SDLT AND IMPLEMENTING NIL RATE BAND DISCRETIONARY TRUSTS IN WILLS

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Background

SDLT commenced on 1st December 2003 and its provisions are contained in Finance Act 2003 (FA 2003) and further provisions have been added in subsequent Finance Acts, including some developments in the recent Budget, and by Statutory Instrument.

It applies to a 'land transaction', which is the acquisition of a chargeable interest[2] . It is a 'chargeable transaction' if it is not exempt[3]. Tax[4] is charged as a percentage of the 'chargeable consideration'[5].

A transaction for no consideration is exempt[6]. Consideration for SDLT purposes includes 'money or money's worth'[7]. Paragraph 8 of Schedule 4 deals with debt as consideration – debts satisfied or released or assumed (this is similar to the old s.57 Stamp Act 1891 concepts).

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2 s.43 FA 2003

3 s.49 & Schedule 3 FA 2003

4 s.55 FA 2003

5 Defined in s.50 and Schedule 4 FA 2003

6 Paragraph 1 Schedule 3 FA 2003

7 Paragraph 2 of Schedule 4 FA 2003

Nil rate band discretionary trusts in Wills

It was due to the popular use in Wills of what has become known as the nil rate band discretionary trust debt/charges schemes that what is now HMRC Stamp Office published a now (hopefully) well known statement on 11th November 2004[8].

Commonly, the wording of a Will provides for a settled legacy of cash representing the maximum sum that can be given without the payment of inheritance tax (IHT) to be held on discretionary trusts for a class of beneficiaries including the surviving spouse.

The personal representatives (PRs) and the nil rate band legacy trustees (NRB trustees) are then respectively given particular powers and indemnities in order to enable the PRs to conclude the administration of the estate without having to pay cash to the NRB trustees or appropriate assets of equivalent value to them. Instead, the Will permits the PRs to arrange either a promise of payment of this amount for the NRB trustees offered by the residuary beneficiary (who will be the surviving spouse or an interest in possession trust for the benefit of that spouse for life); or, a charge over assets under the control of the PRs.

It therefore means that essentially there are two methods of replacing the cash gift with an equivalent asset:

- The binding promise of payment or IOU or
- The charge.

Often the deceased's estate will comprise some personal chattels, some modest investments and the matrimonial home. As far as the house is concerned this might be held by the deceased and the surviving spouse jointly as either tenants in common in equal shares or joint tenants or it might have been in the sole name of the deceased. In such cases the surviving spouse usually wishes, at least initially, to remain in the matrimonial home. There are frequently insufficient resources in the deceased's estate to transfer to the trust unless the deceased's interest in the matrimonial home is used. Until the Budget 2006 the main concern of the estate planner in such circumstances was to avoid the possibility of the surviving spouse acquiring an interest in possession in the deceased's interest in the property by substituting, under the special provisions in the Will, a debt equivalent to cash for the interest in the property.

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8 http://www.hmrc.gov.uk/so/nilband.htm.

There are many cases where the deceased and the surviving spouse held the property as joint tenants rather than tenants in common or where the Will did not contain the appropriate clauses to effect the gift outlined above. In which case practitioners will be familiar with executing Deeds of Variation either to sever the joint tenancy retrospectively for IHT purposes and/or to include a substituted Will containing the relevant clauses.

This therefore introduced a third scenario: that the cash gift might be introduced by way of Deed of Variation and the binding promise of payment or the charge might arise behind such a Deed.

Stamp Office statement

The Stamp Office statement therefore dealt with all three issues. In summary this has meant that:

1. If you use the IOU and legal charge to secure the debt (***debt scheme***) in favour of the discretionary trustees then SDLT will apply at the appropriate percentage (1% or 3%) to the value of the debt to the extent that the PRs transfer to the residuary beneficiary an interest in land as a result of the IOU being given.

2. Where the legacy is secured by a non-recourse or equitable charge (***charge scheme***) entered into by the PRs before assignment of the estate's interest in the deceased's property to the residuary beneficiary then provided it is clear that no liability to pay this debt falls on the residuary beneficiary there will be **no** charge to SDLT.

3. Arrangements set up and implemented as a result of a Deed of Variation will not incur SDLT.

The statement's treatment of the debt scheme has been criticised from the outset[9]. However, in my experience of lecturing up and down the country to practitioners it would seem that many now do not use the debt scheme unless it takes place behind

a Deed of Variation or does not involve a land transaction. This is the pragmatic answer to the question of whether the statement is correct in its approach to the debt scheme rather than engage in costly correspondence or even litigation (despite some members of the Bar's generous offers to undertake this on a pro bono basis).

