

## **IHT and DOTAS updated (Lecture P1075 – 14.28 minutes)**

When DOTAS first appeared in FA 2004, it was noticeable that IHT did not feature in the list of taxes that were covered. In fact, the reason for this omission was sensible. If a taxpayer uses a planning arrangement to mitigate, say, a corporation tax or CGT liability, one would expect HMRC to make a more or less immediate decision about whether or not the ploy works. However, with IHT planning, it may be many years before the effectiveness of the scheme is determined – often only on the taxpayer's death. Thus it was initially thought inappropriate to include IHT.

Eventually, in 2011, regulations were introduced which required promoters to disclose arrangements involving relevant property trusts (eg. discretionary trusts) where the main benefit of the scheme was to avoid or reduce an IHT entry charge on the transfer of property to a trust. Schemes that were the same, or substantially the same, as those first made available before 6 April 2011 did not have to be notified.

The Inheritance Tax Avoidance Schemes (Prescribed Disclosure Of Arrangements) Regulations 2017 (SI 2017/1172) are replacing the previous rules with effect from 1 April 2018. As is well known, the DOTAS regime relies on 'hallmarks' to describe the avoidance arrangements that have to be disclosed. There have been wide-ranging consultations with stakeholders in recent years on how best to extend the scope of the very narrow current IHT hallmark with a view to making it more effective. It is believed that there have only been a few IHT disclosures to date, due mainly to the fact that the reporting requirement is so restricted. In other words, from an HMRC perspective, the hallmark has not been capable of providing them with information about IHT avoidance schemes. The wording of the latest updated version has been refined to take stakeholders' comments and concerns into account. The Government want to ensure that the new hallmark is appropriately targeted to catch IHT avoidance schemes, but not to catch:

- the straightforward use of reliefs and exemptions; and
- ordinary tax planning arrangements.

The crux of the new regulations is found in Para 4 that reads as follows:

'Arrangements fall within the description in this regulation if it would be reasonable to expect an informed observer (having studied the arrangements and having regard to all relevant circumstances) to conclude that condition 1 and condition 2 are met.

Condition 1 is that the main purpose, or one of the main purposes, of the arrangements is to enable a person to obtain one or more of the following advantages in relation to IHT:

1. Avoidance or reduction of a relevant property entry charge;
2. Avoidance or reduction of a charge to IHT under Ss64, 65, 72 or 94 IHTA 1984;
3. Avoidance or reduction of a charge to IHT arising from Ss102, 102ZA, 102A or 102B FA 1986 where there is no charge to income tax under Sch 15 FA 2004;
4. A reduction in the value of a person's estate without giving rise to a chargeable transfer or potentially exempt transfer.

Condition 2 is that the arrangements involve one or more contrived or abnormal steps without which the tax advantage could not be obtained.'

A particular complexity arises in relation to established retail IHT planning products which would potentially fall within the new hallmark but which accord with established practice accepted by HMRC – this may have happened through published material such as HMRC guidance notes or in some other way. Such products do not have to be disclosed if they continue to be sold and implemented after these regulations take effect, provided that they were first made available and entered into before 1 April 2018.

HMRC have confirmed that they will be publishing guidance 'in good time' prior to the relevant commencement date to explain:

- how the new DOTAS hallmark works;
- the conditions to be met in order for arrangements to be notifiable; and
- the circumstances for certain arrangements to be exempted from disclosure.

*Contributed by Robert Jamieson*

NOTE: This guidance has now been released (see below)

## **IHT DOTAS guidance**

On 29 March HMRC published updated guidance to replace the IHT chapters (12 and 13) of HMRC's main DOTAS guidance, to reflect the new IHT hallmark which is effective from 1 April 2018. This will be incorporated into HMRC's guidance on the DOTAS regime and will replace the guidance previously in chapters 12 and 13.

The revised guidance:

- provides some background to the changes in the IHT hallmark;
- describes the new hallmark and explains how it works;
- gives details of the 2 conditions that must be met for the arrangement to be notifiable;
- explains how the established practice exception applies;
- gives examples of arrangements which are not notifiable, that might be notifiable, and that are notifiable

### *Cessation of grandfathering provisions*

The provisions that excepted certain arrangements in place before 6 April 2011 will cease to apply from 1 April 2018. This means arrangements that would have been excepted from disclosure under the old hallmark will, from 1 April, have to be tested against the new IHT hallmark.

### *New 'established practice'*

A new 'established practice' exemption will remove the need to disclose established IHT planning schemes entered into before 1 April that are 'substantially the same' as other arrangements HMRC has previously agreed.

*Two conditions to be notifiable*

Condition 1 is that the main purpose, or one of the main purposes, of the arrangements is to enable a person to obtain an IHT advantage in relation to one or more of the following:

- (a) avoidance or reduction of a relevant property entry charge;
- (b) avoidance or reduction of the charge on relevant property at the ten-year anniversary or at any other time, the charge on property leaving employee or newspaper trusts, and the charge arising in connection with close company transfers;
- (c) avoidance or reduction of the charge on gifts with reservation of benefit, where there is also no pre-owned asset income tax charge; or
- (d) reduction in the value of a person's estate without giving rise to a chargeable transfer or potentially exempt transfer.

Condition 2 is that the arrangements involve one or more contrived or abnormal steps without which the tax advantage could not be obtained. Whether arrangements are contrived or abnormal, or involve contrived or abnormal steps, has to be considered from the point of view of an 'informed observer'. The informed observer is not necessarily a tax practitioner, but is independent, has all the relevant information about the scheme and has sufficient knowledge to understand both the scheme and the relevant statutory context.

