

Excluded property trusts

(Lecture P1159 – 13.31 minutes)

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

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. Where a foreign-domiciled settlor establishes an excluded property settlement but subsequently becomes UK-domiciled (or deemed to be domiciled in the UK by virtue of S267 IHTA 1984) and then adds overseas assets to that settlement, are those added funds also excluded property?

The dilemma in this 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 has reacquired excluded status.’

The answer is that it all depends on what is meant by the words ‘at the time the settlement was made’. 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 overseas – should qualify as excluded property. However, HMRC take 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 has become UK-domiciled, as happened here – the settlor became deemed domiciled in the UK from the start of 2003/04, having set up the original trust some two years earlier, the new trust assets will not rank as excluded property.

There are some very real difficulties with the HMRC interpretation. For example, S44(2) IHTA 1984 provides that, where more than one person is a settlor in relation to a settlement, the settled property is treated as being comprised in separate settlements. One might reasonably conclude that the principle in S44(2) IHTA 1984 is not in point where the original settlor adds property to a settlement – the legislation could, after all, easily have said so and one assumption would be that this was therefore deliberate. This would seem to be consistent with the wording in S67 IHTA 1984 which provides a detailed procedure for the calculation of a 10-year anniversary charge where further assets have been added to a relevant property settlement by the settlor. On the HMRC interpretation, S67 IHTA 1984 could be seen to be redundant.

Can Parliament be presumed to have passed legislation which has no effect? This was a difficult judgment, especially given the High Court's words that Parliament 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 – Mann J described this conclusion as 'striking'.

His words were:

'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 has become domiciled. Why should that subsequent contribution be able to acquire the characteristic of the original £100 in those circumstances?'

There can be no doubt (because S43(2) IHTA 1984 says so) that a settlement includes a disposition – and an addition is clearly a disposition – but that does not seem, in one commentator's mind, 'to get us past the express words of S48(3) IHTA 1984' as well as S67 IHTA 1984.

In a careful and detailed judgment (which, interestingly, contains no reference to S67 IHTA 1984), the High Court concluded that the words 'at the time the settlement was made' were capable of describing both the making of the original settlement and the later addition of property to that settlement. Accordingly, the subsequent addition to the settlement by the settlor did not have the character of excluded property.

However, this ruling was overturned by the Court of Appeal two years later, with all three judges finding in the taxpayer's favour. Henderson LJ, who delivered the leading judgment, stated:

'I cannot accept the (High Court) judge's view that the word "settlement" may have two different meanings in S48(3) IHTA 1984.'

As a result, a later addition of overseas assets to an excluded property settlement was regarded as an excluded property transfer, even if, in the meantime, the settlor had become UK-domiciled.

From HMRC's perspective, the Court of Appeal's decision had two possible outcomes:

1. An appeal to the Supreme Court (which may or may not have been successful); and
2. An amendment to the statutory wording in IHTA 1984.

In the event, HMRC have opted for the latter alternative. Following the publication of draft Finance Bill clauses on 11 July 2019, it has been decided that, when property is added to a settlement, the domicile of the settlor will be considered at the time of the addition rather than at the time when the settlement was first created. This will apply for any chargeable events taking place on or after the date of Royal Assent (which, it is assumed, will occur in early 2020). For example, in S48(3) IHTA 1984, instead of 'at the time the settlement was made' one will now read 'at the time the property became comprised in the settlement'. This avoids the previous semantic uncertainties.

There is to be a similar rule for property moving between settlements.

Contributed by Robert Jamieson