

## **Inheritance Tax: New settlement rules proposed**

Following two initial consultations (initially aimed at ‘simplification’) HMRC has now issued a third consultation on how settlements are charged to Inheritance Tax (IHT) – but now aimed at making things ‘fairer’...

IHT on settlements is complicated at best. Based on the settlor’s cumulative transfers, 3 month quarter periods, ten year period and fractions of ‘30% of 20%’ tax rates means that even determining if there is a charge is difficult enough. Often the completion of the over complicated form and calculation of tax costs more in professional fees than the tax itself.

This was made worse in 2006 when the Government decided that those settlements not within the IHT charging regime should be and almost any new settlement is chargeable.

The problem then was HMRC could not cope with the volume of IHT returns being submitted, especially as many requested HMRC to work out the tax. So, in 2008, the rules were further changed to exclude the need for a form where a settlement’s assets were within certain classes and values and no tax was due.

However, this still left many settlements where a small charge arose and the completion of a form was required at an excessive cost due to its complexity.

This is when HMRC decided to embark on simplifying the rules. However, from the first consultation was a hint that the main purpose was to stop the use of multiple settlements to avoid IHT – multiple pilot settlements could be set up to receive assets on a death, each would benefit from its own nil rate band, so for example a £3m estate could be sheltered entirely from future IHT by using 10 settlements.

We now have the expected conclusion, which is a consultation on making the IHT charges on settlements ‘fairer’. It may be labelled as a consultation, but the proposed rules will come into force from the date it was issued, 6 June 2014, which suggests it is very likely to happen.

It is worth noting that the rules are in relation to the charge on settlements, not the settlor. When a settlement is created, it is an immediately chargeable lifetime transfer by the settlor – therefore, if more than the IHT nil rate band £325,000 is put into a settlement, a lifetime charge to IHT at 20% arises on the excess. As with any lifetime gift, there is a 7 year cumulative period to take into account, so the gift uses up your nil rate band should you die within 7 years, but if you survive 7 years you regain your nil rate band and can make another gift into settlement without a tax charge up to the then nil rate band.

The changes mean that, for all settlements created or added to after 6 June 2014, instead of having their own full nil rate band, there will be a 'settlement nil rate band', SNRB, which a settlor apportions between settlements.

So, say settlor A sets up a settlement today with £325,000 and one in just over seven years time for a further £325,000. No immediate charge to IHT arises as both settlements are within the available nil rate band of £325,000 on each occasion.

Under the old rules, each settlement would have its own £325,000 nil rate band and on any exit or tenth anniversary, this first amount would effectively be tax free and the remainder taxed at 6%.

Under the new rules, the settlements will be allocated part of the SNRB by the settlor up to a total maximum of £325,000.

If the settlor allocates half to each, each would have £162,500 of SNRB and the balance would be taxable.

The allocation of SNRB can be increased, but not decreased. Therefore, should the settlor create another settlement in the future, there would be no SNRB left to allocate and the new settlement would be fully taxable at each chargeable event to a fraction of 6%.

So, we have an SNRB which the settlor must allocate to his settlements. This can be made, or amended, at any time up to the first IHT charge arising on a settlement, which at least gives a little time before it is required, unless a settlement is likely to pay out shortly after creation. Following that first charge, it is fixed and can only be added to.

The onus is on the settlor – he must make the allocation and the settlements must use the allocation defined by the settlor on HMRC's prescribed form. If no allocation is made, there is no SNRB for that settlement.

Should a settlement be wound up, its allocation of SNRB would be available to be allocated amongst existing or new settlements. Just making a part appointment from a settlement would not release any of the allocated SNRB.

However, when a settlor dies, the ability to reuse the SNRB dies too. So where the SNRB is split between two settlements and one is wound up, the remaining settlement cannot inherit that part of the SNRB.

HMRC has attempted to introduce some simplification – this allocation of SNRB means that the settlor's cumulative transfers in the 7 years before the settlement was made, and any related settlements, are left out of account in calculating the charges on relevant property settlements.

HMRC intends extending this simplified charging system to settlements existing before 6 June 2014, which presents a possible tax saving for some settlements and does simplify matters to some extent.

But, as with the majority of HMRC's simplification, it is coupled with an additional burden which in this case is a shift in the calculation of the IHT onto the settlements as self-assessment. HMRC still cannot cope with Settlement IHT returns – a recent call suggested its target processing time for a form was 6 months. This was only a target however, from experience it is not meeting this target.

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