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Introduction

At the time of writing the Finance Bill is still staggering towards Royal Assent. The Government has made a few palliative changes to its underhand extension of the scope of Inheritance Tax in a smash and grab raid on interest in possession trusts. The broad outlines of this fundamental change to the tax have not been changed. Tax planning to reduce Inheritance Tax liabilities will now be very much more difficult. Innovative thinking will be required if your clients are not to make the Chancellor the major beneficiary of their lives' work. Please contact us.

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A. CAPITAL GAINS TAX

1. Modernising the Tax System for Trusts – Residence Rules

Context

The draft FB legislation issued on 2.2.06 provided 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 ordinary resident settlors, make an election to be treated as non-UK resident. This measure was subject to not constituting State Aid for EU law purposes (see Item 10 of our Spring 2006 Bulletin Issue No.16).

Non-resident election for certain trustees withdrawn

Following advice [though it is not stated by whom – DTI? European Commission?] that the extension and modification of the current professional trustee test and application for both income tax and chargeable gains would constitute State Aid, this aspect of the proposals has been withdrawn. There seems to be no indication that the issue is being reconsidered.

This will come as something of a blow to many trusts which in the past have taken advantage of the rule in TCGA 1992 s69(2). The new unified regime for income tax and CGT will come into effect from 2007/08.

(Regulatory Impact Assessment for Trust Modernisation para 15.19, 22.3.06)

Comment

It appears that HMRC has not put the point to the EU and that no proposals have been made for anything to take the place of the proposed election which has now been abandoned. Both James Kessler QC and STEP have written to HMRC asking for a copy of the advice given to them by the DTI – though it may be some time in coming!

2. Assets and Goodwill

Context

We reported at Item 5 of our Spring 2006 Bulletin, Issue No.16 the Special Commissioner's decision in favour of the taxpayer in *Balloon Promotions Ltd v Wilson.* HMRC have decided not to appeal.

HMRC comments on the findings and conclusion of the Special Commissioner

HMRC accept the finding of the Special Commissioner that the question of whether a franchisee owns goodwill is principally a question of fact. Where a franchised business is disposed of as a going concern the question of whether there has been a disposal of goodwill will be determined in the light of the relevant facts. These will include a detailed consideration of the terms of the franchise agreement, the extent of control exercised by the franchisor and the terms and conditions relating to the sale. HMRC do not consider that the decision in these appeals is of general application to other cases involving the sale of franchised businesses.

HMRC's opinion that a franchisee's rights under a franchise agreement are an asset within the meaning of TCGA 1992 s21(1) and that they are not part of goodwill is unchanged. However, HMRC do accept that a franchisee may be able to generate some goodwill in a franchised business. The values of franchise rights and goodwill will depend upon the precise facts and, in particular, the level of control exercised by the franchisor.

HMRC agree with the Special Commissioner's conclusion that, for the purposes of TCGA 1992, the term 'goodwill' must be construed in accordance with the principles established by the legal authorities on goodwill and that the accountancy definition is deficient in that context.

In reaching his conclusions the Special Commissioner questioned the approach adopted by HMRC of restricting roll-over relief to specific categories of goodwill. He indicated that he considered that goodwill should be looked at as a whole to include whatever adds value to a business by reason of situation, name and reputation, connection, introduction to old customers and absence from competition. HMRC do not accept that the term 'goodwill' in TCGA 1992 embraces all of the various types of goodwill described in the CG Manual. HMRC will continue to treat inherent and adherent goodwill as part of an asset in the form of a freehold or leasehold interest in land or buildings.

HMRC are hoping to be in a position shortly to publish an updated version of the goodwill guidance in the CG Manual.

(HMRC Tax Bulletin Issue 83 June 2006 p2)

Application

There are likely to remain points of difference between HMRC and the practitioner in particular cases. In order to maximise the chances of success, however, it is essential that both the surrounding circumstances and the documentation provide proof that there has indeed been a disposal of goodwill and what consideration was given for it.

3. The Second Home: Moving it to a younger Generation?

Context: the FA 2004 restriction on hold-over relief

As is well known, FA 2004 Sch 22 put paid, as from 10.12.03, to the traditional device of combining hold-over relief under s260 and main residence relief for the trustees under s225 on a disposal of the residence following its occupation by a beneficiary under the terms of the settlement. Interestingly, however, although hold-over (whether under s165 or s260) is no longer available on a transfer into a settlor-interested trust, the combination of s165 hold-over and s225 relief continues to be available with a non settlor-interested trust.

What is interesting about FA 2004 Sch 22 is that it is only the combination of s.260 hold-over and s.225 relief which has been barred

That is, it remained open to employ the combination of s165 hold-over (business assets) and s225. Among qualifying business assets for this purpose is furnished holiday accommodation (FHA) as defined in ITTOIA 2005 s325 and following.

It therefore became possible, until Budget Day 2006, to shelter a gain on a second home owned, let us say, by a husband (see our Winter 2005 Tax Planning Bulletin issue No.15 Item 2). He would transfer the property to his wife by way of gift, on a no gain no loss basis for CGT purposes under TCGA 1992 s58. She would let the property for a reasonable period (for at least a year or more). She would then give the property to a life interest trust from which both she and her husband were excluded from benefit. The gain would be held over under s165. The trustees would then allow one of the couples' children to occupy it under the terms of the settlement and on a subsequent disposal the whole of the gain, including that arising before the date of settlement, was effectively 'washed' under s225.

S165 relief on business assets can be claimed only where s260 relief is not applicable: see TCGA 1992 s165(3)(d). This therefore, rather sadly, scuppers this particular idea

Unfortunately, the effect of F (No 2) B 2006 Sch 20 is that virtually all settlements are brought within the 'mainstream trust regime', so that gifts to them are eligible for hold-over relief under s260 – whether or not such relief is claimed. The effect of this is that hold-over-relief is available only under s260 and not under s165 (see s165(3)(d)).

Application

On the other hand the point made above about husband and wife transfers still applies, to ensure that throughout the wife's period of ownership the property qualifies as FHA (ensuring that the full amount of the gain can be held over without having to be cut down under Sch 7, Part 2, for example). Second, however, the idea still works where the property is given either to an individual child or to bare trustees for one or more children, so ensuring s223 relief for them on an ultimate disposal.

Bear in mind that property which attracts APR for Inheritance Tax can also be the subject of a s165 hold-over claim – see TCGA 1992 s165(5) – and there is no restriction to agricultural value or for the fact that the property may attract only 50% relief. Accordingly consider a cottage occupied by a current or retired employee which attracts APR. Once the occupation comes to an end, a gift of the cottage could be made to one of the children who would occupy it with the whole of the gain washed under s223.

B. INHERITANCE TAX

4. The New IHT Regime for Trusts

Context

The regime for discretionary trusts which has been with us since 1975 remains – though now to be called the ‘mainstream’ trust regime for IHT. Into this will fall all trusts made after 21 March 2006. It will no longer be possible to create a favoured A&M trust within IHTA 1984 s71 and any trust created on or after Budget Day 2006 which would have attracted s71 treatment will simply fall into the new mainstream trust regime – as indeed will any interest in possession trust, even one for the settlor or his spouse. The regime will not apply to interests in possession arising under a will or intestacy to which the beneficiary becomes absolutely entitled on the death of the testator or intestate. Such interests are known as immediate post death interests (‘IPDI’). All this is subject to a transitional regime which applies to interest in possession (but not A&M) trusts in being at Budget Day and to interests arising before 6.4.08 replacing such interests in possession.

