Budget Note without having been mentioned in the Budget Speech has raised a storm of protest and is the most shameless stealth tax since the Chancellor's raid on pension funds. Because most lifetime IHT planning involves the use of interest in possession trusts, the changes have, in practice, almost reintroduced Capital Transfer Trust reinforced by the gifts with reservation and pre-owned asset rules and numerous other anti-avoidance provisions which have been imposed on long-suffering tax payers since 1986. Part of the fundamental design of Inheritance Tax and its predecessor Capital Transfer Tax is the treatment of the holder of an interest in possession (“IIP”) as if he were the beneficial owner of the assets in which his interest subsists. Now all IIP trusts except a small class of qualifying settlements and all accumulation and maintenance trusts (“A&M”) will be subjected to the special regime which previously applied only to particular forms of discretionary trusts. This change will apply to existing A&Ms and IIPs, subject to the transitional rules described below.

Operative date

The new rules apply from 22nd March 2006 to new trusts, additions of new assets to existing trusts and, subject to transitional provisions, to other IHT-relevant events in relation to existing trusts. Transitional rules will provide for a period of adjustment for certain existing trusts up to 6.4.08, and for continuing exclusion from the ‘relevant property’ charges if they satisfy conditions for ongoing protection.

Proposed revisions

Legislation in the Finance Bill will limit these special rules [for A&M and IIP trusts] to trusts that:

- are created on death by a parent for a minor child who will be fully entitled to the assets in the trust at age 18; or
- are created on death for the benefit of one life tenant in order of time whose interest cannot be replaced (more than one such trust may be created on death as long as the trust capital vests absolutely when the life interest comes to an end); or
- are created for a disabled person either in the settlor's lifetime or on death (see IHTA 1984 s89(4)).

Any other trusts will fall into the mainstream IHT rules for ‘relevant property’ trusts.

New trusts

In the case of trusts created on or after 22nd March 2006, this means that lifetime transfers into trusts are no longer eligible for special treatment unless they are set up for a disabled person. All other transfers will be immediately chargeable. Trusts that do not qualify for special treatment - whether they are created in life or on death - will be liable to the periodic and exit charges applying to ‘relevant property’ trusts.

Existing A&M trusts

Where existing A&M trusts provide that the assets in trust will go to a beneficiary absolutely at 18 - or where the terms on which they are held are modified before 6th April 2008 to provide this - their current IHT treatment will continue.

Where they do not, the trust assets will become 'relevant property' from 6th April 2008 and the periodic and exit charges will apply. Ten-yearly anniversaries will arise by reference to the original date of settlement. For the first ten years after 6th April 2008, the rate of charge will reflect the fact that the property has not been 'relevant property' throughout a full ten year period. For example, if the first ten-yearly anniversary falls in November 2008, it will be one twentieth of the normal charge.

Existing IIP trusts

The current rules for existing IIP trusts will run on until the interest in the trust property at 22nd March 2006 comes to an end. If someone then takes absolute ownership, this will be a transfer by the person with the interest in the property - either a transfer on death or a 'potentially exempt transfer' if they are still living - and will receive the same IHT treatment as now. The trust will have no further IHT consequences.

If the interest comes to an end so that the property remains on trust, this will be treated as the creation of new settled property:-

- if it comes to an end during the lifetime of the person beneficially entitled to it, this will be a transfer creating 'relevant property' (unless the new trusts are for charitable purposes) and will therefore be immediately chargeable; and
- if the interest comes to an end on death, it will form part of the person's IHT estate as now and the settled property will then become 'relevant property' (unless the charity exemption applies).

In both cases, the periodic and exit charges will apply.

However, any new IIP that arises when an IIP created before 22nd March 2006 comes to an end before 6th April 2008 - whether on death or otherwise - will be treated as an IIP that was in place on 22nd March 2006.

Gifts with reservation

Where an individual is beneficially entitled to an interest in settled property, and continues to be treated for IHT purposes as owning the property, a termination of the interest in the individual's lifetime on or after 22nd March 2006 is treated as a gift for the purposes of the IHT 'gift with reservation' rules. So if they retain the use of the settled property after their interest in it ends, it will remain chargeable in their hands in the same way as if they had formerly owned it outright.

Capital gains tax consequentials

Changes to the IHT treatment of trusts will have a number of implications for CGT:-

- transfers into and out of trusts that will now come within the 'relevant property' rules will automatically be eligible for hold-over relief under TCGA 1992 s.260(2)(a);
- hold-over relief under s.260(2)(d) will be restricted to trusts that meet the new IHT rules for trusts for minor children;
- the special rules in s.72 and s.73 relating to the death of a person entitled to an IIP will be restricted to assets that are subject to an IIP which meets the new IHT rules.

(HMRC Budget Release 2006 BN25 22.3.06)

Comment: Impact of legislation enacting BN 25

Obviously, we must await the outcome of the vigorous representations which are in the process of being made by various professional and industry bodies but, on the face of it:-

- a gift by Will or *inter vivos* to a surviving spouse is exempt if outright but chargeable if on life interest trusts (unless it is a gift on death and that interest 'cannot be replaced' and when it comes to an end it is succeeded by absolute interests);
- gifts into trust on or after 22nd March 2006 are immediately chargeable (except where for a disabled person) and so the periodic and exit charges under the discretionary trust regime will apply to new A&M and IIP trusts;
- existing A&M trusts will enter the 'relevant property' regime on 6th April 2008 unless by then the trust deed as amended provides for capital to vest absolutely at age 18. The date of the first 10 year anniversary will depend on when property first became comprised in the trust;
- IIP trusts at 22nd March 2006 will run on until the current interest comes to an end. If a person becomes absolutely entitled that will be either a transfer on death or a PET by the life tenant. If the property remains in trust, that will be the creation of a new settlement, whether arising *inter vivos* or (when it will be accumulated with the chargeable estate) on death;
- if an IIP created before 22nd March 2006 ends before 6th April 2008 in favour of a new IIP, the latter will be treated as if it were in place on 22nd March 2006;
- as for CGT, the special rules in TCGA 1992 ss.72 and 73 relating to the CGT-free uplift on death will apply only to assets which are within an IIP trust under the new IHT rules;
- but of course hold-over relief under s.260 will now apply more generally.

In consequence, subject to any changes in the proposed regime, the terms of all Wills where the testator is still alive and all A&M and life interest trusts need to be critically examined.

