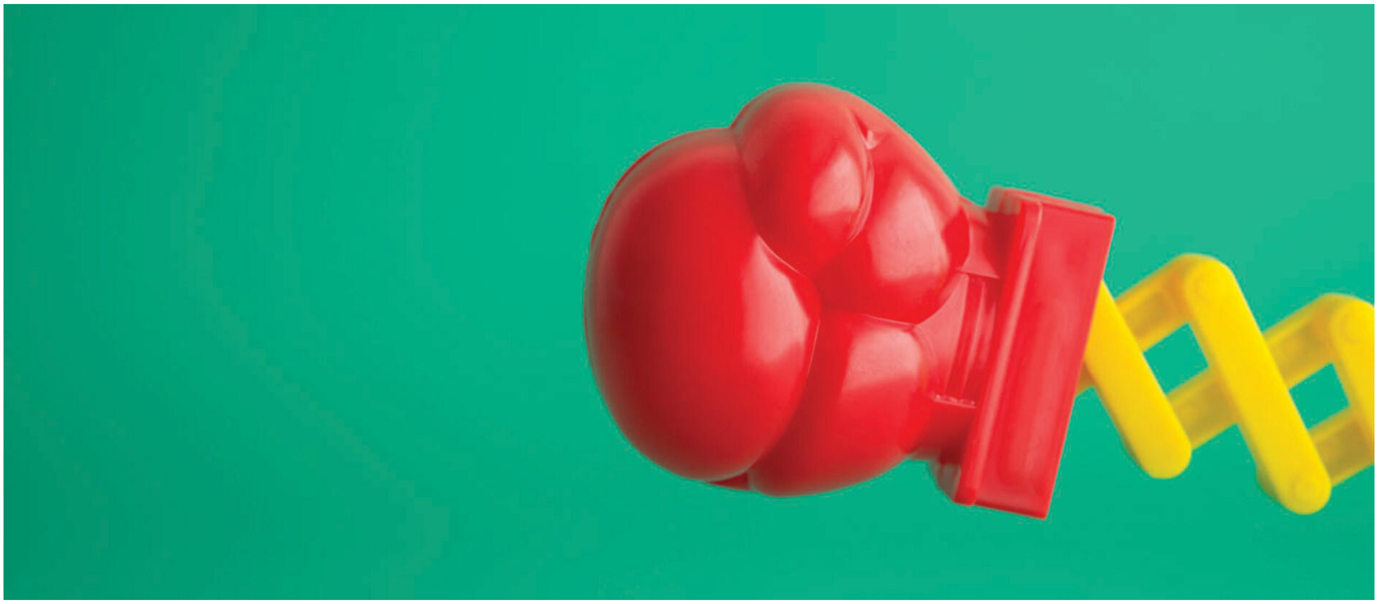
Carvajal v HMRC: attempts to mitigate inheritance tax

Inheritance tax and trusts Management of taxes



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We consider an appeal that concerns a flawed death-bed scheme intending to avoid inheritance tax.

Key Points

What is the issue?

The case concerns arrangements made by Mrs Fleet eight days before her death, potentially to mitigate inheritance tax. She settled £20,000 into a trust for her sons, which then borrowed £1.4 million with Mrs Fleet providing a personal guarantee. The loan proceeds were used to purchase bonds, which were distributed to her sons. The aim was to reduce Mrs Fleet’s taxable estate by £1.4 million due to the liability from the guarantee.

What does it mean for me?

HMRC initially challenged the arrangements on three grounds but was forced to abandon two due to inadvertently issuing a certificate of discharge. The tribunal rejected the remaining ground, finding that the guarantee did not amount to a lifetime transfer and would only be called upon after her death.

What can I take away?

The executors had a lucky escape due to HMRC's procedural error, as the tax planning was ineffective. HMRC is expected to tighten procedures to prevent similar errors, while executors facing inheritance tax challenges should check for any inadvertent certificates of discharge.

Without wishing to comment on the accuracy of the general public's perception of inheritance tax, it is probably fair to say it is widely considered to be an unpopular tax. The principal sentiment behind the tax's opponents is the desire to be able to pass wealth down the generations without what is perceived to be a large slice being taken by the authorities.

It is therefore unsurprising that many taxpayers have often taken steps to reduce the impact of the charge. In many cases, this is by using the exemptions and reliefs clearly set out in the legislation. (This article is being written ahead of the 30 October budget, which might propose radical changes to the tax landscape.) In other cases, it involves using schemes that might be viewed as more questionable.