The PET regime restricted

From 22.3.06 the PET regime in IHTA 1984 s3A will cover only (a) outright gifts to other individuals, (b) gifts to qualifying disabled trusts (F (No 2) B 2006 Sch 20, para 9), (c) premiums paid on or after 22.3.06 to trustees of life policies settled before that date and (d) a lifetime termination of an IPDI in favour of a bereaved minors trust.

Person’s ‘estate’ not to include certain interests in possession

The rule familiar to us, which under s49 treats a person with an interest in possession as entitled to the underlying assets and which in s5 defines estate for broadly charging IHT on death, is dramatically changed. So assets subject to an interest in possession will only be deemed to form part of a person’s estate if the interest is:-

(a) an immediate post-death interest (‘IPDI’);
(b) a disabled person’s interest;
(c) an interest in possession in existence at 22.3.06; or
(d) a transitional serial interest (see below).

Transitional Serial Interests

These are defined in new s49C inserted into IHTA 1984 by F (No 2) B 2006 Sch 20, para 5. To be a ‘transitional serial interest’ four conditions must be met:=

1. The settlement commenced before 22.3.06 and immediately before that date settled property was property in which B or someone else was beneficially entitled to an interest in possession (‘the prior interest’) .
2. The prior interest came to an end at a time on or after 22.3.06 but before 6.4.08 [but note Report Stage qualification for spouses as discussed below.]
3. B became beneficially interested in the current interest at that time.

4. The settled property is not a trust for a bereaved minor under s71A and the interest is not a disabled person's interest.

Such a transitional serial interest will be taxed on death in the normal way. That is, amendments to IHTA 1984 s54 (exceptions from charge on death) ensure that the settled assets will not be aggregated with the deceased's estate if the property reverts to the settlor or passes to the settlor's spouse or civil partner, the settlor died within two years before the life tenant and such spouse or civil partner is UK domiciled. Presumably also the normal spouse exemption is available. Certainly the usual CGT-free uplift on death and the existing rules in TCGA 1992 s73 will apply.

If the interest in possession ends during the lifetime of the life tenant he will be treated as making a transfer of value, which may be either a PET (under the new rules) or a chargeable transfer.

In terms of the replacement rules, it does not much seem to matter under new s49C how this arises, i.e. whether because of the death of the life tenant, or automatically under the settlement or by exercise by the trustees of their power of appointment. The PET regime would continue in such a case qualified e.g. by the spouse exemption – or indeed (possibly) a chargeable transfer if the property were held on discretionary trusts.

Pre-22.3.06 IIP trusts are unaffected, whilst the interest in possession of the life tenant at that date continues. There is a two-year transitional period during which a transitional serial interest can arise. Otherwise there is a chargeable transfer if the trust continues, on termination of the IIP, with the potential for continuing IHT charges.

Government Report Stage Amendments

Transitional treatment will apply where a pre-Budget IIP for one spouse or civil partner comes to an end on their death on or after 6.4.08, if at that time their surviving spouse becomes entitled to an IIP. The amendments also provide for a 'disabled persons interest' created for the settlor or spouse to be disregarded when charging the trusts created by the same settlor.

Accumulation and maintenance trusts

It is better to refer to the 'A&M regime' rather than 'A&M trusts', because once an interest or absolute interest arises under the A&M trust the s71 conditions are no longer satisfied. S71 will not apply to property settled on or after 22.3.06 (F (No 2) B 2006 Sch 20, para 2). Amendments by para 3 ensure that there will be no exit charge under the 'mainstream trust regime' if:

- There is under the terms of the trust and in the family circumstances an exit from the regime before 6.4.08.
- If, on an exit on or after 6.4.08, the exit arises because the beneficiaries obtain a right to capital (only) at the age of eighteen, whether or not following a change in the terms of the trust.

Government Committee and Report Stage Amendments

Following changes to the regime for trusts for bereaved minors (see below), changes are made also in relation to accumulation and maintenance trusts established before 22 March 2006. There is an alternative to changing the terms of the trusts before 6 April 2008 to provide that capital vests at 18. As a fallback possibility, the terms of the trust could be changed before 6 April 2008 to provide for capital to vest at no later than age 25. If so, the 'relevant property' regime will not apply until the beneficiaries reach age 18 and will then apply to settled property to which they are presumptively entitled between the ages of 18 and 25. That is, there would be a maximum IHT charge on exit of 4.2% - and no doubt in most cases rather less than that, given the availability of the nil-rate band etc.

This represents *some* concession by the Government to all those representations made on the Budget proposals. But a statement made by Des Browne, Chief Secretary for the Treasury, makes it clear that the Government continues to claim that there should be a tax penalty in any situation where capital entitlement arises after age 18. He said:

"On the point about reducing the relevant age for those trusts, let me just say this: on reaching their 18th birthday people can vote, fight for their country and even get their child trust fund, but as things stand they may not get their trust assets for another seven years. That is an anomaly, and the Bill fixes it."

Disabled trusts

The regime in IHTA 1984 s89 excludes what would otherwise be a discretionary trust from the discretionary trust regime in circumstances where, broadly, not less than half the trust assets are applied for the benefit of the disabled person. Para 6 of F (No 2) B 2006 Sch 20 makes a slight improvement to the conditions relating to the receipt of attendance allowance or disability living allowance in specified circumstances.

Government Committee Stage Amendments

Amendments to s89 ensure that s89 treatment applies to trusts which give an IIP to a disabled person (whereas hitherto there must have been no IIP in the settlement). New s 89A provides for a new category of qualifying trust, viz where a person who expects to become disabled in the future establishes a trust to provide for his or her future needs.

Privileged treatment for disabled persons trusts will apply to IIP's for a disabled person which arises on or after 22.3.06, even where the settled property was transferred into settlement before that date.

Immediate post-death interests

To qualify as an IPDI under new s49A a beneficial interest in possession must satisfy four [originally six] conditions:-

1. The settlement was made by Will or arises on intestacy [i.e. it cannot arise under an *inter vivos* settlement].
2. The beneficiary L became beneficially entitled to the interest in possession on the death of the testator or intestate.

3. [Withdrawn].
4. [Withdrawn].
5. There is not a trust for a bereaved minor or a disabled trust.
6. Condition 5 has been satisfied at all times since L became beneficially entitled.

Government Committee Stage Amendments

Somewhat surprisingly, but no doubt in response to pressure from STEP and others, the whole of conditions 3 and 4 have been excised from s49A (Immediate post-death interest) – but conditions 5 and 6 do not seem to be renumbered! Also, the special provisions relating to protected interests are deleted. And the whole of s49B (Immediate post-death interest: powers to end interest) goes.

This means that the spouse exemption continues in those cases where the Will (or indeed the intestacy rules) establish(es) a life interest trust, in whatever terms. That is, Wills standardly drawn with a flexible power of appointment structure where the testator dies after 21 March 2006 will not be prejudiced. To secure the spouse exemption on the first death, it no longer matters what happens on termination of the spouse's interest. However, of course, if the property remains settled, the 'relevant property' regime will apply even in the case of a life interest.

