capacity fully to understand a complicated transaction during this period. Christopher Nugee accepted this evidence saying:[14]

> 'In terms of the test in *Re Beaney*, it seems to me that Mr Sutton not only needed to be capable of understanding that he was giving away his house to his son, but that the effect of this would be to deprive himself and his wife (in the event of his predeceasing her) of any entitlement to the house or legal right to stay there.'

Proof of lack of capacity

1.11 Section 1(1) of MCA 2005 provides that for the purposes of that Act a person must be assumed to have capacity unless it is established that he lacks capacity. If the evidence is that a person would only have understood the nature of the transaction if he had had it carefully explained to him then, unless, it can be demonstrated that on the balance of probabilities, there had been such an explanation, the gift will fail. In *Williams v Williams*,[15] the judge found that the solicitor dealing with the transfer of a house into joint names by a man with severe learning difficulties was unaware that the man could not read and unaware of the extent of his disability. Accordingly he held that the transaction was void for lack of capacity because the man had not received the kind of explanation which he needed.

Gifts on behalf of persons lacking capacity

1.12 Attorneys and deputies have power to make limited gifts on behalf of persons who lack capacity.[16] These powers do not include power to make gifts for tax planning purposes. Where a deputy or attorney wishes to make gifts for such purposes, they must make an application to the Court of Protection for authorisation. The Court will make the decision in the best interests of the person who lacks capacity. In an appropriate case, it may authorise the gift of a property as being for the benefit of an incapacitated person where the sole motivation is IHT mitigation. However, it would have to be clear that there were substantial surplus assets.[17]

3. VOID OR VOIDABLE?

1.13 Where a person makes a gift which is later declared invalid as a result of lack of capacity there is some uncertainty as to whether the gift is void or voidable.

In *Sutton v Sutton*[18] the parties had asked for a declaration that the effect of lack of capacity was to render the transaction void as opposed to merely

[14] At [27].
[15] *Williams v Williams* [2003] EWHC 742 (Ch); [2003] WTLR 1371.
[16] See Chapter 2.
[17] An example of such a situation, albeit one that arose under the pre-MCA 2005 legislation, is *Re C (a Patient* [1997] 1 FCR 501.
[18] [2009] EWHC 2576 (Ch).

voidable. This was because they feared adverse tax consequences if the transaction was merely voidable. Christopher Nugee QC sitting as a deputy judge said he doubted whether it would make any difference at all. From an inheritance tax point of view the property would be treated as if it had never left Mr Sutton's estate and would therefore be comprised in his estate at the date of his death.[19] So far as capital gains tax (CGT) was concerned, he thought it would follow from the transfer being set aside that the son would have acquired nothing under the transfer (save for the bare legal title) so that there was unlikely to be any charge to CGT.

1.14 Nevertheless, he reviewed the authorities and concluded that the position was unclear. He made the following points:

(a) in *Re Beaney*[20] the judge said:

> 'The facts of the present case make it unnecessary for me to consider whether that distinction [void or voidable] could be material in the case of a voluntary disposition, and I express no view on that point.'

(b) in *Special Trustees for Great Ormond Street Hospital for Children v Rushin*[21] the agreement was in the form of a contract not a gift. While Rimer J proceeded on the basis that lack of capacity makes a gift void, the main part of his judgment related to incapacity in relation to a contract where, at most, it makes the contract voidable. His judgment cannot fairly be regarded as a considered decision reached after argument that incapacity renders a gift void rather than voidable;

(c) in *Williams v Williams*,[22] Kevin Garnett QC held that the gift was void. However, he based his decision on *Re Beaney* and *The Special Trustees for Great Ormond Street Hospital for Children v Rushin* neither of which are really authorities for that point;

(d) a similar approach was taken by Warren J in *Qutb v Hussain*,[23] where an elderly and suggestible woman gave £80,000 by deed of gift to the defendant and transferred her house to him. Warren J found that she lacked capacity. He said that there had been no argument that such a gift is rendered voidable rather than void, nor had there been any suggestion that the decisions in *Re Beaney* and *Special Trustees for Great Ormond Street Hospital for Children v Rushin* were wrong. He, therefore, proceeded on the basis that a gift would be rendered void as a result of the lack of capacity of the donor.

Christopher Nugee QC therefore concluded:[24]

[19] See Inheritance Tax Act 1984 (IHTA 1984), s 150 in the case of voidable transfers.
[20] [1978] 2 All ER 595 (at 774B).
[21] [2001] WTLR 1137.
[22] [2003] EWHC 742 (Ch).
[23] [2005] EWHC 157 (Ch).
[24] At [39].

(b) resolutions which include deliberations and arguments pertaining to decisions; and

(c) trustee correspondence and memoranda.

8.04 It is of course the latter type of document which is likely to contain evidence of a breach of trust; for example:

(a) failure to understand and act on the terms of the trust (eg investment decisions taken in ignorance of the width of powers);

(b) failure to act honestly in the best interests of beneficiaries (disclosure of non-trust motives such as loyalty to the settlor);

(c) malice; or

(d) lack of even-handedness.

The justification for the restrictions in the *Londonderry* decision appears to rest on the bald assertion that the job of a trustee would be impossible if the rule were otherwise.

8.05 It appeared from the *Londonderry* decision that beneficiaries who did not have fixed, assignable interests (for example, members of a discretionary class of beneficiaries) had no rights to see any trust documents.

2. THE *ROSEWOOD* CASE

8.06 In *Schmidt v Rosewood Trust*[2] (an appeal to the Privy Council from the Isle of Man) the claimant was strictly no more than the object of a power. Lord Walker giving the opinion of the board held that the right to seek disclosure of documents was one aspect of the court's inherent jurisdiction to supervise and, if necessary, intervene in the administration of trusts. There was no authority for the proposition that the right to seek the court's intervention depended on entitlement to a fixed and transmissible beneficial entitlement.

Lord Walker concluded that 'no beneficiary has any entitlement as of right to disclosure of anything which could plausibly be described as a trust document'. The court's jurisdiction is discretionary and its role should be to conduct a balancing exercise weighing the competing interests of different beneficiaries, the trustees and third parties.

The outcome was that the Privy Council remitted the case to the Isle of Man for reconsideration on that basis.

8.07 This ruling has a potentially radical impact on this area of law. In particular it makes clear that:

[2] [2003] 2 WLR 1442.

(a) the right to disclosure does not depend on having a fixed interest in a settlement – a member of a discretionary class or object of a power may be entitled to disclosure;

(b) the distinction between trust documents and other documents is weakened; and

(c) the test for whether a document will be ordered to be disclosed should be whether such disclosure will be conducive to the proper administration of the trust.

On the face of it the decision appears to offer the hope of obtaining disclosure to a wider class of beneficiaries over a larger range of documents. On the other hand some of the certainties which beneficiaries appeared to enjoy under the *Londonderry* rules have been dissolved by the more pragmatic nature of the *Schmidt* test.[3]

8.08 A recent decision on disclosure which went in favour of the claimant was that in *Stuart-Hutcheson v Spread Trustee Co*.[4] The Guernsey Court of Appeal allowed as a matter of principle an appeal against a first instance decision refusing disclosure. The claimant was a discretionary beneficiary and the first instance court had based itself on section 22 of the Trusts (Guernsey) Law 1989, which appears not to confer rights on such class. The Court of Appeal held that section 22 did not codify the whole of the law but sought to set out principles broadly reflecting English law. It 'imposed a duty on trustees to provide full and accurate information as to the state and amount of the trust property'.

Evidence from the law reports suggests that courts around the world are exercising their newly recognised inherent power (see eg *Foreman v Kingstone*,[5] *Alhamrai v Russa Management Ltd*[6] and *Broere v Mourant & Co*).[7] If this trend is maintained *Schmidt* would appear to signal a significant shift in favour of beneficiaries.

[3] For an incisive article on the pros and cons for the parties of this development see le Poidevin in *Trust Quarterly Review*, Edition 3.

[4] *Stuart-Hutcheson v Spread Trustee Co* 5 ITELR 140.

[5] *Foreman v Kingstone* (2003–04) 6 ITELR 841 (New Zealand).

