RECENT DEVELOPMENTS

James Henderson[1]

Private client taxation has recently been changing at an almost unprecedented rate. In the past few months new legislation has come into effect while sweeping legislative proposals have been announced. This article merely mentions what has happened with little detailed analysis. Practitioners should hopefully already be aware of most of these changes. They are central to private client taxation.

SDLT

It is probably only tax practitioners that will remember 1st December 2003 as SDLT day. However, the introduction of SDLT, after more than 300 years of stamp duty, is a change that will affect vast numbers of people. Stamp duty land tax replaced stamp duty on land transactions from 1st December 2003. Unlike stamp duty, it is in no sense a voluntary tax. All consideration is now dutiable and there is an obligation to notify and pay SDLT within 30 days of completing a land transaction. SDLT applies whether or not there is an instrument or transfer, wherever the instrument, if any, is executed, and wherever the parties may be. The new code contains 88 sections and 17 Schedules of the Finance Act 2003. There is further legislation in the Finance Act 2004.

Restrictions on holdover relief

In his Pre Budget Report on 10th December 2003 the Chancellor announced the Government's intention to change the CGT rules with immediate effect 'to stop people exploiting gifts relief under section 165 or 260 TCGA on disposals to settlor interested trusts'. The legislation is contained in Schedule 21 Finance Act 2004.

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Presumably one of the main targets of this new legislation were 'Melville' schemes. In *Melville v IRC* [2001] STC 1271 itself the taxpayer created a discretionary trust of which he was a beneficiary. He retained a power of appointment exercisable after the expiry of 90 days from the date of the trust to direct the trustees to exercise their powers in such manner as he should specify. The taxpayer then (within the 90 day period) transferred valuable shares and loan notes to the trustees. The issue was whether the power of appointment was "property" as defined in section 272 IHTA 1984. If it was then the diminution in value of the taxpayer's estate was small because of the ability to get the trust assets back after the expiry of the 90 day period. The Court of Appeal held that the power was property.

This decision was reversed by the Finance Act 2002. The definition of "property" in section 272 was altered so as not to include a "settlement power" (see section 47A IHTA 1984). However as with much legislation enacted to deal with a defeat in litigation it was, arguably, focused far too narrowly on the facts of *Melville* itself (see also the legislation enacted following the Revenue's defeat in *Ingram* [1999] STC 37). Rather than use a power of appointment, tax practitioners used reversionary interests. The settlor would settle property onto, say, a 100 day discretionary trust with the property reverting to him after that period. Reversions were still property in the hands of the settlor so that the gift into the trust with a retained reversion was a limited transfer of value.

The transfer to the discretionary trust was still, however, a chargeable transfer, although within the nil rate band, so the settlor could claim holdover relief under section 260 TCGA. Within the 100 days, the settlor could either direct the trustees to hold property on the trusts of a settlor-excluded sub-fund or settle the reversion on new trusts. This was a PET.

Holdover relief (usually under section 165 TCGA) also allowed taxpayers to "restart the clock" for taper relief purposes. A taxpayer might own shares which currently qualified for business asset taper relief but did not qualify for periods before April 2000. The period of ownership during which the shares were non-business assets would dilute the taper relief. However, if the taxpayer transferred those shares to an interest in possession trust for himself, claiming business asset holdover relief, the trustees would be able to claim full business taper relief within only two years.

All of the above strategies (and many more) have apparently been halted by the changes to holdover relief. In many cases, the taxpayer will wish to retain an interest in the settlement. In the case of the *Melville* schemes, the settlor's initial reversionary interest would mean that he had an interest in the settlement, even if he subsequently gave that interest away (see the new section 169B). The changes are therefore very sweeping indeed.

Changes to PPR Relief

A further change announced in the pre-budget report concerned principal private residence relief. The effect of these new provisions (contained in Schedule 22 Finance Act 2004), which 'compliment' the holdover relief changes, is that PPR relief will not be available in circumstances where the computation of the amount of any gain arising has to take account of gifts relief under section 260 TCGA. In other words, PPR relief will not be available if any of the gain is a held-over gain. This applies, even if the transfer on which holdover was claimed was before 10th December 2003 (subject to some transitional relief).

Again this is an important change. Take one example: a taxpayer owns a property which he has allowed his son to live in. The taxpayer himself lives in another house nearby. On the disposal of the house in which the son lives, full principal private residence relief will not be available. It might formerly have been proposed that the property be transferred to a discretionary trust. This might have been a *Melville* trust or (if the house was not too valuable) an ordinary discretionary trust from which the settlor was excluded. Even assuming it was the latter, in which case the new legislation amending holdover relief should not apply, the fact that holdover relief is claimed on transferring the property to the discretionary trust would mean that the new legislation on PPR relief will apply.

Rate Applicable to Trusts

Another important change is that the rate applicable to trusts is increased from 34% to 40% for income and gains and 32% for Schedule F income.

Tax Treatment of Pre-Owned Assets

In recent years, partly provoked by soaring house price prices, taxpayers have entered into a variety of inheritance tax schemes. Most seek to take the value of their house out of their estate while continuing to live in it (preferably maintaining CGT PPR relief in the process). Obviously a level of sophistication is required in order to avoid falling foul of the inheritance tax reservation of benefit provisions. In the late 1990's many entered into lease carve schemes or '*Ingram*' schemes. Variations on this scheme have since been adopted, such as the reversionary lease scheme, to avoid falling foul the legislation enacted following

Ingram. More recently, taxpayers have entered into *Eversden* schemes. The basic idea here was for the taxpayer to settle a house on his or her spouse for life with the possibility of appointment in favour of the wider family but without excluding the taxpayer from benefit. Alternatively, the spouse was given a short fixed interest. Section 18 IHTA 1984 and section 102(5)(a) FA 1986 were relied on to assert that there was no gift with reservation of benefit. Following the success of the taxpayer in the Court of Appeal in *Eversden* (STC [2003] 822), legislation was enacted which at least attempted to prevent such schemes.

Other taxpayers entered into so-called 'home loan' or 'double trust' schemes. It remains to be seen whether such schemes (or the many varieties of them) were successful. However, it seems that the government's patience has worn thin. In December, the Inland Revenue published a consultation document entitled 'Tax Treatment of Pre-owned Assets'

The ensuing legislation is contained in Schedule 15 Finance Act 2004. The chances are that, however the above-mentioned schemes have been implemented, they will now be caught by the Schedule 15 charge once it applies. Matthew Wentworth, currently a pupil at Pump Court Tax Chambers, discusses these new provisions in more detail in this issue.

Changes to Taxation of Trusts

Despite the dramatic nature of many of the recent developments mentioned above, perhaps the most sweeping changes may be yet to come. The government has initiated a consultation process on the taxation of trusts generally. It is beyond the scope of this article to deal with all the suggestions here. The consultation document is available on the Inland Revenue website.