

Death Taxes and Policy
Parsons Lecture University of Sydney
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First, may I say what an honour and privilege it is for me to be standing here to give the Parsons Lecture. I first met Ross when he was a Visiting Professor at what was then Queen Mary College in the University of London in 1978. I accepted an invitation to a public lecture which he gave and I talked with him afterwards. He came to Cambridge and gave a wonderful seminar to our tax students. He talked kindly of something I had written describing it as 'a good piece of work'; as I got to know him better over the years I realise that this was high praise indeed. Ten years earlier Ross had been at a Ford Foundation Workshop on Revenue Law in London. The Rapporteur said he gave 'a vigorous, critical analysis' of developments in corporate income tax in the sixties.¹ Some of you can imagine what that must have been like.

In 1979 I met Ross again, this time in Sydney, having been invited by him to participate in one of his LLM classes while I was based in Melbourne. On that occasion I had the pleasure of staying out in Turrumurra and of meeting Marian. I also had the pleasure of meeting Ross's fellow instructor, Tom Magney, and so over the years I kept in touch with all three. I went back to Cambridge deeply impressed by – and envious of – the Sydney LLM programme, which seemed to me to balance the theoretical and the practical and to give appropriate emphasis to the strengths and weaknesses of each; I did not then know that Ross had started out working in legal philosophy. It did not then occur to me that the programme actually made money for the Law School but I had not then been the head of my law school and I had had one of those educations which, Max Beerbohm is supposed to have said, taught one to despise the wealth it prevented one from earning.

This is, I gather, the first time this lecture has been held since the death of Justice Graham Hill. We shall miss his writings and judgments and the clarity of thought and the depth of analysis which led to the respect in which he was held across the Commonwealth and especially the tax world. I like to think that these special qualities are often to be found in those judges who have also been active academics. Thanks not least to Margaret McKerchar

* I am indebted to many for their help but wish particularly to mention Geoffrey Shindler of Lane Smith and Shindler LLP of Manchester who gave me a (very clear) practitioner's insight into these things.

¹ Douglas Lawton (1968-69) 10 JSPTL NS 211.

and Cynthia Coleman we in the UK have been following the litigation in Commissioner of Taxation v Stone with interest and so are aware of his role in that fascinating case.² Graham's status as 'a tax titan' is secure. However his role this evening is not purely commemorative. In 1964 the British Tax Review published a series of articles organised by Ash Wheatcroft on estate and gift taxation around the world leading to the publication of a collected volume – Graham wrote the section on Australia.³ No serious student of the history of our subject can afford to ignore this work and I was informed by an impeccable source that his contribution helped to shape the Asprey Committee's views on this topic (chapter 24). I am of course aware that some regard the approach used in Asprey as a little dated and lacking in economic analysis but it remains an excellent example of a particular school of thought and one which still seems appropriate in our area.⁴ Rereading Asprey is an eerie experience since so much of what it recommended was being enacted or at least proposed in the UK at the same time under the guidance of Denis Healey, our Chancellor of the Exchequer. Asprey will be one of my principal sources; another will be the UK's Meade Report the 25th anniversary of which we are about to celebrate, a bit late, next month at the Institute for Fiscal Studies Biennial Conference to be held Cambridge. I shall also refer to Alan Auerbach's IFS Annual Lecture 2006.⁵ I have also incorporated some material from an interesting one hour debate on the UK inheritance tax held in the House of Lords on Thursday 1st February.⁶ One of the noble Lords confessed that the only newspaper he read these days was the *Racing Post*, because it was the only newspaper where the facts could mostly be trusted.⁷ The House of Lords will also feature this evening in another capacity. The Select Committee of Economic Affairs has taken to having a sub-committee look at one or two aspects of the Finance Bill each year; its role is still way short of that of the US Senate but it is a start.⁸

Ross, as we shall see, approved of these taxes on death so much so that he wanted a real and effective system of taxation which integrated lifetime transfers with ones on death to make one seam-less progressive tax. In the UK Denis Healey was introducing just such a tax in 1974. It lasted while Labour remained in power but Mrs Thatcher removed its teeth in stages.

² Studies the History of Tax Law vol 2 chapter 13

³ 1964 BTR 317

⁴ For criticism see AR Prest (1975) 51 Economic Record 576 cited by K James 2007 BTR Issue 3 (forthcoming) at n. 61

⁵ The Structure and Reform of Direct Taxation, Report of A committee chaired by Professor J E Meade IFS George Allen and Unwin 1978, especially chapters 15 and 16.

⁶ Hansard House Of Lords 1 February Columns 451-468

⁷ Lord Sheikh col. 458

⁸ The Reports and Minutes of Evidence are available on the House of Lords website.