On the other hand, now that the spouse exemption is generally going to be extended, a traditional flexible life interest to a spouse will not be a chargeable transfer and thus will not make use of the nil-rate band. So here we may be back to arrangements such as the debt or charge scheme or indeed, following the Special Commissioner's decision in *Judge*, some form of discretionary trust over part of the family home.

What will qualify as an IPDI?

- A trust to pay income to the surviving spouse (or anyone else) for life, whatever happens on termination of that interest.

What won't qualify?

- Not much, now!

However, if you want a chargeable transfer and there is a surviving spouse, what about a seven-month survivorship period (see IHTA 1984 s92)? Or indeed an appointment out of a discretionary Will trust within 3 months after death?

Bereaved minors trusts

This is a regime to be introduced by new IHTA 1984 s71A (inserted by F (No 2) B 2006 Sch 20, para 1). A 'bereaved minor' is a person under the age of eighteen at least one of whose parents has died. It must be emphasised that the conditions for s71A to apply are very much more restrictive than those for old A&M trusts under s71. S71A will cover a trust:-

(a) arising on an intestacy;
(b) established under the Will of a deceased parent of the bereaved minor; or
(c) arising under the Criminal Injuries Compensation Scheme.

Certain conditions must be satisfied in relation to (b) and (c):

(i) The bereaved minor must on or before attaining the age of 18 become absolutely entitled to the settled property, any income arising from it and any income which has been accumulated.
(ii) While the minor is under the age of 18, any of the settled property that is applied must be applied for the benefit of the bereaved minor [only – and not for example for any of his siblings].
(iii) While the bereaved minor is living and under the age of 18 either he receives any income from any of the settled property or no such income can be applied for the benefit of anyone else.

Where s71A applies, there will be no IHT charge on the bereaved minor's attaining the age of eighteen, if dying under that age or having capital paid or applied for his advancement or benefit. Apart from that there will be an IHT charge when property leaves the s71A regime (and the rules in s70 applying to property leaving temporary charitable trusts are applied with some amendments accordingly).

Note: s71A will apply only where the trusts arise on the death of the parent of the minor – not on the death of the grandparent see below.

While the minor is under the age of eighteen it does not matter whether the trusts are interest in possession or discretionary. Different income tax and CGT implications would apply to each so a decision is to be made here. Note that if the bereaved minor is given an interest in possession and dies under the age of eighteen there will be the usual CGT-free uplift on death.

The existence of the statutory power of advancement under Trustee Act 1925 s32 does not of itself disqualify the trust from falling within s71A (s71A(4)) but of course s32 is usually enhanced by extending the power of advancement to the whole of the presumptive share of capital and as originally drafted this would have caused the trust to fall outside s71A. A committee stage amendment allows the power of advancement to be exercised over more then one half of a beneficiary's presumptive share but whether the power is subject to a maximum equal to the presumptive share or may be exercised over the whole trust fund is uncertain.

In relation to capital that is within the s71A regime there will (as for A&M trusts under s71) be the twin benefits of falling outside the mainstream trust regime and yet not being treated as part of the minor's estate. Equally, CGT hold-over relief under TCGA 1992 s260 will apply to a gain arising on capital becoming owned outright on or before attaining the age of eighteen (see para 32 of F (No 2) B 2006 Sch 20 extending s260(2) of TCGA 1992).

Government Committee and Report Stage Amendments: 'age 18-to-25 trusts'

This is an 'add on' to the new s71A regime for trusts for bereaved minors. Capital need not vest outright at age 18 and could vest at an age of up to 25, subject, however, to accepting that between the ages of 18 and 25 the 'relevant property' regime will apply, i.e. a maximum rate of IHT for those seven years of 4.2% on exit.

The term ‘parent’ is defined to include ‘step-parent’ and also a person with parental responsibility.

Two-year discretionary Will trusts

The position on s144 has been improved by a Government Committee Stage Amendment but not wholly rectified. Suppose Mr X died before 22.3.06 leaving his estate on two-year discretionary trusts but the trustees have not yet exercised their powers of appointment. They want to obtain the spouse exemption. They can appoint property to the spouse absolutely and, as this is 'an event on which tax would (apart from s144) be chargeable', there will be a reading back. The spouse exemption will be available.

However, suppose the trustees wish to appoint some of the property to the spouse for life, remainder to the children absolutely (which would be an IPDI trust and so benefit from the spouse exemption if contained in the will of the deceased). Giving a beneficiary an interest in possession is not 'an event on which tax would (apart from s144) be chargeable' because the trust property will not cease to be relevant property and so there will be no reading back. If there is no reading back, the relevant property trust regime will continue and no spouse exemption will be available.

The Government tabled an amendment to s144 to allow reading back on appointments out of discretionary trusts to an IPDI but only if the death occurs after 21.3.06, not if the appointment occurs after Budget day but the death is before 22 March. This leaves people who died before that date but in the last two years where no appointment has yet been made, in a state of limbo. If the trustees have not appointed pre-Budget Day they cannot bring themselves within s144 unless the appointment is outright to the spouse or children.

Appointing on continuing trusts has no effect for inheritance tax purposes and the relevant property regime continues. The Paymaster General indicated in the Parliamentary debates that she would review the matter before Report Stage – see below.

(Taxation 29.6.06 p356, article by Emma Chamberlain)

Government Report Stage Amendments

Committee Stage amendments to Sch 20 provided that the s144 treatment would apply where the appointment would (if made under the Will of the deceased person) have created a trust for a bereaved minor, an age 18-to-25 trust or an IPDI. But this applied only where the person making the Will died on or after 22.3.06. The amendment extends the provision for distributions from discretionary Will trusts to deaths before that date.

Foreign domiciliaries

The Finance Bill as originally drafted disapplied s80 for property settled on or after 21.3.06. This meant that a trust for a spouse created on death by a testator entered into the calculation of the rate of tax on other trusts created by the Will, since the trust for the spouse was treated as a related settlement. Previously, it would not have been, because it was treated as coming into effect for these rules only when the last life interest ceased.

Government Amendment 373 means that s80 can apply on or after 22.3.06, but only where a settlor leaves an interest in possession for his spouse on death which qualifies as an IPDI. As a result, since s80 applies, such an interest for a spouse will not be taken into account in computing the tax charges on other trusts created by the Will.

Unfortunately the amendment does not help foreign domiciliaries who have set up excluded property settlements where the trust was set up pre-Budget and the foreign domiciliary took an initial interest in possession. If the foreign domiciliary or his spouse have an interest in possession which is terminated when the last life tenant is deemed domiciled in the UK, then although there is no immediate charge, at that point the settled property loses its excluded property status under the relevant property regime. It is necessary for both the original settlor at the date of settlement and the person who has the last interest in possession at the time immediately before the property becomes held on trusts under which there is no interest in possession, to be non-UK domiciled if excluded property status is to be preserved for the purposes of the relevant property regime (see ss 80 to 82). Otherwise the settled property will be subject to ten-year and exit charges.

