

FINANCE BILL 2020 - IHT CHANGES

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1. INTRODUCTION

In respect of Inheritance Tax, the Finance Bill 2020 contains few changes. Just three sections address IHT.

By far the most important is the specific change to the scope of excluded property trusts, which have been brought in in response to the Court of Appeal's decision against HMRC in *Barclays Wealth Trustees (Jersey) Ltd and Dreelan v HMRC* [2017] STC 2465.

2. EXCLUDED PROPERTY TRUSTS - THE CURRENT LAW

Section 48(3) IHTA defines as 'excluded property' property in a settlement that was 'made' whilst the settlor was non-UK domiciled¹.

Subsection (3) currently states:

- (3) *Where property comprised in a settlement is situated outside the United Kingdom—*
- a. the property (but not a reversionary interest in the property) is excluded property unless the settlor was domiciled in the United Kingdom at the time the settlement was made ...'*

This provision is analogous to the section 6(1) definition of excluded property in a non-trust situation. Two similar conditions have to be satisfied if the settled property in question is to qualify as excluded property: the situs of the property must be outside the UK and (ii) the settlor must be non-UK domiciled. The key point in this context

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1 and not 'a formally domiciled resident' – i.e. having a UK domicile of origin, another domicile of choice, and a UK residence for 1 of the last 2 years. For the purpose of this note I will include this category under 'UK-domiciled'.

however is that the domicile condition only has to be satisfied by the settlor ‘*at the time the settlement was made*’.

An accepted consequence of this is that where a settlor makes a settlement of property situated outside the United Kingdom at a time when he is not UK-domiciled, and the property then remains comprised in the same settlement, its status as excluded property will not be lost merely because the settlor subsequently acquires an actual or deemed domicile in the United Kingdom.

Transfers between settlements

Section 82 deals with the case where property moves from one settlement to another. It needs to be read with s 81(1), which allows movements of property between trusts to be disregarded for IHT purposes so long as the underlying beneficial interest does not alter:

‘Where property which ceases to be comprised in one settlement becomes comprised in another then, unless in the meantime any person becomes beneficially entitled to the property (and not merely to an interest in possession in the property), it shall for the purposes of this Chapter be treated as remaining comprised in the first settlement.’

Section 82 then states that where the property transferred is excluded property within s48(3), it can only be transferred in this way if the trust it is going to is also one made when the settlor was non-UK domiciled:

- (1) *In a case where, apart from this section, property to which section 80 or 81 applies would be excluded property by virtue of section 48(3)(a) above, that property shall not be taken to be excluded property at any time (“the relevant time”) for the purposes of this Chapter (except sections 78 and 79) unless Conditions A and B are satisfied.*
- (2) ...
- (3) *Condition A referred to in subsections (1) and (2) above is –*
 - a. ...
 - b. *in the case of property to which subsection (1) or (2) of section 81 above applies, that the person who is the settlor in relation to the second of the settlements mentioned in the subsection concerned,*
was not domiciled in the United Kingdom when that settlement was made.
- (4) *Condition B referred to in subsection (1) above is –*

- a. ...
- b. *in the case of property to which subsection (1) or (2) of section 81 above applies, that the person who is the settlor in relation to the first or second of the settlements mentioned in that subsection,*
was not a formerly domiciled resident for the tax year in which the relevant time falls.

3. Barclays Wealth Trustees [2017] STC 2465

Barclays Wealth Trustees addressed the question, in relation to section 82, of whether the excluded property status of property transferred between trusts depended on whether a settlement was ‘made’ when:

1. it was first established (as the taxpayer contended), even if the property had been added to it at a later date, or
2. whenever property was transferred to the settlement (as HMRC contended).

The Court of Appeal held that, as in general trust law, under section 82 a settlement is ‘made’ when it is first established. This meant that non-UK property transferred between settlements retained its excluded property status, even if the settlor is UK domiciled at the time of the transfer: the only requirement is that the settlor of both trusts was non-UK domiciled when the settlements were originally established.

This gave trustees the flexibility to move property between trusts even after the settlor of the trusts became deemed domiciled, without jeopardising the excluded property status of the trust funds.

The Court of Appeal refused to rule on the equivalent point in section 48(3): whether a non-UK domiciled individual can establish a trust before becoming UK (deemed) domiciled, and then take any future acquired non-UK property out of the scope of IHT by transferring it into that trust. But the logical consequence of *Barclays Wealth Trustees* is that such an individual could.

4. The New Provisions

The main change is to ‘correct’ the Court of Appeal’s decision by replacing in section 48(3) the words ‘*time the settlement was made*’ with new wording ‘*time the property became comprised in the settlement*’.

It is retrospective, in that it applies to all IHT charges after the Finance Act 2020 is passed, even if the property was added to the settlement before that date.

This will dramatically reduce the potential use of trusts for non-UK domiciles intending to make the UK their home or to at least stay long enough to engage the deemed domicile rules.

There are also changes to section 82 IHTA and these are slightly more complicated and extensive.

Firstly, the new rules in section 82 apply differently to transfers made before and after the new legislation is passed.

Non-UK property transferred between trusts before the Finance Act receives Royal Assent is dealt with in the modified s82. The changes are modest: Such property will remain excluded property if:

- a. the settlor of the transferring settlement was non-domiciled when the property became comprised in the settlement – i.e. under the new s48(3) rule; and
- b. the settlor of the recipient settlement was non-domiciled when the recipient settlement was made - i.e. under the old s48(3) rule.

