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Practical TAX Newsletter

When is an Omission Chargeable to IHT?

Helen McGhee considers the Parry case.

The case of *Parry & Others (Mrs RF Staveley's Personal Representatives) v HMRC* [2014] UKFTT 419 TC03548 decided by the First-tier Tribunal in May 2014, attracted some attention in the tax press, but some of the issues deserve further consideration.

The facts

The case concerned the estate of Mrs Stavelely. In 2004 Mrs Staveley was diagnosed with ovarian cancer and by 2006 her prognosis was poor and she was offered only palliative care. Shortly after receiving this diagnosis, at the age of 56 she transferred significant funds from an existing pension scheme to a personal pension plan under which she could advise who was to benefit from the fund upon her death (albeit the decision was ultimately left to the discretion of the pension fund administrator). Mrs Staveley made the transfer to the new plan for various reasons but largely to ensure that the funds were protected from ever reverting back to her ex-husband, who was also her ex-employer. Mrs Staveley had access to the funds after the age of 50 but chose not to take any benefits from the plan and sadly died six weeks after the transfer.

IHT charges

HMRC sought two charges to inheritance tax (IHT); one on the transfer of the funds into the new scheme and another on the basis that the omission by Mrs Staveley to take any benefits from the scheme prior to her death was a transfer of value under IHTA 1984, s 3(3). Mrs Staveley's personal representatives contended that no IHT was due as neither the transfer nor the omission was intended to "confer any gratuitous benefit on any person" within the meaning of IHTA 1984, s 10.

Tribunal decision

The First-tier Tribunal accepted that the transfer of funds into the new pension scheme did not attract a charge to IHT as a result of IHTA 1984, s 10. It was not Mrs Staveley's intention to *confer* a gratuitous benefit on her sons (the beneficiaries under her Will) by way of IHT planning; her intention was to protect the fund from her ex-husband, however misguided this may have been. Her sons were the beneficiaries under the new pension plan just as they were under the old pension plan.

The Tribunal had considered the second charge entirely separately; unconvinced by HRMC's arguments that the transfers should taint each other under IHTA 1984, s 10(3) or be viewed as associated operations under IHTA 1984, s 268.

The Tribunal confirmed that section 10 could apply to omissions as it does to transfers, but decided that it could not be invoked in respect of the second disposition on the grounds that there was a gratuitous intent.

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Analysis of omission

Aspects of this second charge on the omission are of real interest. The Tribunal decided that Mrs Staveley's omission to draw any benefit out of the fund led to a diminution in the value of her estate because she lost the right to lifetime benefits under the fund. The Appellants fought this contention under two limbs. The first limb was that the wording of IHTA 1984, s 3(3) requires a causal link (in both timing and value) between the diminution of her estate and the increase in value of her sons' estate, and secondly that the omission under IHTA 1984, s 3(3) must be deliberate.

Deliberate intention

Dealing with the second limb first, the Tribunal decided that on the evidence before them, the omission to take benefits was not inadvertent and therefore must be deliberate, as it was understood that amongst other intentions she may have had, she acted to preserve the value of the fund for the benefits of her sons' upon her death.

Causal link

In reaching their conclusion on the first limb, HMRC made reference to the case of *Fryer & Others (Arnold's Personal Representatives) v HMRC* [2010] SFTD 632. In this case Mrs Arnold declared a discretionary trust over her pension fund assets allowing the benefits to accrue to a trust on her death. The Tribunal considered this case to be analogous, notwithstanding that in *Parry* there was a discretion for the pension fund administrators as regards who the funds would be distributed to, which potentially broke the required causal link between the omission and the increase and value of the sons' estates. In fact the link was not broken due to the existence of a letter of wishes.

Diminution of estate

It is perhaps worthwhile to dwell on how the omission diminished Mrs Staveley's estate and whether it in fact enhanced the estate of her sons. Mrs Staveley's estate of course was not *enhanced* as she did not take the benefits out of the pension fund, but this cannot be the same as it actually being diminished.

One can envisage a circumstance when this might occur in relation to an omission, for example where a person refrains from exercising his right to buy shares in a company under a rights issue. In such circumstance the value of a person's shareholding could actually go down as a result of the omission. How did Mrs Staveley's omission make the value of her estate actually go down?

HMRC contended that at the point of her death she lost the right to exercise her lifetime benefits and the Tribunal accepted that this was a diminution of her estate. In reaching this conclusion the Tribunal considered that if on death she acquired a right to death benefits then this diminution would not have occurred; however this was not the situation here. One might argue that it must therefore follow that it was in fact her death that caused the diminution and not her omission. The Tribunal considered this but applied a purposive interpretation of IHTA 1984, s 3(3) and decided that the disposition took place at the last time when her omission could be relevant.

Increase in sons' estates

A question of equal importance is whether her omission actually increased the value of the estate of her sons, as required by IHTA 1984, s 3(3)? As a matter of common sense one would say no. What they later inherited was more than it might have been but that may not be the same as saying that her failure to exercise her rights increased the value of their estate. The Tribunal decided that it did.

Subsequent legislation

It is worth examining the judgment in *Parry* in relation to IHTA 1984, s 12(2B) and its successor section 12(2ZA). These sections were not considered in *Fryer* as section 12(2B) did not come in until 6 April 2006 (all that existed prior to it was HMRC guidance) and section 12(2ZA) was introduced by FA 2011.