Since s 80 does not apply to most trusts set up on or after 22.3.06, post Budget excluded property settlements will not be subject to this condition, even if the non-domiciled individual takes an immediate entitlement to income. The exception is if a foreign domiciliary's spouse takes an IPDI under a Will trust where s 80 can still apply. However, pre-Budget *inter vivos* offshore settlements where the settlor or spouse took an immediate interest in possession are still caught.

The negative impact of ss80 to 82 is now much harder to avoid when that interest in possession ceases, because new qualifying interests in possession cannot be created over existing interest in possession trusts on or after 6 April 2008. An Opposition amendment to change this so that pre-Budget trusts were not put in a worse position has failed.

Remember GWR!

One of the main exceptions to the GWR regime is the case where the individual is entitled or treated as entitled to the assets in any case. Prior to Budget 2006, this would of course have covered the situation of a life interest trust and the effect of IHTA 1984 s49(1). The application of the GWR regime still requires a disposition by way of gift (subject to the new anti-avoidance rule where the interest of a life tenant is removed by act of the trustees, but the beneficiary continues to enjoy the trust property). The GWR regime which speaks from death (taking into account terminations of benefit within the seven years before death) does of course have the effect of bringing back into a person’s estate assets which would not otherwise be there.

Comment

The above represents very much a ‘bird’s eye’ view of the essential elements of the new regime, as slightly ameliorated by the Government’s amendments at both Committee and Report Stage. While obviously the principal headline grabbing announcement was the significant climb down on the definition of IPDI, so that generally all Wills drafted pre-budget would continue to attract the spouse exemption on the first death, no one should underestimate the impact of the new regime on trusts in general. And, while the original 1975 regime for discretionary trusts remains relatively benign, in imposing a ten year anniversary charge on the basis of the lifetime rates of IHT, one cannot rule out a change in this to the death rates which (in the context of the rationale for the charge back in 1975), viz to tax the

property in such trusts as if they had been subject to the same IHT which would have been incurred in transfers down the generation one cannot rule out the application of the death rates. This would change the landscape dramatically.

5. Pre-owned Assets: HMRC's Guidance Revised

Context

HMRC's Pre-owned Asset detailed guidance has been amended. It includes updated guidance on the treatment of loans and cross refers to the additional technical material contained in the Code of Practice 10 letter which can be found on the STEP/CIOT websites.

HMRC have now confirmed that loans to enable someone to acquire property do not satisfy the contribution condition, which is very welcome. The Guidance also contains new sections on: reservation of benefit issues in connection with home loan schemes (HMRC's view); land - meaning of occupation; valuation; post-death variations of an estate.

New examples are given in a number of areas including: the *de minimis* exemption; calculating the benefit subject to the charge; reasonable attribution; sales at undervalue and double charges: see below. HMRC also comment on what happens re the POA charge when a person subject to the charge moves home during the five year valuation period.

However, the news is not good with regard to equity release schemes, as HMRC assert that they continue to be within the POA charge, even if there is a sale (post March 2005) between members of the family at full value. This can have some very unfair results and has no logic. The Paymaster General has remained firmly opposed to any change in this area. (See recent Standing Committee debates: www.hmrc.gov.uk).

(Taxation 22.6.06 p320)

The de minimis exemption (Sch 15 para 13) – Example 1

The £5,000 is based on the chargeable amount for the year. So if a person is chargeable throughout the whole tax year and the annual benefit is calculated at £5,000 or less they do not have to declare the benefit on their income tax return. If a person is chargeable for only part of the year, say they only become chargeable for the last six months of the year where the full annual benefit would be £8,000, their exposure for the last six months is half that and the benefit of £4,000 would be covered by the de minimis. *Where two people are equally chargeable for the whole year in respect of the same property, for example a property with an annual rental value of £8,000, their benefit would be £4,000 each and would be covered by the* de minimis. *(On the death of one, you should consider former ownership of the property, and the terms of occupation, in deciding whether the whole or a half of the rental value is chargeable on the survivor).*

How to calculate the benefit subject to the charge: land
The concept of the 'non-exempt sale'

Para 4(4) introduces the concept of a 'non-exempt sale' for a disposal which is a sale of the chargeable person's whole interest in the property for cash, but which is not an excluded transaction as defined in para 10. The 'appropriate proportion', which is relevant for

ascertaining the 'appropriate rental value in paragraph 4(2), can be determined using the formula

$$\frac{MV - P}{MV}$$

Where MV is the value of the interest in land at the time of the sale and P is the amount paid.

Example

A sells his house to his daughter for £100,000. It is worth £300,000. He lives in the house. In these circumstances HMRC would say that only two thirds of the value of the house is potentially within the charge to POAT. However, since he made a gift of that two thirds HMRC would accept that he is protected under para 11(5)(a) reservation of benefit from a charge on that two thirds.

Note that if he sold part of his house to his daughter at an undervalue then the non-exempt sale provisions would not apply. So in the above example if he sold half his house to his daughter for £100,000 and that half share was in fact worth £300,000, although he would have reserved a benefit in two thirds of that half share, the £100,000 cash would be subject to POAT.

Chattels (Sch 15 para 7): Example

In 2005/6 A was caught by Schedule 15 in respect of an earlier disposal of chattels. The chattels were worth £1,000,000 at the relevant valuation date on 6th April 2005. He will be treated as receiving a taxable benefit of 5% (current official rate of interest in 2005/6) x £1m = £50,000.

Note that the charge is computed differently from land and while any rental payments made to the owner will reduce the amount on which he is chargeable, the fact that he pays a market rent for their use does not prevent an income tax charge arising. Hence if he pays £10,000 rent he will still be taxable on a £40,000 benefit. Tax is due on 31 January 2007 unless A elects.

The provisions for ascertaining DV, V and defining a 'non-exempt sale' and the 'appropriate proportion' in relation to chattels are similar to the provisions relating to land.

Comment

This is very odd. The assumption must be that the market rent paid by A represents 'full consideration' for the use of the chattels. Under para 11(5)(d) of Sch 15 there is no reservation of benefit because of the payment of full consideration and therefore no POA charge. The point is being put to HMRC.

House sharing

Where people enter into an arrangement whereby they contribute to a shared property (land & buildings) owning venture and whereby they intend to and do in fact share the occupation of and the expenses arising from the occupation of the property broadly equally, it is not the intention of FA 2004 Sch 15 to levy an income tax charge on any part of that arrangement.

Such circumstances are generally covered by FA 1986 s102B(4), which is made applicable to Sch 15 by para 11(5)(c). However, if the situation is that the contribution made by each person is not commensurate with their respective enjoyment of the property and/or the expenses were shared unequally, the circumstances may fall to be scrutinised in the context of FA 2004 Sch 15. In such circumstances, a charge to income tax may well result.

Sales at undervalue

The application of para 4(4) in respect of land to which the disposal conditions of para 3(2) applies by virtue of a 'non-exempt sale' is restricted to sales of the whole interest in the property. If there is a sale of part only of the chargeable person's interest in the relevant land, no account can be taken of the consideration actually paid by the purchaser.

As the consideration must be paid in sterling or another currency, this sub-paragraph will not apply if the consideration took another form, i.e. if one item of land was exchanged for another.

