DOUBLE TAXATION REGULATION DEATHBED REPURCHASE PLOY

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I found myself sitting in a colleague's room taking Chambers tea recently. When the conversation turned into gossip, I idly picked up a copy of the 1993 No 3 issue of *Private Client Business*, a periodical published by the august house of Sweet & Maxwell. The briefest, yet nevertheless one of the more interesting, articles is by Chris Whitehouse and is headed "Double Taxation Regulation Deathbed Repurchase Ploy". It discusses, in less than 200 words, an artificial scheme for the avoidance of IHT based upon what is considered to be defective drafting of the Inheritance Tax (Double Charges Relief) Regulations 1987.

The scenario Mr Whitehouse envisages is very simple. He assumes that in 1990 a father made a potentially exempt transfer of Blackacre to his son, the value transferred being £150,000. It subsequently becomes clear that the father will not survive the potentially exempt transfer by seven years, so that the potentially exempt transfer would become retrospectively chargeable. Mr Whitehouse's suggested solution is that the father should buy Blackacre back from his son at an undervalue - he suggests £130,000. He states that the result is that "his estate for inheritance tax purposes will be reduced by £130,000, so that an inheritance tax saving of £52,000 (assuming a 40 per cent tax rate) is produced in relation to the charge that would otherwise have arisen in respect of the property actually comprised in his estate immediately before his death." As Mr Whitehouse appears to be writing for a reader with very limited time, his technical explanation is compressed into one sentence: "This, it seems, is the inevitable result of regulation 4, in particular of regulation 4(3)(a)."

As readers of this Review have a little more time to dispose of, I shall set out at some length what I understand to be the full technical analysis which apparently supports Mr Whitehouse's reasoning. Firstly, one or two very important words about the background to the Regulations.

The changes made by FA 1986 to IHT/CTT had opened up possibilities of double charges. One obvious case is where a person made a disposition which was both a PET and a GROB. If he died within the seven year period, one might find that the PET became retrospectively chargeable while the property was also included in his estate for IHT purposes on his death.

A less common situation but one which might nevertheless arise would be where A made a gift *inter vivos* to B, typically a PET, and died within the seven year period but during that period B had made a gift back to A so that A's estate on his death was swelled by the value of B's gift. Until 1986, this would probably not have been a problem, as there were statutory reliefs for mutual transfers. These were so defectively drafted and had been so consistently exploited[1] that the Revenue, instead of employing the services of a competent draftsman, eventually managed to persuade the Chancellor to procure their repeal *in toto*.

It was with this background that FA 1986 s.104 was passed. The relevant provisions in this context are:

> "(1) For the purpose of the 1984 Act the Board may by regulations make such provision as is mentioned in subsection (2) below with respect to transfers of value made, and other events occurring, on or after 18th March 1986 where -
>
> > (a) a potentially exempt transfer proves to be a chargeable transfer and, immediately before the death of the transferor, his estate includes property acquired by him from the transferee otherwise than for full consideration in money or money's worth;
> >
> > ...
>
> (2) The provision which may be made by regulations under this section is provision for either or both of the following, -
>
> > (a) treating the value transferred by a transfer of value as reduced by reference to the value transferred by another transfer of value; and
> >
> > ..."

Let us now consider the Regulations themselves. Reg 4 provides:

> "4. (1) This regulation applies in the circumstances to which paragraph (a) of section 104(1) of the 1986 Act refers where the conditions ("specified conditions") of paragraph (2) are fulfilled."

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[1] See, for example, *IRC v Countess Fitzwilliam*, decided by the House of Lords 1st July 1993.

There is no doubt that in the circumstances hypothesised FA 1986 s.104(1)(a) does apply. For on the death of the father the potentially exempt transfer of Blackacre previously made by him will retrospectively prove to be exempt and, immediately before his death, his estate will include property, namely Blackacre, acquired by him from the transferee otherwise than for full consideration in money or money's worth.

