

THE PRE-BUDGET STATEMENT 9TH DECEMBER 2009 AND INHERITANCE TAX AVOIDANCE

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Note: since the time of writing the changes discussed in this chapter have become enacted by the passing of the Finance Act 2010. They are found at sections 52 (reversionary interest) and 53 (interests in possession).

1 Scope of Chapter

Various amendments to the Inheritance Tax Act 1984 were proposed in a Revenue announcement “Inheritance Tax Avoidance” (“the Announcement”) issued at the time of the Chancellor’s Pre-Budget Statement on 9th December 2009. They would take effect from that day.

It is by no means clear that Mr. Darling will be in any position to secure the enactment of these amendments or whether any new government will adopt them wholesale without further amendment. *Hence, in the main text, I have not assumed that the proposed changes will take effect but have simply referred to them at various points.* The purpose of this article is to discuss changes to the law on the basis that the proposed amendments will be made, and without further amendment. While I shall therefore refer to them as “the Amendments”, it must be remembered that they might never take effect.

2 Overview

2.1 The Effect of the Changes

The changes fall into two broad categories, dealt with in draft Clauses 1 and 2 respectively. The effect of draft Clause 1 is that a certain type of interest in

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possession is added to the categories of recognised interests in possession for most, albeit not all, purposes. The effect of draft Clause 2 is first that, where a certain type of reversionary interest comes to an end, there can in certain circumstances be a deemed chargeable transfer of value and secondly a transfer of value “of” that type of reversionary interest is precluded from constituting a potentially exempt transfer.

2.2 The Perceived Need for the Changes

The problem, from the Revenue’s point of view, arises from their wholly misconceived changes to the inheritance tax treatment of trusts, enacted by Finance Act 2006. If they had left the inheritance tax treatment of settlements undisturbed as it had stood for over thirty years, the “avoidance” which the amendments are designed to prevent would not have been possible. Moreover, if they had not botched the Finance Act 2006 changes, the “avoidance” would still not have been possible.

Perhaps the main effect of the 2006 changes was that an unrecognised interest in possession was in general to be disregarded for inheritance tax purposes. In particular, an individual beneficially entitled to it was not to be treated as owning the settled property and the interest was deemed not to form part of his estate for inheritance tax purposes. The settled property would thus become “relevant property” in the absence of a special exclusion and there would in principle be periodic and exit charges on it. Perhaps most importantly from the Revenue’s point of view, when, on a transfer into settlement, property became relevant property, there would normally be no question of the settlor making a potentially exempt transfer. And the Gifts with Reservation of Benefit or Previously Owned Assets Provisions could still apply in relation to the settled property.

The difficulty was that, in their crusading zeal, the Revenue overlooked the simple fact that the value attributable to a reversionary interest which is part of a person’s estate, even one which does not constitute excluded property, may suddenly drop out of his estate by the reversionary interest becoming an unrecognised interest in possession, yet without any attendant transfer of value, because there is no related disposition. That opened up possibilities of avoidance. The avoidance was not that easy, because one had to ensure not merely that there was no transfer of value when the estate of the settlor was reduced in value but that neither the Gifts with Reservation of Benefit Provisions nor the Previously Owned Assets Provisions would apply.

2.3 Did the Avoidance Work?

In my view, if properly implemented, the “avoidance” would have been effective and tax-efficient. The Announcement has simply confirmed my view and, if anything, reinforced it. There is no mention by the Revenue that they think the “avoidance” was not effective - which is what they often say when they are

proposing new anti-avoidance legislation, “for the avoidance of doubt” or “to restore the position to what it was generally thought to be”. Instead, they seem fully to accept that the “avoidance” was effective. They have tried to legislate against it. The Amendments assume the strategy works.

2.4 Will the Amendments Achieve their Purpose?

While there is no doubt that the Amendments will achieve their desired result in certain cases, it took me five whole minutes to devise at least three different variants on the basic “avoidance” strategy which are, in my view, left untouched by the Amendments.