Since 1986 we have had a system, misleadingly called inheritance tax but really a form of estate duty, much like that in Australia and which Ross criticised so strongly in Asprey; it invites you to play games. Since I am very aware not only that that Australians are very good at games but also that many of you have not had to wrestle with these things for a long time if at all, I intend to begin with a game – how much inheritance tax can we avoid if we live in the UK? Assume that we start with a clean slate – no prior gifts. The purpose of the game will be to show how much wealth you can give away before death without incurring IHT . This will lead us to some of the central policy problems of the tax – if it is easy to avoid why have it? Is a bad version of the idea better than no version at all or does it come within GK Chesterton’s quip ‘If a thing is worth doing it is worth doing badly’? If some people can avoid it but others not, is it a ‘fair’ tax? Should people be encouraged by the tax system to give wealth away? If you do not want to play these games, are you really willing to live with quite severe systems created by Healey and endorsed by Ross? Are you willing to have, as we had, progressive rates up to 75%

The amount of tax is determined by the value transferred and the relevant rate The current principal rate of inheritance tax is 40%; for some but only some lifetime gifts 20%. The threshold or ‘zero rate band’ is £300,000 or A\$720,000. If you die leaving an estate of £300,000 and have not made any lifetime gifts your IHT bill is zero; the estate is covered by the zero rate band of £300,000. If your estate is £400,000 the first £300,000 is covered by the zero rate, leaving £100,000 to be taxed at 40% and I can be confident that even lawyers can work that out to be £40,000 so the beneficiaries get £360,000, net of IHT. EASY PROBLEMS 1 and 2

So now let us turn to gifts before death - those lifetime gifts. Games have rules.

a) The rate: the normal rate of tax on death (40%) also applies to gifts made within the last seven years of life LIFETIME GIFT RULE 1

b) If you make a gift which comes within the category of ‘potentially exempt transfers’ e.g. a simple gift there is no tax - if you survive seven years. LIFETIME GIFT RULE 2

The law assumes that you will survive so there is no question of paying the tax and then reclaiming it. Such generosity - or weakness - is not part of Ross’ scheme; you pay on a lifetime cumulative basis however long you survive

c) If you make a gift which does NOT come within the category of ‘potentially exempt transfers’ and so is an immediately chargeable gift e.g. a gift on discretionary trusts, the rate of tax is 20%. LIFETIME GIFT RULE 3

So if you put £400,000 into such a trust you pay tax at 20% in relation to that £100,000.⁹ I shall refer to these immediately chargeable trust transfers as Type 1 – the technical term is trusts of ‘relevant property’. There are further IHT disadvantages to such trusts. First there is a deemed disposal every ten years and although the tax rate is low (a maximum of 6% each time) there are inconveniences such as the costs of valuing the assets and paying all those lawyers. Secondly, when property leaves such a trust there is a proportionate exit charge - to reflect the number of quarters of the year the property has been there so if the property comes out after 5 years and 1 day the rate of tax is 3% not 6%.

d) in principle you cumulate gifts as you go along so if you then make another gift of £100,000 to a discretionary trust you pay at 20%. THE CUMULATION PRINCIPLE. However when Mrs Thatcher had finished with it, the period had been reduced to 7 years . So you can make a series of discretionary trusts every seven years and pay no IHT on the creation of the trust – assuming you make no other chargeable transfers in between . Since spouses are separate persons we can each do it.

Now let us play with what we have so far. Suppose that you are married, or living in a civil partnership, and that you have £1.6m to give away and that you want to give it away to your (deserving) relatives. You give away £800,000 (a PET) but die the next day, so it ceases to be a PET. The first £300,000 is exempt (the nil rate band) the rest of the £500,000 and all your estate passing on death is taxed at 40% so out of the £800,000, the donee will pay tax at 40% on £500,000 (£200,000) and end up with £600,000. The whole of the estate passing on death is taxed at 40%.

Now suppose that you give away £800,000 in a form qualifying as a PET, e.g. an absolute gift, but this time you survive seven years. IHT on this £800,000 is zero. The system encourages you to give it away. Is this a good tax? (Ross said NO)

It is clear that the system encourages you to make a gift in a form qualifying as a PET, e.g. an absolute gift, rather than through a discretionary trust. If however you are very very rich you don’t want to bother with trivial games around the rather footling threshold of £300,000 and you don’t like the discretionary trust charges .

⁹ If the trustees bear the tax the bill is £20,000; if the settlor bears the tax it is £25,000- see Tiley Revenue law ¶67.3.3.

