

A continuing excluded property dilemma

(Lecture P1060 – 8.51 minutes)

Two years ago, the High Court examined a long-standing area of uncertainty relating to excluded property held in a trust (*Barclays Wealth Trustees (Jersey) Ltd v HMRC* (2015)).

S48(3) IHTA 1984 provides that, where settled property is situated outside the UK, it represents excluded property for IHT purposes unless the settlor was domiciled in the UK at the time when the settlement was made.

This seems clear enough, but what is the position where a foreign-domiciled settlor establishes an excluded property trust, subsequently becomes UK-domiciled (or deemed to be domiciled in the UK) and then adds overseas assets to that trust? Are those added funds also regarded as excluded property?

The dilemma in the High Court case was succinctly summarised by Mann J when he said at the start of his judgment:

‘The facts are short, but it will help in understanding their significance if I distil the facts and issues to their simplest. Trust property in Trust No. 1 was “excluded property”, settled by a non-domiciled settlor, and so would have been free from the 10-year charge had it stayed there. Some of it was transferred to Trust No. 2, which had the same settlor but who had by now become domiciled in the UK, and it became (at that point) not excluded property. It was then transferred back to Trust No. 1. The question, distilled to its simplest, is whether it had reacquired excluded status.’

The answer depends on what is meant by ‘at the time the settlement was made’ in S48(3) IHTA 1984. It can be forcefully argued that a settlement is made at the time when it was originally established, in which case the added funds (if of foreign situs) should qualify as excluded property. However, HMRC have always taken the opposing view by suggesting that a new settlement comes into being whenever funds are added. Accordingly, if the addition takes place when the settlor is UK-domiciled (as happened here, the settlor became deemed domiciled in the UK from the start of 2003/04, having set up the trust some two years earlier), the new trust assets will not rank as excluded property.

Mann J’s decision was to agree with HMRC’s stance. Parliament, he commented, could not have intended additions of foreign property to a settlement after the settlor had acquired a UK domicile to have the character of excluded property. He said:

‘This result is even more striking if one imagines a settlement which was seeded with a nominal sum (which frequently happens), with a massive subsequent contribution made when the settlor became domiciled. Why should that subsequent contribution be able to acquire the characteristic of the original £100 in those circumstances?’

He therefore concluded that the words 'at the time the settlement was made' were capable of encompassing both the making of the original settlement and the later addition of property to that settlement. The subsequent addition to the settlement by the settlor did not have the character of excluded property.

The trustees appealed against this finding and, in *Barclays Wealth Trustees (Jersey) Ltd v HMRC* (2017), the Court of Appeal have unanimously reversed Mann J's decision. The leading judgment was given by Henderson LJ.

He considered that the settlement represented a single settlement for IHT purposes, constituted by a number of separate dispositions of property to be held on the settlor's trusts.

He stated:

'Not only is this how a trust lawyer or practitioner would view the matter, but it fits comfortably with the definition of "settlement" in S43(2) IHTA 1984 which applies for all purposes of the 1984 Act. In particular, the express reference to "disposition or dispositions of property" in the definition is in my view naturally read as intended to cover the common situation where a settlement is first made, often with a small or nominal sum of money, and further assets are then added by the settlor.'

Henderson LJ went on to add:

'I find it implausible to suppose that, in S48(3) IHTA 1984, the same word "settlement" was intended by Parliament to have two different meanings or that it has a single meaning which requires one to focus separately on each occasion when property is added to a settlement.'

He continued:

'The natural (and, in my opinion, correct) interpretation of the subsection is that it requires one to look at a single settlement as it is constituted from time to time, whether by one or a series of transfers into settlement, and provides that any foreign property comprised in it is excluded property unless the settlor was UK-domiciled "at the time the settlement was made". The time when the settlement was made will then be ascertained in accordance with the usual principles of trust law and will normally be the occasion when the settlor first executed a trust instrument and constituted the trust by providing property to the trustee.'

Interestingly, the Court of Appeal – like Mann J in the High Court – made no mention of S67 IHTA 1984 which provides a special procedure for the calculation of a 10-year anniversary charge where further assets have been added to a relevant property settlement by the settlor. If the HMRC interpretation had been found to be correct, S67 IHTA 1984 would appear to be redundant.

Could Parliament really be presumed to have passed legislation that has no effect?

One final point should be noted. Before making the assumption that further foreign property can always be added to what was originally an excluded property trust on a tax-efficient basis, Henderson LJ's important caveat needs to be borne in mind:

‘For completeness, I should mention that different considerations may arise in cases where a settlor makes an offshore settlement when he is non-UK domiciled, later acquires a UK domicile and then makes further substantial transfers of property into the settlement. It may arguably seem anomalous that, in such a case, the property in question – if it is or becomes foreign property – should qualify as excluded property in the settlement merely because the settlor was non-UK domiciled when the settlement was originally made. I emphasise that the present case is not of that character . . . I express no view on the question whether the same result as in the present case should be reached in cases of the other type which I have described, because wider policy considerations may then be engaged.’

Enough said!

Contributed by Robert Jamieson