City of Westminster and Holborn Law Society

Response to HMRC Discussion Paper on Inheritance Tax and Pension Simplification

September 2005

This Society represents around a thousand solicitors working in the area of its name. It is the leading centre for practice in the field of private client work. Collectively its members have unrivalled experience of pensions and of administering substantial estates.

Background

1

1.1 As well as simplification of the different rules which presently apply to particular types of pension arrangement, the changes on 6th April 2006 (A-day) will mean significantly enhanced freedom of choice and flexibility for those contributing to pension schemes, particularly self-invested personal pensions (SIPPs) and small self-administered schemes (SSAS).

Pensions should be used to encourage savings for retirement years, and the reliefs given should encourage that, but in attempts to prevent avoidance, the legislation and penalties in the form of additional tax liability should not be so draconian, or so complex and open to misinterpretation as to turn the taxpayer away from this mode of saving. Otherwise more and more ordinary taxpayers will decline to make provision, and some will rely on Social Security for maintenance in old age.

Recent events, from the abolition of relief for tax credits on dividends, Equitable Life, the insolvency of many company schemes, the rush out of final salary schemes by employers, to the perceived complexities and restrictions imposed from A day, all the subject of constant media attention, have already caused the less wealthy public to doubt the advantage of pension provision. A perceived additional IHT liability, coupled with the advantages highlighted by the media for the wealthy to avoid tax on first or second homes, chattels etc., could be the final straw to destroy the will to save for retirement in a sensible manner (and especially through an employer-based fund) at a time when Social Security is becoming less able to afford the alternative.

1.2 The changes currently proposed likely to be of most interest to current and potential contributors to pension schemes are:

1.2.1 that the range of assets which after that date may be held within a SIPP or SSAS will be much wider than at present and will include chattels and residential as well as commercial property, which may be acquired by purchase from the contributor

1.2.2 that the contribution limits on which income tax relief is available will be significantly higher than those which currently apply

1.2.3 that the requirement in all cases to purchase an annuity by age 75 will no longer apply and contributors reaching that age who have not purchased an annuity and receive unsecured pension in the form of income drawdown will be able to continue to receive it in the form of alternatively secured pension (ASP) for the remainder of their lives

1.2.4 the ability to create family trust pension plans via SIPPs (family SIPPs) which in the event of the pension contributor's death whilst receiving ASP will enable the assets to remain in the contributor's fund at his death and to pass in the form of a pension fund to his spouse or dependants or, on the spouse's death, other nominated recipients who are members of the same SIPP, part or all of whose pension arrangements will thereby be satisfied.

Above all however the Society believes that the contributor needs to be assured that in the normal run of cases the result will be no different fiscally from the present arrangements in the same circumstances, which certainly include the position up to age 75. The importance of this consultation therefore is to retain the system which has worked well to date, and only to cover the new circumstances.

1.3 As a result of these factors it is the intention that the overall level of contribution to pension funds by both existing and new contributors, particularly those who are in a position to make substantial contributions to their fund, will be significantly greater following A-day, so reducing correspondingly the number of persons with no, or with inadequate, pension provision.

1.4 It follows however that:

- there will be more cases in future where a charge under Section 3(3) Inheritance Tax Act 1984 would need to be considered under the present rules set out in the 1992 Statement of Practice

- the circumstances in which pension funds, invested in family SIPPs and transmitted on death to the spouse, dependants, nominated family members and others who are members of the same scheme, should be liable to inheritance tax, and who the accountable parties should be, need to be statutorily established for the first time, but without changing the practical effect of the current rules.

- there will be a greater inclination to use a pension wrapper for assets in specie, whether second homes, works of art, or other less easily realisable assets, where tax relief within the pension fund is assured and there might be the ability to use the pension as an IHT avoidance vehicle, rather than for its proper objective of providing for the taxpayer in old age.

- While the current concept of SIPP is confined to:

  (a) single wrappers for individual taxpayers; or

  (b) partners in business who have been advised to fund new premises through the medium of a joint pension fund and the current 75% gearing facility;

the logical conclusion of the family asset sheltering schemes being mooted in the financial Press and promoted by some IFAs will be for future generations:

(i) to be "made" to join the family scheme (rather than an employer's which may be more appropriate to their circumstances); and

(ii) for the unexpended contributions of the earlier generations to be depreciated by means of successive "prudent" reserving to take account of ever increasing life expectancies.

