

Delay caused unnecessary tax bill

A recent case at the Special Commissioners has highlighted the importance of taking good tax advice at an early stage. If things are left until it is too late, there may be little which can be done to remedy the position.

The case was *Bailhache Labesse Trustees Limited v HMRC* heard before the Special Commissioners on 12 and 13 May 2008. The facts were very straightforward. A taxpayer made a trust during his lifetime in which he was the principal beneficiary, receiving the income for life. At his death, there was a discretionary trust, but ultimately in default of any different appointment by the trustees, the trust fund would be divided into four equal shares, two shares going to charities and the other two shares going to members of the family.

He also made a will in broadly the same terms, so that when he died there was of course no quarrel about the inheritance tax treatment. The funds passing to the charities were free of inheritance tax, but the shares passing to the members of the family were chargeable in the normal way.

But what about the trust? Here the position was slightly different. On the death of the taxpayer, even though it was clear what was intended to happen in due course, in strict terms a discretionary trust arose with the trustees having power to appoint the funds as they thought fit, although in practice they knew what the intentions of the settlor/taxpayer were. After a short period of time, they made appointments in accordance with his wishes and one half of the trust fund went out to the two charities and the other half to members of the family.

Unfortunately the inheritance tax position was not the same as with the deceased's estate. On the taxpayer's death there was a chargeable transfer of the whole trust fund as discretionary trusts followed, and although there was charitable exemption for inheritance tax purposes on the appointments to the two charities, this was simply an exemption from any exit charges from the discretionary trust, which of course would have been minimal in any event.

Counsel for the trustees made a valiant attempt to persuade the Special Commissioners that this ought not to be the case. There are provisions in the inheritance tax legislation relating to wills and will trusts so that where there is a distribution from an estate within two years of a person's death it may be possible to read back into the will the ultimate beneficiaries of the estate, thus retrospectively giving charitable exemption, or spouse exemption, as the case may be. There is no such provision for discretionary trusts.

The inheritance tax exemption for gifts to charities does contain certain provisions relating to conditional gifts to charity which allow for the relief to apply so long as the condition is satisfied within twelve months of the chargeable transfer. Unfortunately, the Special Commissioner thought that this did not apply in the present case because it was not so much a matter of the gift being conditional to the charities, but rather it was left open to the trustees to decide whether or not to make the appointments which the settlor wanted.

The moral of this unfortunate tale is that any delay in seeking tax advice can be expensive. It is human nature to put off things which do not have to be done today until such time as they become urgent, but this can be very unfortunate in the realm of tax. If the trustees had sought advice during the life of the settlor, they could have made appointments under their discretionary powers at that time to take effect immediately on the death of the settlor. In that event, the inheritance tax for the gifts to charity would apply and there would be no problem. Leaving the appointments until after the death of the settlor turned out to be expensive in tax terms.

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