[6] *Alhamrai v Russa Management Ltd* (2004–05) 7 ITELR 308 (Jersey).

[7] *Broere v Mourant & Co*) [2004] WTLR 1417 (Jersey).

> 'a power or authority enabling the person by whom it is exercisable to appoint or dispose of property as he sees fit.'[25]

(b) because the original owner has not been excluded from all or virtually all benefit, the reservation of benefit rules apply.

10.15 In such a case the transferee may argue that the intention was to create a tenancy in common of the whole account, so that there was an initial absolute gift of one-half of the balance. Either party would then be entitled to withdraw one-half and would have to account to the other for any excess withdrawals. In such a case IHTA 1984, s 5(2) would not be in point. The reservation of benefit rules would not apply either as possession and enjoyment of one-half of the account would pass wholly to the transferee. Such an arrangement is possible but it would be necessary to demonstrate an accounting mechanism for keeping track of withdrawals.[26]

10.16 Taxpayers have had little success arguing for a tenancy in common as they have been unable to show any such mechanisms. In *Sillars v IRC*,[27] a mother had put an account into joint names with her two daughters. The Revenue claimed that the whole account was included in her estate at death. The taxpayers argued, unsuccessfully for a tenancy in common. The special commissioner, Dr Avery Jones said:

> 'That would have required accounts to be kept of who owned the funds and would have required an understanding by the parties, which is lacking, of how deposits and withdrawals were dealt with.'

10.17 In *Matthews v HMRC*,[28] an elderly lady put money inherited from her husband into joint names with her son. David Demack J rejected the argument for a tenancy in common saying:

> 'The account being one for mother and son. I should not have expected the parties to have kept records showing who owned the funds, and what arrangements were in place for withdrawals from it. However, I should have expected Mr Matthews to have been able to explain what understanding existed between him and his mother as to how deposits and withdrawals were to be dealt with. In the event, it appeared from his evidence that they were matters that had not been considered or, if they had been considered, the consideration had been at a most superficial level, and had reached no conclusion.'

[25] Note that where IHTA 1984, s 5(2) applies more than one person may be treated as entitled to the whole account for inheritance tax purposes.

[26] See *Sillars and Deeprose v IRC* [2004] STC (SCD) 180; *Matthews v HMRC* [2012] UKFTT 658 (TC) where the taxpayers advanced these arguments but were unsuccessful because there was no evidence of any such agreement or accounting mechanism.

[27] *Sillars and Deeprose v IRC* [2004] STC (SCD) 180.

[28] *Matthews v HMRC* [2012] UKFTT 658 (TC).

In *Matthews*,[29] the taxpayer was not helped by the IHT 400 which had been submitted on the basis that half of the account had passed by survivorship. David Demack J said:

> 'I have most carefully reflected on the evidence relating to Mr Lundie's claim in the latter behalf, and observe that it is inconsistent with the inheritance tax return which clearly states that one–half of the balance on the account at date of death passed (beneficially) by survivorship.'

10.18 Practical points arising from these cases are that any taxpayers intending to claim a tenancy in common after a transfer into joint names ought to draw up a written agreement dealing with accounting for withdrawals (much easier if the account consists of a one-off payment than if it is fed with income on an ongoing basis). They also need to decide on their arguments before submitting the IHT 400 to ensure that their arguments are consistent.[30]

Double taxation?

10.19 In *Sillars*,[31] the taxpayer argued that IHTA 1984, s 5(2) could not have the result the Revenue contended as it would produce the illogical result that two or more people could be treated as having a general power over the same account and be taxed on the whole account. Dr Avery Jones did not rule this out saying:

> 'Whether or not s 5(2) can produce cases of double taxation does not arise in this appeal and on the facts found this is not a case where double taxation could arise. I do not consider that the appellants had any such general power.'

Gifts from joint accounts

10.20 Where one account holder dies within 7 years of a gift from the joint account, it will be necessary to decide whether the gift was made equally by the account holders or solely by one. This is a question of intention.

If the account is in joint names for reasons only of administrative convenience, the gift will be made by the original owner of the account irrespective of who withdraws the funds.

Similarly if the intention of the person putting the account into joint names (A) was to pass to the joint owner (B) only what was left in the account at the date of the death, any gifts made before that date will be made by A.

[29] *Matthews v HMRC* [2012] UKFTT 658 (TC).

[30] For a similar problem with an IHT Account see *Hanson v HMRC* [2012] UKFTT 95 (TC), where an attempt to claim an interest in a house under a constructive trust failed because the claimant, who was also the executor, had submitted an account describing the property as owned beneficially by the deceased.

[31] *Sillars and Deeprose v IRC* [2004] STC (SCD) 180.

"In *Nichols* the lease contained a full repairing covenant by the donee. The right to have his property repaired at the donee's expense was held to be a benefit which the donor did not enjoy before."'

12.23 Other points from the decision should be noted:

(a) which limb of s 102(1)(b) is relevant?

'... in the present case it has not been made entirely clear (and it is not common ground) whether the case is said to come within the first or the second limb of s. 102(1)(b), namely whether the gifted property is said not to have been enjoyed to the exclusion of the donor or whether it is said that there is a benefit to the donor by contract or otherwise. It seems to me that potentially it is both.

...

The covenants must logically either be comprised in the property retained or in the property given away. In this case ... the covenants were an integral part of the relationship between Mrs Kamhi and the trustee rather than some incidental benefit which was only tangentially referable to the gift.'

(b) did the deceased receive any benefit from the covenants?

'It was submitted that it is primarily for the benefit of the undertenant that it should perform the covenants in the head lease. This is so that it can enjoy the sub-demised rights without a forfeiture, and thus that it can deliver up the property at the end of the term in accordance with its obligation to do so.

I find this to be a false premise since the donor could in theory undertake the sole obligation to comply with the obligations in the head lease. The fact that, without negotiation, the donor could not do so without contravening the terms of her head lease is in my view irrelevant.

Although it is common ground that benefit falls to be construed widely, it must be precisely identified. The First-tier Tribunal did specify the relevant benefit, namely the benefit to Mrs Kamhi of the trustee owing her covenants mirroring the covenants which she owed under the head lease: see paragraph 73 of the decision. This in my judgment reflects Millett LJ's analysis in the Court of Appeal in Ingram referred to above.'

(c) did it matter that the covenants did not reduce the value of the gift (ie that they were for full consideration)?

'... it is not necessary that a reservation of benefit under s. 102 should diminish the value of the gift. ... it is irrelevant whether full consideration has been given for the reservation of benefit:

"If he has not been so excluded, the eye need look no further to see whether his non-exclusion has been advantageous or otherwise to the donee."'[35]

(d) the equivalent covenants would not be implied into the underlease as a matter of law if they had not been expressly included.

A hard case

12.24 The effect of the decision is that the gratuitous grant of an underlease will inevitably involve a reservation of benefit by the grantor given that he will be obliged to include covenants mirroring those in the headlease. Of course, the majority of reversionary lease arrangements involve carving a lease out of the freehold interest and so the problem will not arise provided that the landlord does not retain beneficial covenants.[36] At the time of writing the decision is under appeal.

There are cases where, even after the anti-*Ingram* legislation in 1999, a reversionary lease can be created without falling foul of the reservation of benefit rules.[37] However, in such cases the POAT charge will apply.[38]

10. SHEARING TODAY[39]

12.25 The following illustrates situations where shearing operations may be attractive in IHT planning.

Example 12.11

(1) Dan is a controlling shareholder and managing director of Dan Limited. He wishes to give his shares to his children but to continue to receive profits from the company in the form of directors' remuneration.
Analysis: the gift of the shares and the continuation of the payment of remuneration could be viewed as a reservation of benefit by means of collateral arrangements. It appears unlikely, however, that the benefit is directly reserved in the gifted property, namely the shares. The Revenue have stated that the continuation of:
'reasonable commercial arrangements in the form of remuneration of the donor's ongoing services to the company entered into before the →

[35] *Chick v Commissioner of Stamp Duties* [1958] AC 435 at 449.
[36] Commercially this is, of course, a nonsense given that the tenant will come to enjoy a long lease equivalent to ownership of the property.
[37] See FA 1986, s102A(3), (5).
[38] FA 2004, Sch 15, paras (3)–(5). Reversionary leases may be attractive when the property is let and the owner wants to keep the rent for (say) 20 years.
[39] For the possible impact of GAAR, see **17.06** et seq.