2. Pensions Simplification and IHT: Budget 2006

Context

This measure sets out how IHT will apply to choices made under the new pension scheme rules, which came into effect on 6th April 2006. It legislates an existing IHT concessionary practice for scheme members who die under the age of 75 and sets out how IHT is to be charged on death on or after age 75 where funds are held in an alternatively secured pension.

Current law and proposed revisions

Death of scheme member before age 75

The present IHT rules will continue to apply to registered pension schemes in much the same way as they do currently. This measure will legislate the IHT concessionary practice dating from 1992 in relation to pension choices by scheme members. The practice was first published in Inland Revenue Tax Bulletin 2 (February 1992) and was subsequently updated in 1999 to take account of the introduction of income withdrawal under pension schemes.

An IHT charge can arise in a scheme member's lifetime under IHTA 1984 s.3(3) if they do not exercise their right to take pension benefits. The charge applies at the latest time when the right could be exercised i.e. immediately before death. For example, if a scheme member did not take their pension when their life expectancy was seriously impaired, and this resulted in an enhanced death benefit being paid to their beneficiaries, then IHT could apply. Currently, by concession, IHT is not charged in respect of these enhanced death benefits where the beneficiary is a spouse, civil partner or person who is financially dependant on the scheme member. Nor is IHT applied where a scheme member chooses not to exercise a right at a time when this choice does not trigger a charge (for example, choosing not to take a pension when they are in good health) and does not subsequently vary that choice, even when a reduction in their life expectancy would in strictness trigger an IHT charge.

This concessionary treatment will be legislated in the Finance Bill. In addition, payments arising in these circumstances which are made to charity will also be exempted from IHT.

Death of scheme member on or after age 75 - Alternatively Secured Pension

The pensions tax simplification rules provide that an individual must secure an income before they reach the age of 75. The new pensions tax regime introduces an option for securing their retirement income - an Alternatively Secured Pension (ASP).

The Government will apply an IHT charge on left-over ASP funds on death (or later) as follows:-

- any funds paid as a 'transfer lump sum death benefit' (where the funds remain within the scheme for the benefit of other scheme members) or refunded to an employer or used to provide benefits for a dependant who is not a spouse, civil partner or person who is financially dependant on the member will be subject to an IHT charge on the death of the original scheme member as if the funds were part of the scheme member's own taxable estate on death;
- any funds paid to charity on the death of the scheme member will be exempt from IHT, as will funds expended for the scheme member's spouse, civil partner or person who is financially dependant on the scheme member;
- any left-over funds, once use by the spouse, civil partner or person who is financially dependant (the beneficiary) has come to an end, will be chargeable to IHT on the earlier of the cessation of those benefits and the death of the beneficiary. These remaining funds will be treated as if they were an addition to the original scheme member's estate. However, any left-over funds that are paid to charity will be exempt from IHT;
- in certain circumstances, an IHT charge on ASP funds will fall on the estate of a dependant (rather than that of the original scheme member). This will apply where a dependant - within the meaning of the pension scheme rules - opts for an ASP derived

from 'benefits' inherited from a scheme member who died before age 75. Here, any left-over funds on the dependant's death will be charged to IHT as if they were part of the dependant's taxable estate on death.

The IHT charge

IHT will be payable on the value of the taxable property at the time the charge arises, and calculated by reference to the tax-free threshold and rate of tax in place at that time. The pension scheme administrator will be responsible for accounting for and paying any IHT due on the ASP funds.

There are two instances where the tax charges on ASP funds overlap. One is where the funds are paid to an employer and the other is where on the death of a dependant under age 75 any remaining funds are paid out as a lump sum other than to a charity. The IHT charge takes priority over the pension scheme tax charge which is then applied to the net fund after deduction of IHT.

Application: impact

HMRC has said that it will work closely with the pensions industry on the necessary processes to help minimise any regulatory impact on pension schemes. Personal representatives of estates will be required to provide information in the estate account about the ASP. This will include an estimate of the value of the left-over ASP funds at the date of death together with details of the name and address of the scheme administrator (who will be liable for any IHT payable).

(HMRC Budget Release 2006 BN26 22.3.06)

3. Spouse Exemption: £55,000 limitation for Non-UK Domiciled Transferees

Context

Where the donor spouse is UK domiciled but the donee spouse is not, the spouse exemption is restricted by IHTA 1984 s.18(2) to £55,000.

Confirmation from Dawn Primarolo that the £55,000 threshold will not be increased

A letter by the Paymaster General to Scottish Life International (SLI) confirms that the threshold will not be raised. The letter says 'the purpose of this restriction, which dates back to 1975, is to safeguard the Exchequer from loss of tax through UK capital, which has been transferred with the benefit of an IHT exemption, being taken abroad. It also prevents the use of a non UK domiciled spouse as an intermediary for the transfer by a UK domiciliary of foreign assets to a third party ... Generally, increasing the £55,000 figure itself would undermine the anti-avoidance mentioned and could be seen as running counter to our commitment to tackling avoidance and encouraging a fairer tax system.'

Comment

However, as pointed out by SLI, inflation has risen by 150% since the introduction of the threshold in 1975.

Where the non-UK domiciled spouse is an EU citizen it is doubtful whether these provisions are compatible with EU law.

(STEP Domestic News Digest 10.3.06)

B CAPITAL GAINS TAX

4. Company Residence: 'Central Management and Control'

Context

Chargeable gains accruing to a company which is not UK resident but, if UK resident, would be a close company are under TCGA 1992 s.13 apportioned to participators in the company who are resident or ordinarily resident in the UK and who, if an individual, is domiciled in the UK. Apportionment of the gain follows their interests in the company subject to a 10% *de minimis* provision. Subject to anti-avoidance provisions, a no gain - no loss rule operates under s.171 for transactions within UK resident 75% groups.

Wood and another v Holden: the facts

Mr and Mrs Wood were settlors of a number of non-resident settlements set up as a part of what the Special Commissioners described as a 'sophisticated scheme to avoid CGT'. The trustee of those settlements was the sole shareholder of a BVI registered company, CIL. In July 1996 CIL sold some shares to Eulalia, a Netherlands incorporated company and wholly-owned subsidiary of CIL. The scheme assumed that CIL and Eulalia were not merely incorporated outside the UK but were also resident outside the UK.