Achievement of the Government's Aims

2 The Government's stated aims of greater choice and flexibility in pension arrangements are likely to be compromised, and the level of future contributions to pension schemes accordingly likely to be lower than would otherwise have been the case, if potential contributors, whose genuine objective is the provision of funds in retirement rather than potential IHT avoidance, are concerned:

- that the circumstances in which inheritance tax may be payable on the contributor's death or subsequently are unpredictable at the time the contributions are made, or are likely to be the subject of amending legislation in the future as a result of over- use of pension funds for avoidance.

- that a liability to inheritance tax may arise in cases where the contributor's main objective is the provision of a lump sum and a continuing income in retirement for the contributor himself and his immediate family, rather than in cases where assets are being acquired by family SIPPs with the saving of inheritance tax as a major objective for the contributor,

- that if inheritance tax is payable by the recipients of the fund, they will face significant practical difficulties in satisfying their statutory obligations to deliver returns and pay inheritance tax by the due dates.

Such concerns are also inevitable in the light of the government's current policy to outlaw age discrimination. This will have the eventual outcome of encouraging normal working life to be extended beyond 65, but should not have the effect of increasing the risk of IHT liability on unused funds at premature death.

The present position

3

3.1 **Where the deceased contributor has not assigned the death benefit under his pension policy and has (a) died before attaining minimum pension age (b) has attained that age but has then died no later than age 75 before purchasing an annuity and so in receipt of income drawdown or (c) has attained minimum pension age but has then died after purchasing an annuity guaranteed for a particular period extending beyond his death and payable to his estate**.

In such cases, sums payable to the deceased's estate as of right which may consist in

cases (a) and (b) of a return of premiums paid usually with interest or, generally, the return of the value of the fund (subject in the case of (b) to a charge to income tax at 35%) and in case (c) of pension payments for the balance of the guaranteed period, will form assets of the deceased's estate in the usual way. Similarly, any such benefits, which he had the general power to nominate to anyone, will form part of his estate. These sums will be liable to inheritance tax in the hands of his personal representatives, subject to spouse or charity relief where the assets pass to them under the terms of his Will or intestacy.

No change to the inheritance tax position in these specific circumstances is proposed, nor does the Society consider it necessary.

3.2 Lifetime disposition of prospective benefits on death: the 1992 Statement of Practice.

3.2.1 The Statement indicates that a claim for inheritance tax under Section 3(3) Inheritance Tax Act 1984 by reference to the deceased contributor's omission to purchase an annuity will arise only where

3.2.1.1 There is evidence that the contributor was aware that he was suffering from a terminal illness or was in such poor health that his life was uninsurable

3.2.1.2 At or after that time he

- took out a new policy and assigned the death benefit on trust
- assigned on trust the death benefit of an existing policy
- paid further contributions to a single premium policy or enhanced contributions to a regular premium policy where the death benefit had been previously assigned on trust or
- deferred the date for taking retirement benefit

3.2.1.3 There was evidence that the contributor's intention in failing to take up retirement benefits, was to increase the estate of someone else rather than to benefit himself

3.2.1.4 The death benefit was paid to someone other than the deceased contributor's spouse and/or dependants

3.2.1.5 The contributor did not survive for (generally) two years after the making of such arrangements and

3.2.1.6 The contributor's taxable estate on his death, including the lifetime transfer of these amounts, exceeded the nil rate band applicable at his death.

3.2.2 In cases to which the Statement of Practice applies, the assets of which the deceased has by his omission to purchase an annuity deprived his estate are treated for inheritance tax purposes as the subject of a lifetime gift by him at the latest date when the contributor could have exercised that right (generally at the moment immediately before death), and accordingly the gift will be treated as a failed PET.

3.2.3 Exemptions and reliefs applicable to lifetime gifts may therefore where appropriate be set against the value of the gift. Any unused nil rate band will be

set against any balance of the taxable value of the gift, only the part of the nil rate band then remaining being available to set against the deceased contributor's taxable estate on his death.

3.2.4 The assignee or person benefited is, as the donee of the assets which are the subject of the gift, primarily responsible for the payment of the tax, except in cases where the tax remains unpaid one year from the deceased contributor's death, when by virtue of Section 199(2) Inheritance Tax Act 1984 as limited by Section 204(8)(b) of that Act the deceased contributor's personal representatives will become jointly liable to pay the tax.