(a) *under TCGA 1992, s 165*: gains can normally be held over on a gift or transfer of business assets to an individual or a trust, but not on a transfer of shares or securities to a company;

(b) *under TCGA 1992, s 260*: gains can normally be held over where the transfer is a chargeable transfer for IHT purposes. So, after 22 March 2006, lifetime transfers into settlements other than those for the disabled can qualify for hold-over relief,[38] as they are not potentially exempt transfers. So too can capital distributions out of a relevant property trust.

Example 14.6

(1) Jim gives his baker's business to his son Jack in 2013. For CGT purposes any gain resulting from this gift of chargeable business assets may be held over on the joint election of Jim and Jack.

(2) Zac settles his ironmonger's business on trust for his grandson Abe absolutely contingent on becoming 30 (Abe is aged 10). As in (1) above, s 165 will apply: however, in this case only Zac need elect. When the trust ends on Abe becoming absolutely entitled to the business, a further hold-over election may then be made by the trustees and Abe to postpone payment of tax which would otherwise arise under TCGA 1992, s 71.

(3) Olivia is the sole shareholder and director of an unlisted fashion company and owns the freehold property used by the company. She gives away her shares to her four daughters equally and the freehold to her son. Section 165 relief is available to postpone tax on all five gifts. The gift of the freehold qualifies for relief because the company is Olivia's personal company.

Non-residents

14.17 CGT is charged only on individuals who are resident or ordinarily resident in the UK, so it used to be possible for taxpayers to avoid the tax by moving abroad and making the disposal in a tax year in which they were neither resident nor ordinarily resident in the UK. However, TCGA 1992, s 10A[39] now provides that an individual who leaves the UK is liable to CGT on realising assets owned before departure if:

(a) he has been resident or ordinarily resident in the UK for any part of at least 4 out of the 7 years before departure; and

(b) he becomes non-resident and not ordinarily resident for a period of less than 5 years.

[38] Provided that the trust is not settlor-interested: see further Chapter 19.

[39] Added by FA 1998, s 27.

An individual who has been resident in the UK for 4 of the previous 7 years must therefore be prepared to become non-resident for at least 5 years to take advantage of the exemption. If the individual does move abroad, he should delay the disposal until the tax year following his departure.

14.18 HMRC guidance on residence and ordinary residence was, before 6 April 2013, contained in its booklet HMRC6 (2010) Residence, Domicile and the Remittance Basis[40] which replaced the earlier guidance contained in IR20 Residents and Non-residents – liability to tax in the UK. In *R (on the application of Davies and another) v RCC; R (on the application of Gaines-Cooper) v RCC*[41] the Supreme Court considered a claim from taxpayers that the Revenue had failed to interpret IR20 correctly and had unlawfully refused to apply it. Although the taxpayers were unsuccessful in their contention, the Court did accept that, where the Revenue had issued clear statements, it would be bound by those statements until it issued fresh guidance. From 6 April 2013 a statutory residence test has been in force.[42]

7. DEATH AND CGT

14.19 Death is not a disposal by the deceased to his personal representatives and there is therefore no charge to CGT. Instead, the personal representatives are deemed to acquire the deceased's assets at the date of his death at market value.[43] Where assets have increased in value since acquisition, this 'death uplift' may save a considerable amount of tax. If personal representatives sell property of the estate, the chargeable gain is calculated by deducting from the sale price the deemed acquisition cost at death and any allowable subsequent expenditure and disposal costs incurred by the personal representatives.

Example 14.7

Riki dies on 6 April 2013 owning a first edition of Fitzgerald's *Great Gatsby* valued at £100,000.

(1) Riki's PRs acquire the book at its market value on 6 April 2013 (ie at a value of £100,000).[44]

(2) Were the PRs to sell the book for £125,000 in June 2014, their gain would be calculated by deducting from the sale consideration incidental costs of sale (eg if sold by auction, the fees charged by the →

[40] There were only a few statutory provisions dealing with residence: see ITA 2007, ss 820–832.

[41] [2011] UKSC 47.

[42] FA 2013, s 218 and Sch 45.

[43] TCGA 1992, s 62(1). For when the uplift is available in the case of settled property, see Chapter 15.

[44] See TCGA 1992, s 274: when the value is 'ascertained' for IHT purposes (as will be the case if the estate is taxable at 40%) that ascertained value will be the CGT market value.

the case of freehold or leasehold land, requires the donee to notify HMRC on Form SDLT1[65] and, where relevant, pay the tax calculated at the relevant rate.

16.31 Note, however, that where the land is gifted by means of an assent or appropriation under a will or on intestacy, the fact that the land is gifted subject to a debt secured on the property does not mean that tax is payable by reference to the value of the debt assumed: such a debt is ignored and the gift remains exempt from stamp duty land tax.[66]

Where a gift of land is made to a company and the donor is a person connected to that company the transaction is treated as taking place at market value at the effective date of the gift[67] with the consequence that the company must, in the case of a gift of a commercial freehold or lease, notify HMRC by means of an LTR (Form SDLT1) irrespective of whether there is any tax to pay.[68] For this purpose the deemed market value rules override the exemption in Sch 3 to FA 2003.[69]

16.32 Gifts can give rise to other tax charges (eg to IHT and CGT) and it is not uncommon for the terms of a gift to include an indemnity in respect of tax liabilities in favour of the donor. Such an indemnity is clearly of value to the donor or the donor's estate, and consequently can, in certain circumstances, be treated as money's worth, and thus as chargeable consideration, for stamp duty land tax purposes. Until 12 April 2006 an indemnity given to a donor, or to the donor's estate, in respect of capital gains tax or inheritance tax on a gift or bequest of land could have given rise to a charge to stamp duty land tax.[70] However, on or after 12 April 2006, in relation to gifts or dispositions of land under a will or on intestacy, any indemnity, agreement to pay or actual payment of inheritance tax by the donee will not be treated as chargeable consideration.[71] And for gifts of land that are capital assets on or after 12 April 2006, any liability for capital gains tax falling on the donee or any payment of capital gains tax by the donee is not be treated as chargeable consideration.[72]

Limiting stamp duty to instruments relating to stock or marketable securities

16.33 With the introduction of stamp duty land tax, stamp duty was limited to 'instruments relating to stock or marketable securities'. Further, for instruments gifting stock or marketable securities on or after 13 March 2008 there is neither

[65] Ie requires a land transaction return made on HMRC Form SDLT1.
[66] FA 2003, Sch 3, para 3A (assents and appropriations by personal representatives).
[67] FA 2003, s 53 as amended.
[68] FA 2003, s 77(3).
[69] FA 2003, s 53(4).
[70] Ie under FA 2003, Sch 4, para 1.
[71] See FA 2003, Sch 4, para 16A as inserted by SI 2006/875.
[72] FA 2003, Sch 4, para 16B as inserted by SI 2006/875.

ad valorem nor a fixed-rate duty to pay.[73] This means that the stock transfer form, which is required to effect a gift of shares, need no longer include a certificate that the transfer is a voluntary arrangement falling within category 'L' in the Schedule to the Stamp Duty (Exempt Instruments) Regulations 1987.

It should be noted that there is no charge to stamp duty reserve tax on a gift of stock or marketable securities because that tax only applies where the agreement to transfer is made for a consideration of money or money's worth.[74]

3. VAT

16.34 VAT is rarely considered in the context of the gift of assets, not least because VAT cannot be charged unless there is a supply of either goods or services in the course or furtherance of a business,[75] and there is no supply if there is no consideration.[76] As a result, a gift of goods or services, being a transaction carried out for no consideration, does not fall within the VAT regime. If, however, the transaction takes the form of a gift but in reality the terms of the gift are such that consideration is given (such as an indemnity), the value of the consideration will mean that this is a supply for VAT purposes. For instance, the gift of a mortgaged property made subject to that mortgage is a supply for consideration because the donee is assuming the outstanding mortgage. The VAT charged is calculated on the value of the outstanding mortgage.

