

Capital taxes round up – October 2024 (Lecture P1457 – 14.54 minutes)

Charitable donations and holiday lets

Summary – Business Property Relief was not available on a let property and the 36% IHT rate did not apply.

Samuel Marks died in April 2014 leaving various pecuniary legacies with the residue of his estate to be held on trust for his wife, Hilda. The terms of the Will Trust stated that:

- Hilda was entitled to receive income from the trust during her lifetime;
- The trustees had the power to appoint funds out of the trust to specified relations, which they did, including a property to the grandchildren;
- On Hilda's death, the trust capital was to be divided 25:75 between a charity and specified relatives.

Hilda died in October 2015 and her executors submitted the IHT account IHT400 and supporting schedules, which included a charitable donation of £29,063 and a claim for Business Property Relief on a holiday let included within the free estate;

In November 2016 HMRC commenced a review, looking initially at the Business Property Relief claim and the valuation of the shares and properties included as part of the estate.

Following this review, the executors decided that the original Will Trust had been incorrectly interpreted and they submitted revised IHT Forms, including IHT Form 430, claiming the reduced rate of IHT as they believed that at least 10% of Hilda's net estate had been left to charity. On the IHT Form 430 the executors elected to merge the Free Estate and the Will Trust and to claim the reduced IHT rate on both components.

HMRC understood that the executors believed that:

- under the terms of the Will Trust the 25% of the estate payable to charity should be computed by reference to the value of the property in the Will Trust as at the time of creation of the Trust, and not by reference to the residue after the appointments out during Hilda's lifetime.
- As these appointments from the trust had left insufficient funds in the trust to be able to discharge the 25% charitable payment requirement in her husband's will, the shortfall should be made from Hilda's Free Estate.
- The charitable contribution from the Trust should be recomputed by reference to the trust assets valued when created;
- As the recomputed charitable contribution would exceed 10% of both Free Estate and the Will Trust, the reduced rate of IHT should apply across both components in accordance with the election made in IHT Form 430.

HMRC disagreed and issued Determinations that effectively reinstated the original Form 400 position.

The Executor appealed challenging the entitlement to use the 36% tax rate and also the fact that HMRC denied the Business Property Relief claimed. On the latter, the executor sought to rely on two factors which he claims differentiated her property business, moving it into the non-investment category which were:

- Hilda's personal involvement in the business; and
- the fact that it was a kosher holiday let, aimed at a specific type of holidaymaker.

Decision

The First Tribunal noted that, had the executor been right and the charitable donation be based on the value of the Will Trust on its creation, the contribution to charity would be in the region of £250,000 and would amount to at least 10% of the combined Will Trust and Free Estate. This would result in the lower rate of IHT applying to the entire estate.

By contrast, HMRC argued that the terms of the husband's Will Trust provided for the charitable donation to be calculated as 25% of her husband's residuary estate when Hilda died, and so after the appointments out during lifetime. This would have depleted the residuary estate such that the charitable contribution of 25% would be around £29,000. As this would not amount to 10% of the combined Will Trust and Free Estate, the lower rate of IHT would not be available across the entire estate.

Consequently, the First Tier Tribunal stated that it needed to determine:

- the correct interpretation of the late husband's will as it applied to the charity donation;
- whether the appointments made to the grandchildren were advances in respect of their entitlement to the husband's ultimate residuary estate or were they absolute appointments of trust property at the time. If advances, the payments would not deplete the residuary estate, and the sum to the charity would be calculated by reference to the intact residuary property.

On the Will interpretation issue, the First Tier Tribunal found in HMC's favour. The Tribunal stated that on reading the terms of the Will, the late husband's residuary estate was to be applied during Hilda's lifetime by the Trustees as they saw fit and for the charitable donation to be determined by reference to what is left on her death. There was no requirement in her husband's Will to maintain the quantum of the contribution to charity. Further, as noted by the Tribunal, the donation actually made was computed by reference to the remainder of the Residuary Estate after the appointments, resulting in only £29,063 being approved and paid over by the executors. Why had this happened if the executors had expected the sum to be around £250,000?

As for the 'advances' argument, this too was rejected, with the Tribunal stating that the Will Trust made specific reference to 'appointments'; there was no mention of advances.

As a consequence, the First Tier Tribunal found that the lower 36% rate did not apply as the conditions had not been satisfied. The Tribunal accepted that the Trustees would not have taken the steps that they took had they understood the full IHT consequences of doing so, but this could have no impact on the outcome of their decision.

The Executor was no more successful in their claim for Business Property Relief. The Tribunal reminded us that:

- there is no statutory definition of what is meant by a business "wholly or mainly holding investments" for the purposes of Business Property Relief;
- each case is dependent on its own facts and an evaluative exercise must be carried out to determine the outcome.