The quality of the drafting of the Amendments leaves much to be desired. I suspect this arises more from the Instructions to the Parliamentary Draughtsman than from his incompetence. Explanatory Notes were issued on December 9th 2009 along with the draft clauses.² What immediately strikes one on reading the Explanatory Notes is that they have been drafted by someone who is not only ignorant of how inheritance tax works but who is not entirely literate. Moreover, he appears not to have read the draft clauses themselves or, if he has, he has not properly understood their effect where it is undoubted. It is difficult to see how any court could take these Explanatory Notes seriously.

3 Draft Clause 1

3.1 Preliminary

3.1.1 Overview

The draft Clause 1 is headed “Interests in Possession”. Its ten subsections deal with amendments to the Inheritance Tax Act 1984. The principal effect of these amendments is to ensure that a new type of interest in possession is in general a recognised interest in possession. There is, however, one glaring, deliberate and outrageous omission. Even though this type of interest in possession is in general a recognised interest in possession, the settled property will still in principle constitute “relevant property” and thus be subject to two sets of inheritance tax charges! This is going further than merely counteracting tax avoidance. And the double charge will apply whether or not there was any tax avoidance motive at all!

There is a second, deliberate, omission. The new type of interest in possession will not be prevented from forming part of a person’s estate by virtue of Inheritance Tax

² It is an interesting point to what extent Explanatory Notes issued by Her Majesty’s Commissioners of Revenue and Customs are a legitimate aid to construction of legislation. In my view, the position is probably that they can be relied on by the taxpayer, but not by the Revenue. That, however, is a very large question which is beyond the scope of this work.

Act 1984 section 5(1). However, in view of the amendment of Inheritance Tax Act 1984 section 49, that is in my view of itself of little, if any, consequence, to the taxpayer. Indeed, it will if anything help him to argue that he does not have an interest in possession of the relevant type. See Q.3.2.3.

The new type of recognised interest in possession is perhaps best referred to as a “section 5(1B) interest”. I explain below (at Q.3.2) precisely what is meant by this term. However, very roughly indeed it is a purchased interest in possession.

3.1.2 Coming into Force

Subsection (10) provides:

“The amendments made by this section have effect in relation to an interest in possession to which a person is beneficially entitled if the person becomes beneficially entitled to it on or after 9 December 2009”.

3.2 Section 5(1B) interest in possession

3.2.1 Definition

There will be inserted into Inheritance Tax Act 1984 section 5 a new subsection (1B) in the following terms:

“(1B) An interest in possession falls within this subsection if the person-

- (a) was domiciled in the United Kingdom on becoming beneficially entitled to it, and
- (b) became beneficially entitled to it by virtue of a disposition which was prevented from being a transfer of value by section 10 below.”

Inheritance Tax Act 1984 section 10 (Dispositions not intended to confer gratuitous benefit) provides:

- “(1) A disposition is not a transfer of value if it is shown that it was not intended, and was not made in a transaction intended, to confer any gratuitous benefit on any person and either-
- (a) that it was made in a transaction at arm’s length between persons not connected with each other, or
 - (b) that it was such as might be expected to be made in a transaction at arm’s length between persons not connected with each other.

(2) [Applies only to a sale of unquoted shares or unquoted debentures]

(3) In this section-

...

“transaction” includes a series of transactions and any associated operations.”

3.2.2 Purpose of Section 5(1b) Interests in Possession

What I imagine the draughtsman had in mind is the following scenario. A taxpayer, T, buys an interest in possession in settled property at its market value. He makes a disposition in paying the purchase price. On the basis that the interest in possession acquired by him is not a recognised interest in possession, his estate will immediately be diminished in value, not in reality, but for inheritance tax purposes, on account of Inheritance Tax Act 1984 section 5(1).³ Thus he will *prima facie* have made a transfer of value; see Inheritance Tax Act section 3(1). However, T would have an argument that section 10 would operate to prevent this *prima facie* transfer of value from being a transfer of value. If that argument were sound, then his estate would have been diminished in value for inheritance tax purposes as a result of the purchase without his making any transfer of value at all.

