

Unscrambling inheritance tax schemes

Many inheritance tax schemes have become uneconomic following the introduction of pre-owned asset tax. For example, a popular scheme at one time was the 'Ingram' scheme in relation to the main residence; this involved the taxpayer keeping a leasehold interest in the residence and giving away the freehold to his or her children or to a trust for them.

This scheme was never a cure for all ills. It was certainly quite effective in inheritance tax terms, but that tax saving was replaced with a capital gains tax liability which would normally arise on the freehold interest given away. We have seen cases where the inheritance tax saving was not much greater than the capital gains tax incurred.

Another feature of these schemes was that they were commonly carried out by people whose main asset in their estates was the main residence, i.e. those who were least able to carry out any other form of inheritance tax planning. They were therefore something of a last resort.

The introduction of pre-owned asset tax has placed many of these taxpayers in extreme difficulty. They are often pensioners on low incomes and they simply cannot afford the tax. This does not apparently concern the Chancellor, but it is of great concern to us as advisers. The schemes therefore now need detailed review. A good solution last year was the setting up of a reverter to settlor trust for the freehold interest but unfortunately the Inland Revenue seems to have heard about these schemes very quickly, possibly through their being broadcast at professional conferences. They have therefore been stopped in their tracks already.

The simple solution of making the pre-owned asset tax election for inheritance tax treatment is scarcely likely to be a solution which one can recommend. This cures the pre-owned asset tax problem, but it leaves double tax liability. The capital gains tax on the freehold remains and the inheritance tax liability is reinstated – a pernicious and wholly unfair result.

In many cases, the scheme will have to be unscrambled as best as can be done. This may mean that the capital gains tax liability on the freehold will remain as a potential liability, but it can be possible to defer this until the death of the home owner. If a scheme involved placing the freehold in trust, an assignment of the interests in the trust might be the solution, although once again there are capital gains tax issues to be alert to.

The home loan scheme

Another popular inheritance tax scheme which was widely marketed was the home loan or double trust scheme. The home was sold to a settlor interested trust leaving the proceeds outstanding as a debt due to the taxpayer. The taxpayer then gave the debt away to another trust which was for the benefit of his or her children.

These schemes appeared in a variety of guises, some becoming ever more complex in order to overcome perceived drawbacks with the original straightforward version which involved an IOU given to the children's trust. It should be noted that these simple versions are now said by the Revenue to be ineffective; the Revenue is arguing that there is a reservation of benefit in the debt if it is repayable on demand, and that despite this the pre-owned asset charge is still incurred. Most of these schemes are therefore now being dismantled. Once again this is not necessarily a straightforward matter and we have seen cases where the course of action being recommended requires a clear breach of trust by the trustees for the children. However, there are in fact a number of ways of dismantling the schemes, and in some cases it may be possible to preserve some of the inheritance tax benefits whilst also avoiding a pre-owned asset charge.

Parmentier Arthur can advise in this area after detailed review of the scheme concerned.

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