Despite the claim that Hilda had been directly and personally involved in the running of the business, there was no 'material direct evidence of the way in which the business was operated' provided to the Tribunal, which included a lack of basic records that would typically be expected such as invoices and receipts or letting contracts and terms.

The Tribunal considered what activities had been undertaken by the deceased, but concluded there was nothing in this list that persuaded them that her business was anything other than one of mainly holding investments.

Some of the services provided were 'investment' related such as the steps taken to finding guests, letting them into the property, collecting the payments as well as expenditure on repairs and redecoration of the property.

The Tribunal commented that the provision of food could be a key non-investment service but no information as to how often guests would actually require it to be provided was supplied and the precise nature of the 'catering' service was also unclear.

The Tribunal reached the same conclusion on the Kosher related services. On the information available, the Kosher related services specified did not seem to be sufficient to alter what would otherwise be mainly a business of holding investments.

David Marks (Executor of Hilda Marks) V HMRC (TC09253)

IHT Deathbed scheme

Summary – Although an IHT avoidance scheme was ineffective, HMRC could not recover the loss as a certificate of discharge had previously been issued.

On 16 May 2011, Jennifer Fleet established The Jennifer Fleet Trust with initial capital of £20,000 and her sons, Luis and Nicholas Carvajal as the beneficiaries. Bourse Trustee Company Limited was the trustee.

To assist funding the trust, Havelet Finance Limited offered a £1.4 million term loan facility which could be drawn in one amount up to a month from acceptance. The facility required Jennifer Fleet to provide a personal guarantee and indemnity. The loan was repayable on demand and was also repayable on whichever was the earlier of the death of Jennifer Fleet or five years following the date on which it was drawn down. The fee charged by the lender was £20,000.

On 17 May 2011, having satisfied the conditions, the loan was drawn down and credited to the trustee's client deposit account, who immediately invested the money in Bonds, charging the bonds in favour of the lender and then seeking permission from the lender to distribute the Bonds to the trust beneficiaries. The lender gave permission, provided the beneficiaries "collateralised" the personal guarantee provided by their mother, which they did.

On 23 May 2011, having received guarantees and indemnities the trustees resolved to allocate the funds to the beneficiaries, which was reflected in the general ledger on that date showing the two capital distributions of £700,000 each. This left the trust with no assets.

Jennifer Fleet died the next day and the debt became repayable and in November 2011, Jennifer Fleet's £1.4 million guarantee appeared on her Form 400 as a liability, reducing her death estate to below her available nil rate band

In March 2015, Havelet Finance Limited issued a demand, which was addressed to the beneficiaries, rather than as executors of Mrs Fleet's estate, referring to the absence of assets within the estate and requesting that the son's settle the debt under the terms of their guarantees, which they duly did by paying £1,400,000 from the redemption of the Bonds. Havelet Finance Limited confirmed that the debt due by the trustee had been discharged in full.

The accountants for the estate applied for a certificate of discharge under s.239(2) IHTA 1984, which was issued by HMRC on 11 December 2018. In doing so, the executors did not populate section B of the IHT 30 form that related to IHT liabilities on lifetime transfers.

Later, having enquired into the case and unaware of the discharge certificate having been issued, HMRC stated that the scheme did not work and so raised determinations in June 2019 to collect the IHT due on the £1.4 million.

The executors appealed.

Decision

The First Tier Tribunal found that by implementing the tax planning, and providing the guarantee, Jennifer Fleet had not made a transfer of value. Consequently, the scheme was ineffective in reducing the value of her estate for IHT purposes.

However, with HMRC having issued the clearance certificate, which confirmed that no more IHT was due on her death, HMRC was prevented from clawing back the underpaid IHT.

HMRC argued that the execution of the guarantee had resulted in a chargeable lifetime transfer, which was not covered by the clearance certificate. However, the First Tier Tribunal rejected this. The scheme failed in its entirety as there was no lifetime transfer of value made by Jennifer Fleet on the execution of the guarantee.

The appeal was allowed.

Note: The Tribunal was clear that 'had the Respondents not issued the Clearance Certificate in error, and thereby debarred themselves from pursuing ... the transfer of value on death ... the Respondents would have succeeded in relation to the appeals.'

Luis and Nicholas Carvajal (Executors of Jennifer Elizabeth Fleet's Estate) v HMRC (TC09248)

Multiple dwellings relief claim

Summary – Despite two dwellings having common utilities and internal doors, they were found to be suitable as separate dwellings and multiple dwellings relief was allowed.

James Winfield acquired Gilboa Barn for £1.8 million on 16 December 2021.

On completion, the property comprised two "dwellings":

- Dwelling 1 had been unoccupied since completion, and consisted of a large bedroom, a snug/office, a bathroom, a large living/dining area, kitchen/utility room, downstairs toilet, office/storage room. It also had separate outside entrances.
- Dwelling 2, was where James Winfield's family currently lived; it had four bedrooms, two bathrooms, toilets, sitting room, dining room, kitchen/utility room, large hallway, and separate outside doors for access.