If, as a result of the Amendment, he becomes entitled to a section 5(1B) interest, he will be deemed to own the settled property itself, not because of the operation of section 5 as amended (as to which, see below Q.3.6.) but because of the amendment to section 49 (as to which, see below Q.3.3). Hence, his estate for inheritance tax purposes will not be diminished in value but would, if anything, be increased in value.⁴

3.2.3 The Perpetually Revolving Door and the Gordian Knot

Section 5(1B) is one of those dreadful sections which gives rise to the problem of the revolving door which perpetually revolves. If an interest in possession does not fall within the proposed new section 5(1B), and is not otherwise a recognised interest in possession, then the acquisition of it would indeed give rise to a transfer of value, which might be capable of being saved from being a transfer of value by section 10. On that basis, it could fall within section 5(1B). If, however, it falls within section 5(1B), then its acquisition may involve no transfer of value at all⁵ in

³ This is set out below in section Q.4.

⁴ In determining whether he has made a transfer of value, however, Inheritance Tax Act 1984 section 49(2), which disapplies section 49(1), needs to be taken into account.

⁵ In this context, Inheritance Tax Act 1984 section 49(2), which disapplies section 49(1), needs to be taken into account.

which case it should not fall within the proposed new section 5(1B)! Yet in that case there could well be a transfer of value so that it could fall within the proposed new section 5(1B), and so on *ad infinitum*! The courts would somehow have to cut the Gordian knot. This is, of course, a problem for the Revenue rather than the taxpayer.

3.2.4 The Explanatory Notes

It is stated in the Explanatory Notes in the commentary on draft Clause 1:

- “7. Subsection (3)(b) inserts new subsection (1B) into section 5 of IHTA, so that it includes a new category of interest in possessions [sic]⁶ that will be included as part of a person’s estate. These are interests to which a UK domiciled person is entitled and that [sic] the person acquired that interest in an arms’ length transaction (as defined in section 10 IHTA).”⁷

This is a complete misreading of the proposed new section 5(1B). The condition is that the person who is beneficially entitled to the interest in possession should have become beneficially entitled to it “by virtue of a disposition which was prevented from being a transfer of value by section 10 below.” First, if the disposition would not have been a transfer of value at all even disregarding section 10, then the condition is not satisfied. Secondly, it is not necessary for section 10 to apply that “the person acquired that interest in an arms’ length transaction”: see section 10(1)(b). Thirdly, even if the disposition would have been a transfer of value but for section 10, the mere fact that the person acquired the interest in possession in question in an arms’ length transaction does not mean that section 10 is satisfied.

Clause 20 of the Explanatory Notes offers a somewhat different (incorrect) explanation. It states:

“The clause provides that where an interest has been purchased at full value than that interest will be treated as part of a person’s estate. Where a person puts funds in to a trust in the normal course of events the normal IHT charges will apply, and the changes in the new section 5(1B) will not apply. If a person purchases an interest in a trust other than at arms length then section 10 of IHTA will not apply and there will be a transfer of value in the normal way.”

⁶ As mentioned, the draughtsman of the Explanatory Notes is not quite literate. The plural of “interest in possession” is “interests in possession”.

⁷ Further evidence of the limited literacy of the draughtsman of the Explanatory Notes is the faulty syntax of the second sentence.

The second sentence, while somewhat ambiguous and not entirely accurate,⁸ is not the contentious one. It is the first and third sentences which are highly inaccurate. As to the first sentence, where an interest in possession has been purchased at full value, then it will fall within the proposed new section 5(1B)⁹ only if

- (a) the purchase involves the purchaser making a prima facie transfer of value and
- (b) section 10 prevents it from being a transfer of value.

Where an interest has been purchased at full value, that might or might not be the case. If it has been purchased for less than full value, the interest may still fall within the proposed new section 5(1B). If it has been purchased for more than full value it can still fall within section 5(1B), depending on the circumstances. While the value given is not entirely irrelevant to the application of the proposed new section 5(1B), provided some value is given, whether or not it is full value is not the crucial point.

It might be asked how could a purchase at full value give rise to a potential transfer of value at all? The answer is: “Only if the interest immediately acquired is already an unrecognised interest in possession (and not a reversionary interest).”

As to the third sentence, this is plumb wrong, as section 10(1)(b) has been overlooked.