Example

X exchanges his house valued at £800,000 for Y's property valued at £200,000 (Y's property in this example could be taken to mean land, a business, a right, in fact any property other than cash). X continues to live in his former property. Under the provisions of para 4(4) the value of Y's property is not regarded as consideration to be taken into account, and X will be subject to a POA charge on £200,000. On X's death there will be a GWR in respect of a ¾ share of his former property, and his estate for IHT purposes will include the £200,000 from Y.

Double charges

The regulations relating to the income tax charge (SI 2005 No. 724) include provisions to avoid a double charge to IHT where the chargeable person elects that the GWR provisions apply to the relevant property. A double charge may arise where the chargeable person makes a gift of property which is a PET for IHT. If that property is then liable to the income tax charge they may decide to make an election that the property is subject to the GWR provisions. If they then die within 7 years of the original gift a double charge to IHT will arise – first on the original transfer that must now be aggregated with the death estate and second on the property subject to the reservation.

The provisions to avoid double charges effectively retain the charge on the transfer that produces the higher overall amount of IHT and reduce the other transfer to nil.

Further regulations were made SI 2005 No.3441 to deal with the double charges that may arise where the taxpayer decides to dismantle a ‘double trust scheme’ and return to the position they were in prior to that arrangement.

It should be noted that the double charges provisions will not always apply when a perceived double charge arises. In particular, if an election is made in respect of property subject to an *'Eversden'* type arrangement with the result that the life tenant has made a potentially exempt transfer and the settlor's estate includes property subject to a reservation, both charges to tax are unaffected by the double charges provisions. The provisions only apply where there is a double charge in respect of the same individual.

(HMRC's Guidance on the Pre-Owned Assets Regime)

Comment

A number of these points of interpretation are very welcome, in particular that even interest-free loans will not trigger the contribution condition. But a number of points of uncertainty do remain – and the general terror imposed by the POA regime must not be underestimated. As a general point, do remember that when relying on any HMRC guidance in advising clients, the relevant page should be downloaded printed out and date stamped, as all such guidance is subject to change.

C. STAMP DUTY LAND TAX

6. F(No.2)B 2006 Sch 24: Transfers of Land to and from a Partnership – Simplification

Context

The beneficial changes to the SDLT regime announced by the Chancellor in his Budget on 22 March 2006 were summarised at Item 7 of our Spring 2006 Bulletin, Issue No.16. This spells out the changes in a bit more detail.

Transfer of Chargeable Interest to a Partnership

For transfers with an effective date of on or after the date of Royal Assent, a simplified formula is introduced, based solely on market value, as follows: MV x (100 - SLP)%.

There is no amendment to the ascertainment of the 'sum of the lower proportions' in FA 2003 Sch 15, para 12.

Where the chargeable consideration includes rent, Sch 24, para 3 introduces a simplified formula for calculating the SDLT charge on the grant of a lease to a partnership by a partner or a person connected to a partner. The calculation of the charge on the net present value of any rent payable under such a lease is also simplified.

Transfer of chargeable interest to a wholly corporate partnership

Changes to FA 2003 Sch 15, para 13 are made by para 4, consequential on the changes noted above.

Post-transaction consideration: F(No 2)A 2005 measure

An amendment to FA 2003 Sch 15 para 17A is made by F(No 2)B 2006 Sch 24, para 10, to remove the potential double charge where there is a para 14 SDLT charge on general principles on the transfer of a partnership interest, but there is also a para 17A charge because of a withdrawal of funds from the partnership by the transferor partner within three years of the transfer of a chargeable interest in the partnership. The double charge is removed by reducing any para 17A charge by the para 14 charge.

Transfer of a Partnership Interest

The Budget Announcement is found in Sch 24 of F(No 2) B 2006, para 9. A new heading '*Transfer for consideration of interest in property-investment partnership*' clarifies the thinking behind the change, that is, from Royal Assent, to restrict the para 14 charge to cases where there is a transfer of an interest in a partnership for consideration to a 'property-investment partnership'. This is defined by new FA 2003 Sch 15, para 14(8) as 'a partnership whose sole or main activity is investing or dealing in chargeable interests (whether or not that activity involves the carrying out of construction operations on the land in question)' – the phrase 'construction operations' having the same meaning as in FA 2004 Part 3 Chapter 3.

Transfer of Chargeable Interest from a Partnership

An amendment corresponding to that noted above is made (again with effect from Royal Assent) to the para 18 charge on the transfer of land from a partnership, so as to restrict the formula to market value: MV x (100 – SLP)%.

In the case where the partnership grants a lease to a partner or someone connected with a partner, para 6 (amending FA 2003 Sch 15 para 19) provides a similar measure to para 3 of F(No 2)B 2006 Sch 24, for a lease being granted to a partnership.

And, by F(No 2)B 2006 Sch 24, para 7, changes to para 23 are made consequential on the changes to FA 2003 Sch 15, paras 10, 11, 18 and 19.

(F(No 2)B 2006 Sch 24)

Comment

All of these changes take effect from Royal Assent to F(No.2) B 2006 which may be expected towards the end of July. Why on earth they could not have been incorporated into the original regime applying from July 2004, one is left only to wonder! Interestingly, however, the change in computation of the SDLT charge on land both entering and leaving a partnership by withdrawing the 'actual consideration' element of the formula, reflects HMRC's Stamp Taxes' practice over quite a long time – a point not generally in the public domain and appreciated only by those 'in the know' – hardly a mark of 'open Government'.

7. Chargeable Consideration – Budget Clarification

Context

As reported at Item 7 of our Spring 2006 Bulletin Issue No.16, Treasury Regulations provide that as from 12.4.06 a number of features of common transactions are taken out of the scope of SDLT.

***The Stamp Duty Land Tax (Amendment to the Finance Act 2003) Regulations 2006* SI 2006/875**

The Regulations supplement the provisions in FA 2003 for determining what is and what is not chargeable consideration for SDLT purposes. 'Chargeable consideration' is the amount on which SDLT is charged.

The Regulations deal with the following issues:-

Payment of Inheritance Tax—the transfer of property to a person as a gift, or under a Will or intestacy, may result in that person having a liability or potential liability, or agreeing, to pay inheritance tax. The Regulations provide that this liability or agreement is not chargeable consideration.

Payment of Capital Gains Tax—the transfer of property to a person as a gift, or in other circumstances which do not amount to a bargain made at arm's length, may result in that person having a liability or potential liability, or agreeing, to pay Capital Gains Tax. The

Regulations provide that this liability or agreement is not chargeable consideration. This exclusion does not, however, apply if there is any other chargeable consideration.

Payment by tenant of landlord's costs—the Regulations provide that the payment by a tenant of a landlord's costs on the grant or enfranchisement of a lease is not chargeable consideration.

Agreement by tenant to surrender entitlement to the Single Farm Payment—it is common for agricultural leases to include an obligation on the tenant to surrender their entitlement to the Single Farm Payment to the landlord on termination of the tenancy. The Regulations provide that this obligation is not chargeable consideration.

The effective date

As the Regulations clarify areas where there was uncertainty HMRC will accept returns, or amended returns, made on the basis that these provisions applied since the introduction of SDLT.

