

"Lost Hopes - But No Loss"

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This paper deals with some of the technical aspects of the hypothetical problem already circulated (concerning the Chase family and Messrs Wolfram & Hart). It will then deal briefly with a couple of other situations in which negligent tax planning advice might be an issue. Lest it be thought that the sample problem is ridiculously far-fetched, it has to be emphasised that we in chambers are seeing problems of this kind with increasing frequency.

Gilead and I will be looking at such interesting, if difficult, questions as whether there is any (and, if so, what) recoverable loss, who are the proper claimants, and when times begin to run for limitation purposes. However, at the risk of putting the cart before the horse there is one all important lesson to be learnt from the whole sad sorry story: tax is a technical and complicated subject, and whatever the temptations and budgetary pressures no practitioner should be giving tax advice (even on apparently relatively straightforward matters) unless he or she is fully conversant with the area. Delighted as we in chambers are to make a living from trying to sort out the mess after the event, it would be more satisfying to be involved in giving the right tax planning advice in the first place.

Going back to our sample problem, questions of recoverable loss, proper claimant, and limitation will usually be inextricably linked. However, the starting point will nearly always be to endeavour to identify the supposed loss, which will in turn generally involve identifying (a) what about the actual advice given was either wrong or inappropriate; and (b) what correct or more appropriate advice ought to have been given.

As to (a), it is easy enough to see what was wrong about the advice given by Wolfram & Hart:-

- (i) a potentially exempt transfer ("PET") is not inevitably exempt, since full exemption will only be achieved if the donor survives for 7 years after making the gift;
- (ii) even if a failed PET does not itself attract any tax charge because it falls within the nil-rate band, it may cause an increased tax charge for the donor's estate at death by eating into the available nil-rate band;
- (iii) if the donor retains any benefit in the property given away, for tax purposes the gift might just as well not have been made since the whole of the property (not just the value of the benefit reserved) will be treated as being within the donor's estate;
- (iv) if there is a gift with reservation of benefit and the donor relinquishes that benefit during his or her lifetime, the donor is treated as having made a PET of the whole of the property at that time, which brings us back to points (i) and (ii) above.

There is one further little wrinkle here. In 1993 Wolfram & Hart made no inquiries about Mrs Chase's existing Will. Plainly they ought to have done so, because estate planning cannot take place in a vacuum. Does their failure to consider the beneficiaries under the Will impact on any claim by those beneficiaries that a duty of care ought to have been owed to them? Having started that particular hare running, I will leave it to Gilead to take up the chase if he sees fit.

So what ought the solicitors' advice have been? Here it is necessary to sound a cautionary note. By the time the issue surfaces one will have the benefit of hindsight and the comfort, for instance, of knowing for precisely how long the client did in fact survive and in what circumstances. The temptation then is to devise a scheme of esoteric complexity safe in the knowledge that it would probably have worked. But that is a far cry from saying that the original solicitors *ought* to have followed that route and were negligent in failing to do so. In all fairness one ought instead to be concentrating on alternatives that were sufficiently familiar and accepted at the date of the original advice as to warrant the conclusion that any reasonably competent solicitor (or

accountant) holding himself or herself out as capable of providing tax and estate planning advice should have adopted them.

Let us start by seeing what would have been the outcome if the advice in 1993 and 1997 had been do to do nothing because of the risks involved. Mrs Chase can be assumed to have died with an estate of £1.4 million (i.e. should would still have the second home with its value of £400,000, plus the £100,000 she actually gave her daughter). Tax on that would have been £463,200. Assume also that she would still have wished to give her daughter the second home and the £100,000, only by Will rather than lifetime gift. Take the tax and the daughter's legacies off the £1.4 million and there is only £536,800 left for the grandchildren. In fact what they got was £1 million less IHT at 40%, so they got £600,000. Thus had nothing been done, the daughter would have saved the IHT that she had to pay, but would not have had the use of the gifts in the meantime. The grandchildren, on the other hand, would have been worse off had nothing been done: viewed from that perspective, they have actually benefited from the negligent advice.

