Revenue practice on residence

A recent case before the Special Commissioners concerning the residence and domicile of a taxpayer has caused sufficient shock to be widely discussed in the columns of the money pages of weekend newspapers. In the case of Gaines-Cooper v HMIT the taxpayer followed the clear Inland Revenue practice set out in its booklet IR20 to the effect that days of arrival in and departure from the United Kingdom are ignored in counting the days which are spent in this country when applying the tests for residence purposes. This practice does not accord with the High Court decision in Wilkie v CIR but it has been a longstanding practice and so far as is known it has been followed by the Revenue up till now virtually without any question. Of course, it is conceivable that one could spend every day of the year in the United Kingdom under this test and still not be resident here so long as one comes into the country early in the morning of one day and always leaves by the evening of the next.

For some unexplained reason, the Revenue refused to apply this practice in the Gaines-Cooper case. The taxpayer clearly travelled widely throughout the world as part of his business activities and it transpired that by counting his hours in the United Kingdom it was possible to establish that the time spent here amounted to more than 90 days per annum. The Special Commissioners therefore held that as a matter of law the taxpayer was resident in the United Kingdom.

It has always been considered slightly risky to base one's hopes on what amounts to a Revenue concession, however clearly stated it may be. Booklet IR20 says that 'the normal rule' is that days of arrival and departure are ignored, but nowhere in the booklet does it give any indication at all as to when the circumstances are sufficiently abnormal for the normal rule not to apply. The taxpayer can of course apply to the High Court for judicial review where the Revenue refuses to apply one of its stated practices, but it is notoriously difficult to win such applications. In 1986, a very experienced stamp duty practitioner took a judicial review case to the High Court (ex parte J Rothschild Holdings plc) on the basis that it was widely known amongst practitioners that the Stamp Duty Office had a certain practice. However, proving this to the satisfaction of the High Court proved impossible and the case was lost. Similarly, proving the extent of the Revenue's 'normal rule' on residence will be equally difficult. Last year this 'normal rule' was not applied by the Revenue in Shepherd v CIR, so perhaps we can expect it to be modified before long.

In the meantime, taxpayers are best advised not to rely on Revenue practices in booklet IR20.

Children's trusts

No new accumulation and maintenance trusts within section 71, IHTA 1984 can be set up following the Finance Act 2006, but in place it is possible to set

up trusts by will for ‘bereaved minors’, or ‘age 18 to 25’ trusts for the children of the testator.

In addition, existing accumulation and maintenance trusts can be converted, before 5 April 2008, into ‘age 18 to 25’ trusts thereby preserving a small inheritance tax benefit for them.

On the strict wording of the Finance Act, both these types of trust for children required the funds to be separately earmarked for each child, with no possibility of the income arising being paid to any other beneficiary whilst that child is alive. The wording seemed to rule out pooling of funds along the lines of previous accumulation and maintenance trusts.

Strangely, it appears that the Finance Act wording is slightly misleading in this respect. The Society of Trust and Estate Practitioners, and the Chartered Institute of Taxation have recently jointly published a number of questions put to the Revenue concerning trusts following the Finance Act, with replies provided by the Inland Revenue. Questions 21 and 22 deal with cases where funds are held for ‘such of my children as reach the age of 25 and if more than one in equal shares’. Can such trusts qualify as bereaved minors’ trusts or age 18 to 25 trusts? The surprising answer given by the Revenue is that they can. The Revenue says that it considers that each child while alive and under the age of 18 or 25 has a presumptive share that is held for his or her benefit and one can apply the Finance Act provisions child by child and presumptive share by presumptive share.

In practice what this means is that existing accumulation and maintenance trusts for children who will receive their funds absolutely upon attaining the age of 25 will automatically qualify as age 18 to 25 trusts without any revision to the terms of the trusts being required.

Revertor to settlor trusts

Revertor to settlor trusts had very significant tax advantages prior to this year’s Finance Act and they had several uses in tax planning situations.

A simple scenario was where parents gave their home to their children and at a later time, the children put the home back into a trust for the parents for their joint lives, and after the death of the survivor the children would receive the trust fund (i.e. the property) back again. The initial gift of the home would be a gift with reservation of benefit for inheritance tax purposes, but the trust back in favour of the parents eliminated this, because it put the property back in their estates. Nevertheless a specific inheritance tax exemption applied on the death of the parents and so this neatly got everybody out of inheritance tax problems.

Those who were well advised would have slightly embellished the terms of the trust. Instead of the funds going back to the children absolutely on the death of the survivor of the parents, there would be a short term interest in

possession trust for the children and then the trust would end with the children taking the funds absolutely. This did not affect the inheritance tax exemption, but it also provided a tax-free uplift in the trust property for capital gains tax purposes.

Those who carried out this strategy now need to review the trusts and, undoubtedly, some changes will need to be made. Following the Finance Act 2006 the only benefit which the trust will now retain is the capital gains tax exemption. All the inheritance tax advantages have been removed. Worse still, a charge to pre-owned asset tax will also arise. This must be one of the few situations where the taxpayer has liability to the pre-owned asset tax, whilst that asset will also be liable to inheritance tax on his death.

There are several courses of action which may be taken to deal with this double tax liability, and Parmentier Arthur can advise in this respect.

Parmentier Arthur Group Plc

90 Long Acre
Covent Garden
London
WC2E 9RZ

Tel: 020 7849 3018
Fax: 020 7849 3171

7 The Waits
St Ives
Cambs
PE27 5BY

Tel: 01480 465522
Fax: 01480 461221

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