(Consideration Note published by HMRC reported at [2006] SWTI Issue 17)

Comment

Again, as noted at Item 12 above, all this is helpful – although an awful lot of both professional and official time has been 'wasted' in discussing these points since the introduction of SDLT on 1 December 2003. But at least we have a good outcome. However, practitioners should look back in their files to identify any cases in these areas where SDLT had been paid unnecessarily: they should submit an amendment to the SDLT 1 together with an application for repayment together with repayment supplement.

It seems from the above paragraph under 'the effective date' that if an SDLT return had been submitted in one of these four cases and SDLT paid, HMRC Stamp Taxes would entertain an amended return applying for a repayment of the SDLT with repayment supplement.

D. MISCELLANEOUS

8. Settlor-Interested Trusts: Who Pays the Income Tax?

Context

ITTOIA 2005 s624(1) reads as follows: *'Income which arises under a settlement is treated for income tax purposes as the income of the settlor and of the settlor alone if it arises –*

(a) during the life of the settlor, and
(b) from property in which the settlor has an interest.'

So far, so good – but what is the tax liability of the trustees, especially if it is an accumulation and discretionary trust? Obviously the basic income tax charge on a person in receipt of income persists.

The F(No 2)B 2006 Sch 13 changes

Para 2 amends TA 1988 s686(2)(b) to remove from the exclusion of the rate applicable to trusts income which is '*treated for any of the purposes of the income tax acts as the income of a settlor'.*

So it looks as though we have a conflict, certainly so far as income which is taxed at more than the basic rate is concerned. The implication from what HMRC have said is that the trustees have the primary liability and a credit for tax paid by them (at whatever rate) is available to the settlor.

However, it is not entirely clear how this happens under the legislation – apart from the HMRC 'assurance'!

Comment

There is something of a muddle here. HMRC's preferred analysis seems to be that all the tax, at 40% or 32.5%, is a liability of the trustees and the settlor in submitting his own self-assessment claims a credit for the tax paid by the trustees – and of course, if he is no more than a basic rate taxpayer, this will generate a repayment of tax. But in terms of both compliance and cash flow, would it not have been much simpler to stick to the previous system whereby any tax liability on the income of settlor-interested accumulation or discretionary trusts is down to the settlor rather than to the trustees?

9. Deceased Estates: Taking out a Grant Where Solicitors have Converted to LLP

Context

Those firms of solicitors which have converted to LLPs have had particular concerns about the status of appointments in clients' Wills appointing the firm as an executor. If the firm has since become an LLP is a partner still eligible to take out a grant?

***The decision in* Re Rogers deceased**

Lightman J had to address the issue as to whether the intention of the testatrix to appoint as executors the solicitors conducting the practice carried on by Lawrence Tucketts at the date of the Will was frustrated by the exercise of the option available to those solicitors to alter the legal character of the vehicle through which they carried on the practice. He concluded that the Court can and should take a practical and common sense view in eliciting and giving effect to the intention manifested by the testatrix. In the circumstances he was satisfied that the appointment in the Will was apt to embrace the profit-sharing members of the LLP as the equivalent to partners in the previous partnership.

However, Lightman J emphasised his view that, even as the 'partner in the partnership' means in a case of a partnership a profit-sharing partner and not merely a salaried partner or a person merely held out (but not in fact) a partner, so when transposed to a limited liability partnership a member must mean a profit-sharing member. He added that, to avoid any doubts or questions arising in the future, testators will be well advised to make express provision whether on the conversion of any appointed firm of solicitors or successor firm and (if this is desired) for the appointment of employee as well as for profit-sharing members as executors.

(In the Estate of Edith Lillian Rogers deceased [2006] EWHC 753 (Ch) and the Law Society's Gazette 21 April 2006 p3)

Comment

The 'cutting the Gordian knot' approach of Lightman J may have a certain attractive simplicity about it, but more than a moment's reflection highlights the difficulty. What about the not inconsiderable numbers of grants issued in the past to non-equity partners in the firm, whether salaried partners or indeed other employees? Are these technically ineffective? And pending any statement by the Government or the Law Society, the cautious conclusion is that a firm needs to think more carefully about the status of the person taking out the grant.

10. Production of Documents Requested by HMRC

Context

There have since the beginning of 2006 been four successful applications by HMRC to a Special Commissioner (in each case Dr John Avery-Jones) to serve notices on first a 'tax haven company' and second a 'financial institution' (which we now know to be Barclays Bank plc) under TMA 1970 s20(8A) to produce specified documents relating to bank accounts under their management.

The requirements of TMA 1970 s20 (8A)

Where the identity of the taxpayer in relation to whom HMRC want further information is known, they can straightforwardly serve a notice in relation to him. Where however the identity is unknown, the service of notices on a third party requesting certain information requires the prior consent of a Special Commissioner. The four matters which HMRC have to satisfy the Special Commissioner are as follows:-

(a) that the notice relates to a taxpayer whose identity is not known to the inspector or to a class of taxpayers whose individual identities are not so known;
(b) that there are reasonable grounds for believing that the taxpayer or any of the class of taxpayers to whom the notice relates may have failed or may fail to comply with any provision of the Taxes Acts;
(c) that any such failure is likely to have led or to lead to serious prejudice to the proper assessment or collection of tax; and
(d) that the information which is likely to be contained in the documents to which the notice relates is not readily available from another source.

The Tax Haven Company Cases

The Special Commissioner held that, for the purposes of para (a), the class of taxpayers was effectively the clients for whom the bank acted as prime broker who were UK resident individuals and who conducted share transactions via a company registered in a tax haven enjoying institutional investor status. That was a proper class, and certainly not in the nature of a fishing expedition by HMRC.

A large number of exclusions from the class had been agreed leaving about 227 potential members. The individual identities of members of the class were not known to HMRC. There was evidence that people in the same position had seriously failed to comply with their tax obligations and so HMRC's grounds for believing that others might be in the same position were reasonable for the purposes of the requirements of para (b). Based on the enquiry so far settled which yielded about £1.5 million per person, HMRC estimated that if half of the 70 of the 227 clients affected by the notice were similar to the ones already investigated and the average yield was £1 million per client, the tax yield would be of the order of £35 million. Therefore para (c) was also satisfied. The requirement, in para (d), that the information was not readily available from another source, was also fulfilled. In two separate cases SpC 533 and 537 the Special Commissioner gave his consent to the issue of the notice.

The Financial Institution Cases

Again, there were two cases SpC 517 and SpC 536. Detailed defences put on behalf of the taxpayer bank were rejected by the Special Commissioner. The ruling in *HMRC v Financial Institution SpC 517* required Barclays Bank to produce information about customers whose credit cards were associated with offshore bank accounts. The second decision, SpC 536, is broader, as it requires information to be produced by customers with UK addresses and non-UK bank accounts.

Professional comment

The decision has been described as '*ground-breaking*' and '*the most significant decision handed down in relation to investigation work by a tribunal*'. It is understood that HMRC have been preparing very thoroughly for this attack for two years, as the report of the Special Commissioner's shows. HMRC are setting up eight offices specifically for this purpose. While they will not form part of the SCI network, many of the staff will have served in SCI.

What happens next?

The major financial institution has been identified as Barclays. HMRC are now expected to pursue similar rulings concerning other banks. They have indicated that there is a total potential yield of £1.5 billion in unpaid tax as a result of the decision.