What are the "specified conditions"? The regulation continues:

> "(2) The specified conditions to which paragraph (1) refers are
>
> (a) an individual ("the deceased") makes a transfer of value to a person ("the transferee") which is a PET,
>
> (b) the transfer is made on or after 18th March 1986,
>
> (c) the transfer proves to be a chargeable transfer, and
>
> (d) the deceased immediately before his death was beneficially entitled to property to which paragraph (3) refers."

Conditions (a), (b) and (c) are clearly fulfilled. For condition (d), let us return to the regulation:

> "(3) The property to which paragraph (2)(d) refers is property -
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> (a) which the deceased, after making the PET to which paragraph (2)(a) refers, acquired from the transferee otherwise than for full consideration in money or money's worth,
>
> (b) which is property which was transferred to the transferee by the PET to which paragraph (2)(a) refers ..., and
>
> (c) which is property comprised in the estate of the deceased immediately before his death (within the meaning of section 5(1)), value attributable to which is transferred by a chargeable transfer (under section 4)."

Hence, Blackacre is "property to which paragraph (3) refers". It is acquired by the father from the son otherwise than for *full* consideration in money or money's worth; it was transferred to the son by the PET in question and it is property comprised in the estate of the father immediately before his death so that it is taken into account in computing the chargeable transfer made on his death.

Hence, the conditions of application of regulation 4 are satisfied. What is the effect of the regulation applying? The regulation continues:

> "(4) Where the specified conditions are fulfilled there shall be calculated, separately in accordance with sub-paragraphs (a) and (b), the total tax chargeable as a consequence of the death of the deceased -
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> > (a) disregarding so much of the value transferred by the PET to which paragraph (2)(a) refers as it attributable to the property, the value of which is transferred by the chargeable transfer to which paragraph (3)(c) refers, and
> >
> > (b) disregarding so much of the value transferred by the chargeable transfer to which paragraph (3)(c) refers as is attributable to the property, the value of which is transferred by the PET to which paragraph (2)(a) refers."

While this is not the most limpid of prose, once one has wrapped a damp towel round one's head and pierced the obfuscatory clouds of language in which it is clothed, the concept is clear and unambiguous. Firstly, one calculates the total tax chargeable as a consequence of the death ignoring the PET. Secondly, one calculates the total tax chargeable as a consequence of the death ignoring, in computing the value of the deceased's estate on his death, the property which was returned to the deceased by the transferee under the PET.

The phrase "the total tax chargeable as a consequence of the death of the deceased" involves a great deal more than might be initially supposed. It includes not only tax charged on the transfer of value deemed to be made immediately before the death but also the tax on PETs which become retrospectively chargeable or chargeable transfers which become retrospectively taxable at a higher rate. It also could include the charge on discretionary trusts either created by the deceased or to which he had added property after making a PET which becomes retrospectively chargeable as a result of the death. To keep matters simple, however, let us assume in the present case that the only relevant transfer the father ever made *inter vivos* was the PET of Blackacre.

The regulation continues:

> "(5)(a) Whichever of the two amounts of tax calculated under paragraph (4)(a) or (b) is the lower amount shall be treated as reduced to nil but, subject to sub-paragraph (b), the higher amount shall be payable ..."

Hence, the Revenue receive whichever is the higher amount of tax.

Regulation 4(5)(b) applies where, under regulation (4)(5)(a), the PET falls to be disregarded. Its aim, in which it may or may not succeed, is clearly to require the PET to be retrospectively disregarded for all IHT purposes.

One oddity of regulation 4 is that it does not provide for the situation where the tax chargeable disregarding the PET is exactly the same as that which would be chargeable if one disregarded the property gifted back to the donor in computing the value of his estate on his death. My experience suggests that the flexibility of professional valuers would ensure that such a problem never arose.

Does the strategy work? So far as the wording of regulation 4 is concerned, it does. Let it be supposed that the value of Blackacre on the father's death is £X. The net effect of the transactions is that the father has "gifted" £150,000 *inter vivos*, and £X on death but his estate has been increased by £20,000 *inter vivos*. The net total transfers of value he has made (actual or deemed) is thus £130,000 plus £X. Yet, if the PET is disregarded the only transfer of value which is chargeable is the £X on his death. Conversely, if the value of Blackacre is disregarded on his death, the only relevant transfer of value he would be regarded as having made is the PET of £150,000. Putting it another way, provided it is the PET which falls to be disregarded, the amount that the father has paid to buy back Blackacre drops out of charge altogether.