We now come to trust, type 2 . Put off by the charges on type 1 trusts, you return to the legislation and read the definition of a ‘potentially exempt transfer’ and find that it included not only a gift to A absolutely but also one to A for life, a fixed trust, i.e one under which A was entitled to an interest in possession. So, so long as you survived 7 years, no tax; an insurance policy could cover that risk. Of course there might be the inconvenience of A dying. The reason why it was a PET was that the system treated A as being entitled to the underlying property not just the life interest (just as Ross suggested in Asprey). If A died the whole fund was taxed as part of A’s estate; the corollary of this was that the tax was not usually bothered with reversionary interests.¹⁰ This is the Type 2 trust.

You might then go back to the legislation and find the type 3 trust - the accumulation and maintenance settlement. Although this is a form of discretionary trust, it was treated much favourably A gift to such a settlement is a PET. So if you put £1.6m into such a trust – the beneficiaries could be your children and grandchildren – no tax if you survived 7 years. Moreover there was no ten yearly periodic charge either and only a small exit charge.

And then you realise that the volume you are looking at contains the legislation for 2005-06 and a little bird is saying – didn’t the rules change in 2006? Your little bird is right. There has been the most unholy row in the UK about the changes made in 2006 and which apply on or after 22nd March 2006. This is another of the reasons Professor Vann thought you might be interested in these things – not just for the row but because of the effects on the practice of the law of trusts in the UK.

The Asprey Committee reported in January 1975 and chapter 24 recommended a greatly strengthened ‘death’ tax- not the wimpish tax system I have just outlined for you . In March 1974 a rather surprised Harold Wilson had found himself returned to power in the United Kingdom and leading a Labour government in which the Chancellor of the Exchequer was Denis Healey. He replaced Estate Duty with a Capital Transfer Tax which covered gifts made not just within a certain period before death but all gifts or, more accurately transfer of value, which occurred on or after 22nd March 1974. This integrated estate and gift tax was replaced by the Inheritance Tax in 1986 which we have just looked at. The important thing is that our tax is not technically an inheritance tax as commonly understood since, like its two predecessors, it is a tax based on the circumstances of the donor and not those of the donee. CTT had no place for potentially exempt transfers and no

¹⁰ Asprey §24.19; IHTA 1984 s.49; FA 1894 s.2 (1(b))

nonsense about cumulating for only seven year – lifetime meant lifetime. So do you want Ross ‘purity of principles or a system with loopholes?’

You will wish to note that while Denis Healey was pleased with his handiwork, Nigel Lawson the Conservative party Chancellor was no less pleased to have partially dismantled it. “It was as Chancellor under her [Mrs Thatcher’s] Premiership that I was able to transform the economical and socially damaging CTT into a broadly acceptable IHT.”¹¹ He wanted to make Britain a nation of inheritors and regarded the change from CTT to IHT as one of several measures to reduce the bias against savings.¹²

So may I thank you for coming out on a March evening to think about an area of tax you got rid of more than 20 years ago. I realise that the chances of your reintroducing such a tax can be summarised in one word, ‘Queensland’, but I still believe that there are important tax policy issues here.

Why talk about it? The first reason for talking about it is that the role of an estate and gift tax is a topic of much debate outside Australia, especially among parties of the left. Mr Prodi’s Italian government reintroduced their succession taxes last year. So far the other main United Kingdom political parties have not wanted to abolish taxation on death but make the system more effective; details and references in the full edition. Whether they will go as far as Ross and our CTT we know not.

Although the tax is in the process of progressive repeal in the United States it is, under the present legislation, meant to spring back into full effect in 2011 so giving great disparity of tax treatment according to whether a person dies in 2010 or 2011. The rather unsophisticated tax advice ‘time to push granny off the train’ masks important issues of fairness and stability. Consider the legal issues which could arise in wondering whether to turn off a life support system or where the consent of three members of a family is needed but one has been left out of the will and will not consent. To an outsider the need to make such restoration in order to satisfy rules about the balanced budget show why the United States legislative process gives the rest of the world so much to wonder at.¹³ I think such cliff edge changes are bad for the credibility of a tax system

¹¹ The View from No 11 p. 13.

¹² Ibid pp 819 and 343; the others were the abolition of investment income surcharge and the introduction of Personal Equity Plans.

In May 2000 the Office of Tax Policy Research at the University of Michigan Business School and the Brookings Institution held a conference; the papers were published as *Rethinking Estate and Gift Taxation*.¹⁴ You are no doubt thinking that I am going to suggest that you read it and in one sense you are right – no academic can resist suggesting that people go away and read things even if they are written by others. There is much valuable information and discussion to enjoy. However the 2001 tax reform process which led to the temporary repeal of the tax has generated one of the classic of modern political analysis. I refer to Graetz and Shapiro's *Death by a Thousand Cuts*.¹⁵ One of the facts of that story is the way in which all the academic learning whether legal or economic came to be disregarded; nothing could stand in the way of what was partly a moral argument based on the great tradition of hard work and thrift and partly an argument that taxing transfers on death was an imposition on the great American dream.