However, there were fairly obvious steps that could have been advised back in 1993 and 1997:-

1. Mrs Chase could have made an outright gift of half of the house in 1993, so that she and her daughter held as beneficial tenants in common in equal shares. That would have been a PET and would have fallen out of account by 2000. It would not have been a gift with reservation of benefit because it would have fitted within the Revenue's published tolerance of co-ownership situations (see the technical note at the end of this paper).
2. Come 1997 Mrs Chase could still have moved out and given her remaining half share (value £110,000) to her daughter together with £100,000.
3. When Mrs Chase died in 2001 the 1997 PETs to Cordelia would lose their exemption, but no tax would actually be payable by Cordelia since the value of the gifts (taken as at 1997, i.e. £210,000, but taxed at rates prevailing at death) would be within the nil-rate band. That certainly makes it look as if Cordelia suffered a loss as a result of the negligent advice, and suffered it when on her

mother's death she had to pay £18,720 more tax than necessary. Before that point it might have been inevitable (assuming no change in the law) that a loss was going to be suffered, but it had not yet crystallised into an actual liability or loss.

4. In this scenario the personal representatives and the grandchildren would still find much of the nil-rate band being used up by the 1997 gifts. So far as they are concerned, the only advantage of this "improved" advice would have been that £210,000 of the nil-rate band would have been used up rather than the full £242,000. In effect the only improvement would have been to save them tax on £32,000, that is £12,800.
5. Of course, the effect of losing the nil-rate band might perhaps have been covered by 7 year term life cover taken out in 1997. Even if they had got everything right up until that point, this would have given Wolfram & Hart another opportunity to slip up. Decreasing term cover is habitually taken out to protect the donee against the risk of the donor dying within 7 years, but here the values meant that Cordelia faced no such risk. What was needed was term cover for the personal representatives to protect against the effect of losing most of the nil-rate band on Mrs Chase's death within 7 years.

Of course the grandchildren's position might have been substantially improved had Mrs Chase still given away the second home in 1993 but decided (having been given correct advice) that she ought not to move in with her daughter. But is that getting too fanciful?

Melville and CGT holdover relief

So-called "*Melville* schemes" relied on obtaining holdover relief for CGT under s.260 TCGA1992, which is available for gifts that are also chargeable to IHT (even if the value of the gift is such that no, or very little, IHT is actually payable). To achieve this, the gift was made into what was effectively a short-term discretionary trust, but at the end of the day the property would emerge from the discretionary trust into the hands of the intended donee having suffered no, or minimal, IHT and no CGT. Following the decision

in *Melville v. IRC* [2002] 1 WLR 407; [2001] STC 1271 the Revenue were known to be looking to counteract such devices. The Revenue's first step was taken in the Finance Act 2002 but, unusually for anti-avoidance measures, did not go far enough and as a result *Melville* Schemes Mark II continued to flourish. One of the Revenue's responses was in the Finance Act 2004 to remove the CGT principal private residence relief with effect from 10.12.03 in any situation in which an earlier claim for holdover relief (whenever made) comes into the calculation.

We can, perhaps, anticipate seeing a number of claims from clients who were advised to enter into such schemes in the past and now find themselves exposed to large capital gains tax charges as the result of FA2004. Such claims are likely to face enormous hurdles.

First, what was wrong with the original advice? With any such schemes it is always good practice to warn clients that their success depends on the law remaining unchanged. By 2001 it would probably also have been necessary to warn that it was most unlikely that the law would remain unchanged, although it would have been difficult to predict what the changes would be.

Secondly, what is the loss? Such schemes were entered into by those facing a capital gains tax charge in any event unless radical measures were taken, and there is much to be said for the view that even failed schemes have succeeded in postponing tax and that nothing better could ever have been achieved.

Home Double Trust Schemes

In broad outline, these depend upon selling one's home to a trust under which one has an interest in possession, but leaving the purchase price outstanding as a debt. That debt is then settled on trusts for, say, one's children. The idea is that although the value of the house forms part of one's estate on death, the debt to the second trust is a liability that has to be deducted. By this conjuring trick one effectively gives away the

value of one's home but continues to live in it without any of the usual IHT complications. There always were plenty of opportunities for such schemes to fail or to produce unforeseen tax charges, which is why I have sometimes described them as the last refuge of the terminally desperate. Now they face the additional hazard of the new pre-owned asset charge, although it is not universally accepted that the charge will actually bite on such schemes. It is still too early to say what the fall-out from all of this will be, but one can anticipate a number of claims to recover the hefty fees charged for such schemes and the costs of unravelling them (if possible), although it is likely to be extremely difficult to pinpoint exactly what tax will have been lost overall.

Technical Note

The Revenue confirmed in a release dated 18 May 1987 that the gift of a share in a house would not be seen as involving a gift with reservation of benefit by reason of the donor's continued occupation, if and for as long as all the joint owners remain in occupation without any collateral benefit to the donor (i.e. the donee must not pay the donor's share of the outgoings). It was also confirmed that this conclusion would not necessarily be jeopardised merely because the gift was of an unequal share.