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9 See Steel, '*Some welcome clarification?*' p.4 Trusts and Estates Law & Tax Journal, December 2004 and http://www.kessler.co.uk/dtwt/NRBDebtArrangments.html

It should be said that an IOU might be offered where there is no land in the deceased's estate but plenty of other assets, like stocks and shares. It may be that the type of investments suit individual ownership rather than trustee ownership. It thus makes sense to take the value of the settled legacy as a debt which may be secured on property owned by the surviving spouse instead of the deceased's investments, which are ultimately transferred to the surviving spouse. In such a situation there is no land transaction and SDLT does not arise.

Equally, in small estates the value of the property interest may be below the SDLT threshold (which has been raised to £125,000 in the Budget[10]). In which case, even if the practitioner did follow the statement's approach to the debt scheme it would still be possible to proceed with an IOU for the value of the property in the knowledge that any 'consideration' which that IOU was deemed to represent was still below the tax threshold.

Most practitioners now seem to use the charge scheme. The statement indicated that provided the charge was placed on the land interest **before** that interest was transferred to the residuary beneficiary it would not represent consideration in money or money's worth for the land transaction. It is most important that the charge is therefore an equitable charge which is undertaken between the PRs and the NRB trustees without any recourse to the residuary beneficiary for repayment.

Where the deceased owned an equitable interest in the matrimonial home as tenant in common with the surviving spouse and that interest was valued at say £200,000 but his total estate was worth £300,000 then the situation is not so straightforward. It is not possible to enter into an equitable charge for a value greater than the value of the equitable interest in the property so an equitable charge can be done for the £200,000 but the nil rate band at the deceased's death was say £275,000 and so the settled legacy needs to be topped up either by cash or the appropriation of assets worth £75,000 or by an IOU for this amount. Care would be needed here not to undertake the IOU at a time when the land transaction had not been concluded since it is possible for the 'linked transactions' provisions to apply in s.108(1) FA 2003 which states:

> "(1) Transactions are 'linked' for the purposes of this Part if they form part of a single scheme, arrangement or series of transactions between the same vendor and purchaser or, in either case, persons connected with them.
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> Section 839 of the Taxes Act 1988 (connected persons) has effect for the purposes of this subsection."

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10 Budget Note 20

Again, to the extent that the IOU was not consideration in money or money's worth for the assent of the equitable interest in the property to the surviving spouse then the giving of the IOU will not be consideration for a land transaction and no SDLT will be payable.

Deeds of Variation

Paragraph 6 of the statement is the relevant paragraph and says:

> "*We have also been asked about the consequences for Stamp Duty Land Tax purposes of a Deed of Variation made by beneficiaries after the death of the deceased person. A Deed of Variation may effect a land transaction if it alters the beneficial interests in land, for example by settling land in trust. However, placing a charge on land is not in itself a land transaction. In addition paragraph 4 of Schedule 3 FA 2003 provides that under certain conditions a land transaction effected by a Deed of Variation is exempt from charge.*"

The analysis of this paragraph suggests that therefore:

- If a Deed of Variation is used to sever a joint tenancy and then the debt scheme is used to implement the settled legacy we must remember that the severance is only happening in the IHT world and not in the 'real' world. This means that the severance is not recognised for SDLT. Instead, the surviving spouse already owns the legal and equitable interest in the property which passed by survivorship so no land transaction by the PRs is taking place as a result of the Deed. No land is being transferred into trust. The surviving spouse is simply providing the IOU in respect of the cash gift given that the value of the deceased's interest in the house is deemed for IHT purposes to be in his estate.

- If a legal charge is imposed on the surviving spouse's property that on its own is not a land transaction so that aspect of the NRB trustees acquiring greater security for the IOU is not taxable either.

- Similarly, if the deceased already owned the house as a tenant in common but the Deed of Variation was used to introduce different terms to the Will then an equitable charge can be placed on the deceased's interest and this again would not represent a land transaction and so there is no SDLT.

- Finally, reference is made to paragraph 4 of Schedule 3 FA 2003 which states:

> "(1) A transaction following a person's death that varies a disposition (whether effected by Will, under the law relating to intestacy or otherwise) of property of which the deceased was competent to dispose is exempt from charge if the following conditions are met.
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> (2) The conditions are –
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> (a) that the transaction is carried out within the period of two years after a person's death, and
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> (b) that no consideration in money or money's worth other than the making of a variation of another such disposition is given for it .
>
> (3) This paragraph applies whether or not the administration of the estate is complete or the property has been distributed in accordance with the original dispositions."

So no SDLT is charged where land is transferred or otherwise dealt with pursuant to a Deed of Variation in respect of the land owned by the deceased if carried out within two years of his death and for no consideration other than the varying of the another disposition.

From the above analysis of paragraph 6 of the statement it would appear that pretty much all of the arrangements that most practitioners are likely to put in place following a Deed of Variation are covered by it so that no SDLT will be due.