3.2.5 Where it is apprehended at the deceased contributor's death that a charge to inheritance tax arises on this basis, the valuation can usually be prepared forthwith on the death by the pension provider and supplied to the donee, so enabling the donee to complete the inheritance tax return relating to the gift within the statutory period allowed for submission of such returns and accordingly before any penalty for late submission arises. It is also possible for the funds to be realised and paid to the donee shortly after the deceased contributor's death so that the donee is then able to pay the inheritance tax due on those assets before the due date, ie before any charge to interest arises, in circumstances where the applicability of the instalment option does not fall to be considered, and before the deceased contributor's personal representatives become jointly liable for the payment of that tax.

3.2.6 The Society submits that these rules, in particular the fact that no charge to inheritance tax will normally arise where the deceased contributor has survived for two years from the assignment of the death benefit, maintain in principle an appropriate balance between the need on the part of contributors for certainty as to the circumstances in which inheritance tax will be payable where the death benefit has been assigned or the date for taking retirement benefit deferred, and the need on the part of the Government to ensure that potential loss of tax through abuse of the rules is prevented. The Society therefore considers that the present rules should be retained in such cases, subject to what is said in 4 and 5 below, and the Statement of Practice given Statutory authority.

4 Following A-day, SIPPs and SSAS may well contain UK or overseas residential property (whether this is the deceased contributor's principal residence or a portfolio of buy to let properties and/or holiday homes) and possibly chattels. To enable the pension provider in the circumstances outlined in 3.2.1 above - generally the SIPP manager - to advise the donee of the value of the fund on the contributor's death, professional valuations by land agents or chattels valuers as appropriate will need to be obtained by the pension provider (since in practice no-one else may have exact details of the composition of the fund at that time) at the expense of the fund.

5

5.1 In relation to cases where the deceased contributor has simply assigned the death benefit and died without purchasing an annuity, liquidation of a fund including residential property or chattels is likely to be a much more protracted exercise than where the fund comprises securities or let commercial properties, particularly if the death occurs, for example, during a period of decline in the residential property market. Then, unless other liquid or near-liquid assets are available within the fund, it may not be possible for the pension provider to achieve a sale of the assets in time to release the proceeds to the donee prior to the date when inheritance tax becomes payable.

5.2 If that situation should arise, since the donee's entitlement is to the death benefit itself rather than to the underlying assets, it would appear that the instalment option might not be available in cases where those underlying assets themselves would otherwise attract it. It is submitted that in such cases it would be equitable and avoid hardship to the donee, who may have to borrow the sum needed to pay the tax pending the realisation of the assets of the fund and payment to him of the proceeds, for the instalment option to be available, subject to interest where chargeable, pending release to him of the proceeds when the instalment option would of course cease in the usual way.

5.3 If, exceptionally, the tax remains unpaid one year after the death of the deceased contributor, either because of difficulty in realising the fund or more generally because it is not agreed until then that a claim under Section 3(3) has arisen, the deceased's personal representatives then become jointly liable for its payment. It is accepted that this follows necessarily from the treatment of the omission as a lifetime gift and that personal representatives will in future need to make specific enquiries in relation to pension arrangements so that any potential tax liability in the estate in relation to an assignment of the death benefit can be provided for. It is however expected that such cases, which will only arise where liquid or near-liquid assets to pay the tax are unavailable within the fund and there is difficulty in realising real or other property instead, will continue to be comparatively rare.

6 Where the deceased's fund passes under a family SIPP to the deceased's spouse, dependant children or, on the spouse's death, to nominated family members or others who are members of that SIPP in circumstances where the deceased was still in receipt of ASP at his death.

6.1 Under the present rules, a contributor may of course purchase pension provision, which includes from the outset a successor pension for his surviving widow or dependant children without any question of inheritance tax arising save in the limited circumstances outlined in 3.2.1 above. That fund may in the case of a SIPP or SSAS include commercial property. The fact that the fund available for transmission for the benefit of the deceased contributor's widow or dependant children may after A-day include residential property or chattels should not of itself, it is submitted, impose a liability to inheritance tax where one would not have arisen had the fund simply been differently constituted.