In cases where an individual's health starts to deteriorate and death appears to be imminent (as opposed to cases where the individual dies suddenly), a realisation that the individual's estate will be subject to inheritance tax might focus the individual's mind (or the minds of the likely beneficiaries of the estate) on strategies to mitigate the impact of the tax.

By that time, it is likely to be too late to undertake the more conventional forms of inheritance tax planning and any taxpayer seeking to mitigate the impact of inheritance tax is more likely to be attracted to some form of deathbed planning; most such planning is likely to fall under the general heading of 'tax avoidance'.

This article considers the case of *Carvajal and Carvajal (Executors of the Estate of Mrs Jennifer Fleet) v HMRC* [2024] UKFTT 651 (TC). The case concerns arrangements entered into by Mrs Fleet eight days before her death. The timing of her death might well be coincidental and it is entirely possible that Mrs Fleet had no awareness of her imminent demise, but was simply entering into the scheme with a view to saving inheritance tax at some future date. Equally, it does not seem unreasonable to infer that she had embarked upon some deathbed tax planning. In any event, Mrs Fleet's motives are irrelevant to the effectiveness (or otherwise) of the arrangements that she entered into.

The facts of the case

In May 2011, Mrs Fleet's net estate was worth about £1.5 million. In the previous seven years, she had made lifetime gifts of just over £100,000. As a result, were she to die immediately, her estate would be subject to an inheritance charge of about £500,000 (ignoring any charitable or other exempt legacies that she might have chosen to make). Perhaps anticipating this charge, the following steps were taken.

First, Mrs Fleet settled £20,000 onto a trust of which her two sons (and, later, executors) were the beneficiaries.

The trust was then, on 16 May 2011, offered a facility to borrow £1.4 million from a finance company. That offer was to remain open for 24 hours. Any loan would be repayable on demand but was also repayable on the earlier of Mrs Fleet's death or the expiry of five years after any loan was made. A condition for any loan was that Mrs Fleet would give a personal guarantee and indemnity to the lender.

The arrangement fee for the loan facility was £20,000.

Mrs Fleet gave the guarantee and, the next day (17 May), the loan was duly taken by the trustee. The funds received were used to invest in bonds which were charged by the trustee to the lender.

The trustee, with the lender's consent, then distributed the bonds (as charged) to Mrs Fleet's sons (i.e. as beneficiaries of the trust), but subject to the sons giving collateral to the lender.

Mrs Fleet died a few days later.

Leaving aside the £20,000 fee, which was paid for by the initial settlement made by Mrs Fleet, the net effect of these arrangements was that Mrs Fleet had given nothing away other than a guarantee and indemnity; conversely, her sons received bonds worth £1.4 million but they had also provided collateral of the same amount. In other words, ignoring fees, there was no net transfer of value amongst the parties. Nevertheless, the scheme was predicated on the assumption that, by giving her personal guarantee, Mrs Fleet newly had a £1.4 million liability at the date of her death which reduced her taxable estate significantly (so that, even after taking into account her lifetime gifts, her estate was now covered by the nil rate band).

Although HMRC was looking at the case to see whether, despite the arrangements, inheritance tax was due from Mrs Fleet’s estate, HMRC issued a certificate of discharge under the Inheritance Tax Act 1984 s 239(2) in relation to any inheritance tax arising on Mrs Fleet’s death. As a result of the effect of s 239(3)(b), that certificate precludes HMRC from pursuing any further tax arising as a result of the transfer of value that was deemed to have taken place on Mrs Fleet’s death.

Unaware of the fact that the certificate of discharge had been issued, HMRC then issued a determination for inheritance tax on three alternative bases:

a) first, that Mrs Fleet’s guarantee did not amount to a liability of her estate immediately before her death;

b) secondly, giving a guarantee was a lifetime disposition that led to an immediate reduction of the value of Mrs Fleet’s estate by £1.4 million; and

c) thirdly, that Mrs Fleet, even if she was called to pay under the guarantee, had a right to recover £1.4 million from the trust.

The first contention effectively meant that the purpose of the arrangement was not satisfied. Mrs Fleet’s estate would still have had about £1.3 million over and above her available nil rate band at the date of her death.

The second contention amounted to arguing that Mrs Fleet made a lifetime transfer a few days before her death on which inheritance tax would need to be paid.