Now a words about Gifts with Reservation (GWRs). If you decide to fall short of Ross' rules, you will almost certainly need rules, as we have in our IHT and you had in your estate duty, to deal with gifts from which the donor had not been sufficiently excluded, known to specialists as gifts with reservation (GWRs). These were not needed in the days of the integrated lifetime gift and death tax but were revived when inheritance tax was born. They are enthralling to those of us who like such things and you may be interested that your Australian courts have contributed some of the leading case in the area in the old estate duty days.¹⁶ For example there is a crucial distinction between giving the farm away but continuing to live in say 1/3 of it (caught and so taxable in full) and only giving away the 2/3 in the first place (gift of 2/3 effective pay tax on 1/3).

Over the last ten years the limits of these rules have been tested by tax payers and their advisers. It is very well to talk grandly as we did earlier about giving away £300,000 or £800,000 but this is only possible when one has realisable assets. For most people in the UK with potential IHT problems the wealth is not realisable - it is tied up in the family home.

¹³ An enlightening introduction is provided by Atiyah and Summers *Form and Substance in the Anglo American Common Law*, Oxford, 1987 Chapter 4.

¹⁴ Brookings Institution 2001

¹⁵ University of Princeton Press 2001; there is also the transcript of a discussion at the Brookings Institution on Thursday 24th March 2005 see the Brookings Institution website.

¹⁶ E.g. *Munro v Stamp Duties Commissioner* [1934] AC 61 and *Stamp Duties Commissioner for New South Wales v Perpetual Trustee Cop Ltd* [1943] AC 425

Schemes proliferated exploiting the limits of the GWR rules; some were stopped in 1999;¹⁷ others in 2003.¹⁸ Yet practitioners began to devise scheme to get round the rules as they coming into force; for one practitioner, just as a barren field suddenly exploded into a carpet of colourful wild flowers, so a whole series of post Eversden schemes appeared to brighten the lives of clients intent on having access to property they had given away.¹⁹ The Minister later suggested that as many as 30,000 taxpayers may have implemented revised schemes.

In 2004 the UK introduced an income tax charge on ‘preowned assets.’ The 2004 changes applied a charge to income tax to apply in circumstances where the death tax rules on reservation with interests had been avoided.²⁰ The charge applies to real property, chattels and certain settled intangible property. Although the income tax charge was enacted by FA 2004 it applied as from 6th April 2005, the start of the tax year 2005-06. However it applied to arrangements made by taxpayers at any time after 17th March 1986,²¹ and so was, to use the terminology adopted by HMRC though not necessarily by others, retroactive though not retrospective. Dickson J, the great Canadian judge, once said “no one has a vested right to continuance of the law as it stood in the past.”²² This legislation illustrates that proposition.

The consultation process which led to the income tax charge began on 10 December 2003. The Minister said “It is not enough to tackle new arrangements and future avoidance. The Government want to send a clear message that artificial avoidance of that kind is not acceptable. Those who devise and market such schemes and the people who take advantage of them need to understand that and not assume that avoidance is risk free. Such schemes have grown so rapidly because they are regarded as a one way bet... Given the perception of risk and rewards it is not surprising that people and their advisers have found such schemes increasingly attractive. The clause gives notice that that is a false perception.... People are right to think that they will get any inheritance tax saving that the scheme is able to assure but

¹⁷ One scheme was upheld in *Ingram v IRC* [1999] STC 37 so incurring retaliatory legislation which took effect from 9th March 1999, IHTA ss. 102A-102C.

¹⁸ The case *IRC v Eversden* [2003] STC 822; the legislation was in FA 2003 and took effect as FA 1986 s. 102 (5A)-(5C) ; for discussion whether that legislation would have been effective to stop the other scheme see Chamberlain and Whitehouse Chapter 16

¹⁹ Chamberlain and Whitehouse 1-04

²⁰ FA 2004 s. 84 and Sch 15; see especially para 11 (1) which excludes the charge where the value of the property forms part of that person’s estate for IHT. Among several books Chamberlain and Whitehouse *Pre-Owned Assets* London 2004 provides a good introduction (and more).

²¹ FA 1986 s. 102; another revival of an old rule can be found at FA 1986 s. 103 (debts).