Offshore assets – HMRC contact

HMRC say that following recent media publicity it is apparent that some customers or their representatives wish to contact HMRC to make disclosures in respect of assets held offshore, where there may be unpaid duties.

HMRC claim that they are anxious to facilitate such approaches. They have set up a single point of contact to handle your queries. Contact Tony Preston (an Assistant Director Compliance) telephone 07747 461833 or email via the link at www.hmrc.gov.uk/offshorefunds/assets.htm.

([2006] SWTI Issue 19)

Comment

Obviously this is a massive exercise going to require huge manpower on the part of HMRC. Some of the cases will be relatively small and indeed some taxpayers may have the remittance defence available to non-UK domiciliaries. In other cases, however, there may be large amounts of income tax under-declared, with HMRC clearly claiming penalties as well as interest for blatant tax evasion. Equally, however, of interest to HMRC may not just be income tax evasion but also the possibility of breaches of the money laundering regulations and indeed evasion of other taxes as well, for example IHT. A question could be raised in any particular case, for example, as to the source of the funds generating interest and whether these derived from a deceased estate which should have been liable to UK IHT in the past.

11. The Disclosure Regime: Direct Tax Extension from 1 August 2006

Context: The Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations 2006

Issued on 27th April 2006 was the draft SI following the Pre-Budget Report announcement that the disclosure regime would be extended to all of income tax, CGT and corporation tax (replacing the existing regime for financial products and employment products). The start date has been deferred from 1 July to 1 August 2006. In very broad summary:

- Following definitions of 'business' (to embrace a company or person or firm who carries on a trading or property business) and 'small or medium sized enterprise', are seven 'prescribed prescriptions of arrangements'. The first four of these, following broadly the 2004 regime for financial products and employment products, are:-

  - confidentiality in cases involving a promoter;
  - confidentiality in cases not involving a promoter;
  - premium fee; and

- off-market terms.

The remaining three are:-

- standardised tax products
- loss schemes; and
- leasing arrangements [though why this was necessary in the light of recent amendments to the statutory regime is unclear].

- Clearly the new regimes for standardised tax products and loss schemes, both of which presuppose a promoter, are aimed at taxpayers across the board (subject, in the case of standardised tax products, to a list of exclusions in para 11).

- Is IHT not included, because most IHT avoidance is thought by HMRC to be caught by the Pre-owned Assets regime and therefore within income tax?

Table of Exempted tax products

- *Enterprise investment schemes.*
- *Venture capital trusts.*
- *Corporate venturing scheme.*
- *Community investment tax relief.*
- *Individual savings accounts.*
- *Approved share incentive plans.*
- *Approved share option schemes.*
- *Approved company share option plans.*
- *Grants under the enterprise management incentive scheme together with any reasonably necessary steps (or steps notified to HMRC in accordance with ITEPA 2003 Sch 5 Pt 7).*
- *Registered pension schemes.*
- *Overseas pension schemes subject to tax relief under TA 1988 s615.*
- *Relevant non-UK pension schemes within the meaning of FA 2004 Sch 34 para 1(5).*
- *Schemes allowing personal injury damages to be paid periodically.*
- *Any arrangement consisting solely of one or more plant or machinery leases is not subject to description 5. This is because such leases are subject to their own specific description.*

Professional Comment

Three of these new hallmarks target new and innovative schemes, one is aimed at standardised products, another at loss-making investment schemes and the final one at plant and machinery allowances schemes. A number of points arise: for example what is 'standardised, or substantially standardised, documentation'? Could this catch even benign tax planning, accepted as such by HMRC just because the parties rely on a solicitor's standard precedent documentation?

How will legal professional privilege ('LPP') operate within the new rules?

Although LPP has been narrowly extended to accountants for the purpose of reporting under the money laundering rules, the authority for that was the terms of the EU Money Laundering Directive rather than a desire by HM Treasury to widen the scope of LPP generally. It was

most unlikely that HMRC would ever agree to a widening of LPP to include persons not already within its scope for the purposes of the tax scheme disclosure rules.

But why has the regime been extended at all?

Was there a feeling within HMRC that advisers had been applying an insupportable interpretation to the existing regime, which in most cases is most difficult to enforce before a Tribunal on the current subjective basis? The new rules will make it easier for HMRC to proceed against tax advisers who fail to disclose.

The scope of 'standardised tax products' needs to be limited

Because this description requires there to be a promoter involved, there is no exclusion for individuals and smaller businesses. This means that virtually every piece of advice or device can fall within description 5 if it can be used by more than one other person (i.e. at least three in total).

It should be added that the draft regulations provide some exceptions. These are generally arrangements that are thought to be so harmless that actually the Government would wish to encourage their take-up (or at least be seen to encourage them). These are set out above.

12. The *Hastings-Bass* Principle: HMRC's Current Views

Context

The purpose of an article in the latest issue of the Tax Bulletin is to give an indication of HMRC's current views on some aspects of the so-called *'Hastings-Bass'* principle. The principle has been applied in the context of trusts where a trustee is given a discretion as to some matter, on which he acts, but where the purported exercise of his discretion has unintended consequences, very often in fiscal terms.

Background

The name of the principle comes from the case of *Re Hastings-Bass deceased* [1975] Ch 25 (*'Hastings-Bass'*). In that case the Court of Appeal upheld the validity of an exercise by trustees of the statutory power of advancement, save to the extent that it was necessarily void for perpetuity, on the basis that the court should not interfere where a trustee is given a discretion as to some matter in which he acts in good faith, notwithstanding that his action does not have the full effect which he intended, unless it is clear that he would not have acted as he did

- had he not taken into account considerations which he should not have taken into account or
- had he not failed to take into account considerations which he ought to have taken into account.

The* Mettoy *reformulation

The second limb of the principle was purportedly reformulated into a more readily understood, positive version by Warner J in *Mettoy Pension Trustees Ltd v Evans and others* [1990] 1 WLR 1587 ('Mettoy') at 1621A-H as follows:

'Where a trustee acts under a discretion given to him under the terms of the trust, the courts will interfere with his action if it is clear that he would not have acted as he did had he not failed to take into account considerations which he ought to have taken into account'.

This reformulation in fact involved a substantial leap from the original formulation of the principle in Hastings-Bass itself, for two reasons. First, the word 'will' apparently denotes an obligation on the court to intervene whenever the stated conditions are satisfied. Secondly, the negative proposition that the court should not interfere unless certain conditions are fulfilled is not logically equivalent to the much wider positive proposition that the court should, or even may, interfere if those conditions are fulfilled. Nevertheless, after reviewing a number of authorities Warner J concluded in *Mettoy* that there was a principle in the positive form stated above which was separate both from the equitable remedy of rectification and from the jurisdiction of the court to set aside a written instrument for mistake.

Over the past few years there has been an increase of interest in and reliance on the principle, which has resulted in a number of decided cases at first instance, including *Abacus Trust Company Ltd v NSPCC* [2001] STC 1344 ('*Abacus v NSPCC')*, *Breadner v Granville-Grossman* [2001] Ch 523, *Abacus Trust Company Ltd v Barr* [2003] Ch 409 ('*Abacus v Barr*'), *Burrell v Burrell* [2005] STC 569 and *Sieff v Fox* [2005] 1 WLR 3811 ('*Sieff v Fox'*) which contains a detailed and valuable review of the case law by Lloyd LJ. Apart from case law, the emerging principle has also generated a great deal of discussion and commentary by academics and practitioners alike.