3.3 Amendment of Inheritance Tax Act 1984 section 49

Inheritance Tax Act 1984 section 49 (Treatment of interests in possession) is to be amended (by Clause 1(4)) by the addition of the italicised words:

- “(1) A person beneficially entitled to an interest in possession in settled property shall be treated for the purposes of this Act as beneficially entitled to the property in which the interest subsists.
- (1A) Where the interest in possession mentioned in subsection (1) above is one to which the person becomes beneficially entitled on or after 22nd March 2006, subsection (1) above applies in relation to that interest only if, and for so long as, it is—
 - (a) an immediate post-death interest,

⁸ For example, it takes no account of exemptions or reliefs.

⁹ I pass over another inaccuracy: that, because of the proposed change to Inheritance Tax Act 1984 section 49, it will not in fact form part of his estate. See above.

- (b) a disabled person's interest, or
- (c) a transitional serial interest.

or falls within section 5(1B).

...”

Thus, a person beneficially entitled to a section 5(1B) interest in possession will be treated as being beneficially entitled to the settled property. For this purpose, his interest in possession will be a recognised interest in possession.

3.4 Occasions of Charge on Lifetime Disposal or Termination of Section 5(1B) Interest in Possession

While section 49 is sufficient by itself to cause settled property in which there subsists a section 5(1B) interest in possession to be in general included in the estate, and thus brought into charge to inheritance tax if other conditions are satisfied, on the death of an individual beneficially entitled to it, it will be recalled that there are special charging provisions which operate where an individual ceases to be beneficially entitled to an recognised interest in possession during his lifetime or in certain cases where the value of the settled property in which it subsists is artificially reduced. In order to extend these occasions of charge to a Section 5(1B) interest, Clause 1(4) also amends Inheritance Tax Act 1984 sections 51(1A) and 52(2A) and (3A) by adding the words italicised as follows:

“51 Disposal of interest in possession

- (1) Where a person beneficially entitled to an interest in possession in settled property disposes of his interest the disposal-
 - (a) is not a transfer of value, but
 - (b) shall be treated for the purposes of this Article as the coming to an end of his interest;

and tax shall be charged accordingly under section 52 below.

- (1A) Where the interest disposed of is one to which the person became beneficially entitled on or after 22nd March 2006, subsection (1) above applies in relation to the disposal only if the interest is-
 - (a) an immediate post-death interest,

(b) a disabled person's interest within section 89B(1)(c) or (d) below, or

(c) a transitional serial interest.

or falls within section 5(1B).

...”

“52 Charge on termination of interest in possession

(1) Where at any time during the life of a person beneficially entitled to an interest in possession in settled property his interest comes to an end, tax shall be charged, subject to section 53 below, as if at that time he had made a transfer of value and the value transferred had been equal to the value of the property in which his interest subsisted.

(2) If the interest comes to an end by being disposed of by the person beneficially entitled to it and the disposal is for a consideration in money or money's worth, tax shall be chargeable under this section as if the value of the property in which the interest subsisted were reduced by the amount of the consideration; but in determining that amount the value of a reversionary interest in the property or of any interest in other property comprised in the same settlement shall be left out of account.

(2A) Where the interest mentioned in subsection (1) or (2) above is one to which the person became beneficially entitled on or after 22nd March 2006, that subsection applies in relation to the coming to an end of the interest only if the interest is-

(a) an immediate post-death interest,

(b) a disabled person's interest, or

(c) a transitional serial interest.

or falls within section 5(1B)

(3) Where a transaction is made between the trustees of the settlement and a person who is, or is connected with,-

(a) the person beneficially entitled to an interest in the property,
or

- (b) a person beneficially entitled to any other interest in that property or to any interest in any other property comprised in the settlement, or
- (c) a person for whose benefit any of the settled property may be applied,

and, as a result of the transaction, the value of the first-mentioned property is less than it would be but for the transaction, a corresponding part of the interest shall be deemed for the purposes of this section to come to an end, unless the transaction is such that, were the trustees beneficially entitled to the settled property, it would not be a transfer of value.

- (3A) Where the interest mentioned in paragraph (a) of subsection (3) above is one to which the person mentioned in that paragraph became beneficially entitled on or after 22nd March 2006, that subsection applies in relation to the transaction only if the interest is-

- (a) an immediate post-death interest,
- (b) a disabled person's interest, or
- (c) a transitional serial interest.

or falls within section 5(1B).

...”