This means that where a settlor has established two trusts before becoming UK-domiciled or deemed domiciled, the trustees can still transfer property between the trusts after becoming UK domiciled or deemed domiciled but before the Finance Act is passed, without jeopardising the excluded property status of the transferred property. But they still have to get through the new s48(3) gateway.

This is a sensible concession – it will not penalise trustees for transfers they have already made.

However, future transactions are dealt with under a new section 82A, which is much more restrictive:

“82A Excluded property: property to which section 81 applies (new cases)

(1) This section—

- a. *applies where, at any time on or after the day on which the Finance Act 2020 is passed, property ceases to be comprised in a settlement (“the first settlement”) but is treated as a result of section 81 as remaining comprised in that settlement for the purposes of this Chapter, and*
- b. *applies whether or not at any subsequent time the property is comprised in the first settlement without regard to that section.*

- (2) *If the property would apart from this section be excluded property by virtue of section 48(3)(a) or (3A)(a), the property is to be regarded as excluded property for the purposes of this Chapter, except sections 78 and 79, at any time **only if the non-domicile condition is met in relation to each qualifying transfer occurring on or before that time.***
- (3) *Section 65(8) has effect in relation to the property at any time only if (in addition to the condition mentioned there) the non-domicile condition is met in relation to each qualifying transfer occurring on or before that time; but, for the purposes of this subsection, the non-domicile condition has effect with the omission of subsection (6)(a)(ii).*
- (4) *For the purposes of this section each of the following is a “qualifying transfer”—*
- a. the occasion on which section 81 applies to the property; and*
 - b. any subsequent occasion on which the property would, if the effect of section 81 were ignored, become comprised in a settlement to which this Chapter applies (including the first settlement).*
- (5) *But a qualifying transfer does not occur as a result of—*
- a. an assignment by a beneficiary of an interest in a settlement, or*
 - b. an exercise of a general power of appointment,*
- unless the time of the assignment or exercise of the power falls on or after the day on which the Finance Act 2020 is passed.*
- (6) *For the purposes of this section “**the non-domicile condition**” is—*
- a. in a case where a qualifying transfer occurs as a result of an assignment by a beneficiary of an interest in a settlement or an exercise of a general power of appointment, that the beneficiary or the person exercising the power—*
 - i. was not domiciled in the United Kingdom at the time of the assignment or exercise of the power, and*
 - ii. is not a formerly domiciled resident for the tax year in which the time mentioned in subsection (2) falls;*

- b. *in a case in which section 81 applies which is not within paragraph (a), that the person who was the settlor of the property in relation to the first settlement was not domiciled in the United Kingdom immediately before the time when the property ceased to be comprised in the first settlement;*
 - c. *in any other case, that the person who was the settlor of the property in relation to the first settlement was not domiciled in the United Kingdom immediately before the time of the subsequent occasion.*
- (7) *If—*
 - a. *the settlor mentioned in subsection (6)(b) or (c) has died before the time mentioned there, and*
 - b. *the death does not give rise to a qualifying transfer, the non-domicile condition is treated as met.*
- (8) *In this section any reference to a qualifying transfer occurring as a result of—*
 - a. *an assignment by a beneficiary of an interest in a settlement, or*
 - b. *an exercise of a general power of appointment,**includes the transfer occurring partly as a result of the assignment or exercise of the power.*
- (9) *In this section any reference to an assignment includes an assignation.”*

This means that section 81 only works to keep property excluded if the settlor is non-UK-domiciled at the time of the transfer. This creates a real risk that the excluded property of a taxpayer who becomes UK domiciled after a settlement is made could be brought into the charge to IHT by an administrative procedure.

The section now also covers pretty much any kind of assignment of a beneficiary's right to trust property, so that UK domiciled beneficiaries cannot move the benefit of a trust interest in excluded property around without losing that status, either.

5. Issues

Retrospectivity

Arguably the change imposes retrospective changes that undermine thus far legitimate expectations based on established law. Yet there is no accusation of avoidance here,

which is generally the justification for retrospectivity under HMRC policy and Human Rights law. HMRC would of course claim that the change does not have retrospective effect, as with the loan charge.

There will also likely be significant practical difficulties in assessing a trust with a long history, especially where the 10 year charge is concerned.

Tainting of mixed funds

The rules work fine for fixed assets, but cash raises questions. If £1m is added to an excluded property fund of £4m, is the whole trust now non-excluded property?

Barclays Wealth Trustees would suggest you will have to apply the (difficult) trust rules on tracing and mixing. So will the trustees need a new accounting pool? Or perhaps they should treat the fund as 20% excluded property?

Meaning of 'property'

Already difficult is the question of whether a transfer of value counts as an addition of property to the trust? Or, conversely, the receiving a loan? This is not a new question, but it will matter more now.

Coombes v HMRC [2008] STC 2984 indicates, however, that 'settling property' should be a quite narrowly defined term. In that case, the taxpayer had provided funds to a company owned by the trustees of an offshore settlement but it was held that this was not the provision of funds to the settlement so that he did not thereby become a settlor in relation to it. This could present opportunities.

6. Other Changes

Initial interest of settlor or spouse or civil partner

The part of section 82 that deals with section 80 (Initial interest of settlor or spouse or civil partner) has been moved to a new section 81B, presumably for clarity.

But in addition, substantially the same change have been made: the property must have been put into a trust for the benefit of the settlor or their spouse or civil partner when the settlor was UK domiciled.

WWII Victims

There is also a niche addition to the IHT treatment of one-off compensation payments. The new German Kindertransport Fund pays €2,500 to eligible survivors. That

payment will now not be subject to Inheritance Tax, per section 153ZA, with effect in relation to deaths occurring on or after 1 January 2019.