²² *Gustafson Drilling (1964) Ltd v MNR* [1971] 1 SCR 271 at 282-3, cited by Loomer 2006 BTR 64 at 67

they are wrong to think that that protects them against any future tax change. That is at the heart of the changes under the Schedule.”²³

The government had got tired of trying to keep up with schemes and so produced this attack. They ‘generously’ allowed taxpayers to elect that the income tax charge should not apply to them - if they opted back into inheritance tax gift with reservation treatment instead.²⁴ Naturally the Revenue are under no obligation to reimburse the costs incurred in getting into the scheme in the first place nor of any cost incurred to undo the scheme. It is not necessary to undo the scheme – one can simply elect to remain within the GWR rules one thought one had avoided. If one wishes to undo the scheme one is faced with a visit to the court to get the deeds set aside for mistake. The law reports contain one recent example of that where the court distinguished a mistake as to the legal effects of a transaction which would justify setting the deeds aside and a mistake as to the fiscal effects which would not. The case is *Wolff v Wolff* and there is a summary in the footnote of the printed version.²⁵

These are interesting ways of legislating. They reward the person who has not ‘gone tax planning’. I think this a welcome trend. It reminds me of the position taken by one of the lords in the debate. Lord Sheik said “If children are given big inheritances, they lose pride in their own achievements and the incentive to succeed. I think that £300,000 between one’s kids is quite enough. I certainly will take no measures to avoid paying my share of inheritance tax on my money which exceeds that threshold.”²⁶ No doubt more than one view can be taken on that matter.

²³ Hansard Standing Committee May 28 2004, col 238

²⁴ Paras 21 and 22; on problems see Chamberlain and Whitehouse *op cit* Chapter 11

²⁵ 2004 STC 1633. The taxpayers executed documents creating reversionary leases as part of an IHT avoidance scheme (at [5]). Mr Wolff did so believing that: (a) it was a ‘paper exercise’ only; (b) that in practice nothing would change; (c) he and his wife would pay a peppercorn rent of £1 a year; and (d) they would be able to continue to live in the property. The real effect was that they were to *receive* the peppercorn rent and that they would have *no* right to live in the property. Mrs. Wolff said she did not know what a lease and a trust really were (at [5]). They did however understand that the scheme involved giving away their home to their daughters but still remaining entitled to live in it. The evidence also showed that they were advised that ‘the scheme might not work but it was not necessary to go to tax counsel’ (at [6]). One may ask what it does for the reputation of the tax system if people can be persuaded to enter into such transactions. In the case itself Mann J allowed the taxpayers to set aside the deeds though not without much wrestling with the facts and the law – see especially paras [25] and [26]. Because of the IHT implications, the Revenue were informed of the application; they said they would be bound by the court’s decision provided certain authorities were cited.

²⁶ Hansard House Of Lords 1 February Col 458

We now come back to those trust changes in 2006. Whereas the 2004 changes were designed to protect an existing sound rule, the 2006 changes were revolutionary in their intent and delivery. This Act contains rules which have been described in the United Kingdom as the ‘greatest attack on trusts since the Statute of Uses’ and in the law school of Meagher, Gummow and Lehane I do not need to add – of 1535. Robert Venables²⁷ has referred to the most savage and unprincipled attack on the law of trusts since their invention. James Kessler is no less scathing and I strongly recommend the first chapter of the new edition of his book showing both how serious the effects may be in practice and how very badly their introduction was handled.²⁸

You will recall the IHT rules for discretionary trusts, (TYPE 1 trusts) - the charge at the beginning, the 10 yearly charge thereafter and the proportionate charge when property when property left the discretionary trust regime there has been a charge to tax since 1975²⁹ though its severity has varied. By contrast the ending of an interest in possession in a fixed trust (the Type 2 trust) could be treated as a potentially exempt transfer. So if property is held for A for life remainder to B and A surrenders the interest to B – and survives seven years, there is no charge to IHT. It was a potentially exempt transfer which has become a wholly exempt transfer.

The effect of the 2006 changes, which took effect from 22nd March 2006, was to extend these discretionary trusts rules to almost all other types of trust most notably most trusts with interests in possession (Type 2). They are no longer potentially exempt transfers so they are chargeable when created, without the benefit of relief if the settlor survives seven years, and are subject to the periodic charge. Moreover, as I have already said and subject to exceptions for interests in possession which had vested before that date, the new charges apply to existing trusts. As the interest existing on the 22nd March ends the type 1 rules kick in.

The periodic charge is interesting; the maximum rate is 6% (1/3 of the usual 20% lifetime charge)³⁰ but what is its nature? It is certainly an arbitrary tax and is probably best

²⁷ Robert Venables QC, *The Taxation of Trusts Post Finance Act 2006* Key Haven Intelligence Report para 1.x.x.

