

## **The 2002 Budget and IRC v. Melville**

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### *Introduction*

The Budget has attempted to deal with the anomalies thrown up by the Court of Appeal decision in IRC v Melville. This article seeks to highlight some of the problems caused by the Melville decision. It is hoped that, as a result of the announced new measure, the Melville decision will now no longer trouble holders of powers over trusts.

### *The Impact of the Melville case*

*Melville* is best seen against the background of schemes that sought to take advantage of s260 TCGA 1992 holdover relief on disposals. As you are no doubt aware, s260 provides that capital gains tax holdover relief is available, inter alia, for disposals that are also immediately chargeable transfers for inheritance tax purposes. As a tax saving plan, this does not, at first sight, seem to make much sense because it seems that in order to get relief for capital gains tax one has to incur an inheritance tax charge.

However, the clever feature about these schemes was that the value of the inheritance tax transfer of value was reduced, so that, although a gift was treated as an immediately chargeable transfer for inheritance tax purposes so

that s.260 TCGA 1992 holdover relief was available for capital gains tax purposes, the amount of the inheritance tax charge that arose was kept to a minimum.

As you will recall, in Melville itself the taxpayer transferred property to a discretionary trust. The taxpayer, however, was able, after a period of 90 days, to exercise a power of appointment under which he could appoint the trust fund to several persons including himself. The trustees were given various powers which were in theory capable of affecting the value of the taxpayer's general power of appointment. These powers of the trustees were, however, only exercisable with the settlor's consent during the lifetime of the settlor.

The taxpayer argued that the value of what he had given away was very low because, effectively, his general power of appointment gave him the ability to revoke the trust. Consequently, the value of the property that left his estate was not high: effectively, it amounted to the income that arose in the 90 days during which the settlor could not exercise his power of appointment.

The Revenue, however, argued that the general power was not property comprised in his estate for inheritance tax purposes. Consequently, he had made a chargeable transfer of the entirety of the property transferred into the discretionary settlement.

Mr. Justice Lightman found for the taxpayer. He held that the general power of appointment was a valuable right in the taxpayer's estate.

The Court of Appeal held that the holder of a general power of appointment unquestionably had a valuable right, the value of which had to be taken into account in the value of the holder's estate under s.5(1) IHTA 1984 unless excluded by some other provision of the IHTA 1984.

The Court of Appeal went on to hold that it was a remarkable proposition that although the holder of a general power of appointment had effective dominion over the settled property if he chose to exercise it, nevertheless it was to be left out of account on the death of the holder.

*Problems thrown up by IRC v Melville*

The net effect of the Melville case was somewhat troubling. Effectively, if a person with an interest in possession in a revocable trust died, his estate included the value of the settled property by virtue of s.49(1) IHTA 1984 (because he was treated as owning that property, by virtue of having an interest in possession in it). His estate also included, by virtue of Melville, his right to revoke the settlement. The value of this right was equal to the value of the property within the settlement. Effectively, therefore, it was possible for such a settlor to be taxed twice on the value of the property within the settlement.

Another example of a problem thrown up by Melville is as follows: Assume that a non-domiciled individual created an excluded property settlement, i.e. a settlement created while he was non-domiciled which consisted of non-UK situs assets. He, however, retained for himself a general power of appointment or, perhaps, a right to revoke the settlement. Over the course of his life, that settlor became UK-domiciled.

As a result of the Melville case, on his death after he became UK-domiciled, the value of the property within the settlement would not fall outside the scope of UK inheritance tax. Even if the settled property itself was excluded property, the right to revoke or, indeed, the general power of appointment retained by the UK-domiciled settlor, was a chargeable asset for inheritance tax purposes because at the time of his death he was a UK-domiciled individual holding a valuable right. This was the position even if he was situated abroad at the time of his death.

#### *The 2002 Budget New Measure*

In the press releases following the Chancellor's Budget speech, the Revenue state that they have introduced a measure which provides that powers over trust property are to be disregarded for inheritance tax purposes. The stated aim of the measure is reverse the decision in IRC v Melville.

There are however situations where the new measure will not apply. First, the new measure will not apply if it creates increased tax avoidance opportunities. Anti avoidance provisions will be introduced in similar terms to the anti avoidance provisions dealing with reversionary interests. The second exception is that powers which have been acquired for money or money's worth will not be ignored for inheritance tax purposes.

This new measure is to take effect from 17 April 2002. Nevertheless, the statutory fiction that the new measure has always had effect is to operate.

### *Conclusion*

Without having had sight of the manner in which this new measure has been drafted, it is difficult to gauge accurately its impact. The press release speaks in broad terms about "powers" over trusts. Is one to understand, therefore, that the new measure will cover both powers to revoke a settlement as well as general powers of appointment? One also needs to see in exactly what terms the anti avoidance measures are drafted. It may be that they have much wider impact than that intended by the Revenue.

The true impact of this new measure will only become clear once the words of the new measure are seen and analysed. It is, once again, a matter of "wait and see".

