HM Revenue
& Customs

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Laura Kermally
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Dear Laura,

Further to the last HMRC STEP meeting, HMRC took away a number of action points. One of these action points related to DOTAS and IHT and the points raised by Emma Chamberlain on 14th June 2018. Please find HMRC's response to the seven points raised below.

1. Deeds of variation: Example 6. It is suggested that a deed of variation does not reduce the deceased's estate – which of course is correct – but it does reduce the donor's (i.e. the person executing the deed of variation). However Example 6 notes "*The property is treated as never being comprised in the donor's estate so there is no reduction in the donor's estate and Condition 1d is not met in respect of the donor.*" This suggests that no deeds of variation are notifiable. In the real world the donor's estate is being reduced. Is HMRC's view therefore that deeds of variation are never disclosable?

It is the overall arrangements that may or may not be notifiable, not merely one step in those arrangements. Example 6 does not consider all possible scenarios where a deed of variation is used. It considers a simple standalone deed of variation and analyses whether that arrangement would be notifiable. In particular Example 6 does not consider situations where a deed of variation is only one step in arrangements which seek to gain one of the tax advantages set out in Condition 1 of the IHT DOTAS hallmark. Where that was the case Condition 1 would be met.

2. Undivided shares: Example 10. Why do HMRC suggest that gifts of undivided shares might be disclosable where the donor only retains a very small proportion of the property in comparison to their level of occupation? What proportion would this be? Gifts of undivided shares are very common and nothing is said in the legislation about the share being linked to the level of occupation. What share requires reporting?

Condition 2 requires consideration of whether an informed observer would reasonably be expected to conclude that the arrangements which lead to the tax advantage contain one or more contrived steps without which the tax advantage could not be obtained. In HMRC's view an informed observer is likely to conclude that being able to have use of a property which is proportionate to the share of ownership is neither unusual nor contrived. However, we take the view that an informed observer is likely to conclude that having the use of a property which is significantly disproportionate to the level of ownership is abnormal and/or contrived. Ultimately it falls to the promoter to determine whether they consider that their particular arrangements are caught by Conditions 1 and 2.

3. BPR: Example 16. It is suggested that transfers of shares into trusts that qualify for BPR would not normally be a disclosable transaction. However, if the shares were sold back to the settlor soon after then it might be disclosable. Suppose the shares were transferred into a trust shortly before a planned sale to a third party i.e. along *Reynaud* lines. Is this not simply established practice now and is it right that would not need to be disclosed?

The 'established practice' exception in Regulation 5 of the IHT DOTAS hallmark covers the implementation after 1 April 2018 of a specific proposal that had previously been implemented before 1 April 2018. The exception does not apply to a general description of proposals containing common features, but rather to the specific proposal. For the exception to apply the proposal being implemented must be the same proposal that was previously implemented. It seems likely that arrangements designed to achieve this outcome would be bespoke and are therefore unlikely to meet the 'established practice' exception in Regulation 5.

4. Reversionary leases: Example 17 – HMRC suggest that the grant of a reversionary lease would be within Condition 1c and Condition 2 and therefore notifiable if done in such a way that no POAT charge arises under Schedule 15 FA 2004. It is not clear whether HMRC consider that reversionary lease schemes are only disclosable if they avoid POAT e.g. if executed by a non-resident or in respect of let property or disclosable more generally. Why would all of these not be within the established practice exception given that in 2010 HMRC explicitly accepted in their own guidance that reversionary leases would avoid a reservation of benefit if done correctly and were therefore potentially caught by POAT but only if the POAT conditions are satisfied.

The tax advantage in Condition 1(c) is the avoidance or reduction of a gift with reservation charge in circumstances where no POA Income Tax charge arises. Reversionary lease schemes can only therefore be caught by Condition 1(c) where they do not give rise to a POA Income Tax charge.

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5. Gilts. Suppose a non-resident UK domiciled person is diagnosed with a terminal illness and uses all his cash to buy gilts which he gives away to his children. Is this a disclosable transaction? Does the age or the person's health make any difference?

Arrangements need to be tested against the hallmark conditions. In this example it seems clear that condition 1(d) would be met as there is a reduction in the transferor's estate without giving rise to a chargeable transfer or PET. Whether Condition 2 is met depends on the particular circumstances and whether the arrangements involve one or more contrived or abnormal steps to achieve the tax advantage. It seems likely that, in the circumstances described, Condition 2 would be met.

6. Shares and freezer arrangements. These are common in family companies e.g. A shares carrying growth and B shares having dividend rights. The creation of such shares in itself does not reduce the donor's estate. Is it right they are non-disclosable?

Unless the arrangements result in any of the tax advantages set out in Condition 1, which does not appear to be the case, they would not be notifiable.

7. Setting up several trusts to split value. E.g. five trusts set up and funded on different days or over a period of time hold 100% of a company rather than one trust holding 100%. This reduces the value charged on each trust's shares on the ten-year anniversary (but will have other economic consequences). Trust fragmentation schemes are common and arguably part of established practice; are they not disclosable?

These arrangements seek to achieve a tax advantage within Condition 1(b) and also appear to involve one or more contrived or abnormal steps in order to achieve that tax advantage, indicating that Condition 2 is also met.

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In addition, for the 'established practice' exception to apply, the arrangements must have accorded with established practice and HMRC must have indicated their acceptance of that practice. The basis on which you consider these two requirements may be satisfied is not clear.

Regards

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