

Tax case makes the headlines

It is not often that a decision of the Special Commissioners makes the main news story in the daily press, but the decision in *Phizackerley v HMRC* did exactly that a short time ago. As the news reports betrayed a complete misunderstanding of the case (including blaming it on Gordon Brown as a new stealth tax!), we will explain here what the case was really all about and what the true significance of it was.

The inheritance tax legislation contains a rather obscurely worded rule which deals with the situation where a person makes a gift and then borrows the money back from the donee. For example a person might give some money to his son who then agrees to lend it back to his father so that he continues to have the use of it. The father may hope to be able to have the debt which he owes to his son deducted from his estate for inheritance tax purposes, but the rule mentioned above prohibits the deduction. It is designed to ensure that nothing will be achieved for inheritance tax purposes by making a lifetime gift of funds and then receiving the money back from the donee as a loan.

It has always been recognised that this particular legislation reaches beyond the grave, so that if a person makes a gift of money in his or her lifetime and after the death of the donee his executors lend the money back to the donor from the donee's estate, the borrowing by the donor will still not be deductible on his or her death. The normal circumstance where this has an impact is where the gift was between husband and wife and the borrowing is made from the estate of the donee after his or her death.

The recent Special Commissioner's decision concerned exactly this type of scenario. It did not therefore break any new ground, as was suggested in the news reports. What it was all about was to test an argument that the rule ought not to apply where the original gift was from husband to wife since that gift should qualify as an exempt gift for the maintenance of the wife. In the case concerned, the gift was a share in the family home and it was argued that nothing is more clearly for the maintenance of the wife than the provision of a roof over her head.

Unfortunately, the Special Commissioner did not accept this argument. He thought that the gift of a share in a house was not within the ordinary meaning of the word 'maintenance',

This was an interesting argument, but the fact that it was rejected should not have caused all the excitement which there was about the case at the time. Counsel for the taxpayers was hoping to narrow the scope of the inheritance tax rule with a new argument, and regrettably did not succeed.

The case could go to the High Court on appeal, but in the particular circumstances of the case this may not in fact be necessary, as counsel for the taxpayers managed to get a finding of fact from the Special Commissioners which will probably conclude the case on other grounds in favour of the taxpayers. The finding of fact was that the original gift of the house was not made with a view to the wife's executors lending money back to the husband and that should be conclusive to take the case outside the scope of the relevant inheritance tax rule.

The true significance of this case is simply that it underlines the need for careful structuring of nil rate band discretionary will trusts which are very popular at the current time. In order that husband and wife can both use their inheritance tax nil rate bands (currently £300,000) on each of their deaths, the first to die may arrange that the first £300,000 of their estate should go into a family discretionary trust, rather than direct to the surviving spouse. If the first to die has only a share in the family home in his or her estate, for other tax reasons, that share in the home should not go into the discretionary trust; instead it may be transferred to the surviving spouse upon him or her giving an undertaking that the £300,000 due to the discretionary trustees will be paid in after the death of the second to die and in the meantime will be an interest-free loan from the trustees.

The recent case has highlighted the fact that this arrangement will not work if the surviving spouse gave cash or assets of at least £300,000 to the other spouse during his or her lifetime. This is just another example of where the inheritance tax rule will reach beyond the grave.

This does not mean that the nil rate band trust scheme cannot be adopted in these circumstances. There are alternative methods of structuring the matter which will not be caught by the inheritance tax rule, and we can advise fully in this area.

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