6.2 Although a family SIPP will not enable the fund to pass outright to the deceased contributor's nominated recipients it may:

6.2.1 enable the fund to pass on the contributor's death, if his spouse has already died, for the benefit of someone who is neither the spouse nor a dependant child of the contributor provided he or she is a member of the SIPP and has been nominated by the contributor to receive it including the ability for that nominated recipient to take a cash lump sum equal to 25% of the fund on attaining minimum retirement age, or

6.2.2 enable further transmissions to be made on the death of the nominated beneficiary or his or her successors

6.3 The Society considers that genuine pension arrangements such as those available from

recognised institutional pension providers, ie those having as the contributor's main aim the provision of a cash lump sum on retirement and an income after retirement for himself, his spouse and his dependant children are to be encouraged. The Society agrees however that arrangements having as their main or as a significant aim the saving of inheritance tax on assets which would otherwise bear it are less obviously deserving of support and that the imposition of a tax charge limited to such cases would be appropriate. It is in any case only then that any loss of inheritance tax compared with the position prior to A-day might result from the changes, which will come into effect on that day.

This objective might be met by imposing a liability to inheritance tax only on those assets of a pension fund from which the nominated beneficiary other than the contributor's spouse or dependant children may benefit irrespective of whether the nominated recipient has by then attained minimum pension age, such as residential property which on the death of the contributor or his spouse or dependant child as the case may be becomes available for full or part-time occupation by the nominated recipient or chattels then becoming available for his use. However, this test alone would not necessarily give rise to an equitable result in practice.

6.4 In cases where, on this basis, the fund would become liable to inheritance tax, then in contrast to the position in 3.2.1 above, it is submitted that significant difficulty and unfairness might result if the deceased contributor were to be regarded as having made a lifetime transfer direct to the nominated recipients in case 6.2.1 above, possibly immediately before his death, by omitting to exercise his right to purchase an annuity. In many, and perhaps most, cases, the recipients will not have attained minimum pension age, and will not have access to any of the assets comprised within the fund in order to pay the inheritance tax for which they would be liable as donees. Even if they had attained pension age, the maximum cash lump sum available to them (if not already taken) would be 25% of the fund which would plainly be inadequate to meet inheritance tax at 40% assuming it could be realised from the fund before the due date for payment of the tax, which might well be difficult if the SIPP assets comprised mainly residential property. Nor will the recipients necessarily even have the detailed knowledge of the composition of the fund needed to prepare the inheritance tax return. In such circumstances, not only might the recipients become liable to a penalty for late submission of the return and interest for late payment of the tax but the tax might often still be outstanding one year after the deceased's death and the deceased's personal representatives might find themselves liable to pay the tax from the deceased's estate. It seems likely that there will be many more cases in this category than will arise under 3.2.1 above, and that this possibility would be likely severely to inhibit the ability of personal representatives in those cases to administer the estate until the expiry of that period.

Furthermore, it is difficult to see how cases of a second or subsequent transmission of the fund could be dealt with at all on this basis.

6.5 Even if the pension provider - generally, again, the SIPP manager - as trustee for the nominated recipient, were instead to be regarded as the donee for the purposes of Section 3(3), whilst the difficulties outlined above in relation to cases of transmission to nominated beneficiaries other than the deceased contributor's spouse or dependant children in cases within 6.2.1 above would be avoided, it would still be difficult to adapt that approach to cases of second or subsequent transmissions within 6.2.2 above.

6.6 Furthermore, even in relation to cases within 6.2.1 above this approach involves setting

the deceased contributor's nil rate band first against the value of the gift represented by the transfer of the fund to the pension provider, leaving only any balance to be applied against the taxable value of the deceased contributor's free estate and any aggregable property.

In view of the values, which SIPPs are likely to have in such cases, the whole of the nil rate band would be absorbed in many cases against the gift of the fund. In view of this, and the significant departure from present practice which treating the pension provider as the donee would already involve, it is submitted that the alternative proposals below would address all these difficulties in a way which should prove both fairer and easier to operate in practice.

Proposals for change of Inheritance Tax legislation

7

7.1 **The Society believes that the success in practice of the current provisions and the Statement of Practice, should be preserved in principle, and merely expanded to cover the new regime for pensions. It is considered that this could best be done firstly, by providing a series of Statutory rebuttable presumptions (outlined below), where the current differentiation between Section 3(3) and Section 10 cases is preserved; and secondly, by making various small technical changes to facilitate payment and incidence of any tax due.**

7.1.1. There should be a presumption that, regardless of the constituents of the residual fund, on death before the normal retirement age of the particular individual taxpayer, or on the death while the taxpayer is still actually working for say not less than 12 hours per week, or where the taxpayer being under 75 is drawing down a reasonable annual proportion of the available fund, there is no gratuitous intent. As now this presumption, and the others referred to below, should be rebuttable in the same circumstances as now apply in practice.