16.35 Even if a transaction is on its face a gift, the VAT legislation can impose VAT on the open market value where goods forming part of a business are disposed of out of the business for no consideration.[77] Equally, VAT may also be chargeable where goods forming part of the assets of a business are transferred or made available for a private purpose even if for no consideration.[78] Prima facie, VAT has to be charged on the gift if the supply is standard-rated rather than exempt or zero-rated: for instance, when the gift is of land over which the option to tax has been exercised, or is of a new commercial building.

[73] As a result of the repeal of FA 1999, Sch 13, para 16 by FA 2008, s 99(1), Sch 32, paras 9, 10(1), (3)(a).
[74] See FA 1986, s 87(1) as amended.
[75] See Value Added Tax Act 1994 (VATA 1994), s 4.
[76] See VATA 1994, s 5(2)(a).
[77] See VATA 1994, s 19, Sch 6, para 6(1)(b).
[78] See VATA 1994, Sch 4, para 5 as amended. VATA 1994, Sch 4, para 9 makes it clear that land or buildings are goods for these purposes. VATA 1994, s 19, Sch 6 as amended provides that in such circumstances, the value of the supply on which VAT must be calculated is the price which the donor would have to pay to acquire the goods concerned.

17.53 A promoter must also notify notifiable arrangements within 5 business days of first becoming aware of any transaction forming part of notifiable arrangements, unless they implement a proposal already notified.[60]

Exemption for substantially the same scheme[61]

17.54 A promoter is required to disclose the same scheme only once (except for certain stamp duty land tax schemes).[62] Minor changes, for example to suit the requirements of different clients, need not be separately disclosed providing the revised proposal remains substantially the same.

What constitutes a change in a scheme or arrangement so that it is no longer substantially the same is a matter which will need to be considered on each occasion. HMRC say in the DOTAS guidance[63] that in their view a scheme is no longer substantially the same if the effect of any change would be to make any previous disclosure misleading in relation to the second (or subsequent) client. In general, provided the tax analysis is substantially the same, HMRC will regard schemes as 'substantially the same' where the only change is a different client including a different company in the same group.

17.55 A client who is required to disclose[64] must do so within the period of 5 days beginning on the day after that on which the person enters into the first transaction forming part of the notifiable arrangements.

17.56 Where a scheme has no promoter (including 'in-house' schemes), the user must disclose within 30 days of entering into the first transaction forming part of the scheme (weekends, bank holidays, Good Friday and Christmas Day are included for the purposes of determining the due date).[65]

Procedure

17.57 There are four different forms available for use in the following circumstances:

AAG 1 – Notification of scheme by promoter;

AAG 2 – Notification by scheme user where offshore promoter does not notify;

AAG 3 – Notification by scheme user where no promoter, or promoted by lawyer unable to make full notification; and

[60] FA 2004, s 308(3).
[61] FA 2004, s 308(5).
[62] See para 12.2.4 of DOTAS Guidance with effect from1 November 2012.
[63] See para 12.2.3 of DOTAS Guidance with effect from1 November 2012.
[64] Where there is no UK promoter: see FA 2004, s 309. The same period applies where the promoter is a lawyer and legal professional privilege prevents him from providing all or part of the prescribed information to HMRC.
[65] FA 2004, s 310 and SI 2012/1836, regs 5(8) and 2(3)).

AAG 5 – Continuation sheet.

Use of the forms is a legal requirement. When notifying HMRC of the existence of an arrangement, sufficient information must be provided to enable them to understand how the expected tax advantage is intended to arise. The explanation should be in straightforward terms and should identify the steps involved and the relevant UK tax law. Common technical or legal terms and concepts need not be explained in depth.

17.58 HMRC has 30 days from notification by the promoter in which to provide the promoter with a reference number for the scheme. The promoter must then notify the scheme reference number to the client[66] within 30 days of the later of the date:

(a) when the promoter first becomes aware of any transaction forming part of the notifiable arrangements; or
(b) on which the reference number is notified to the promoter by HMRC.

17.59 Users of schemes which have been notified to HMRC by the promoter, must include the scheme reference number in the relevant tax return[67] or Form AAG4.

The number must be entered on the return that relates to the year of assessment, tax year, accounting period or earnings period (as the case may be) in which the user first enters into a transaction forming part of the scheme, unless one of the following applies when Form AAG4 is used:

(a) the user is an employer of an employee, by reason of whose employment a tax or NI contribution advantage is expected to arise;
(b) the user expects to obtain a tax or NI contribution advantage but does not have a return on which to enter the information;
(c) the user is late submitting the return for the relevant period such that it will not be submitted to HMRC before the statutory filing date;
(d) the user has submitted the return for the relevant period but has not included the information in it;
(e) the user needs to notify more scheme reference numbers than there are spaces on the return; or
(f) the scheme gives rise to a claim to relief made separately from a return under s 261B of TCGA 1992 (treating trade loss etc as CGT loss) or any of the various loss relief provisions within Part 4 of ITA 2007. In these circumstances the scheme reference number must also be included on the income tax or corporation tax return affected by the use of the scheme.

[66] Using Form AAG6.
[67] FA 2004, s 313.

(ii) the trading company or holding company is the transferor's personal company.'

Agricultural property qualifying (or which would qualify on a chargeable transfer being made) for agricultural property relief at either 100% or 50% is specifically treated as a business asset for these purposes.[12]

19.12 The election must be made on the prescribed form within 4 years from the end of the tax year in which the disposal occurred.[13] The effect of making the election is that the consideration for the disposal and the acquisition costs of the trustees is reduced by the amount of the held-over gain.[14]

19.13 A subsequent sale of the property by the trustees may, of course, result in the held-over gain becoming chargeable.

Example 19.2

(1) In 2005, Francis settled a Durer etching worth £500,000 on a life interest trust for his sister, Greta, remainder to his brother, Gerd. He elected to hold over a gain of £150,000:
   (a) *if the trustees sell the picture* for £600,000, a CGT charge on a gain of £250,000 will arise (this gain comprising the held-over gain of £150,000 along with the gain realised during the trustees' period of ownership of £100,000);
   (b) *if the picture remains unsold on Greta's death*, the normal CGT uplift in value rule is modified and only applies to the gain arising since the creation of the settlement.[15] The held-over gain of £150,000 is chargeable although, given that an IHT charge will arise on Greta's death, a further hold-over claim may be made.[16]

(2) In 2009,[17] Silus set up a relevant property trust for his siblings holding over the chargeable gain. In 2012 the trustees appoint all the settled property to his brother, Siegfried, absolutely. A further hold-over claim may be made (by the trustees and Siegfried).

[12] TCGA 1992, Sch 7, para 1.
[13] Taxes Management Act 1970 (TMA 1970), s 43. Use Form IR295 (Relief for Gifts and Similar Transactions).
[14] The relief is also available for sales at undervalue when it is the balance of any gain which is held over.
[15] TCGA 1992, s 75. Because the settlement was set up before 22 March 2006, Greta enjoyed a qualifying interest in possession.
[16] Under TCGA 1992, s 260.
[17] The settlement (whatever its form) will be taxed under the relevant property regime and Silus will make an IHT chargeable transfer when he creates the settlement.

Settlor-interested trusts

19.14 A major restriction on the relief is that it is not available for a gift into a settlor-interested trust. A settlor has an interest for these purposes, not only if he enjoys an interest but also if 'an arrangement subsists under which such an interest will or may be acquired by a settlor'.[18] An interest for these purposes exists if:[19]

> 'any property which is or may at any time be comprised in the settlement or any derived property is, or will or may become, payable to or applicable for the benefit of the [settlor] or his spouse or civil partner in any circumstances whatsoever.'

The definition was extended in 2006 to include: 'a child of the [settlor] at a time when that child is a dependent child of his.'