However, HMRC took the view that, while CIL was resident outside the UK, Eulalia was resident in the UK and made assessments on that basis. The gains made by CIL on the disposal of the shares were attributed to the trustee under TCGA 1992 s.13. Mr and Mrs Wood were assessed to CGT in respect of those gains, which were treated as accruing to them under s.86 (attribution of gains to settlors with interests in non-resident settlements).

The Special Commissioners found for HMRC, though the taxpayers' appeal to the High Court was upheld (see Bulletin Issue 14 Summer 2005). Park J found that, on a proper application of the law to the facts, the only tenable conclusion for the Commissioners to have reached was that, under the common law of corporate residence applying the test of central management and control, Eulalia was resident in the Netherlands. He concluded that the Commissioners either had to have applied the wrong test or, if they had applied the right test, they had come to a conclusion which could not properly be reached in an application of it, so as to exhibit an error of law. Park J accordingly allowed the taxpayers' appeal.

HMRC appealed against that decision. They contended that the Commissioners had directed themselves correctly in point of law, and the judge had not, therefore, been entitled to interfere with their decision.

The decision (CA): Chadwick, Moore-Bick LJJ and Sir Christopher Staughton

Park J had been correct to hold that the only conclusion open to the Special Commissioners, on the facts which they had found, was that Eulalia was resident in the Netherlands.

In seeking to determine where 'central management and control' of a company incorporated outside the UK lay, it was essential to recognise the distinction between (a) cases where management and control of the company was exercised through its own constitutional organs

(the board of directors or the general meeting) and (b) cases where the functions of those constitutional organs were 'usurped', in the sense that management and control was exercised independently of, or without regard to, those constitutional organs. In cases which fell within the former class, it was essential to recognise the distinction (in concept, at least) between (a) the role of an 'outsider' in proposing, advising and influencing the decisions which the constitutional organs took in fulfilling their functions and (b) the role of an outsider who dictated the decisions which were to be taken.

The facts which necessarily led to the Commissioners' conclusion included the finding that Eulalia's directors had not been by-passed nor had they stood aside, since their representatives had signed or executed documents, and that the directors had accepted the agreement. Park J's decision to reverse the Commissioners' findings as to the residence of Eulalia on the basis of the central management and control test was therefore upheld.

(Wood and another v Holden EWCA Civ 26 26.1.06 reported at [2006] SWTI Issue 4)

Comment

What is the relationship between the Court of Appeal decision in *Wood v Holden* and the 2000 Court of Appeal decision in *Deverell*? *Deverell* was not a tax case, but held that for purposes of constituting someone a shadow director, directions or instructions can include advice (other than professional advice which is excluded by ITEPA 2003 s.67(2)). Note also the 2005 High Court decision in *Ultraframe v Gary Fielding and others [2005] EWHC* where the Court concluded that the individual must do something before the directors can be accustomed to act on his directions or instructions, so as to constitute him a shadow director (whether for Companies Acts or Taxes Act purposes).

More generally, might the provisions of TCGA 1992 s.13 be vulnerable to the principle of freedom of movement under the EU Treaty?

5. Roll-over Relief: Establishing Goodwill

Context

As is well known, goodwill is a qualifying asset for purposes of roll-over relief under TCGA 1992 s.152ff. Goodwill is distinct, for example, from rights under a franchise agreement, the subject of the dispute in this Special Commissioner's case.

Balloon Promotions Ltd v Wilson: the facts

The taxpayers had been restaurateurs. They had operated pizza restaurants, as franchisees of the 'Pizza Express' company. The taxpayers were obliged to purchase dough and tomato sauce from the franchisors, who supplied the menus and the wine list. The taxpayers had to provide the premises and staff, and in practice had considerable freedom in obtaining ingredients other than dough and tomato sauce, and in offering dishes additional to those specified in the franchisor's menu.

The franchisor company decided that it wished to manage the taxpayers' restaurants, instead of leaving them to be run by the franchisees in exchange for a turnover-based franchise fee. The Pizza Express Company therefore bought the taxpayers' restaurant business from them, the overall trading stock, equipment and the premises. HMRC did not dispute the sums

allocated to these heads. The balance of the consideration was largely allocated to goodwill, with nominal amounts of £1 allocated to the compensation for the ending of the franchise agreement.

The taxpayers claimed roll-over relief, in respect of the gains attributable to the goodwill, on the basis of the proportion of the sale price allocated by them to the goodwill. HMRC argued that the payment related to the disposal of the rights under the franchise agreement, rather than goodwill, and was therefore not eligible for roll-over relief.

The decision (SpC)

The appeal was allowed: there had been a disposal of goodwill by the taxpayers.

The Special Commissioner noted that 'goodwill' was not defined in the CGT legislation, for the purposes of roll-over relief, and it was therefore necessary to use the general legal meaning. He discussed a number of cases, and comment by text book writers. He rejected HMRC's argument that in a franchised business the goodwill belonged to the franchisor. The ownership of goodwill, as between franchisor and franchisee, was a question of fact. The Special Commissioner concluded that the evidence showed that there had been a disposal of goodwill by the taxpayers. Their apportionment of the consideration had been based on accountancy advice and there had been no evidence to show that it was wrong.

Comment

What this case does illustrate is that, where a business is being sold as a going concern, it is important to have sustainable valuations attached to those elements which consist of assets which will qualify for roll-over relief. To the extent that it seems to be significant essentially to attach a substantial value to the goodwill, on the basis that the value is the difference between the value of the tangible assets and the price received, it will be important to show that a disposal of goodwill has taken place. Here important factors will be, first, that there has been a disposal of a business and, second, a non-competition agreement by the vendor.

(Balloon Promotions Ltd v Wilson [2006] SpC 524 reported at Farm Tax Brief March 2006 p3)

C. STAMP DUTY LAND TAX

6. SDLT: Residential Transactions - Threshold Increase: Budget 2006

The nil-rate threshold is to be increased from £120,000 to £125,000 for any land transaction involving residential property with an 'effective date' of on or after 23rd March 2006.

(HMRC Budget Release 2006 BN20 22.3.06)

7. SDLT: "Simplification and Clarification Measures": Budget 2006

Context

A number of measures are included in the Finance Bill with the aim, the Government say, of simplifying and clarifying the law relating to SDLT. In addition Treasury regulations have been made under existing powers to take a number of transactions outside the scope of SDLT.