7.1.2 There should be a presumption that on a death while the taxpayer aged 75 or over is drawing down a reasonable annual proportion of the available fund consisting of readily realisable assets there is no gratuitous intent so far as that part of the fund consisting of such realisable assets is concerned.

7.1.3 There should be a presumption that on a death over 75 of a taxpayer, those assets in the fund in a not readily realisable form in any event, together with those assets in realisable form in excess of those reasonably required to support the continued draw down and/or a later pension requirement, and all assets where no draw down of a reasonable proportion was in operation and the taxpayer was not working for 12 or more hours per week, were not eligible for Section 10 relief. Again, this presumption would be rebuttable in the appropriate circumstances.

7.1.4 It would be necessary to define "readily realisable assets" but such would obviously not include realty, chattels etc, which while justifiable as investments in the run up to retirement/drawdown, are seldom appropriate for providing income in old age.

7.1.5 The Society believes that the incorporation of these presumptions would ensure that the present results in similar circumstances would continue to apply until age 75, and that thereafter deserving cases would be treated similarly, and in compliance with the Government's anti age discrimination policy; but avoidance wrappers would be unsuccessful.

7.2 In the Society's view it is preferable, in the cases of transmission on death of pension funds through family SIPPS which do in the event become subject to IHTto treat the deceased as having had an interest in possession in the pension fund which came to an end on his death, and the nominated beneficiary as having a succeeding interest in possession in it (but so that no charge to inheritance tax arose in the case where the original contributor's spouse or dependant children or the spouse or dependant children of a nominated successor became entitled on death to a pension and/or cash lump sum or in relation to fund assets other than residential property or chattels). In such circumstances, the pension provider, by whom the assets would then be held, would become responsible as trustee for submitting an inheritance tax return in relation to assets liable on this basis to inheritance tax, notifying the personal representatives of the relevant deceased (who would be the deceased contributor in 6.2.1 above and the nominated beneficiary in 6.2.2 above) of the position to enable the inheritance tax liability arising on the relevant deceased's death (reflecting any unused nil rate band) and its allocation between the pension fund, the relevant deceased's taxable free estate and any other taxable aggregable property to be calculated, and paying the tax due on the fund.

7.3 The pension provider would however need to be empowered to take the following action which in most cases will not currently be permitted under the terms of the pension scheme:

7.3.1 to commission a valuation from land agents or chattels valuers where the fund includes land or chattels, the cost of obtaining the valuation being met by the deceased's pension fund and

7.3.2 where tax is payable, to release sufficient cash from the deceased contributor's fund to pay the tax where assets to do so can be realised within six months after the death of the relevant deceased and to pay that amount within that period direct to HMRC Capital Taxes, so avoiding any liability to interest, or

7.3.3 in cases where tax is payable but the composition of the fund is such that realisation of the assets within that period of six months is undesirable or cannot be achieved at all (eg where the fund consists only of the deceased contributor's principal residence or other residential properties in circumstances where the relevant deceased had died at the time of a decline in the residential property market), to mortgage the property to provide the tax, which would again then be paid direct to HMRC Capital Taxes within the six month period following the relevant deceased's death. The borrowing together with interest on it would then become a charge against the fund and might be repaid from

- a sale of the property with the consent of the nominated beneficiary within say five years of the relevant deceased 's death to enable the sale to be deferred until a revival in the property market had taken place

- out of future contributions by the nominated beneficiary over that five year

period, or

- in circumstances where the nominated beneficiary had not consented to an earlier sale and was not in a position to make sufficient contributions to repay the principal and interest in full by the end of that five year period (whether because of lack of funds, ineligibility to do so through insufficiency of earnings, or because the relevant tax-free contribution limit had already been reached), or where the nominated beneficiary died within that period before full repayment had been made, the proceeds of sale of the property itself at the end of that period, without the nominated beneficiary's consent, or on his earlier death.

7.4 The difficulties inherent in this situation would again be reduced if the eligibility of the underlying assets for the instalment option as proposed in 5.2 above were also to apply in family SIPP death transmission cases where the fund included assets which would have qualified for the instalment option if the relevant deceased had owned them directly, when it would apply for the usual ten-year period or until the assets eligible for the instalment option were sold by the pension provider.

