UPDATE ON IHT HOME LOANS SCHEMES – Technical note January 2013

Home Loan or Double Trust Schemes proliferated in the decade ending 1 December 2003. With the introduction of the Pre-Owned Assets Income Tax charge ("POAT") from 6 April 2005, HMRC had to form a view on whether the arrangements, if properly implemented, succeeded in their goal of reducing the IHT charge on the taxpayer's main residence provided that he survived for seven years (with some savings if he survived three). If the schemes did succeed in reducing inheritance tax then POAT would generally be payable.

HMRC initial approach was published in the POA Guidance Notes in 2005 which stated their views as follows:

(i) in cases where the loan was repayable on demand because the trustees had not called in the loan they had conferred a significant benefit on the taxpayer in enabling him to continue to reside in the property "and therefore the debt was not enjoyed to the entire exclusion of any benefit to the vendor(s) by contract or otherwise".

(ii) in cases where the debt was only repayable at a time after the death of the life tenant "since…the loan cannot be called in by the loan trustees it is generally thought that these schemes will not be caught as gifts with reservation".

Accordingly taxpayers in some cases opted to pay the POAT charge in the belief that the inheritance tax savings would be secure.

In October 2010, however, the Guidance was revised by the inclusion of the following sentence:

"*HMRC is now of the view that these schemes ……..[i.e. gifts where loan is not repayable on demand] are also caught as gifts with reservation. Further guidance, including the consequences for the POA charge, will be issued shortly*".

In 2011 HMRC re-issued the POAT guidance. This then said:

"A variant of the scheme described above is where the terms of the loan provide that the debt is only repayable at a time after the death of the life tenant. Since, unlike the position with loans repayable on demand, the loan cannot be called in by the loan trustees, it was previously thought that, in general, these schemes would not be caught as gifts with reservation. However, it is now HMRC's view that as the steps taken under the schemes are a pre-ordained series of transactions a realistic view should be taken of what the transactions achieve, as a composite whole, when considering how the law applies. This follows the line of authority founded on W T Ramsay v IRC [1981] 1 AER 865. The composite transaction has the effect that the vendor has

made a "gift" of the property concerned for the purposes of s102 FA 1986 and has continued to live there. The property is therefore subject to a reservation of benefit.

It is considered that this approach will apply to all variants of the home loan or double trust scheme and, where it produces a higher amount of tax, will be applied in preference to the position outlined above where the loan is repayable on demand."

HMRC therefore now consider that any home loan scheme fails to mitigate IHT for four reasons:

a. s103 FA 1986 applies with the result that the loan is not a valid deduction against the trust fund of the Property Trust;

b. the so-called "*Ramsay* principle" applies so that the gift is to be re-characterised as being a gift of the house and the continued occupation by the taxpayer involves a reservation of benefit;

c. the scheme involves a series of associated operations so that there is a reservation of benefit in the loan;

d. in any event, if the loan is repayable on demand, on basic principles alone it is subject to reservation of benefit.

The strength of the HMRC arguments is discussed in an article in Tax Adviser in [March 2013]. A case where the loan was not repayable on demand proceeded to move forward in early 2012 with notices of determination and appeals. In the meantime other estates were held

up; this in turn meant that until the outcome of the litigation was known it was not clear whether the Property Trust or the Debt Trust or the executors (or none) would be liable to pay any

inheritance tax and therefore a certificate of tax deposit could not easily be purchased to stop

interest running. To deal with this problem in their August 2012 Newsletter HMRC

commented as follows:

"*HMRC is aware that in a number of estates, the correct treatment of home loan schemes for the purposes of Inheritance Tax (IHT) and the pre-owned assets charge is the only matter to be resolved and is holding up the administration of the estate being wound up. In order to allow executors and trustees to deal with the estate as far as possible HMRC will, on request, provide an estimate of the tax that might be payable should litigation find in HMRC's favour.*

Executors and trustees may then choose to make a payment on account with HMRC to stop further interest accruing, or they may make and retain an appropriate reserve from funds in their hands. Where money is paid on account, HMRC acknowledges that this does not signify

acceptance of HMRC's view and in the event that litigation is decided in favour of the taxpayer, HMRC will then adjust the IHT position as necessary and refund any money that has been overpaid".

Latest developments

In December 2012 the above "test" case settled in favour of the taxpayer and therefore HMRC are now looking for a new case to take. Although inheritance tax was repaid on the test case HMRC did not accept the technical merits of the scheme. HMRC agreed that the loan was deductible for inheritance tax purposes but only on the particular facts of that case. In that case:

(a) The deceased taxpayer who died before the change in guidance clearly had relied on the 2005 guidance and paid POAT on the reasonable assumption that the scheme would be accepted as inheritance tax effective by HMRC and the executors and trustees were prepared to take that point alone to judicial review;

(b) HMRC had previously enquired into the taxpayer's affairs and in particular the valuation for POAT purposes and had accepted that the correct amount of POAT had been paid.

In fact it was not the apparent reliance on the old guidance that made HMRC settle the case. HMRC commented: "*With home loan schemes, there is a direct connection between the POA charge and IHT – if HMRC has agreed that the POA charge is properly payable it must follow that none of the [POAT] exemptions apply; and if the exemptions don't apply, it must be accepted that there is no potential IHT charge. Reading across to IHT, it is not unreasonable to take the view that the closure notice could operate as 'clearance' for IHT such that HMRC is not able to re-open the matter on death."*

In short, HMRC now state that "*where there has been an enquiry into the POA charge and HMRC has accepted that the charge applies, either in the figures returned or after adjustment,* ***HMRC may not revisit the position on death.*** *But where the POA charge has been paid and has not been the subject of an enquiry, HMRC is entitled to maintain on death that the home loan scheme is ineffective and seek to recover the IHT accordingly – although where it does so, allowance will be given for the income tax already paid."*

It is therefore important that executors of anyone who has done a home loan scheme should establish whether there has been any past POAT enquiry into the taxpayer's return. If there has been such an enquiry and a closure notice has been issued, with or

without amendment, then HMRC have indicated they will now accept the scheme is effective for inheritance tax purposes.

In addition HMRC do appear to accept that where the taxpayer died before the change in guidance and the executors submitted the probate papers claiming a deduction for the loan that was initially accepted by HMRC and only later queried, the deduction will generally be given.

However, HMRC do not accept that the guidance that was repeatedly reissued before October 2010 is binding on them or raised any expectation that the taxpayer was entitled to assume that home loan schemes where the debt was not repayable on demand were accepted for inheritance tax purposes. In the view of some (as set out in the Tax Adviser article) this is not correct on the basis that a legitimate expectation has been raised. CIOT cannot comment on this but it is desirable that advisers are aware of what is happening to ensure a consistent approach to resolving cases is adopted. Advisers should read that article for further information including details of any fighting fund.

In the meantime the technical arguments on whether the home loan case actually works remain unresolved. HMRC will no doubt issue notices of determination against which another taxpayer can appeal and another case will have to be taken.

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