The guidance includes a number of useful examples of schemes that are not notifiable. Including:

- A lifetime gift to a spouse or civil partner (Condition 2 is not met);
- Regular gifts out of income (Condition 2 is not met);
- Transfers of value equal up to the available nil rate band into trust, which may be repeated every seven years (Condition 1 is not met);
- Making a lifetime transfer to a bare trust for a minor beneficiary (Condition 1 is not met);
- Executing a will that leaves property to an exempt beneficiary such as the spouse or a charity (Condition 1 is not met);
- Executing a deed of variation to which s.142 IHTA 1984 applies to transfer assets on death to an exempt beneficiary (Condition 1 is not met);
- Disclaiming an entitlement under a will to which s.142 IHTA 1984 applies where there is an exempt residuary beneficiary (Condition 1 is not met);
- Purchase of shares that will qualify for business property relief after they have been owned for two years (Condition 1 is not met);
- Gift of land where the donor continues to use that land but pays full consideration for their use (Condition 2 is not met);

- A non-UK domiciled individual who is not UK resident transfers funds from a sterling denominated UK bank account into a US dollar denominated UK bank account, so that the bank account is left out of account under section 157 IHTA 1984 (Condition 1 is not met);
- A non-UK domiciled individual transfers non-UK situs property into a trust just before they become deemed domiciled in the UK. The individual can benefit from the trust (Condition 2 is not met);
- Immediately before a ten-year anniversary a distribution is made from a relevant property settlement to reduce the charge on the subsequent ten-year anniversary (Condition 2 is not met);
- Gift and Loan Trusts/Loan Trusts (Condition 1 is not met);
- Loans to companies or other entities from which the lender cannot benefit (Condition 1 is not met);

#### *Arrangements that might be notifiable*

Because conditions 1 and 2 have to be evaluated taking all relevant circumstances of those particular arrangements, or that proposal for arrangements, into account, there will be some arrangements and proposals where it is difficult to be definitive about whether they are notifiable. Where arrangements include multiple steps in order to achieve the intended tax advantage however, there becomes an increased likelihood that they may be notifiable, either by reason of the IHT hallmark or because they fall within the confidentiality or premium fee hallmarks:

Consider the example where arrangements are made to gift shares qualifying for business property relief into trust and subsequently sell the shares back to the transferor

In isolation the transfer of shares qualifying for business property relief into a trust, or the sale of trust assets by the trustees, would not meet condition 1. Where arrangements are entered into with the intention that all of these steps take place, the arrangements have the effect of placing cash into a relevant property trust, but without incurring a relevant property entry charge. As one of the main purposes of these arrangements is to reduce or avoid a relevant property entry charge it would be reasonable to expect an informed observer to conclude that condition 1(a) is met.

This can be contrasted to a situation where, for example, family company shares are transferred into trust for succession planning purposes, at which time there is no intention of the trustees selling those shares. If the trustees later took an independent decision to sell the shares it is unlikely that an informed observer would conclude these separate steps form part of a single overall arrangement, or to conclude that condition 1(a) was met.

It would not normally be possible to transfer cash into a relevant property trust without incurring a relevant property entry charge, which is what has been achieved. To achieve this outcome and to gain this tax advantage, contrived steps are necessary, that is the transfer of shares qualifying for relief followed by their sale back to the transferor rather than the simple transfer of cash that would be the non-contrived way of achieving the same result. Without these contrived steps the tax advantage would not arise. It would therefore be reasonable to expect an informed observer to conclude, considering the arrangements as a whole, that condition 2 was met.

Notifiable arrangements.

The guidance includes two examples of arrangements that are notifiable.

1. Creation of a reversionary lease - A person owning a freehold grants a lease to a trust or to their children. The lease starts in 21 years' time, longer than the person expects to survive. The person continues to live in the property until the sub-lease begins.

Condition 1: The arrangements avoid or reduce a charge to inheritance tax arising from the application of the gift with reservation of benefit rules. The person continues to benefit from the property, but the whole value of the property is no longer in the estate. If, in addition, no charge arises under Schedule 15 Finance Act 2004, it would be reasonable to expect an informed observer to conclude that this arrangement meets condition 1(c).

Condition 2: The creation of a lease which only takes effect several years in the future and which in the meantime allows the owner of the property to continue in occupation at no cost is a contrived and/or abnormal step. The tax advantage would not be achieved without this contrived or abnormal step. It is therefore reasonable to expect an informed observer to conclude that this arrangement meets condition 2 and is notifiable under this hallmark.

2. Employee benefit trusts (EBTs) A person owns an investment company with two part-time employees. The directors are that person and his two children. He is the sole shareholder and wishes to transfer the company to his children on his death. He creates an employee benefit trust and settles the shares on that trust. The trust excludes him and his children while he is alive and satisfies section 86 IHTA. His children can benefit after his death.

Condition 1: The arrangements result in a reduction in the value of the person's estate which does not give rise to a chargeable transfer or a potentially exempt transfer. It is reasonable to expect an informed observer to conclude that obtaining this tax advantage was the main purpose, or one of the main purposes, of these arrangements and therefore that condition 1(d) is met.

Condition 2: The use of an EBT in these circumstances is a contrived step. The purpose is to transfer the company shares to the children, but the tax advantage is obtained by using an EBT to achieve that outcome. The tax advantage could not be achieved without this contrived step. It is therefore reasonable to expect an informed observer to conclude that condition 2 is met and this arrangement is notifiable under this hallmark.

*[www.gov.uk/government/publications/disclosure-of-tax-avoidance-schemes-inheritance-tax](http://www.gov.uk/government/publications/disclosure-of-tax-avoidance-schemes-inheritance-tax)*