7.5 If this approach were to be adopted, the inheritance tax consequences of a sale of, say, the contributor's holiday home to his pension fund would be that the proceeds might be taxable in his estate on his death if spouse or charity relief were not available, whilst the property might be liable to inheritance tax within the fund. In this respect however the position would be the same as in any other case where an individual sells an asset which he owns personally to a trust in which he has an interest in possession. This outcome might in any case discourage those whose main aim is the saving of tax rather than the provision of a traditional cash lump sum and income in retirement and would reflect the Society's view that whilst the latter should be encouraged the former should not.

7.6 Whilst this would represent a significant departure from the approach currently adopted under Section 151 Inheritance Tax Act 1984, whereby interests in pension funds are generally excluded from the interest in possession regime for inheritance tax purposes, it is submitted that this approach, which would apply in such cases only, would be significantly less onerous to the recipients of the fund and involve less risk to the Exchequer because:

- payment of the tax would be the responsibility of the pension provider who had access to the pension fund to pay it rather than of the recipients who would generally not have such access

- any unused nil rate band would be shared rateably between the pension fund, the relevant deceased's taxable free estate and any other taxable aggregable property rather than being applied primarily against the value of the assets comprising the lifetime gift represented by the deceased contributor's omission to exercise his right to purchase an annuity

- the relevant deceased's personal representatives would not be jointly liable for the tax, and the administration of his or her free estate would therefore only be affected or delayed in the same way as with any other aggregable property, ie until the value of the pension fund assets had been agreed with HMRC Capital Taxes in the case of chattels or the District Valuer in the case of real property and the allocation of the nil rate band could be ascertained

- any risk of sums released by the pension provider to the nominated beneficiary (if the latter were treated as the donee) not being paid to HMRC to settle the inheritance tax and any interest would be avoided.

8 The Society therefore submits that significant change to the current inheritance tax rules in relation to pensions is required only in the case of transmission on death of pension funds through family SIPPs to nominated recipients in the circumstances outlined above and only where the normal non-gratuitous intent exemption in Section 10 does not apply. The alternative presumptions it is felt will maintain the status quo for deserving cases, but not inhibit the Revenue obtaining tax in the non-deserving cases.

9 Plainly if the approach outlined in 7 above is adopted in family SIPP death transmission cases, pension providers are likely to be involved in additional work in obtaining valuations of assets of the fund where these include real property and chattels which the provider would not have the requisite degree of expertise to value personally, in preparing the inheritance tax return, liaising with the relevant deceased's personal representatives and discharging the tax due. Whilst this would inevitably be reflected in increased charges, the Society considers that the additional work incurred is unlikely to involve more than a minimal increase in those charges.

Replies to Specific Questions

10 Comments were invited on paragraphs 8 to 11 and 34 of the Discussion Paper. The Society would comment, subject to the above proposals, as follows:

> **Paragraph 8.** In cases where the deceased omitted to exercise a right, namely in this case the right to purchase an annuity during his lifetime, it is likely that if he has also assigned the death benefit his estate will always have been diminished by his failure to exercise that right, since he will have lost the opportunity to take the tax free lump sum and if he dies at age 75 or greater the maximum income available from ASP must with effect from A-day be less than he might have obtained from an annuity. However, as the Paper indicates, in the case of a wealthy man who is perhaps working to a far greater age than current normal retirement ages and is in a position to defer taking his pension for a particular period in the expectation that the value of the fund, and accordingly of his eventual pension, will grow as a result, the intention to confer a gratuitous benefit on another person will be lacking so that the exemption in Section 10 Inheritance Tax Act 1984 should then apply even if he dies without purchasing an annuity.
>
> **Paragraph 9.** It is difficult to envisage circumstances in which omitting to exercise the right where the death benefit has been assigned will not increase either another person's estate or the value of property held in trust, and the comments in relation to Paragraph 8 apply equally here.
>
> **Paragraph 10.** It is accepted that many members of pension schemes will be aware of the options available to them and that it may be difficult to show that their failure to exercise the most favourable option at the earliest date at which they might have done

so was not deliberate. However, this will certainly not be the case where contributors have become seriously physically or mentally ill or are suffering from a degenerative mental condition, any of which may prevent the contributor being aware of the options available to him at the time he is able to exercise them. For example, by the time a contributor aged 54 who is a member of a pension scheme under which the minimum retirement age is 55 and who is suffering from a brain tumour attains 55 and becomes entitled to purchase an annuity, to take part of his pension as a cash lump sum or to defer doing either, he may well have lost the capacity to form the requisite degree of intention to enable it to be said that, if he took no action at all and as a result his pension was deferred, he had done so deliberately.