The electricity came into the back of Dwelling 1 but then split into two independent fuse boxes. Although there were two electricity meters, the electricity was billed to the property rather than the separate dwellings.

There was a single oil-fired boiler located at the same place as the fuse boxes which served both dwellings and provided hot water, and water for the central heating system for both dwellings. The boiler had a single timer and temperature setting for both dwellings. This too was billed to the property and not the dwellings separately.

Each dwelling had a separate water supply and stopcock, but the property had a single council tax account and postal address. Both dwellings are registered with the same title number with HM Land Registry and on purchase, the dwellings had been marketed as a single dwelling.

A letter from the previous owner indicated that at various times she had rented out one of the dwellings (and lived in the other), rented both dwellings out separately, and rented out the entire property.

James Winfield argued that property bought consisted of two separate dwellings, suitable for use as such and claimed multiple dwellings relief.

HMRC denied the claim, arguing that the property was a single dwelling, with a single council tax account and address, a lack of privacy and a lack of independent utilities.

James Winfield appealed.

Decision

The First Tier Tribunal adopted a multifactorial assessment, taking into account all of the facts and circumstances to consider whether the occupant's basic living needs were capable of being satisfied 'with a degree of privacy, self-sufficiency and security consistent with the concept of a single dwelling'.

On the privacy issue, the Tribunal commented that many rural developments involved barn conversions as well as other separate dwellings sited close together, often "around a single courtyard, where occupants of one dwelling can readily see into the rooms of another". Any perceived lack of privacy did not seem to matter to the buyers.

The First Tier Tribunal found that the internal doors provide adequate security between the properties as they were 'substantial, lockable, and ... soundproof and fireproof'.

The First Tier Tribunal did not consider the utility access to be an issue. Freehold owners are often subject to common right-of-way. If dwelling 1 were let, access would be on the basis of a proper legal agreement.

Looking at the overall picture, the First Tier Tribunal concluded that multiple dwellings relief did apply. The Tribunal stated:

“The physical configuration and attributes of each dwelling carries very considerable weight, and that is not, in our opinion, diminished by the common utilities or the state of the internal doors.”

Multiple dwellings relief was allowed.

James Winfield v HMRC (TC09259)

Automated notices and assessments

Summary – Automated notices and penalty assessments were validly issued. The effect of s.103 FA 2020 is that it is not necessary for HMRC to prove the involvement of an 'officer of HMRC' in the giving of a statutory notice or assessment.

Peter Marano was a US citizen who delayed reporting a very large capital gain, taxable on the remittance basis:

- In December 2012, his accountant had informed HMRC that he had remitted a chargeable gain, and that the CGT payable was estimated to be £5,744,219;
- On the same day, Peter Marano paid that tax so it could be claimed as a credit against his US tax liabilities;
- As this was part way through the 2012/13 tax year, HMRC had not yet issued any Self Assessment returns for that year.

On or after 6 April 2013, a notice to file a Self Assessment tax return for 2012/2013 was sent to Peter Marano at his last known residential address.

Having failed to file his return by 31 January 2014, HMRC issued a late filing penalty of £100, followed by a daily penalty and a six-month penalty.

In November 2014, HMRC issued a determination based on the amounts shown in Peter Marano's returns for earlier years and a late filing penalty based on that determination.

A second late filing penalty was issued on 3 March 2015.

In 2017, Mr Marano sought to file a tax return which was too late to be assessed but which enabled HMRC to calculate and issue a discovery assessment on 8 March 2017 for £5,744,219.

On 14 March 2017, HMRC also issued a late filing penalty for £574,422 made up of a six-month 5% tax-gated late filing penalty of £287,211 and a twelve-month late filing penalty of the same amount

Before the Court of Appeal, Mr Marano challenged the validity of the notice and the penalty assessments on the basis that their issuance had not involved an officer of HMRC.

S.103 FA 2020 provides that anything capable of being done by an officer of HMRC can be done by 'HMRC'.

Mr Marano argued that s.103 FA 2020 required that statutory notices and penalty assessments required the involvement of an officer of HMRC and not the wider body or department of HMRC. These could not be automated.

HMRC argued that the Peter Murano's interpretation of s.103 FA 2020 was too narrow and that the term 'HMRC' should be taken to mean the wider body or department of HMRC itself.

Decision

The Court of Appeal dismissed Peter Marano's appeal, holding that s.103 FA 2020 makes a distinction between an officer of HMRC and the body or department of HMRC itself. It allows decisions and acts of officers of HMRC to be undertaken by the body or department of HMRC.

This meant that s.103 FA 2020 does not require HMRC to prove that an individual officer, or an officer of a particular type or status, carried out the initial decision-making process involved in issuing the Notice and penalty assessments.

Automated notices and penalty assessments had been not validly issued

Peter Marano v HMRC [2024] EWCA Civ 876