Is the wording of regulation 4 all that one needs to take into account? Clearly not. If instead of the purchase of Blackacre being an after-thought, the gift of Blackacre and the repurchase were part of a pre-ordained series of transactions, then the spectre of *Furniss v Dawson* would loom large.

Much more importantly, however, is the status of the Regulations. They are merely delegated legislation. The Board of Inland Revenue cannot, whether deliberately or by defective drafting, alter the law to a greater extent than permitted by the enabling Act. If an Act of Parliament contains a drafting error, that is one thing. If delegated legislation contains a drafting error, that is a very different thing. Let us therefore return to the enabling Act.

FA 1986 s.104 has the side note "Regulations for avoiding double charges etc". In the old days, side notes were ignored altogether in construing statutes. Since the decision of the House of Lords in *R v Schildkamp* [1971] AC 1, it is now accepted that they can be taken into account in certain circumstances. If the Revenue wished to attack the scheme, the most promising avenue of success would be along the following lines. S.104 authorises the Board to make regulations only for certain purposes. It is a reasonable inference from the wording of s.104, particularly if one takes into account the side note, that the purpose of the section is to empower the Revenue to prevent double charges to tax, particularly double charges which may arise as a result of the FA 1986 changes to CTT/IHT. The section does not authorise the Board by regulations to confer any further immunity from taxation. Even, therefore, if regulations purportedly made in pursuance of the section can be construed so as to confer such immunity, such regulations would to that extent be *ultra vires* the enabling Act and therefore void.

This conclusion is reinforced when one considers the wording of s.104. It is in wide terms which would apparently permit the most extraordinary regulations. For example, reading s.104 literally, given that the conditions of s.104(1)(a) are satisfied in the example of the gift and re-purchase of Blackacre, s.104(2)(a) would enable the Revenue to make regulations treating the value transferred by any one transfer of value as reduced by reference to the value transferred by any other transfer of value, neither of which might have the slightest relevance to the gift and repurchase of Blackacre, or to each other. Indeed, there is no reason why such transfers of value should have been made either by the father or the son or have anything to do with the property mentioned in s.104(1)(a)! Such a construction of s.104 would be clearly absurd. Although the section expressly lays down the outside parameters within which the Board of Inland Revenue must act in making regulations, there is the further implied requirement that the regulations must confer no immunity from tax beyond that which is necessary to avoid double taxation.

I must say that this argument is one which I find very convincing. More importantly, it is one which I predict the courts would accept so as to avoid a tax loophole. To my mind, the only debateable point is the extent to which regulation 4 is *ultra vires*. Does the whole regulation fall because it is too widely expressed? That would clearly be a pity. In my view, it would be possible for the court to identify the extent to which the regulation was *ultra vires* and to provide that it should operate only insofar as it was authorised. A rough analogy might be drawn between the equitable treatment of powers of appointment which are invalidly exercised. Sometimes, the invalidity is so essential that the purported exercise of the power is entirely void. In other cases, however, the exercise of the power is said to be simply excessive, and the power is held to be validly exercised insofar as the exercise is not excessive.

In this case, there is no difficulty where the father reacquires Blackacre by way of pure gift. In that case, there is no anomaly. The anomaly arises from the fact that the Revenue, in drafting the regulations, have failed to take into account that the father's estate will have been diminished by the price paid for the repurchase of Blackacre. A simple and uncomplicated approach for the Court to adopt would, in my view, be (a) to allow regulation 4 provisionally to operate according to its tenor and to see what relief from tax was thereby purported to be given; then (b) to calculate the maximum amount of double taxation which would arise but for regulation 4, and (c) to allow regulation 4 to avoid a double charge to tax only to that extent. In the hypothetical case, the result would normally be to allow relief on the father's estate on death by treating the chargeable transfer deemed to be made by him immediately before his death as being reduced by £20,000, i.e., the extent to which his estate was increased by the repurchase of Blackacre.