²⁸ Kessler *Drafting Trusts and Will Trusts A Modern Approach* 8th edition Thomson London 2007

²⁹ From 1969 to 1975 there was also a charge by reference to the proportion of trust assets devoted to the deceased object in the last 7 years – but this was ineffective unless death was unexpectedly early.

³⁰ The word maximum needs expansion. The rate will be 6% if the trust is established by someone one who used up his threshold of £300,000. However it is possible for people with

seen as a periodic wealth tax on property held in trust designed to reinforce the inheritance tax.³¹ If the idea is that over 30 years most of the property will have been subject to the lifetime rate of 20% and if we assume that 30 years is a generation we can relate it, very distantly, to an inheritance tax charge at lifetime rates of 20% on all the property once a generation. If this is the right way to think about it and if 60 years is the right period then there is some sense behind the changes; the government want to make sure that they get the right amount of tax over 30 years, what they regard as the generation period. They no longer rely on the normal processes of life, death and successive life interests producing the right result because those processes no longer produce that result. They have got rid of the gaps through which tax was escaped because of people surviving surrendering interest in possession and surviving seven years.

Mr Dave Hartnett of HMRC, a very senior official responsible for many of the changes to the original proposals - and who came out of the process with great credit even if I am not totally won over - gave evidence to the House of Lords Committee. He explained the Revenue thinking was that there was not much difference between a discretionary trust and the 'flexible interest in possession trust'. "[A person] leaves the whole of his wealth on trust for his widow for life (this is an exempt transfer since she is treated as owning the underlying property and gifts to spouses are exempt)." So far so good. Then Mr Hartnett complains that the terms of the trust allow the trustees to do all sorts of things. "Maybe the husband has left instructions. The sort of thing we see is that, almost the moment after the funeral, the trustees terminate the widow's life interest in the trust, the assets go to the children or grandchildren and, prior to Budget 2006, provided the widow survives seven years, they all move tax free".³² Mr Hartnett also referred to a practice by which people had interests under trusts in everything - which, he had been told, was called 'Trustifarianism'.

One may say several things in reply. First, one may wonder whether what has changed is not the technique so much as the numbers of people taking advantage of those techniques. In the days of the strict settlement - from which the old estate duty introduced in 1894 took so much money and so which the duty did so much to dismantle, I imagine that trustifarianism was rife. What was different was that one would not do anything so impossibly vulgar as to talk about it. Then let us take Mr Hartnett's example of the termination of the widow's life interest and the absence of charge if she survives seven years. If I change two

relatively small amounts of wealth to put into trust to use the threshold or zero rate band to achieve a nil or lower burden of tax

³¹ On the interaction between a death tax and a wealth tax see Meade Report chapter 16.

³² 22 May p 110

words – from ‘husband’ to ‘grandfather’ and from ‘widow’ to ‘granny’ I can change the perception of risk of dying within seven years. Then I worry about this newly discovered flexibility. Looking again at rows of books in the Squire Law Library in Cambridge I find - the older editions usually in the basement – wonderful 19th century books on powers. There is little new about these things. A power of appointment gave its holder extensive, even flexible powers,³³ and the case law has explored the distinction between a dispositive power and an administrative power.³⁴ Some of the schemes which Mr Hartnett discussed later on with the Committee had been discovered only a few weeks earlier and what they may have revealed was a new intensity with which these things were being practised. Whether more thought would have brought about a better balanced set of rules and especially transitional rules must await the unsealing of the records in 30 years time.³⁵

Now a word about situations in which the old treatment going back to 1894 will nonetheless apply to trusts created after 25th March 2006. The first concerns the creation of a lifetime trust for a person who is disabled or the self-settlement by someone facing disability.³⁶ We shall have to wait and see whether these rules are wide enough. In the preface to his book Kessler refers to the disabled persons’ trusts provisions in FA 2005 and the complex income tax and capital gains tax regimes for disabled persons trusts; he notes that it will almost never be used because the tax advantage does not justify the complexity and restrictions imposed.³⁷

Of more general importance is the second rule which allows the old treatment to continue for trusts created after 25th March 2006 on the settlor’s death, i.e by will or on intestacy, but only for one life interest – the immediate post-death life interest .³⁸ So if I leave property by will to my wife for life with remainder to our children and I die, my now widow will have the benefit of the old rule; the settled property will be treated as hers. When she dies the property passes to the children and they take it. If I wanted to leave the property to my wife for life and then to each child for their lives, the old treatment is at risk. If my wife survives me she will have the benefit of the old rule but on her death the old rules will cease to apply and the new rules with their 10 year charge will start to apply. Viewed from the government’s perspective the distinction between a trust created by a will or intestacy,

³³ *Pearson v IRC* [1981] AC 753 had drawn a distinction between a duty to accumulate which prevented there being an interest in possession and a power which did not.