A 'dependent child' means a child under the age of 18 who is unmarried and does not have a civil partner and 'child' includes a stepchild.[20] These restrictions apply to hold-over relief under both s 165 and s 260.[21]

Example 19.3

Alan transfers two investment properties, both commercially let, into a relevant property trust in June 2011. Even if the trust is interest in possession for his daughter, provided that the daughter is adult and that the settlor and his wife (civil partner) and any living minor children are excluded from benefit, hold-over relief is available because Alan has made a chargeable transfer for IHT purposes. Alan will have to pay inheritance tax at 20% to the extent the value of the investment property exceeds his available nil rate. If the value is within his nil rate band, no IHT is payable but hold-over relief is still available because the transfer is chargeable to IHT albeit at 0%.

If, however, Alan's daughter is a minor dependent child, hold-over relief is not available. Accordingly, if Alan wants her to benefit while still a minor he would have to pay any capital gains tax due on the making of the settlement. He will also have to pay inheritance tax at 20% to the extent the value of the investment property exceeds his available nil rate band. No deduction is given to Alan for one tax against the other.[22]

[18] TCGA 1992, s 169B(2). Note also the clawback charge if a settlement becomes settlor-interested in the 'clawback' period which is 6 years from the end of the tax year of disposal: see s 169C.
[19] TCGA 1992, s 169F(2). Note subsection (3) which applies if a benefit is actually enjoyed by the settlor etc (e g a loan or rent-free occupation of a property).
[20] TCGA 1992, s 169F(3A)–(4A).
[21] See s 260(1).
[22] Although IHT is not charged on the CGT paid by the transferor as it is not treated as a loss to

Court of Appeal of Victoria has held that mistake certainly comprehends 'a mistaken belief arising from inadvertence to or ignorance of a specific fact or legal requirement.'

In *Lady Hood of Avalon v Mackinnon*,[92] the plaintiff forgot that she had made a gift to her elder daughter and, seeking to achieve equality between the children, made a subsequent gift to her. This was set aside on the basis of mistake with Eve J commenting:

> 'Having regard to the facts which I have stated, I must assume that Lady Hood, intending only to bring about equality between her daughters, was labouring under a mistake when she thought that equality would be brought about by the execution of the deed appointing £8,600 to her elder daughter. It was obviously a mistake, because the effect of the execution of that deed was to bring about that which Lady Hood never intended and never contemplated.'

20.52 It does not matter that the person making the mistake was careless, unless he must be taken to have deliberately run the risk of being wrong. A unilateral mistake (without the need for fraud or misrepresentation) suffices.[93]

When mistake makes a transaction voidable

20.53 The distinction drawn in *Gibbon v Mitchell* between effects and consequences had been much criticised and, the Supreme Court concluded, had left the law in a state of uncertainty. It was also 'contrary to the general disinclination of equity to insist on rigid classifications expressed in abstract terms'.[94] Accordingly the Supreme Court determined that the correct test for mistake was that set out by Lindley LJ (see **20.47**): ie the gravity of the mistake has to be assessed in terms of injustice ('unconscionableness'). This must be evaluated objectively:[95]

> 'The gravity of the mistake must be assessed by a close examination of the facts, whether or not they are tested by cross-examination, including the circumstances of the mistake and its consequences for the person who made the vitiated disposition. Other findings of fact may also have to be made in relation to change of position or other matters relevant to the exercise of the court's discretion ...
>
> The court cannot decide the issue of what is unconscionable by an elaborate set of rules. It must consider in the round the existence of a distinct mistake (as compared with total ignorance or disappointed expectations), its degree of centrality to the transaction in question and the seriousness of its consequences, and make an evaluative judgment whether it would be unconscionable, or unjust, to leave the mistake uncorrected. The court may and must form a judgment about the justice of the case.'

[92] [1909] 1 Ch 476.
[93] Contrast the added requirements if a contract is to be set aside for mistake: see Lord Walker at para 114.
[94] Lord Walker at para 123.
[95] At paras 126 and 128.

Mistakes as to tax

20.54 In principle, consequences (including tax consequences) are relevant in assessing the gravity of a mistake. However, Lord Walker commented that:[96]

> 'In some cases of artificial tax avoidance the court might think it right to refuse relief, either on the ground that such claimants, acting on supposedly expert advice, must be taken to have accepted the risk that the scheme would prove ineffective, or on the ground that discretionary relief should be refused on grounds of public policy. Since the seminal decision of the House of Lords in *WT Ramsay Ltd v IRC* [1982] AC 300 there has been an increasingly strong and general recognition that artificial tax avoidance is a social evil which puts an unfair burden on the shoulders of those who do not adopt such measures. But it is unnecessary to consider that further on these appeals.'

However, deciding that the mistake in *Pitt v Holt* case should be set aside, he noted:

> 'There would have been nothing artificial or abusive about Mrs Pitt establishing the SNT (special needs trust) so as to obtain protection under section 89 of the Inheritance Tax Act 1984 ... the deputy judge found that the setting aside of the settlement would have no effect on any third party (plainly he was not here treating the Revenue as a third party).'

20.55 The new test for mistake is on all fours with cases in the Jersey courts and other offshore jurisdictions which had declined to follow the *Gibbon v Mitchell* distinction between the effects of a transaction and its consequences. For example in *Clarkson v Barclays Private Bank (Isle of Man) Ltd*[97] the plaintiff had emigrated to Spain from the UK and in order to protect his assets from income tax and death duties set up a discretionary trust in the Isle of Man. He transferred sums to it in 1987 in the belief that those payments would not give rise to any charge to IHT. However, he was deemed domiciled at that time in the UK with the result that a liability to IHT arose on the transfers. Deemster Kerruish held that there was no rational basis for restricting setting aside the transaction to circumstances where a mistake had been made as to the operative effect of that transaction. There could be recovery of the gifted property where the mistake was so serious as to render it unjust for the donee to retain the property, irrespective of the precise nature of the mistake.

20.56 Similarly in *Re Betsam Trust*,[98] as a result of a misunderstanding of the IHT deemed domicile rules, a married couple wrongly believed that a trust they had created had no IHT liability. The Manx courts set aside the voluntary transaction on the ground of mistake, deciding that there was a broad equitable jurisdiction to set aside a voluntary transaction on the ground of a mistake as to its fiscal consequences. In *Mr and Mr P Capital Asset Protection Plan Trust*,[99] a

[96] At para 135.
[97] [2007] WTLR 1703.
[98] [2009] WTLR 1489.
[99] [2008] JRC 159.

(iii) if the interest in possession is replaced by a trust with a disabled person's interest, the beneficiary will make a PET;[14]
(iv) if the trust continues and does not fall within (iii) then the beneficiary makes an immediately chargeable transfer, not a PET;
(v) if on the ending of the interest in possession the property reverts to the settlor or his spouse or civil partner, the 'reverter to settlor' exemption applies and there is no IHT liability.[15]

21.09 The trustees also need to take into account the possibility of the property attracting relief from tax. Notably 100% business and agricultural property relief which is, of course only available once the trustees have owned the property for 2 years.

Capital gains tax

21.10 An exit charge is imposed by TCGA 1992, s 71(1) which is in the following terms:

> 'On the occasion when a person becomes absolutely entitled to any settled property as against the trustee all the assets forming part of the settled property to which he becomes so entitled shall be deemed to have been disposed of by the trustee, and immediately reacquired by him in his capacity as a trustee within section 60(1), for a consideration equal to their market value.'

In practice, the existence of this charge explains why the duration of the settlement is frequently extended by the making of a settled advance.[16]

21.11 The possibility of postponing the CGT charge by making a hold-over election is often a major consideration for trustees.[17]

Example 21.4

(1) The Fawcett discretionary trust has just suffered a 10-year anniversary charge and the trustees are minded to bring it to an end at once so that an exit charge will be avoided.[18] But as a result, CGT hold-over under TCGA 1992, s 260(2)(a) is not available because there is no IHT chargeable transfer.
(2) Sam settled property to a value of £255,000 in 2003 (thereby using up his IHT nil rate band). It has doubled in value and the trustees →

[14] For the definition of a 'disabled person's interest' see IHTA 1984, s 89B(1). For the PET definition see IHTA 1984, s 3A(1A).
[15] IHTA 1984, s 53(3) and (4) and note that if the settlor has died the relief applies if it reverts to his spouse or civil partner within 2 years of his death. And see s 54(2) and (2B) in respect of the relief on the death of the beneficiary.
[16] For settled advances, see Chapter 20.
[17] For when hold-over elections can be made see Chapter 14.
[18] No charge arises on terminations in the first 3 months following a 10-year anniversary or the creation of the settlement: see IHTA 1984, s 65(4).

have decided to end the trust by an absolute appointment in favour of Sam's daughter. If they make the appointment before the 2013 anniversary, the IHT exit charge will be nil (since the original value settled will be taken and that will fall within the nil rate band of the settlement). If, however, they delay until after the 10-year anniversary, a charge will be imposed on the increased value of the settled property. In both cases, hold-over relief is available.