Current law and proposed revisions

Chargeable consideration: new exclusions

Treasury regulations will provide that as from 12th April 2006 a number of features of common transactions will be taken out of the scope of SDLT. This will be done by deeming these features not to be 'chargeable consideration'.

These are:

- a gift of property where the donee or beneficiary agrees or is required to pay CGT or IHT arising on the gift;
- the payment of landlord's reasonable costs on the grant, variation or termination of a lease; and
- a covenant by an agricultural tenant to assign entitlement to the Single Farm Payment to the landlord on termination of the tenancy.

Partnerships

At present there is a charge to SDLT where there is a transfer of an interest in a partnership, if the partnership property includes land. That charge will be removed for all partnerships whose main activity is the carrying on of a trade (other than a trade of dealing in or developing land) or a profession.

There are also two places in the SDLT legislation on partnerships where there is the possibility of a double charge (the charge on 'actual consideration' in Sch 15, para 10 and the interaction between Sch 15, paras 14, 17 and 17A). This potential double charge will be removed with effect from the time at which the Royal Assent is given.

Leases

There is uncertainty as to how the rules on 'successive linked leases' apply where an agreement for lease is followed by the grant of a lease. The measure will provide that the rules on 'successive linked leases' do not apply in these circumstances.

The rules on variations in rent will be simplified. The current charge on rent increases not provided for in the lease (Sch 17A, para 13) will be restricted to increases in the first five years of the lease. All rent increases after the end of year five, whether provided for in the lease or not, will be subject to the 'abnormal increase' rules in paras 14 and 15. The formula for what is an 'abnormal increase' will also be simplified.

The treatment of rent reviews under the legislation governing agricultural tenancies, and of 'interim rents' under the legislation governing business tenancies, will be "clarified".

The rules for notifying assignments of leases will be clarified to make it clear that where a lease was originally granted for less than seven years its assignment need be notified only if there is SDLT to pay, or if there is a relief to be claimed.

Settlements

The measure will ensure that **transfers of assets between sub-funds of a settlement will not attract a charge to SDLT.**

(HMRC Budget Release 2006 BN22 22.3.06)

Comment

Of very considerable practical interest are the first item under 'Partnerships' and the change under 'Settlements'. For family trading partnerships in particular, no longer will there be any concern about possible SDLT implications of transfers of an interest in a partnership. And so long as all the partners are connected with the transferor of land into a partnership and the transferee of land from a partnership, SDLT worries can largely be laid to rest. However, SDLT issues should always be considered in advance of the particular transaction: there can still be counter-intuitive results where there are unconnected persons within the partnership – because of the 'interest in income' measure of partnership share.

And the recognition by HMRC Stamp Taxes that there are no SDLT issues on transfer of assets between sub-funds of a settlement puts paid to a particular scare that had been running for far too long.

8. SDLT: Withdrawal of Unit Trust 'Seeding Relief': Budget 2006

'Seeding relief' gives SDLT relief when property is transferred into a newly formed unit trust in consideration of the issue of units. The Budget 2006 withdraws seeding relief. There will now be an SDLT charge on the transfer of property into a unit trust in consideration of the issue of units, by reference to the market value of the land and buildings transferred.

Current law and proposed restrictions

FA 2003 s.64A currently gives relief where property is transferred to the trustees of a unit trust scheme in consideration of the issue of units, provided that after that transfer the transferor is the only unit-holder.

Section 64A will be repealed as regards land transactions the effective date of which is on or after 22nd March 2006.

On general principles the chargeable consideration for a transfer of property into a unit trust in consideration of the issue of units will normally be the market value of the property. FA 2003 s53 provides explicitly that the chargeable consideration on a transfer of property to a company 'connected' with the transferor, or in consideration of the issue of shares of a company 'connected' with the transferor, should be not less than the market value of the chargeable interest transferred. **Section 53 will be extended to apply to transfers to trustees of a unit trust scheme.**

The measure will not apply where the transfer to the trustees is effected:-

- in pursuance of a contract entered into and substantially performed before 2 pm on 22nd March 2006 ('the relevant time'), or
- in pursuance of any other contract entered into before the relevant time, provided that the transfer to the trustees is not an 'excluded transaction'.

A transaction is an 'excluded transaction' where:-

- the unit trust scheme was not established at the relevant time, or contained no assets, or almost no assets, at the effective time;
- at or after the effective time the contract is varied in a way that 'significantly affects' the transaction (see below);
- the subject-matter of the land transaction is not identified in the contract in a way that would have enabled its acquisition before the relevant time;
- rights under the contract are assigned at or after the relevant time;
- the land transaction is effected in consequence of the exercise, at or after the relevant time, of an option, right of pre-emption or similar transaction; and
- at or after the relevant time there is an assignment, sub-sale or other transaction (relating to the whole or part of the subject-matter of the contract) under which a person other than the contracting purchaser becomes entitled to call for a conveyance.

A variation 'significantly affects' the transaction only if:-

- it substitutes a different purchaser, or
- the subject-matter of the land transaction is varied, or
- the consideration for the land transaction is varied.

(HMRC Budget Release 2006 BN23 22.3.06)

Comment

The surprise with this is not that it happened, but that it happened so late in the day and had not been announced at, for example, the pre-Budget Report on 5th December 2005.

9. SDLT: Compliance Form SDLT60

A new version of SLDT form SLDT 60 (the self certification form) will be introduced on 17th April 2006 by the Stamp Duty Land Tax (Administration) (Amendment) Regulations SI 2006/776. The regulations also provide for a transitional period until 15th March 2007 when either the old or the new forms can be submitted.

([2006] SWTI Issue 11)

D MISCELLANEOUS

10. Modernising the Tax System for Trusts – Comment on the Draft Legislation

Definition of settlor

A common definition of settlor will apply for both income tax and CGT purposes. A settlor will include a person who makes or enters into a settlement directly or indirectly. Also, where the settled property or property derived from it, is property which a person was competent to dispose of immediately before his death, that person will be treated as the settlor.

If one person (A) makes or enters into a settlement in accordance with reciprocal arrangements with another person (B), then B will be treated as the settlor. Where assets are transferred between two settlements, the settlor of the transferor settlement will be treated as the settlor of the transferee settlement (except in certain specified circumstances, one of which is where the transfer happens on the exercise of a general power of appointment).

