IHT PLANNING – THE GIFT WITH REVERSION APPROACH

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A taxpayer may have valuable assets (e.g. a portfolio of shares) with respect to which no business property relief or any other inheritance tax relief is available. If he holds on to the shares then the capital gains inherent in the shares would be "washed" on death but an inheritance tax charge may arise because, for example, he has no spouse to leave the property to in his will.

The taxpayer is therefore in a quandary. He cannot give the shares away without paying capital gains tax; on the other hand if he holds onto the shares he will pay inheritance tax.

Under the gift with reversion approach, to overcome the quandary, the taxpayer would carry out the following steps:-

1. He would set up a discretionary trust under which at the end of, say, a year the trust assets would revert back to him. The members of the discretionary class could include himself. The discretionary class could receive income in the trustees' discretion. For reasons mentioned below the discretionary class would not include beneficiaries who he may want to give the shares to ultimately.

2. Whilst the trust is discretionary, i.e. before the reversionary interest has fallen in, he could give the reversionary interest to an interest in possession trust for the benefit of, say, his children. His children would not be amongst the class of discretionary beneficiaries under the discretionary trust. The intention is the taxpayer would survive the gifts by seven years having not retained any benefit under the new interest in possession trust.

3. At the end of the year the funds (the shares) would go out of the discretionary trust, suffering a small inheritance tax charge, with the capital gains tax holdover election being made.

The transactions are now looked at in more detail.

Transfer of Portfolio of Shares to Discretionary Settlement

For inheritance tax purposes there will have been a chargeable transfer but hopefully the nil rate band would take care of any actual charge to tax. The reduction in value of the estate of the settlor should not be too great because one would take into account the fact that at the end of the year the shares must come back to the settlor. The reversionary interest is not excluded property for inheritance tax purposes. The capital gains tax charge on the gift into the settlement can be held over under TCGA

1992 s.260. There should be no stamp duty or income tax consequences arising from that transaction.

Gift of the Reversionary Interest by the Settlor

This would be a PET within IHTA 1984 s.3A because none of the members of the discretionary class will be the recipients of the gift of the reversionary interest (namely the children who have interests in possession under the new settlement). The pernicious IHTA 1984 s.55 will not apply. That provision provides that if a person receives a reversionary interest and that person already has an interest under the settlement then the reversionary interest is not comprised within his estate; the effect of that would be there would be no PET and there would thus be a chargeable transfer. Oh horror! (if that were the case). By ensuring that the children are not members of the discretionary class it is clear that the gift of the reversionary interest would be a PET. There will be no charge to capital gains tax on the gift of the reversionary interest as it is a gift of an interest under a settlement (TCGA 1992 s.76(1)). There should be no relevant stamp duty or income tax consequences arising from that transaction.

Vesting of Shares in New Trustees of the Interest in Possession Settlement at the End of a Year

Under IHTA 1984 s.65 there would be a small charge to inheritance tax but that would enable any charges to capital gains tax to be held over (TCGA 1992 s.71(1), s.260(1), SDTS C.4.208, CG 33551 and CG 67041 and TCGA 1992, s.77).

The *Ramsay* Approach

It is not felt that the *Ramsay* approach would have any application provided the taxpayer had not determined in advance what was to happen with the reversionary interest. The necessary element of pre-ordination would not be present. The taxpayer may die; he may decide to have the share portfolio back; he may decide to give it absolutely to his children or in trust. Each case, of course, must be examined on its own facts. Almost by definition one cannot have tailor-made schemes which overcome the *Ramsay* approach! It is arguable that *Ramsay* should not apply in any event in such circumstances as only "pure legal" concepts are involved but it may be precarious to rely on such arguments (*MacNiven v. Westmoreland* [2001] STC 237).

Associated Operations

It is felt that all the transactions would be associated operations within IHTA 1984 s.268(1). The disposition, namely the ultimate gift of the shares, carried out by two transfers of value, namely the gift into the discretionary trust and the gift of the reversionary interest, would be treated as having been carried out at the time of the last operation, namely, when the shares vest in the trustees of the interest in possession trust. One therefore has associated operations and these are what may be termed "relevant" associated operations (*MacPherson v. IRC* [1988] STC 262 and *Reynaud v. IRC* [1999] STC (SCD) 185). However, the most that can be accomplished by those provisions applying is that there is a PET made by the taxpayer at the time when the shares vest in the trustees of the interest in possession trust; however credit is available for the earlier transfer of value when the shares were put into the discretionary trust; it is thus not felt that the associated operations have any relevant consequences.

Conclusion

Overall the arrangement has its attraction but one must ensure that the subsequent gift of the reversionary interest is not part of a pre-ordained scheme within the *Ramsay* approach; bearing in mind, of course, that the settlor may die before the gift is made, and he has a year in which to make the gift if he makes the gift at all, that should not be too difficult, one hopes, to achieve.