3.5 Relief Where Property Enters Maintenance Fund

Inheritance Tax Act 1984 section 57A (Relief where property enters maintenance fund) applies where

- “(a) a person dies who immediately before his death was beneficially entitled to an interest in possession in property comprised in a settlement, and
- (b) within two years after his death the property becomes held on trusts (whether of that or another settlement) by virtue of which a direction under paragraph 1 of Schedule 4 to this Act is given in respect of the property.”

It formerly applied only in the case of a specified type of recognised interest in possession. Clause 1(4) will amend it so that it applies also to a Section 5(1B) interest in possession.

3.6 Amendment of Inheritance Tax Act 1984 section 5

Section 5 (Meaning of Estate) (1) of the Inheritance Tax Act 1984 is to be amended by the addition of the words I have italicised:

- “(1) For the purposes of this Act a person’s estate is the aggregate of all the property to which he is beneficially entitled, except that-
 - (a) the estate of a person-
 - (i) does not include an interest in possession in settled property to which section 71A or 71D below applies, and
 - (ii) does not include an interest in possession that falls within subsection (1A) below *unless it falls within subsection (1B) below*, and
- (1A) An interest in possession falls within this subsection if-
 - (a) it is an interest in possession in settled property,
 - (b) the settled property is not property to which section 71A or 71D below applies,
 - (c) the person is beneficially entitled to the interest in possession,
 - (d) the person became beneficially entitled to the interest in possession on or after 22nd March 2006, and
 - (e) the interest in possession is-
 - (i) not an immediate post-death interest,
 - (ii) not a disabled person’s interest, and
 - (iii) not a transitional serial interest.

- (1B) An interest in possession falls within this subsection if the person-
- (a) was domiciled in the United Kingdom on becoming beneficially entitled to it, and
 - (b) became beneficially entitled to it by virtue of a disposition which was prevented from being a transfer of value by section 10 below.
- ...”

Clause 7 of the Explanatory Notes commentary on draft Clause 1, which deals with the proposed new Inheritance Tax Act 1984 section 5(1B), states:

“Subsection (3)(b) inserts new subsection (1B) into section 5 of IHTA, so that it includes a new category of interest in possessions [sic]¹⁰ that will be included as part of a person’s estate.”

I shall now make a point which some might consider pedantic, but which I consider might be highly relevant to the incidence of tax in certain situations. It is *not* the case that the new subsection (1B) will ensure that there is a “new category of interest in possessions [sic] that will be included as part of a person’s estate.” Rather, it will ensure that there will be a new category of interest in possession which will not be excluded from constituting part of a person’s estate by virtue of section 5(1)(a)(ii). What, it might be asked, is the difference? A section 5(1B) interest in possession will not form part of a person’s estate, not because of section 5(1), but because Inheritance Tax Act 1984 section 49 will in general deem him to be entitled to the settled property itself and the effect of that deeming provision is that he is deemed not to be entitled, in addition, to a mere interest in possession in it. Hence, contrary to what the author of the Explanatory Notes states, an interest in possession falling within Inheritance Tax Act 1984 section 5(1B) will not normally be treated as part of his estate.¹¹

3.7 Close Companies

Clause 1 will also amend the close company provisions, contained in Inheritance Tax Act 1984 Part IV.

Clause 1 will amend section 100 (Alterations of capital, etc where participators are trustees), so it extends to the case of a Section 5(1B) interest in possession. It will provide (*italics supplied by RV to words added*):

¹⁰ As mentioned, the draughtsman of the Explanatory Notes is not quite literate. The plural of “interest in possession” is “interests in possession”.

¹¹ For an exceptional case, see Inheritance Tax Act 1984 section 49(2).

- “(1) This section applies where, by virtue of section 98 above, an alteration in a close company’s share or loan capital or of any rights attaching to shares in or debentures of a close company is treated as a disposition made by the participators, and-
- (a) a person is a participator in his capacity as trustee of a settlement, and
 - (b) the disposition would, if the trustee were beneficially entitled to the settled property, be a transfer of value made by him, and
 - (c) at the time of the alteration an individual is beneficially entitled to an interest in possession in the whole or part of so much of the settled property as consists of [unquoted shares in or unquoted securities of the close company.
- (1A) Where the interest in possession is one to which the individual became beneficially entitled on or after 22nd March 2006, this section applies only if the interest in possession is-
- (a) an immediate post-death interest,
 - (b) a disabled person’s interest, or
 - (c) a transitional serial interest.

or falls within section 5(1B)

...”