There will also be common rules setting out who will be treated as the settlor in relation to post-death deeds of variation.

Definition of settled property

There will be no generally applicable statutory definition of settlement. The wide definition of settlement contained in the income tax anti-avoidance provisions will continue to apply only for those purposes. Instead, the current CGT definition of settled property will also apply for income tax purposes. This definition covers all property held in trust other than as a nominee or under a bare trust (where the beneficiaries are absolutely entitled to the assets).

Residence of trustees

The residence test for trustees will be the same for income tax and CGT purposes. The test will be based on the current income tax test. This uses the residence status of the trustees, and takes into account the residence and domicile status of the settlor at the relevant time where there is a mixture of UK resident and non-UK resident trustees. The common test will apply for the purpose of determining the residence status of trustees from 6th April 2007, whenever the trust was created. This will give trustees time to rearrange their affairs to avoid any unintentional change of residence status due to the introduction of the common test.

Non-resident election for certain trustees

One of the effects of the introduction of the new common residence test, is that the current CGT provisions which allow certain UK-based professional trustees to be treated as non-UK resident would no longer apply. Concerns had been expressed that this could make the UK unattractive as a location for international trust administration work. The draft legislation provides that, for both income tax and CGT purposes, trustees of a settlement who act as trustees in the course of a business and who are UK resident could, in relation to settlements created by non-domiciled, non-resident and not ordinarily resident settlors, make an election to be treated as non-UK resident. HMRC have stressed that they are currently consulting with the DTI, as there is a concern that these provisions may constitute State Aid for the purposes of EU law.

Assuming there is no EU objection, this proposal will be good news for UK-based trustee providers seeking to attract international trust business, because it dispenses with the need to appoint a non-UK resident trustee as is currently required for income tax purposes. The draft legislation applies only to trustees who carry on a business and act as trustee in the course of that business.

Definition of settlor-interested trusts

The draft legislation includes changes to the definition of settlor-interested trusts for CGT purposes. HMRC have indicated that this is to bring the CGT treatment more closely into line with the income tax treatment. However, as drafted, a settlement would be settlor-interested for CGT purposes if a minor unmarried child, who is not in a civil partnership, could or does enjoy a benefit from the settlement. For income tax purposes, a settlor is taxable on the income of the settlement in these circumstances only when such a child actually receives a benefit. The new definition will apply to settlements, whenever created, from 6th April 2006 and the concern is that many settlements, which are not currently settlor-interested for CGT purposes, would automatically become so on 6 April as a result of this provision.

Limitation of hold-over relief

One of the (presumably unintended) consequences of this change to the definition of settlor-interested settlements is that hold-over relief, on a transfer of business assets or a transfer which gives rise to an immediate IHT charge, will not be available where the settlor transfers assets into a settlement from which his minor unmarried children, who are not in a civil partnership, are potential beneficiaries. This is a substantial shift in Government policy. Since 1979, an individual making a gift into a trust for such children could do so without triggering a CGT charge. An individual could still make an outright gift of business assets to such children or make gifts either outright or on trust for the benefit of children who are over 18 or are married or in a civil partnership without triggering a CGT charge. It would appear this inequality of treatment has been created as a result of the widened definition of what constitutes a settlor-interested trust - it is to be hoped that the legislation can be amended to remove this anomaly.

Sub-fund elections

Where a settlement has been divided into one or more sub-funds which are administered by either the same, or different, trustees for different beneficiaries, administrative problems often arise because the main settlement and any sub-funds are treated as a single settlement for CGT purposes. The draft legislation would allow the trustees of the principal settlement to elect that a sub-fund be treated as a separate settlement for CGT purposes. In order to be able to make the election, some assets must remain in the principal settlement, the sub-fund must not contain certain jointly owned assets and there must not be any beneficiaries who could benefit under both the sub-fund and the principal settlement.

Making the election would give rise to a disposal, by the trustees of the principal settlement, of the property in the sub-fund for CGT purposes. This means that the trustees would be in the same position as trustees who had used their powers to transfer property out of the principal settlement into a new settlement. Once made the sub-fund election could not be revoked. The availability of this election will only be of real benefit to trustees of settlements who lack the powers necessary to settle property on new trusts.

Other issues included in the draft legislation

The draft legislation also includes provisions in relation to the following:-

- anti-avoidance provisions to stop a settlor taking advantage of the new £500 basic rate band by setting up numerous trusts each having a separate basic rate band;
- the treatment of income from a settlor-interested settlement as though it had arisen directly to the settlor, thus removing the anomalies in the rates of tax that currently exist;
- the treatment of trustees as a single continuing body of persons for income tax purposes, to bring this into line with the current CGT position; and
- a common charging mechanism for various types of receipts, which are capital receipts for trust purposes, but are treated as income for tax purposes.

Effective date

Most of the provisions, with the notable exception of the trustee residence provisions, came into force on 6th April 2006.

Comment

(a) Definitions

It seems unsatisfactory to have a general definition only of 'settled property' but not also of 'settlement' (to which, for example, reference is made in the definition of 'settlor'). The wide CGT anti-avoidance rules in TCGA 1992 s.77 as amended (see (c) below), as well as the income tax anti-avoidance rules, still apply. Is the effect of importing the IHT definition of 'settlor' that bounty is not required to constitute a settlement generally for income tax and CGT purposes? If the answer to this is 'yes', it would clearly not be so for the income tax anti-avoidance provisions which have their own definition of 'settlement' for which bounty remains a pre-requisite. But does the previous HMRC assurance that the capital payments charge for offshore trusts in TCGA 1992 s.87 does not apply to commercial Employee Benefit Trusts still hold good?

(b) Non-resident election for certain trustees

It seems that an election can be made where the trustee is or includes a trust corporation, but not where an employee of a professional firm is a trustee (as not carrying on a business).

(c) Settlor-interested trusts extended for CGT

We find this change surprising. It is hard to see the precise mischief at which the extended definition is aimed, especially in the context of the previously expressed (but little publicised) HMRC desire generally to apply the old s.660B income tax rule to CGT. However, it appears that, under the new regime, gains made by a minor unmarried child whose parent has given them a substantial portfolio of stocks and shares can still take advantage of the child's annual exemption and lower and basic rates of CGT. [The downside of such an arrangement is of course that the child becomes absolutely entitled at age 18. But Budget Release BN 25 (see

Item 1 above) suggests that HMRC do not consider that this is necessarily a bad thing]. Bare trusts of capital are excluded from the definition of 'settled property'.