(3) Under an express power in the settlement the trustees of the Forbes No 1 discretionary trust transfer all the property in that settlement to the trustees of the Forbes No 2 discretionary trust. As a matter of trust law, the No 1 settlement has terminated but for IHT purposes the trust property is taxed as if it were still comprised in that settlement so that the transfer of property is ignored.[19] For CGT purposes, however, the No 2 trustees become absolutely entitled to the property with the result that an exit charge arises and hold-over relief under s 260(2)(a) is not available in the absence of an IHT chargeable transfer.[20]

SDLT and stamp duty

21.12 On the occasion of the termination of a settlement, charges will not normally be incurred. Note especially:

(a) if land is appointed to a beneficiary or becomes vested in a beneficiary at the end of the trust then the absence of any consideration being furnished by the beneficiary means that this is, for SDLT purposes, an exempt transaction. The beneficiary must self certify that a land transaction return is not required;[21]
(b) if the beneficiary provides consideration in respect of the appointment or advancement then SDLT will be charged on that consideration in the usual way. Such situations are rare;
(c) no SDLT is payable if a life tenant surrenders his interest to accelerate the entitlement of the remainderman (because no consideration is furnished) nor on a partition of land between life tenant and remainderman unless equality money is paid (in which case that is dutiable); and
(d) the fixed rates of stamp duty have been abolished with the result that no duty is payable unless consideration is furnished in respect of securities. As a result declarations of trust; appointments etc are free from duty and it is not necessary to include a certificate to that effect.

[19] IHTA 1984, s 81: see further Chapter 22.
[20] The treatment of resettlements for CGT purposes is considered in Chapter 20.
[21] FA 2003, Sch 11.

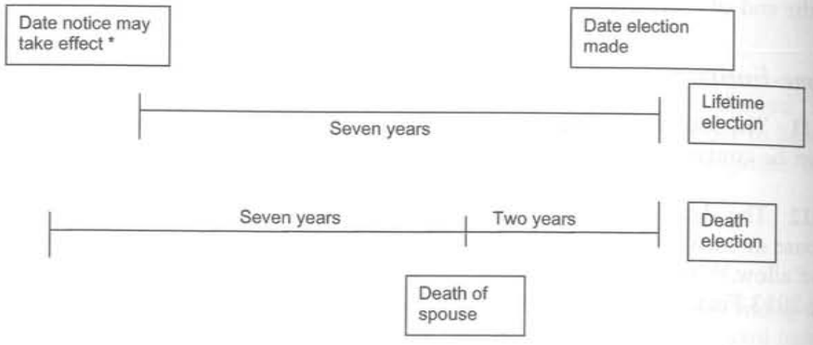
The 'date specified'

25.13 The election notice must specify a date from which the election takes effect as follows:

(a) it cannot be before 6 April 2013;

(b) it must be within the period of 7 years ending with:
   (i) in the case of lifetime elections, the date on which the election is made;
   (ii) in the case of death elections, the date of the spouse's death.[21]

25.14 Diagrammatically the position is:



* *This date must be on or after 6 April 2013.*

Example 25.5

(1) As in **Example 25.4** except that Ben makes the gift to Jen who subsequently realises that she could have made an election for the spouse exemption to apply. She accordingly makes the election, choosing August 2013 as the specified date. The gift is accordingly spouse exempt (so that were Ben to die within 7 years no IHT charge would arise) and Jen's 'run off' 4-year period begins with the date when she makes the election.[22]

(2) Anna, UK domiciled, makes a substantial gift to her Chinese domiciled husband Liu in June 2013 and dies in 2019. Liu can make a death election specifying a date of June 2013 so that instead of a failed PET the gift is spouse exempt. Of course, if the gift was made before they were married the election would not be effective.

[21] In addition, the elector must have been married to or in civil partnership with the spouse who was UK domiciled: see IHTA 1984, s 267ZB(6), (7).

[22] See further for the 'run off' period, **25.15**.

When the election ceases to have effect

25.15 Although the election cannot be revoked, if the person making it is not UK resident 'for the purposes of income tax for a period of four successive tax years beginning at any time after the election is made, the election ceases to have effect at the end of that period'.[23]

Example 25.6

Jen in **Example 25.4** is neither UK domiciled nor resident.

(1) She makes the election on 1 August 2013. The election will remain in force until the tax year 2017/18. This is because the 4-year period begins with the tax year of the election (ie 2013/14). Non-residence is required throughout that year and 2014/15; 2015/16 and 2016/17.

(2) If Jen becomes UK resident in tax year 2015/16, the election remains in force. Contrast the position if she became resident for the first time in 2017/18 when the election has ceased to have effect.

(3) Assume that in August 2013 Jen had been resident in the UK for 16 consecutive tax years. She is not deemed domiciled under s 267[24] and so will still need to make the election. Of course, had she been resident for 17 out of the last 20 tax years in 2013 then her deemed domicile would mean that the full spouse exemption applies and so she would not need to make the election.[25]

The consequences of making the election

25.16 Because the election is irrevocable and remains in force until the end of the non-resident period, the main downside of making the election is that the person's worldwide estate is brought into the IHT net. Not only does this mean that IHT would be payable on their death estate were they to die whilst the election remains in force, but also gifts made after the date specified are potentially bought within the IHT charge. As a result great care needs to be exercised in determining whether the election will be advantageous.[26]

25.17 Diagrammatically the 'run off' period is as follows:

[23] This provision only applies to the individual who made the election not to that person's personal representatives.

[24] IHTA 1984, s 267(1)(a) provides that Jen becomes deemed domiciled when she has been resident in 17 out of the 20 years of assessment 'ending within the year of assessment in which the relevant time falls'.

[25] Curiously the election is available to her since in determining her domicile, deemed domicile under s 267 is ignored.

[26] If the non-residence period began in 2016, then the run off period would be calculated from that date.

26.15 The settlor is not charged to income tax on income which is accumulated. However, such income suffers the trusts rate of tax which is 45% in 2013/14.[25]

26.16 There are provisions to catch attempts to circumvent the legislation by paying minors capital instead of income.[26] If the trustees of a settlement retain or accumulate income arising under the settlement, and subsequently make a payment in connection with the settlement[27] to, or for the benefit of a relevant child of the settlor, the payment is treated as a payment of income so far as there is retained or accumulated income available.[28] Once a child has attained 18 these rules do not apply and such payments will be of capital.

26.17 These income tax rules mean that there is no income tax advantage in parents transferring income producing assets to or settling them on minor children. The income is taxed as the parent's if paid out or is subject to the trusts rate of tax if accumulated. However, a parent might conclude that the income tax position will be no worse than it would be if the assets were retained and there might be sound capital tax reasons for getting assets out of the parent's estate. An alternative strategy would be for the trustees to invest for capital growth: ie to prevent income arising whilst the beneficiary is a minor.

Parents employing children

26.18 To be deductible the expenses must be incurred 'wholly and exclusively' for business purposes. Dual purpose expenditure is not deductible.[29] It is not possible to split a purpose so if a taxpayer incurs expenditure for two purposes, one business and the other personal, none of the expenditure is deductible. It may, however, be possible to split a payment into a portion which is incurred for business purposes and a portion which is not. This approach was taken in

[25] Or the dividend trust rate of tax which is 37.5% in 2013/14.

[26] ITTOIA 2005, s 631.

[27] A payment is made in connection with a settlement if it is made by virtue of or in consequence of (a) the settlement, or (b) any enactment relating to the settlement: ITTOIA 2005, s 631(3).