Since SDLT is a self assessed tax unless practitioners had paid SDLT on transactions effected by Deed of Variation before the statement was published and so were seeking a refund of tax there is not much scope for knowing HMRC

Stamp Office's view in practice unless a practitioner utilises the COP 10 inquiry procedure on a specific matter.

I have been told by several practitioners that where they paid SDLT on the IOU on debt schemes effected post 1st December 2003 and before the statement was issued on 11th November 2004 they have met with a range of interesting responses to a request for a refund:

1. One response has been to refund the money immediately without any comment – which makes sense if paragraph 6 of the statement is to be understood.

2. Another more common response has been to refund the money but remind the practitioner that SDLT is a self assessed tax and it is therefore a matter for the practitioner whether or not their assessment of liability is correct. The Stamp Office in repaying the tax originally offered is not making any comment on whether or not they agree with the practitioner's view on the basis that this is not a case which they have investigated.

   I understand that the correspondence then sometimes goes on to say that if the case is one which is randomly checked and the Stamp Office disagrees with the practitioner then there will be the prospect of penalties and interest on the tax returned which should have been paid. It does seem strange that the Stamp Office is apparently permitted to repay tax without investigating whether it should be repaid or not. Perhaps there is scope for an argument that the Stamp Office had the opportunity to investigate the validity or otherwise of the practitioner's argument at the time of the request and did not take it so are estopped from retracting the repayment.

   Practitioners receiving such a letter must assume that they will not have closure and should consider making a COP 10 enquiry to obtain finality rather than receive a nasty shock at a later date when a demand for the tax plus penalties and interest is made after they have wound up the deceased's estate.

3. More recently I have seen the Stamp Office refuse to refund the money saying that this is a case which comes within paragraph 5 of the statement. Paragraph 5 actually has four subparagraphs of which three are examples of the use of the debt scheme in various guises, which in all three cases the statement indicates will be taxable and the fourth refers to the charge scheme situation and confirms that in the circumstances outlined above it is not taxable. Nowhere in paragraph 5 does it refer to Deeds of Variation.

   Hopefully, this is simply an error and will be resolved when the person handling the enquiry has checked the circumstances. If not, then paragraph 6 of the statement has no meaning.

Post death severances of joint tenancies

I believe that probate practitioners struggle with the concept of post death severances when it is pointed out that this is an IHT fiction and not a real world reality. This is why most of the difficulties in practice seem to stem from the land registration process where people try and register an assent of an equitable interest by the PRs which has only been deemed to be created as a result of the Deed of Variation for IHT.

To be safe it would be wise to use the IOU when the Deed of Variation has severed the joint tenancy since otherwise arguments could be faced on registration if not with regard to SDLT.

The Budget

There were five Budget notices relating to SDLT issued on 22nd March 2006: BN 20 – 24.

BN 20 raised the threshold for residential transactions from £120,000 to £125,000 for any land transaction which takes place on or after 23rd March 2006.

BN 22 indicates that SDLT is to be simplified and clarified in a number of ways. The relevant one for trust and estate practitioners is in relation to the issue of Treasury Regulations which are to set out a number of common transactions which are to be taken out of the scope of SDLT by deeming them not to be for 'chargeable consideration'. These include a gift of property where the donee or beneficiary agrees or is required to pay capital gains tax or inheritance tax arising on the gift.

The draft regulations for this proposal have been issued and are planned to come into force on 12th April 2006. This is a welcome clarification since it will mean that where a beneficiary pays the IHT themselves on the estate in order to enable

the PRs to transfer the deceased's property to him rather than sell it to pay the IHT bill no SDLT will arise. At one point it did look as though the Stamp Office might seek SDLT in this situation as the paying of the IHT bill personally by the beneficiary and not by the PRs was seen as providing consideration for the land transaction.

SDLT remains a complex and difficult tax. Given this and Budget Note 25[11] the popularity of the nil rate band discretionary trust debt/charge schemes may wane. The whole purpose of the schemes is to avoid a situation where a surviving spouse living in a property co-owned by his/her and the NRB trustees could cause an interest in possession to arise.

Perhaps in future the fact that whether or not the surviving spouse has an interest in possession will make no IHT difference (the discretionary trust IHT regime being brought into effect from 22 March 2006 on new accumulation and maintenance trusts and new interest in possession trusts) will encourage more clients to adopt what to them is probably a simpler route – namely to just transfer the deceased's half of the house to the discretionary trust rather than have to worry about complicated documents to achieve the debt or charge correctly. All they will have to worry about then is whether there will be a 10 year IHT charge on the trust fund when its assets only consist of half the value of the property!

11 Aligning the Inheritance Tax Treatment for Trusts