IHTA 1984, s 12 provides that there is no transfer of value to the extent that a transfer would be allowable against the transferor's profits or gains for income tax or corporation tax purposes, thereby excluding most contributions to pension schemes. In 2006, IHTA 1984, s 12(2B) provided that omitting to exercise pension rights would not be treated as a transfer of value provided that the transferor has no reason to believe that they will die within two years of the making of such a chargeable transfer. This was of no help to Mrs Staveley because she was terminally ill.

In order to access IHTA 1984, s 12(2B) the transferor must get past the gateway of IHTA 1984, s 12(2A), which provides that where there is a deliberate omission caught by IHTA 1984, s 3(3) (which is not exempted under IHTA 1984, s 10 by virtue of there being no intention to confer gratuitous intent) then IHTA 1984, s 12(2B) cannot apply, and this is clearly where Mrs Staveley fell down. The Tribunal found that her omission was deliberate and it had been intended to confer gratuitous intent.

Pension rights

IHTA 1984, ss 12(2F), s12(2G) define what is meant by an omission to exercise pension rights, as when a person does not become entitled at a time when he was eligible to be entitled.

However, IHTA 1984, s 12(2ZA), goes further than its predecessors and specifically excludes IHTA, 1984 s 3(3) in relation to *any* omission to exercise most pension rights (regardless of whether it was a section 10 transfer). The aim of this amendment in FA 2011 was to ensure individuals are not caught by IHTA 1984, s 3(3) by failing to purchase an annuity.

If the same situation as befell Mrs Staveley were to arise now, the IHTA 1984, s 12(2ZA) would provide protection regardless of the two-year period, and the question of whether the omission would be protected by section 10 nature falls away. The important question therefore comes back to whether the omission comes within section 3(3) because the

value of the estates have been altered as a consequence of the omission. **TPT**

Helen McGhee

Helen McGhee is an Associate and Chartered Tax Adviser at Squire Patton Boggs (UK) LLP. Tel: 020 7655 1684 or helen.mcghee@squirepb.com.

Special Relief

Philip and Sarah McNeill explain how this can be used.

Special Relief is a statutory solution to the problem of out of time, estimated income tax or corporation tax, self-assessment demands. It replaces the concession called "Equitable Liability", originally published in the Inland Revenue's Tax Bulletin in August 1995.

When using Special Relief we will be dealing with disorganised clients, or cases inherited from disorganised accountants, where a case has slipped into arrears.

Special Relief also covers the previously self-employed, where the client has not been withdrawn from self-assessment. Here, a former trader can face a large immovable estimated tax bill that HMRC refuses to cancel – all because an accountant failed to file the last return or correctly notify cessation of self-employment. This is a cautionary reminder of the importance of ensuring that clients are actually taken out of self-assessment on ceasing to trade.

When can it be used?

Where a taxpayer fails to make a self-assessment return on time, HMRC may make an estimate (called a "determination") of the tax due. This is supposed to be calculated "to the best of their information and belief" (TMA 1970, s 28C for individuals, FA 1998, Sch 18, para 36 for companies).

There is no right of appeal against a determination, but if the taxpayer files a return within self-assessment time-limits, the return replaces the determination.

The time limits for a company are the later of (see HMRC's Company Taxation Manual at CTM23170):

- three years from the day on which the determination could first have been made; and
- 12 months from the actual date of the determination.

For individuals the time limits are the later of (see HMRC's Compliance Handbook at CH56100):

- three years from the filing date (31 January following the tax year); and
- 12 months from the date of the determination.

Where the filing deadline has passed, the determination cannot be changed by submission of return or by appeal, and is enforceable as a Crown debt. This is where Special Relief comes into play.

Second chance

It is important to note that a late determination gives a "second chance" to file an out of date return.

Where a determination has been made *after* the normal self-assessment time limits, the time limit is reset to 12 months from the date of the determination. In the authors' experience, both practitioners and HMRC staff can be unaware of this rule. The result can be a client with a large estimated bill, and only the uncertain remedy of Special Relief.

How to claim Special Relief

HMRC sets out its views on Special Relief in its Self-assessment Claims Manual, from SACM12215 onwards. There are three sets of conditions: A, B and C.

Condition A

In the opinion of the Commissioners it would be *unconscionable* for HMRC to seek to recover the amount charged by a determination, or refuse to repay it if already paid.

HMRC defines further what it means by "unconscionable" at SACM12240. This is likely to be the hardest test to pass.

Unacceptable reasons

HMRC's list of unacceptable reasons for failure to file a tax return in time includes:

a) someone registering as self-employed, but never trading (though in practice, HMRC often allows such claims);
b) someone ceasing self-employment, who does not complete final returns and provide a forwarding address to cover the enquiry window;
c) construction industry subcontractors who neither file tax returns nor respond to HMRC, mistakenly believing that, as they have paid some tax at source, they need do no more;
d) someone moving abroad who does not respond to HMRC as regards outstanding debts or leave a forwarding address; and
e) someone negligent from HMRC's point of view, in that they were aware of their responsibilities but did not act or respond to communications.

In respect of b) HMRC states:

"We expect all people to act reasonably so they should be aware that HMRC has 12 months to enquire into any return; in this situation the person should ensure HMRC has an up to date address or that arrangements are put in place to forward post."

In addition HMRC says:

"People must take responsibility for their own affairs, or engage an