An interesting, but perhaps not surprising, feature of the majority of these cases is that the unintended consequence of the mistake by the trustees was a liability to tax. For this reason HMRC have been interested in this area of the law, as it develops and is shaped by the courts. In recent years it has been the usual practice of HMRC to decline invitations to be joined as a party in cases where the court is being asked to set aside a transaction in reliance on the principle. However, in *Sieff v Fox* Lloyd LJ observed in paragraph 83 that the court's task might be easier in some cases if HMRC did not always decline the invitation to take part in cases of this kind. In the light of that observation, and HMRC's increasing concern (which is shared by many commentators) that the principle as currently formulated is too wide in its scope, HMRC will now give active consideration to participating in future cases where large amounts of tax are at stake and/or where it is felt that HMRC could make a useful contribution to the elucidation and development of the principle. HMRC will be particularly ready to intervene in cases where there would otherwise be no party in whose interest it would be to argue against the application of the principle.

HMRC's current thinking

HMRC said in the article that it would be beyond the scope of the article to discuss the issues which arose in any depth. HMRC went on to say that it must reserve the right to advance whatever arguments appear to them to be appropriate in the circumstances of any given case.

Subject to that caveat, however, HMRC would make the following points in order to give an indication of HMRC's present thinking on some of the main questions which arise.

(1) In the first place, it should be noted that the principle in its present form has little or nothing to do with the type of situation which was considered by the Court of Appeal in *Hastings-Bass* itself, and that it owes its origin to the logically flawed positive reformulation of the principle in *Mettoy*. HMRC consider that any positive formulation of the principle should state merely that the court 'may' interfere with the trustee's action, not that it 'will' do so.

(2) Second, and allied to point (1) above, HMRC consider that the effect of the principle, if it applies at all, should be to make the relevant decision by the trustee voidable and not void, or at the very least should permit the court to take into account the same sort of equitable considerations that apply when it is deciding whether to grant other forms of equitable relief.

(3) Third, HMRC would tentatively suggest that the principle, as it develops, should as far as possible be assimilated with the general principles of law by reference to which (a) the exercise of a discretion by trustees may be impugned (as to which see the decision of the Court of Appeal in *Edge v Pensions Ombudsman* [2000] Ch 602, especially at 627-30 and 633), and (b) the courts will set aside voluntary transactions or written instruments for mistake. It may be the case that, properly understood, there is no room or need for a separate *Hastings-Bass* principle at all.

(4) Fourth, in cases where the trustee acts under a discretion and is not obliged to act, HMRC would agree with the view expressed by Lloyd LJ in *Sieff v Fox*, that the relevant test is whether the trustee 'would' have acted differently if the correct considerations had been taken into account, not whether the trustee 'might' have acted differently.

(5) Fifth, while accepting that fiscal consequences are generally amongst the matters which a trustee should take into account when deciding how to act, HMRC consider that a distinction needs to be drawn between cases where the trustee fails to take relevant fiscal considerations into account at all, and cases where the trustee takes steps to obtain fiscal advice but that advice turns out (for whatever reason) to be wrong. While there may be scope for the principle to apply in cases of the former type, it is felt that in cases of the latter type (which include *Sieff v Fox*) the principle should not apply.

(6) Similarly, in cases where the trustee obtains advice about the tax consequences of a proposed transaction, but then fails to implement the transaction in accordance with that advice (as in *Abacus v NSPCC*), it is also felt that the principle should not apply. A common feature of cases like *Sieff v Fox* and *Abacus v NSPCC* is that the trustee has sought appropriate tax advice, and in reliance on it has deliberately taken certain steps which in trust terms achieve precisely the effect which it intended to achieve. Why then should the trustee be entitled to have the transaction set aside, in a way that would not be open to an individual taxpayer, merely because the advice which he obtained was incorrect, or because he negligently failed to follow the advice correctly? In such cases, it is suggested, the court should not interfere, tax should be paid on the basis of the transaction actually carried out, and the trust should be left to pursue whatever remedies it may have against the trustee and/or the trustee's professional advisers.

(7) Finally, despite what was said by Lightman J in *Abacus v Barr*, HMRC are inclined to agree with Lloyd LJ in *Sieff v Fox* that a breach of duty by the trustee or the trustee's agent or

advisers is not in itself a separate requirement that has to be satisfied if the principle is to apply.

In the remainder of the article, some brief comments are made on various practical issues which have arisen from time to time.

In some instances HMRC have been asked to consent to a reversal of the tax consequences of a particular trustee decision without an order of the court, on the basis that the principle in Hastings-Bass applies, to save the parties the trouble and expense of going to court.

An order of the Court required before HMRC will review the tax implications

HMRC have generally maintained that they require an order of the court before HMRC will review the tax consequences of a decision on the basis of the *Hastings-Bass* principle, and this remains the basic position. The nature and parameters of the *Hastings-Bass* principle are still unclear in many respects and although this is something that HMRC will consider in the context of each case as it arises, it is felt that they would not generally be entitled to agree to unwind a decision, even if they were minded to do so. Crucially, it remains to be clarified by a higher court whether the effect of an application of the principle is to make a decision void or voidable. If the decision is voidable, the question of whether it should be avoided is one for the court and cannot be resolved by consent between the parties.

At other times HMRC have been asked to determine the tax consequences of obtaining an order, while parties consider whether or not to apply to the court. HMRC have generally declined to do this, on the basis that the court may have a wide discretion as to the terms upon which it makes any order. Facts and circumstances in cases susceptible to consideration under the principle vary considerably and these variations may well affect the approach of the court and, in consequence, the tax treatment.

Finally, in a number of cases HMRC have been invited to join the proceedings themselves. Some parties have complained of hardship where HMRC have insisted on a court order before HMRC will review the tax consequences, particularly where the parties are themselves agreed that the decision should be set aside. However, HMRC do not consider that their insistence on a court order leads necessarily to the conclusion that HMRC ought to be joined as parties to those proceedings, although as HMRC have said it is now likely that there will be cases in the future where HMRC would wish to be joined or to intervene in order to resist an application of the principle in a particular case, or to seek to influence the development of the principle in a particular direction.

The article sets out HMRC's current position on the principle in *Hastings-Bass* and seeks to give an indication of the type of stance HMRC might take should HMRC become involved in a case in the future. HMRC are not, however, limiting themselves to these arguments. Clearly this is a developing area of the law, certain aspects of which will require clarification by the higher courts in due course. As things evolve HMRC will keep the principle, and HMRC’s policies, under review but it is hoped that this article will assist taxpayers and practitioners in the meantime.

(HMRC Tax Bulletin Issue 83 June 2006 pp 2-4)

Comment

In the context of various professional articles which have been published over the last three to four years or so, it is interesting to have a statement of HMRC's stance on the issue. While the *Hastings Bass* principle is always a useful one for the practitioner to remember when his back is against the wall, as a possible let out, there are clearly significant limitations on its application. But no doubt there is more life in the old dog yet….

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

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