³⁴ And see Kessler *op cit* chapter 16

³⁵ On lately discovered schemes see 22 May p. 111; on difficulties with grandfathering see 22 May p 115

³⁶ IHTA 1984, s 89 – 89B, added by FA 2006.

³⁷ Preface p. x.

where the old treatment continues in these limited circumstances, and the settlement in lifetime is that before 20th March 2006 it was possible for a lifetime transfer of value to a trust for a person with an interest in possession to be a potentially exempt transfer.³⁹ A transfer on death could never be a potentially exempt transfer since, inevitably, the settlor was not going to survive seven years. Robert Venables, though just as angry as Kessler, thinks that practitioners are in a new world with an arbitrary and erratic tax but should not be down hearted; adjustment may be more fruitful than complaining especially if as Robert suggests all sorts of new things can be tried.⁴⁰

The changes to accumulation and maintenance settlements (Type 3) were more startling; here the changes bite as from 6th April 2008 even for trusts existing before 26th March 2006. As we saw earlier Under the CTT regime introduced in 1975 treatment of the A and M settlement was generous. There was no 10 year periodic charge but only a very low charge at the end. There was no charge when the interest vested – usually at 21 – and so it was more like an immediate gift to the ultimate beneficiaries from the settlor. Since 1987 a transfer to such a trust had been potentially exempt and so only liable to tax if the settlor died within seven years. Lord Robert Walker in a speech published in the Law Quarterly Review on Avoidance described such a settlement for Inheritance Tax purposes as an ordinary relief from tax and a commonplace of tax planning; he equated it with other reliefs or exemptions which he would not term tax avoidance at all.⁴¹ In his evidence to the House of Lords Select Committee Mr Hartnett said that while the law had been stable, what had not been stable was the use made of these trusts to plan quite aggressively to avoid inheritance tax.⁴² There was clear evidence that more people were using such trusts but then that was because there was more money around – as we shall see. There was also evidence that people were using these trust as generation skipping devices; since the terms of the legislation specifically permitted gifts to grandchildren this was not surprising.⁴³ Mr Hartnett said that the assets that had gone into such trusts ‘vastly outstripped what was needed for school fees at the most expensive school in the land and the finest tertiary education that the world can provide.’ This argues for a cap on what is permitted tax free. This is now achieved by having the sums put into such trusts count towards the £300,000 cap; however one must not forget the seven year cumulation rule which allows one to start again after seven years. Yet the money needed is

³⁸ IHTA 1984, ss.49A added by FA 2006

³⁹ IHTA 119084 s. 3A

⁴⁰ e.g. §21.1.1 The whole work is a delight to read but on strategies for the new world see especially chapters 20-22

⁴¹ (2004) 120 LQR 412 at 419; cited to the House of Lords Committee by Malcolm Gammie 26 April col 3.

⁴² 22 May p. 113

much closer to that figure than one might realise and of course ignores the fact that this is a cost per child and most families, at least outside China, have more than one child. The total figure for one child with six years at the Dragon School Oxford, followed by five at Eton followed by three at Harvard is between £300,000 and £400,000 depending on how many ‘extras’ one takes into account. Even taking the more modest range of a day school in Cambridge school one quickly nears £200,000 (per child).

These changes were surprising enough in themselves but two factors made the situation much worse and led to a bitter stand off between the department and the profession. As the House of Lords Select Committee in their report on the Finance Bill in June 2006; “Overall, while we welcome the fact that the government has responded to representations by tabling amendments we believe that neither the process of introducing these changes with a lack of consultation nor the low key way in which both the original proposal and these amendments were released is the way in which tax changes should be made.”⁴⁴

Not only was the only announcement was a very low key press release issued after that Statement but the statement could be read as suggesting that it was part of the outcome of a consultation process which had been going for some time. Later government defences of the proposals suggested that there could not have been consultation as people would have taken pre-emptive action.⁴⁵ This inconsistency in approach was not a happy start. It quickly turned into a breakdown of confidence in the Treasury or HMRC on the part of the practising professions. The practitioners thought the government did not understand the law of trusts and its role in the proper arrangement of family finances. The officials seemed to think that once they had shown that avoidance was going on they were then justified in proposing anything, however ill thought out, and that some of the practitioners were indulging in scare mongering.⁴⁶ The two sides could not even agree on the number of people likely to be affected in the sense that they would have to have their wills reviewed and perhaps rewritten.⁴⁷ It is interesting to note the important and slightly therapeutic role of the House of Lords Committee in enabling the two sides to state their positions. The anger of the practising profession is reflected in the chapter from James Kessler’s book. The Committee recommended that the government explain how it came to its view that ‘only a minority of a