Is the limitation of hold-over relief an unintentional effect – or were HMRC well aware of it? Either way, HMRC are likely to be attracted to this effect in the context of attacks on hold-over relief in general – in particular FA 2004 Schs 21 and 22.

The worst change is the restriction on hold over relief. The fact that gains of e.g. an A&M trust made for minor children will as from 2006/07 be assessed on the settlor should not create a greater charge to tax – and may even be advantageous, e.g. through use of the settlor's annual exemption if not otherwise used, or indeed attract a lower rate of tax than the rate applicable to trusts if the settlor is in that year not a higher rate taxpayer when adding in those gains. It is really just a matter of compliance and who returns the gains and pays the tax.

Is there a point under the claw-back rules which took effect from 9th December 2003? They should of course always be borne in mind in circumstances when a settlement becomes settlor-interested after the gift with hold-over relief. In this case, however, there seems not to be a problem as the claw-back regime cannot apply by virtue of the new definition of 'settlor-interested' to any disposals before 6th April 2006.

So, assuming no change to the draft legislation, how should one now react? It seems to be sufficient if in the year in question no unmarried minor child of the settlor not in a civil partnership can (or does) benefit. Accordingly, perhaps use powers of exclusion in existing settlements to create this effect. And, if desired for new settlements, arrange for 'peg' beneficiaries to be in place before such time as the children attain 18 and can benefit – and perhaps accumulate income meanwhile. In particular the definition of dependent children does not seem to catch future unborn children of the settlor.

(d) Sub-funds

This regime is likely to be of little use in practice. The requirement to have entirely different sets of beneficiaries in the principal settlement and the sub-fund seems unduly restrictive. It is rather odd that the trustees can be the same individuals – contrary to prior discussion on the point. It will usually be easier to use express powers in the principal settlement to create a new settlement for CGT purposes within the principles set out in SP 7/84. Only in a case, typical of older settlements, where there are no such powers might the new regime be useful.

(e) The standard rate band

Note that, following Budget 2006, FB 2006 will introduce an increase in the standard rate band for discretionary and accumulation trusts from £500 to £1,000, as from 2006/07. Perhaps not quite far enough, but welcome nonetheless.

11. Trust Management Expenses: Final HMRC Guidance

Context

Following the first draft of HMRC's paper issued in September 2004 and the revised version in June 2005, a final paper has now been released (see Bulletin Issue 14 (Summer 2005) Item 10). It is to be applied to 2005/06 and subsequent returns of income for trustees of

accumulation and discretionary trusts and for income beneficiaries of interest in possession trusts.

What follows reproduces some of the content of the guidance, especially where this has been amended from the June 2005 version.

'2. CASE LAW ON EXPENSES – INCOME VS. CAPITAL EXPENSES

- 2.6** The main case on trust management expenses is *Carver v Duncan*, 59 TC 125. Lord Templeman explains that the issue in that case involved the consideration of two issues: the trust question of the incidence of trust expenditure as between income and capital; and the tax question of the deductibility of expenses for the purpose of calculating income chargeable to what are now the special trust rates in S686 ICTA 1988. The case did not touch on tax aspects of interest in possession trusts.
- 2.10** The general rule in trust law is that income '*must bear all ordinary outgoings of a recurrent nature, such as rates and taxes, and interest on charges and incumbrances*' while capital '*must bear all costs, charges and expenses incurred for the benefit of the whole estate*'. At this point Lord Templeman is addressing only the first issue, the trust law position. He is not saying anything about the tax position.
- 2.12** The fact that something is recurrent does not necessarily mean it is of an income nature. The annual premiums in *Carver v Duncan* were '*a recurrent charge but not an ordinary outgoing*', and remained capital.
- 2.13** In *re Bennett* (1896) 1 Ch 778 affirms the trust principle that expenditure incurred for the benefit of the whole estate is a capital expense.
- 2.14** In sum, *Carver v Duncan* establishes that anything expended for the benefit of the whole estate, that is both income and capital, is to be charged to capital. **There is no suggestion in case law that there is any basis for apportioning expenses that are incurred for the benefit of the whole estate into income and capital costs.** This is a trust law principle affecting both accumulation/discretionary trusts and IIP trusts.
- 2.15** Annual fees paid to a firm of investment advisers to keep under review and to advise changes in investments comprised in the trust fund are also capital, as established in *Carver v Duncan*. Such fees '*are incurred for the benefit of the estate as a whole because the advice of the investment advisers will affect the future value of the capital of the trust fund and the future level of income arising from that capital.*' This confirms that even if income is affected, the item remains chargeable to capital because it is for the benefit of *both* income and capital.
- 2.16** *Carver v Duncan* also establishes that income bears the cost of '*ordinary outgoings*', which are payments made '*in order to secure the income of the property*'. That is, they are not made in order to distribute the income or apply it in any way, but to '*secure*' it.

4. PRINCIPLES OF TMEs IN ACCUMULATION/DISCRETIONARY TRUSTS

Relief against the special trust rates

4.2 There are certain situations where items that are capital in trust law are deemed to be income for tax purposes, and are also taxable at the special trust rates. If the item is liable to tax at the special trust rates by virtue of being 'treated as income to which s686 applies', for example as in s686A(3) TA 1988 (company purchase of own shares) then the trustees are also entitled to relief for allowable TMEs under s686(2AA) against that deemed income. If the deemed income is liable to tax at the 'rate applicable to trusts', for example s720(5) TA 1988, then there is no basis for relief under s686(2AA), as there is no connection with s686 itself.

'Applied in defraying'

4.8 The statute clearly refers to income treated as being '*applied in defraying the expenses*'. The use of '*defraying*' means that the amounts must actually be paid to be taken into account. It is not enough that they are incurred. So allowable TMEs are taken into account in so far as they are paid in the year for which the return is made.

'In that year'

4.10 This phrase refers back to the start of s686 (2AA) which refers to 'income arising to trustees in any year of assessment'. So relief for allowable TMEs is given on the basis of the tax year in which they are paid.