[28] By ITTOIA 2005, s 631(4), retained or accumulated income is available at any time when A>B where A is the total amount of the income which has arisen under the settlement since it was made, and B is the total amount of disregarded income. 'Disregarded income' means any income arising under the settlement since it was made which has been: (a) treated as income of the settlor; (b) paid (whether as income or capital) to, or for the benefit of, a beneficiary other than a relevant child of the settlor; (c) otherwise treated as the income of such a beneficiary; (d) treated as income of an unmarried minor child of the settlor, and subject to income tax, in any of the tax years 1995/96, 1996/97 and 1997–98; or (e) applied in meeting expenses of the trustees which were properly chargeable to income, or would have been so chargeable but for any express terms of the settlement. For the purposes of (d) above, income is treated as income of the child and subject to income tax so far as it does not exceed the taxable amount which, in relation to a tax year, means the amount by which—TI>TAD where TI is the child's total income for income tax purposes, and TAD is the total amount of allowances and deductions that may be set against the child's total income or net income at Step 2 or 3 of the calculation in ITA 2007, s 23.

[29] *Mallalieu v Drummond* [1983] 2 AC 861.

Copeman v Flood[30] where a private company, employed the 17-year-old daughter and 24-year-old son of the managing director as directors at a salary of £2,600 each. The son had some business experience; the daughter had none. Both performed some services for the company but the Revenue argued that it was not possible to say that the entire salary was incurred wholly and exclusively for business purposes. Lawrence J accepted that the salaries should be apportioned into deductible and non-deductible elements and referred it back to the General Commissioners for them to decide the apportionment.

26.19 Such an apportionment was approved in connection with the wife of the managing director in *Earlspring Properties Ltd v Guest*[31] where Vinelott J said:

> 'the commissioners were plainly entitled to conclude that the remuneration was not wholly and exclusively incurred for the purpose of the taxpayer company's business but represented in part a diversion of income made to achieve a fiscal purpose.'

This approach is now incorporated into statute.[32]

4. TRUSTS FOR VULNERABLE BENEFICIARIES

26.20 Finance Act 2005 makes provision for special income tax and capital gains treatment for vulnerable beneficiaries. Vulnerable beneficiaries fall into two categories:

(a) *Disabled persons:* the definition of disability is contained in FA 2005, Sch 1A which was amended by FA 2013 to reflect the change from disability living allowances to personal independence payments.[33]

(b) *Relevant minors*: defined as a child under the age of 18 at least one of whose parents has died.[34]

26.21 It is undesirable for trustees of settlements created for the long-term benefit of vulnerable beneficiaries to feel obliged to pay out the whole of income arising in a tax year. Yet under the general rules there is a disincentive to accumulating income as the trusts rate or dividend trust rate is payable on all such income. In order to protect vulnerable beneficiaries from these high rates of tax, FA 2005 introduced special tax treatment for qualifying trusts for vulnerable beneficiaries. The effect of the provisions is to ensure that the amount of tax (both income tax and CGT) charged to the trustees is no more than it would have been if the income and gains had been assessed directly as the income or gains of the vulnerable beneficiary.

[30] *Copeman v Flood* [1941] 1 KB 202.

[31] *Earlspring Properties Ltd v Guest* [1993] STC 473.

[32] See ITTOIA 2005, s 34(2) and CTA 2009, s 54(2).

[33] See 23.08 for the amended definition.

[34] FA 2005, s 39.

7. TRUST ASSETS AS A RESOURCE

28.24 When deciding what orders to make in applications for ancillary relief, the court has to assess the financial position of each party. This may require the court to consider the extent to which assets of trusts can realistically be regarded as resources available to one party.

28.25 In *Thomas v Thomas*,[32] Glidewell LJ considered earlier authorities and said that from these he derived the following principles:

> '(a) Where a husband can only raise further capital, or additional income, as the result of a decision made at the discretion of trustees, the court should not put improper pressure on the trustees to exercise that discretion for the benefit of the wife.
> (b) The court should not, however, be "misled by appearances"; it should "look at the reality of the situation".
> (c) If on the balance of probability the evidence shows that, if trustees exercised their discretion to release more capital or income to a husband, the interests of the trust or of other beneficiaries would not be appreciably damaged, the court can assume that a genuine request for the exercise of such discretion would probably be met by a favourable response. In that situation if the court decides that it would be reasonable for a husband to seek to persuade trustees to release more capital or income to him to enable him to make proper financial provision for his children and his former wife, the court would not in so deciding be putting improper pressure on the trustees.'

28.26 The point that the court expects trustees to respond favourably to a request made as a result of a court order was also made in *RK v RK*[33] where Moylan J said the court would expect trustees to respond positively if it had concluded that the interests of the trust and of the other beneficiaries would not be appreciably damaged were the trustees to provide a beneficiary with the resources he required to enable him to make proper financial provision for his wife and children. They would be expected to respond positively because the court would have concluded that the beneficiary would be making a reasonable request and trustees were expected to act reasonably in the discharge of their duties.

28.27 One of the Court of Appeal's most important explorations of the circumstances in which trust assets can be regarded as a resource is in the judgment of Wilson LJ in *Charman v Charman*[34] where he said that the question of whether the trust is a financial resource is 'appropriately expressed as whether the spouse has 'immediate access to the funds' of the trust'.

This was echoed by Lewison J in *Whaley v Whaley*:[35]

[32] *Thomas v Thomas* [1995] 2 FLR 668 at 678.
[33] *RK v RK* [2011] EWHC 3910 (Fam).
[34] *Charman v Charman*, [2006] 1 WLR 1053 at [12]–[13].
[35] *Whaley v Whaley* [2011] EWCA Civ 617, 14 ITELR 1, [2011] 2 FCR 323 at [113].

> 'No judge can make a positive finding about the future: the best that can be done is to assess likelihood. What is relevant is the likelihood of the trust fund or part of it being made available to him, either by income or capital distribution. If the husband were to ask the trustees to advance him capital, would the trustees be likely to do so: *Charman v Charman* [2006] 1 WLR 1053; *A v A* [2007] 2 FLR 467. The question is not one of control of resources: it is one of access to them.'

28.28 The drafting of the trust instrument or letter of wishes will often be significant and care should be taken when drafting both to avoid creating hostages to fortune. In *Charman v Charman* the letter of wishes included the following:

> 'Insofar as is consistent with the terms of the Settlement I wish to have the fullest possible access to the capital and income of the Settlement including the possibility of investing the entire Fund in business ventures undertaken by me.'

This was a significant factor in the Court's decision that the assets of the discretionary trusts were to be treated as a resource of the husband.

28.29 Similarly in *Whaley v Whaley*[36] the letter of wishes provided by the settlor (the husband's father) had requested the trustees to make the trust assets available to his son at a stated age and the son for his own convenience had requested the trustees to keep the assets settled.

The husband had argued that the trustees had to consider the interests of other beneficiaries of two discretionary trusts and, therefore, no order should be made that would require them, against their stated intentions and ignoring their duties to other beneficiaries, to realise assets at a time that would be unpropitious commercially concerned. However, the two trust instruments included the following provision:

> '(D) PROVIDED ALWAYS that the Trustees are hereby expressly authorised in exercising any of the powers hereby conferred in favour of any particular person to ignore entirely the interests of any other person interested or who may become interested under these presents.'

The presence of this clause (together with the fact that the office of Protector was held by a close friend of the husband) was said by Lewison LJ to distinguish these trusts from many discretionary trusts.

28.30 Trustees are often reluctant to give the court information about their trust but failure to co-operate carries with it an increased risk that the court will get the wrong picture. Where trustees are offshore, as they nearly always are in 'big money' cases, they may take a highly defensive and limited position in their participation in the court's inquiry for fear that anything more active will be construed as a submission to the court's jurisdiction.

[36] *Whaley v Whaley* [2011] ECWA Civ 617, 14 ITELR 1, [2011] 2 FCR 323.

Tax analysis

(1) The cash gift is a PET and the GWR tracing provisions do not apply to such gifts.[9] Accordingly the occupation of the granny flat does not involve Ian in a reservation of benefit.