Quite apart from those obvious cases, there is a significant proportion of people who for many different reasons never put their affairs in order, and who fail to take advice or act upon such advice as may have been offerred. It may be just possible to speak of those people, in the words of the Discussion Paper, as being 'conscious of the rights available to them', but it would be quite wrong to attribute to them a 'choice to pass up or defer those rights', when they have failed to make a decision of any kind.

Paragraph 11. As mentioned in the response to Paragraph 8 above and as the Paper recognises, an option to defer will sometimes be taken in the expectation of receiving an enhanced benefit later and there will be no intention to confer a gratuitous benefit at all even if the contributor later dies without having purchased an annuity. However, the Society considers that cases where it was not intended to confer any gratuitous benefit should not necessarily be limited to those where the deceased could be shown to have exercised his commercial judgement in reaching his decision, although circumstances where this would not be so are likely to be rare

Paragraph 34. The sort of considerations which are likely to be relevant in assessing chargeability under Section 3(3).

The deceased's medical history at the earliest time when he might have exercised the right, and subsequently up to his death, is likely to be relevant in determining whether he was capable of forming the requisite degree of intention to defer and, accordingly, whether his omission to exercise that right was or was not deliberate.

Similarly, evidence of his financial circumstances at and between those two dates might be relevant in seeking to show, where there is no other evidence of his intention, whether the deceased contributor had capital or income in excess of his requirements and is likely to have intended to confer a gratuitous benefit on another. In particular, a failure to draw down on a fund after attaining 75, coupled with the availability of a substantial income from other sources not likely to be diminished in future years, might reasonably be assumed to indicate the likelihood of gratuitous intent more than pension provision for the future; the more so if the fund's investment is in non-readily realisable form.

The weight that might reasonably be given to the different circumstances.

This will plainly be a matter of fact in each case and may depend at any rate partly on whether the evidence is provided by independent third parties such as the deceased's medical and financial advisors and is accompanied by appropriate supporting documentation. Where such evidence cannot be obtained, however, information on these aspects provided by the deceased's family would need to be considered on its

own merits in each case and it does not in the Society's view necessarily follow that information from family sources alone will always be insufficiently strong to show that Section 3(3) does not apply. The suggested use of rebuttable presumptions will provide a measure of certainty to the taxpayer as well as to HMRC in cases where no real evidence can be adduced one way or another.

The proportion of scheme members dying at age 55 plus where inheritance tax under Section 3(3) would be (a) seriously in question and (b) due.
It is considered that no reliable estimate can presently be made of the number of cases where inheritance tax under Section 3(3) might be seriously in question or due. One Committee Member's experience is to have only dealt with two cases in twenty-nine years of practice as a probate solicitor where the application of Section 3(3) fell to be considered; that of another member is of only one case in forty years of practice. However, this situation is likely to alter to a wholly unpredictable degree if the changes after A-day result, as is suggested in 1 above, in significantly larger numbers of individuals with substantial funds to invest choosing to place those funds in pension schemes. If that proves to be the case, all that can be said at present is that it is statistically likely that the number of cases in which Section 3(3) falls to be considered under the rules set out in the 1992 Statement of Practice and where the contributor has reached the age of 55 would increase in line with the additional number of new contributors. If Section 3(3) is also applied to family SIPP death transmission cases, it would appear that the likely number of cases in which the section applies will increase significantly, although as indicated in 6 above the practical difficulties to which that would give rise militate against the application of Section 3(3) to those cases. The suggested rebuttable presumptions would nevertheless be suitable to cope with such increase in the same way, as the Statement of Practice is currently able to do, even though this might lead to more cases being rebutted than currently.

– – – – – –

City of Westminster and Holborn Law Society
25 Rotherwick Road,
London
NW11 7DG

– – – – – –

Note Questions arising on this paper may in the first instance be addressed to John Owen,
Messrs Hunters, 9 New Square, Lincoln's Inn, London WC2A 3QN.
Telephone 020 7412 0050. Email: jho@hunters-solicitors.co.uk

– – – – – –