4.11 Sometimes the trustees borrow from the trust capital to pay income expenses, or *vice versa*. In a year where there is not enough income and trustees borrow from capital to pay income expenses, the amount paid from income will reduce the income taxable at the special trust rates to nil. The amount taken from capital to meet the deficit will be an allowable TME for the year in which the trustees reimburse capital from income for those income expenses.

'Properly chargeable to income'

4.12 Section 686(2AA) provides for relief for trust management expenses that are '*properly chargeable to income (or would be so chargeable but for any express provisions of the trust)*' The full meaning of this is explained in *Carver v Duncan* 59 TC 125.

4.13 In that case, the trust deed allowed the trustees to pay certain expenses that were normally capital in trust law out of income. Lord Templeman said that although a settlor may provide that capital expenses shall be paid out of income, the settlor cannot alter the nature of those expenses.

4.14 Lord Templeman went on to examine the second '*problem*' in the case, the tax problem of the deductibility of expenses for the purpose of calculating income chargeable under what is now s686.

4.15 He said '*In my opinion, [s686(2AA)] allows deduction of expenses properly chargeable to income, that is to say, income expenses. The words in brackets are explanatory and are placed in brackets because they are merely explanatory; they remove any possible ambiguity in the expression 'properly chargeable' by emphasising that expenses which are deductible are those which would be chargeable to income in the absence of any express provisions of the trust. The natural construction of [s686(2AA)] seems to me to authorise the deduction of income applied in defraying income*

expenses but not income applied in defraying capital expenses. This construction is consistent with trust law, consistent with income tax law and consistent also with common sense.'

- 4.16** So for s686(2AA) purposes, we ignore the provisions of the trust deed. If under the particular terms of the deed, the trustees pay some expenses that are capital in general trust law out of income, they are not allowable for s686(2AA) purposes.

9. TRUST MANAGEMENT EXPENSES – GUIDE TO SPECIFIC ITEMS

Accountancy and audit costs

Cost of having trust accounts prepared

- 9.5** Where accountancy costs have already been allowed against trading income they will not come into consideration as TMEs. The trust can have relief for a particular expense only once.
- 9.6** Where there is no trade, as in most trusts, case law principles determine the allowance of TMEs (as set out in the Explanatory Note above). It can be argued that, since well-drawn trust accounts include balance sheets and capital accounts, they are to the benefit of the trust fund as a whole so that the cost of having them prepared should fall on capital. However, the nature of trust accounts is such that it is reasonable to accept that the costs of accounting for the trust's income should be treated as a distinct expense, and as such payable out of income.
- 9.7** In each trust therefore, a part of the costs of having trust accounts prepared will be properly chargeable to income, on the basis of a just and reasonable apportionment. Such an apportionment is best made by the person who prepares the accounts.

Cost of having trust accounts audited

- 9.9** Trustees may be empowered by the trust instrument to undertake audits. If the audit is undertaken pursuant to a power in the trust instrument the incidence of the expense of it is governed by general principles. Although an audit is undertaken for the good of the trust as a whole, some of the expenses of such an audit are allowable as TMEs on the basis of just and reasonable apportionment. Such an apportionment is best made by the person who carries out the audit.

Cost of preparing trust tax return

- 9.10** The expense of having a trust tax return prepared is more likely to be income than capital, because the trust returns income each year, but does not always make a chargeable disposal for CGT purposes. If only income is returned in one year all of the costs are allowable TMEs. If both income and capital gains are returned the allowable TMEs are those that relate to income, apportioned on a just and reasonable basis. This is most easily done by excluding the costs of preparing the capital gains part of the return.

Cost of obtaining tax advice

- 9.11** Where the tax advice relates to CGT or IHT, the costs are not properly payable out of income, as they cannot be said to relate to income in any way. These costs are not allowable TMEs.
- 9.12** HMRC says that tax advice is an allowable TME only where it relates directly to the preparation of income tax returns (see above). That is surely incorrect. There is surely no reason why the cost of Income Tax planning advice should not be deducted.

Bank charges and interest

- 9.13** Whether charges on a bank account or overdraft are payable out of income or capital depends on what those charges secure. If they secure a facility that is for the better administration of the trust fund as a whole, such charges should be treated as an expense of capital. So for example charges on a current account, whether or not it incidentally bears interest, or to keep open an overdraft facility that may or may not be taken up, are capital and so the charges are not TMEs properly chargeable to income. They are therefore not allowable TMEs.
- 9.14** Whether interest on a bank loan or overdraft is allowable depends on the actual use of the funds advanced by the bank to the trustees. See 'Interest' below at 9.21-9.23.

Distributing income – cost of

- 9.16** The incidental costs of making distributions such as the cost of posting a cheque to a beneficiary are not properly chargeable to income because they are not concerned (solely or otherwise) with the securing the trust income (see above at 2.16). These costs are therefore not allowable TMEs.

Interest

- 9.21** Interest may have been incurred in the course of a trade or rental business and already allowed as a deduction against trading or rental income. As a separate matter, some interest may be incurred as a trust management expense.
- 9.22** In certain instances interest can be an allowable TME, where it is paid to secure the income of the trust. By '*outgoing*' is generally meant some payment which must be made in order to secure the income of the property. Where the funds are used so that what the payment of interest secures is purely for the benefit of the income fund, for example where interest is paid on a loan taken out in order to purchase an income-bearing asset for the trust, the interest should be regarded as an expense of income. Otherwise, interest is not properly chargeable to income and is therefore not an allowable TME. For example, if a loan is taken out or overdraft arranged to pay for general administration, or to buy a non-income generating asset for the trust, that is not an expense paid to secure the income of the trust, and the interest is not allowable.

- 9.23** Allowable interest includes:

- interest on a loan or overdraft to purchase an income-producing asset, such as shares
- interest on a loan or overdraft taken by trustees for acquiring property that is occupied by a beneficiary

Legal costs

9.29 The trust law text book Underhill & Hayton, *Law relating to trusts and trustees* says at page 535 '*all costs incident to the administration and protection of the trust property, including legal proceedings, are borne by corpus, unless they relate exclusively to the tenant for life. The corpus must bear all costs, charges and expenses incurred for the benefit of the whole estate.*'

9.30 At page 544, it says about '*general costs incident to administration*', '*Legal expenses or investment advice incident to the administration of a trust almost exclusively fall on capital, unless the settlor has expressly provided for them, for they are for the benefit of all persons interested.*'

9.31 So legal costs are not allowable TMEs, unless they relate exclusively to the IIP beneficiary.

Running costs

9.40 Where - typically in larger trusts, such as those established by a business for the benefit of its current and former employees - the method of administration of the trust involves maintaining an office, the attendant expenses are not properly chargeable to income. Such expenses include salaries of personnel, expenses of accommodation, cleaning, and maintenance of equipment and premises. These are the expenses of the operation of the trust as a whole, and so properly chargeable to capital. The fact that such charges may be recurrent does not affect that fact that they are incurred for the benefit of the trust as a whole and hence capital. Furthermore such costs cannot be said to be made solely to secure the trust's income. They are therefore not allowable TMEs.