Clause 1 will also amend section 101 (Companies’ interests in settled property) (1A) so it extends to the case of a Section 5(1B) interest in possession. It will provide ((italics supplied by RV to words added) :

“101 Companies’ interests in settled property

- (1) Where a close company is entitled to an interest in possession in settled property the persons who are participators in relation to the company shall be treated for the purposes of this Act (except section 55) as being the persons entitled to that interest according to their respective rights and interests in the company.
- (1A) Where the interest in possession mentioned in subsection (1) above is one to which the company became entitled on or after 22nd

March 2006 (whether or not the company was a close company when it became entitled to the interest), subsection (1) above applies in relation to the interest only if it is-

- (a) an immediate post-death interest, or
- (b) a transitional serial interest.

or falls within section 5(1B)."

3.8 Gifts with Reservation of Benefit Provisions

Finance Act 1986 section 102ZA (Gifts with reservation: termination of interests in possession) will also be amended so as to extend to a Section 5(1B) interest in possession.

3.9 Potentially Exempt Transfers

Clause 1 amends Inheritance Tax Act 1984 section 3A (Potentially exempt transfers) as follows, words deleted being struck through and words added being italicised:

- “(6) Where, under any provision of this Act ~~other than section 52~~, tax is in any circumstances to be charged as if a transfer of value had been made, that transfer shall be taken to be a transfer which is not a potentially exempt transfer.
- (6A) *The reference in subsection (6) above to any provision of this Act does not include section 52 below except where the transfer of value treated as made by that section is one treated as made on the coming to an end of an interest which falls within section 5(1B) above.*”

I am at a loss to see why a Section 5(1B) interest in possession was marked out for this adverse treatment. I would quite understand this if it had been the case that, had section 3A not been so amended, it would have been possible for a person to arrange for property to be held on certain trusts (under which he was not beneficially entitled) by a strategy which involved his purchasing an interest in possession in settled property and then disposing of his interest in such a way that the disposal involved his making a potentially exempt transfer rather than the chargeable transfer of value he would have made had he simply settled property himself. However, I do not myself see how that could have been the case.

There are three possibilities. The first is that the draughtsman is cleverer than I am and I have missed something. The second is that the draughtsman is somewhat less clever than I am and he has needlessly introduced this discriminatory provision,

honestly thinking it to be necessary. The third is that the provision is inserted out of sheer vindictiveness, not simply to counter perceived avoidance but to punish those who engage in it by imposing a penalty on them which is more than corrective. If the third explanation is correct, then the amendments of section 3A are disproportionate in that they apply whether or not there is a tax avoidance motive.

It will be noted that the amendment of section 3A will have no effect where the person beneficially entitled to the section 5(1B) interest would in any event make an exempt or a chargeable transfer of value.

In practice, I would imagine the situation in which the impact of the amendment is likely to be the greatest is where, consequent on a lifetime termination or disposal of the interest in possession, another individual becomes absolutely entitled to the settled property. This is clearly intended. See Explanatory Notes paragraph 5:

“This means that, for example, where the trust comes to an end and the capital is paid out, the transfer of value will be immediately chargeable to IHT.”

If an individual, T, is beneficially entitled to a section 5(1B) interest in possession, it may often, in my view, be possible to ensure that some other individual becomes absolutely entitled to the settled property without T making a chargeable transfer of value, despite the amendments to section 3A.

3.10 Omissions from Clause 1

The most glaring omission in Clause 1 is the failure to amend Inheritance Tax Act 1984 section 59(1A)(ii) so that a Section 5(1B) interest in possession can be a “qualifying interest in possession” and thus on that account prevent the settled property being “relevant property” within the meaning of section 58 and in consequence being subject in principle to periodic and exit charges to inheritance tax. That results in a potential scandalous double charge to tax on the settled property.