The effect of the third contention was that any deduction from the value of her estate in relation to the £1.4 million liability would be cancelled out by a corresponding £1.4 million asset, being the right of recovery.

Because of the certificate of discharge, however, HMRC was now precluded from pursuing any inheritance tax arising as a result of the transfer of value deemed to have occurred on Mrs Fleet's death. This meant that HMRC was forced to abandon the first and third of its three contentions and instead it had to argue that giving a guarantee was a lifetime disposition that led to an immediate reduction of the value of Mrs Fleet's estate by £1.4 million. (As that was a lifetime transfer, it was not protected by the certificate of discharge.)

As a result, the executors needed to show that the giving of a guarantee was not a lifetime disposition that led to an immediate reduction of the value of Mrs Fleet's estate. HMRC, conversely, sought to argue that it was.

The First-tier Tribunal's decision

The case came before Tribunal Judge Tony Beare. He recorded HMRC's two arguments.

First, HMRC argued that there was a significant likelihood that Mrs Fleet's estate would be called upon to repay the loan made to the trust. (Indeed, the lender did call for the repayment of the loan shortly after Mrs Fleet's death.) Therefore, HMRC argued, by giving the guarantee, that Mrs Fleet was effectively giving away £1.4 million. However, the judge considered that it was not enough to point to the likelihood of the guarantee being called, but that it was also necessary to consider the extent to which the guarantor (in practice, Mrs Fleet's estate) would be able to recover the amounts paid under the guarantee.

The judge also noted that, in practice, the sons (as beneficiaries of the trust) were the ones who repaid the loan, under their own obligations; and therefore the judge was not persuaded that the loan would end up being repaid by Mrs Fleet's estate.

Indeed, as the judge noted, HMRC had initially been arguing that the guarantee did not give rise to any reduction in the value of Mrs Fleet's estate precisely because of her ability (or the estate's ability) to recover any guaranteed sums from others. HMRC was forced to abandon that line of argument only because the certificate of discharge had been issued.

Furthermore, the judge noted that the guarantee would, by necessity, be called upon only after Mrs Fleet's death (as it was only after that event that the loan was likely to become repayable). Giving the guarantee could therefore not amount to a lifetime transfer of value.

The executors advanced two further arguments but these would have failed. In particular, they argued that HMRC's determination was late because of the four year time limit in Inheritance Tax Act 1984 s 240(2). However, that time limit operates only if tax attributable to any particular property has been accounted for and paid (and accepted in full satisfaction of the tax so attributable). The judge explained that there had been no account of any tax in relation to the giving of any guarantee. As the conditions for the operation of s 240(2) were not fully met, the more usual 20 year time limit operated instead.

Nevertheless, despite these two latter arguments failing, the executors achieved a knockout blow as a result of the fact that HMRC had inadvertently issued a certificate of discharge.

Commentary

This was a lucky escape for the executors. The tax planning was ineffective and, contrary to the intentions of the scheme, the £1.4 million should have been a part of Mrs Fleet's taxable estate (albeit with a small element covered by the remaining nil rate band). However, the certificate of discharge meant that HMRC was precluded from collecting this additional tax of half a million pounds.

It is hard to see any fault in the approach taken by the First-tier Tribunal but I note that the parties proceeded with the case in a different way from how some recent PAYE cases have been handled (e.g. *Hoey v HMRC* [2022] EWCA Civ 656). Had HMRC adopted the same approach, it could have argued that the provisions in s 239 concern the *collectability* and not the *assessability* of further inheritance tax and therefore is a matter of the civil courts and not the tribunals. Accordingly, HMRC might then have argued that the First-tier Tribunal should have dismissed the executors' appeal and then left the executors to argue in the County Court (assuming that HMRC pressed for payment) that HMRC's procedural error had cost them the opportunity to collect the tax.

Whatever the correct procedure, the First-tier Tribunal's approach has certainly ensured that the matters can be dealt with in one hearing, by the specialist tax tribunal and without unnecessary delays or uncertainty (and with a corresponding saving of costs for all parties).

What to do next

It is to be expected that HMRC will tighten its procedures to ensure that certificates of discharge are not sent out in similar cases in the future. It is, of course, to be hoped that any new safeguards do not then give rise to delays in other cases.

Equally, executors facing any inheritance tax challenge should ascertain whether any inadvertent certificate of discharge provides them with a trump card.