(2) For POAT purposes, the land charge only applies if Ian contributes to the acquisition costs of Sirena's property, which he has not.

3. THE FATE OF PAST SCHEMES

30.10 Past schemes present a somewhat melancholy picture of a bygone era and offer a stark warning of the dangers of anti-avoidance and even retroactive legislation. Specifically, although the pre-owned assets income tax charge only came into force on 6 April 2005, it may impose an income tax charge on IHT schemes implemented at any time after the GWR rules were introduced in 1986.

4. *INGRAM* SCHEMES

30.11 This classic shearing arrangement was stopped for individuals by the FA 1999 legislation and schemes already implemented before that change are now caught by the POAT land charge. There remains one curious remnant when the house is held in a settlement which has escaped unscathed and may still be implemented as illustrated in the following example.

Example 30.4

When he died, Jasper left his valuable property on a flexible life interest trust for his second wife, Griselda, remainder to the two children of his first marriage.[10] The property is now worth £1.5m and Griselda, well provided for, is aged 75. As matters currently stand the property will be taxed on Griselda's death along with her free estate with the risk of a substantial tax bill.

The arrangement

Step 1 – The trustees carve out a 20-year lease out of the property. This can be done by granting a lease to a nominee.[11] No rent will be payable under the lease and its duration should not exceed 21 years because of the enfranchisement rights which would then apply to enhance its value.[12] It →

[9] See **12.10**.

[10] For flexible IPDIs see *A Modern Approach to Wills, Administration and Estate Planning*, chapter 6.

[11] See **Precedent 30.2**.

[12] The length of the lease may be related to Griselda's life expectancy (ie to how long she anticipates continuing to live in the property). For an older taxpayer, therefore, a shorter lease may be taken. Bear in mind that at the end of the lease term.

is important that Griselda understands that if she is still alive at the end of the lease term, she will have no right to occupy the property. Accordingly if she wants to continue to occupy the property, she will have to pay a full rent to avoid a reservation of benefit.[13]

Step 2 – Having carried out Step 1 the trustees retain the lease on the IPDI trust for Griselda but use their overriding power to appoint the (encumbered) freehold interest to the children.

Step 3 - Griselda continues to occupy the property because of the lease that has been retained in the IPDI trust.

The tax consequences of this arrangement are as follows:

(a) Griselda will make a PET on the termination of her interest in the freehold. Provided that she survives for 7 years, an IHT charge will be avoided. Before the FA 2006 changes in the IHT treatment of settlements, the appointment in favour of the children would usually have been on continuing trusts. However, such trusts are now relevant property settlements and Griselda would therefore make not a PET but an immediately chargeable transfer. If the value of the transfer of value arising on the ending of her interest in possession exceeded her available nil rate band, a 20% charge on the excess would result. Hence, it will commonly be desirable to make an outright appointment to the children;

(b) main residence relief will be available to prevent a CGT charge when the freehold is appointed out of the trust to the children;[14] and

(c) so far as reservation of benefit is concerned, Griselda is treated by s 102ZA as making a gift of the freehold interest (this is the 'no longer possessed property') but she does not reserve any benefit in this property. Her continued occupation of the property results from her entitlement under the lease which has, of course, been retained in the IPDI trust. The arrangement is modelled on the *Ingram* scheme which was stopped in the case of arrangements made by individuals by the 1999 legislation. However, s 102ZA does not apply for the purpose of these sections.[15]

Reversionary leases

30.12 An alternative to the above would be for a reversionary (or deferred) lease to be employed. This would involve the trustees carving out a long

[13] FA 1986, Sch 20, para 6(1)(a).

[14] TCGA 1992, s 225: see **31.17**.

[15] See **12.32**. Because Griselda does not dispose of an interest in land it is not thought that the pre-owned asset income tax charge applies.

activities carried on, the amount of money it can raise and how and when that money must be employed for the purposes of the trade.

34.16 The requirements relating to the kind of company are as follows:

(a) the company must be unquoted at the time of issue. For the EIS rules the Alternative Investment Market (AIM) and the PLUS Markets (with the exception of PLUS-listed)[14] are not considered to be recognised exchanges, so a company listed on those markets can raise money under the EIS if it satisfies all the other conditions. A company can subsequently become a quoted company without the investors losing relief, but only if there were no arrangements for it to become quoted in existence when the shares were issued;

(b) it must not be controlled by another company and must not control any company that is not a qualifying subsidiary.[15] Nor must there be arrangements in existence at the time the shares are issued which could result in that being the case;

(c) it need not be UK resident but from 6 April 2011 the issuing company must have a UK permanent establishment;

(d) it must either carry on the qualifying trade itself, or be the parent company of a trading group. Where the trade is carried on by a subsidiary, but if it is carried on by a subsidiary, it must be at least a 90% subsidiary;[16]

(e) it must have fewer than 250 full-time employees (or their equivalents) at the time the shares are issued; and

(f) the gross assets of the company (or of the whole group if it is the parent of a group) must not exceed £15m immediately before any share issue and £16m immediately after that issue.[17]

34.17 Requirements as to the type of trade are as follows:

(a) the trade must be conducted on a commercial basis with a view to the realisation of profits;

(b) the trade must be a qualifying trade. Most trades qualify, but some do not. Those that do not are termed 'excluded activities'.

Excluded activities include dealing in land, in commodities or futures in shares, securities or other financial instruments, financial activities such as banking, insurance, money-lending, debt-factoring, hire-purchase financing or any other financial activities, leasing or letting assets on hire, except in the case of certain ship-chartering activities, receiving royalties or licence fees (though if these arise from the exploitation of an intangible asset which the company itself has created, that is not an excluded activity), providing legal or accountancy services, property development, farming or market gardening or forestry activities or timber production, shipbuilding, coal and steel production, operating or managing hotels or nursing homes or residential care homes.

A company can carry on some excluded activities, but these must not be 'substantial' part of the company's trade.[18]

[14] The PLUS-listed market is regarded as a recognised stock exchange and shares listed on that market at the time of issue will not qualify for EIS.

[15] Ie the company has more than 50% of the ordinary share capital of the subsidiary, and it is not controlled (by other means) by another company. (If the EIS company has a property management subsidiary that must be at least a 90% subsidiary.)

[16] This means that if the trade is being carried on in partnership then the company will not qualify. See VCM13080.

[17] See VCM13110 and Statement of Practice 2/06 for how assets are valued for the purpose of this test.

34.18 The amount of money that can be raised in any one 12-month period is limited. Companies are not allowed to raise more than £5m in total in any 12-month period from all venture capital schemes. The schemes are the Enterprise Investment Scheme (EIS), the Seed Enterprise Investment Scheme (SEIS) and Venture Capital Trusts (VCTs). Investments from any of these schemes must fall within the £5m limit.[19]

34.19 The money raised by the share issue can be used either for the purpose of an existing qualifying trade or for the purpose of preparing to carry on such a trade. Where the shares are issued before 6 April 2011 the trade, or the preparation for it, must be carried on wholly or mainly in the UK. That requirement is removed for shares issued on or after 6 April 2011.

Alternatively it can be used to carry on research and development intended to lead to such a qualifying trade being carried on.

The money raised by the share issue must be employed for the purposes of the trade or research and development within 2 years of the shares being issued (or within 2 years of the trade commencing, if that is later). From 6 April 2012, using the money to acquire shares in another company does not, of itself, count as 'employment' for this purpose. However, if the money is used to acquire shares in a company which after the investment is a 90% qualifying subsidiary, and that subsidiary uses the monies within the appropriate timescale for the purposes of its qualifying activity, then that will be regarded as 'employment' of the monies.

5. VENTURE CAPITAL TRUSTS

34.20 The Venture Capital Trust (VCT) scheme started on 6 April 1995. It is designed to encourage individuals to invest indirectly in a range of small higher-risk trading companies whose shares and securities are not listed on a

[18] HMRC take 'substantial' to mean more than 20% of the company's activities. See VCM3000.

[19] The £5m limit must also take into account any other investment which the company has received in the relevant 12-month period which is an investment deemed to be State Aid under any other scheme covered by the European Commission's Guidelines on State Aid to promote Risk Capital Investments in Small and Medium-sized Enterprises.