This was quite deliberate. In the Explanatory Notes comment on Clause 1 it is stated:

“21. Where new section 5(1B) applies to treat the interest as part of a person’s estate the property in the trust will still be part of the relevant property regime.”

There is no alteration of the meaning of “postponing interest” in Inheritance Tax Act 1984 section 80 (Initial interest of settlor or spouse or civil partner). That will not normally be of any consequence in the context of a Section 5(1B) interest as section 80 would not in any event normally apply.

4 Draft Clause 2

4.1 The New Inheritance Tax Act 1984 Section 81A

I shall now consider the proposed amendment to the Inheritance Tax Act 1984 contained in draft Clause 2, which would simply add to the Inheritance Tax Act 1984 a new section 81A (Reversionary interests in relevant property) in the following terms:

- “(1) Where a reversionary interest in relevant property to which-
- (a) a person who acquired it for a consideration in money or money’s worth, or
 - (b) the settlor or the spouse or civil partner of the settlor,
- (a “relevant reversioner”) is beneficially entitled comes to any end by reason of the relevant reversioner becoming entitled to an interest in possession in the relevant property, the relevant reversionary is to be treated as having made a disposition of the reversionary interest at that time.
- (2) A transfer of value of a reversionary interest in relevant property to which a relevant reversionary is beneficially entitled is to be taken to be a transfer which is not a potentially exempt transfer.”

4.2 Purpose of Section 81A

It is stated in the commentary on draft Clause 2 in the Explanatory Notes:

- “28. HM Revenue & Customs (HMRC) became aware of arrangements that sought to avoid any IHT charges on assets that are put into a trust. The arrangement was designed to exploit the rules that treat certain reversionary interests as part of a person’s estate in order to reduce the entry charge where assets are put in to trust.
- “29. This clause provides that where certain reversionary interests that are treated as part of a person’s estate come to an end and that person takes their actual interest [sic] in the relevant property trust then there is a deemed disposition for IHT purposes. This means that there is a transfer of value and IHT will be charged based on the value of the reversionary interest immediately before it came to an end. To prevent these charges being avoided by a person gifting their reversionary interest to another person, such a transfer will be an immediately chargeable IHT event.”

This is of rather better quality than the commentary on Clause 1. The reader might ask what are “the rules that treat certain reversionary interests as part of a person’s estate”. So far as I am aware, there are no special rules. It is simply that a reversionary interest is both in reality (and thus for inheritance tax purposes) part of a person’s estate.

4.3 Critique of Section 81A

The Revenue have undoubtedly identified two tax planning opportunities. If a person settles property and retains a reversionary interest under the settlement, then in computing the diminution in the value of his estate one takes into account the value of that interest. Hence, the value transferred by any transfer of value he makes will be reduced accordingly.

If he purchases a reversionary interest in a settlement made by another and pays no more than its value, he will have made no transfer of value.

When, however, the reversionary interest falls into possession, it will normally not be a recognised interest in possession and thus there will at that point be a fall in the value of his estate. As there will be no associated disposition, however, the taxpayer cannot at that point make a transfer of value.¹² Thus, section 81A(1) attempts to overcome this problem (for the Revenue) by introducing a deemed disposition. In some cases it may even attain its object, although, in my view, the number of cases is likely to be rather less than the Revenue imagines.

The purpose of section 81A(2) can best be illustrated by the following. If T wished to do something as wicked as creating an interest in possession trust for his son, not being a disabled person, that would normally involve his making a chargeable transfer of value. Suppose, however, T sets up a trust under which at stage 1 he retains a valuable reversionary interest and at stage 2, if, on mature consideration, he thinks fit, he gifts, say, a life interest in his reversionary interest to his son. At stage 2, T will make a substantial transfer of value but that transfer of value will be a potentially exempt transfer and not a chargeable transfer of value. Hence, the need for section 81A(2). The position would be the same, **mutatis mutandis**, if T purchased a reversionary interest in a settlement created by another.

Again, section 81A(2) may well in some cases attain its object.

5 Conclusion

While the Amendments will make tax planning more difficult, and introduce penal

¹² The Revenue obviously take the view, no doubt correctly, that neither associated operations nor the *Ramsay* principle would help them.

tax charges even for the innocent, there is still scope for the well-advised taxpayer to circumvent their effect.