Travel and subsistence costs

9.41 The incidence of travel and subsistence costs properly incurred by trustees depends on their purpose. Usual principles apply so that the matter turns on whether those expenses were incurred solely for the benefit of/in the course of securing the income of the trust. So, for example, expenses incurred in having meetings to decide which beneficiaries should be given income are not incurred for the benefit of/in the course of securing the income of the trust. They are incurred in the course of the distributive process. They do not result in an increase or maintenance of the income fund - or any part of trust funds. In fact they diminish trust funds. Therefore they are not properly chargeable to income, and are not allowable TMEs. In the vast majority of cases travel and subsistence expenses incurred by trustees will properly fall on capital.

Trustees' fees

9.42 The position on trustees' fees is widely disputed. The issue of trustees' fees is likely to be the subject of litigation between HMRC and other interested parties in the near

future. HMRC's current position is as set out in paras. 9.43 - 9.44. Trust representatives' position is as set out in para. 9.45.

Trusts administered by the Public Trustee

9.43 The following position does not apply to cases administered by the Public Trustee. There is specific statute on the Public Trustee's remuneration. The current fees order is the Public Trustee (Fees) Order SI 1999 No. 855. That provides that all fees are payable out of capital except those specified in the Order. Only those costs specifically chargeable to income by statute are allowable TMEs.

All other trusts

9.44 Trustees' fees represent payment for work done by the trustee in carrying out the terms of the trust as a whole. Corporate trustees' brochures suggest that these fees are in fact charged to capital. The Law Commission paper 175, *Capital and income in Trusts: classification and apportionment* at para. 2.53 says about trustees' fees '*The irresistible conclusion is that the annual fee reflects work done on behalf of both income and capital. Since the work done is for the benefit of the whole estate the fee should be charged to capital...*' On general principles, therefore, trustees' fees are properly payable out of capital.

9.45 Trust representatives have put forward the following arguments. Trustees' fees are annual recurrent expenses. The annual fee reflects work done on behalf of both income and capital. There is a case for apportioning the fees partly to income.

(HMRC Guidance January 2006 2.2.06)

Comment

This published HMRC guidance will have very dramatic effects on the level of expenses typically claimed which will be accepted by HMRC for 2005/06. Many expenses which have formerly been accepted as deductible will now be disallowed. The most contentious issue, that is a complete disallowance of trustee management fees is, we understand, to be the subject of an appeal to the Special Commissioners.

Otherwise, HMRC's general position, based upon an analysis of *Carver v Duncan*, is that where, as in most cases, expenses albeit recurrent are incurred for the benefit of the trust as a whole they are not deductible. The only limited exceptions which HMRC will allow is in the case of preparing and auditing trust accounts and preparing the trust tax return. Otherwise (e.g. see 9.12) HMRC say that an expense of obtaining tax advice will be allowable only where directly related to income tax returns. And there is a quite extraordinary position on bank charges and interest (see 9.14 and 9.21 – 9.23).

Presumably, in a case where part of the trustees' fees can be demonstrably referred to a solely income purpose, as accepted by HMRC, rendering a separate bill for that revenue expense should ensure deductibility? The apportionments referred to at paras 9.7, 9.9 and 9.10 above do not of themselves envisage separate bills, though that would be the most convenient course of action. Arguing the other way, in relation to 9.12 on the cost of obtaining tax advice, presumably the advice referable to the capital gains page of the SA return is not deductible –

and so should be separated out, in case it taints the deductibility of the whole fee! This issue can be expected to run and run.

12. The Official Rate of Interest for 2006/07

The official rate of interest will remain at 5% for 2006/07 (subject to review in the event of significant rate changes).

(HMRC website)

Application

The official rate is used to determine whether a loan to an employee is at a beneficial rate or not. It is also of course used to measure the amount subject to income tax in the case of both chattels and settlor-interested intangible property under the Pre-owned Assets rules.

13. The Settlements Legislation: HMRC Obtain Leave to Appeal *Jones v Garnett*

Further to the Court of Appeal's decision in favour of the taxpayer HMRC have been given leave to appeal to the House of Lords. The HMRC statement outlines the implications for those with cases affected by the litigation.

(HMRC Statement 24.3.06)

14. SA Filing Dates to be advanced from 2008

Context

HMRC's desire to encourage on-line filing is, it appears, to be furthered by shortening the time limits for a number of returns from 2008, self-assessment in particular. But the news was carefully hidden away half-way through one of the voluminous Budget Day publications.

Increasing the use of on-line services

Para 2.13 of a Revenue document issued the day after Budget Day as an annexe to a press release states as follows:

'HMRC will continue to invest in its online infrastructure and supporting systems to deliver robust, high capacity services, which will be rigorously tested. Subject to these services being in place:

- *businesses will be required to file their VAT returns, Pay As You Earn (PAYE) in-year forms (the P45 and P46), and corporation tax returns online in phases from April 2008;*
- *with effect from 2008, filing deadlines for income tax self assessment returns will be by 30 September on paper, or 30 November online, with the enquiry window linked to the filing date, to encourage early online filing; and*
- *from April 2008, agents' computer-generated paper 'substitute' returns for income tax self assessment will no longer be accepted.*

We will work with businesses, taxpayers, software developers, agents and other intermediaries on the implementation of these changes, which will not affect the smallest existing self-employed businesses until at least 2012.'

(HMRC publication 'Progress towards a new relationship: How HMRC is working to make life easier for business' 23.3.06)

Comment

This really seems to be a case of 'burying the bad news'. While still two years away, the prospect of having to file self assessment returns by 30th September on paper or by 30th November if electronically, will certainly concentrate the mind.

NOTE: You should not act (or omit to act) on the basis of this Bulletin without specific prior advice.

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