⁴³ IHTA 1984 s. 71

⁴⁴ HL Paper 204-I Para 163

⁴⁵ House of Lord Committee 22 May 2006 p. 113 (Hartnett)

⁴⁶ In para 150 the Committee thought there had been some truth in this

⁴⁷ The Committee regretted said they were not in a position to go into this further, para 150

minority' of 100,000 discretionary trusts would need to be reviewed; Kessler comments that "no such evidence was ever produced (for the good reason that it did not exist)".⁴⁸

The second factor exacerbating the situation was a very particular part of the original proposal. It was not quite true to say that existing Accumulation and Maintenance settlements would lose all their privileges. They would still be allowed to do so if by 6th April 2008 they conformed to a brave new model of a Treasury Approved Trust. Under this the privileges would be preserved if the trust was altered so that the beneficiary would be able to call for the capital at age 18. This was a political point because the age of majority was 18.

You and I might think that it was entirely appropriate, in the interests of the family as a whole no less than in the interests of the particular child, that age 25 would be better. Well, that could be done but you would lose all the tax benefits. The eventual outcome was a face saving exercise. The political imperative was abandoned for cash; the trust could say 25 after all but there would be a tax of a maximum of 4.2% for the years between 18 and 25 – for the mathematically gifted that is the ten year 6% charge allocated to 7 years. The department has now received an independent survey of trusts – how and why they are set up and how they are run. It shows, not surprisingly, that most trust are set up for reasons other than tax.⁴⁹

I still find the story difficult to disentangle in some respects. It is hard to get rid of the suspicion that these changes had been left late in the day and not fully thought through. The new rules make the IHT on an outright gift, which is still a PET, quite different from a gift in trust which is not. HMRC presumably think that that although people can give money to their successors as absolute gifts they will not do so. It is also the case that it is now expensive – in tax terms - for trusts, of whatever type to last too long. Although it is hard for us as theoreticians to find an absolute principle to guide us in this area, this seems an unfortunate conclusion. It is however quite deliberate; money that is not put in trust may well be taxed more often.

What will be the effect of the change? The Revenue estimate of yield is £15m in the first year which is surprisingly low but presumably the figure may rise later as the ten year anniversaries come round. Against the extra IHT one may have to set the cost of an increased use of the deferment rules for CGT. CGT can be deferred on assets if the disposal is subject to

⁴⁸ p. 5

⁴⁹ HM Revenue and Customs Research Report 25; Research on Trusts: Experience of Setting Up and Running Trusts, especially at pp 61-70. Note comments on low response rate at p.22. The interviews were conducted in 2004.

IHT; a PET was not subject to IHT. What will be the behavioural effects is unclear – it is unlikely that these rules will remain unaltered for ever. I do regard the episode as tragic in giving rise to a breakdown of trust and confidence on both sides.

Since you do not have a system of estate and gift tax in place, you are free to choose whichever form you want. Clearly you would need to think hard about trusts. More broadly I commend the Asprey Committee which at paras 24.7-9 surveyed four options. Two they discarded quickly - one was the idea of treating these as income, as suggested by the then recent Canadian Royal Commission, the Carter Report. The other was the cumulative and progressive accessions tax, now in force in Ireland and which is the choice favoured by our Liberal Democrat party, in which the amount of tax paid by a recipient depended on how much that person had received by way of gift, bequests and so on.⁵⁰ Well may they say, as their participant did in the recent House of Lords debate, that the tax 'would not be straightforward to administer'.⁵¹

This left the choice between a tax by reference to the circumstances of the donor and one by reference to the circumstances of the donee. Asprey began by preferring an estate duty partly because it was familiar and would be complicated to change. However there were also three doctrinal/policy reasons. The Committee was unconvinced that, under the inheritance tax, the burden 'fell' on the beneficiary' or that there was need in Australia to encourage wider dispersion of legacies. As regards the first argument, it stressed that a testator could vary the incidence of the tax by the manner in which he makes his will. A person who wished to leave a sum of money to a beneficiary could provide in his will that inheritance tax should not be charged against that sum but against the balance of his estate. Exactly the same point was made by the United Kingdom Inland Revenue in 1949 when abolishing our legacy and succession duties which had existed since 1780 and 1853 respectively. However Asprey went further adding that even if this was expressly forbidden, it would continue to be open to the testator to make a larger bequest to the beneficiary to compensate for the tax the beneficiary would have to pay.

As to wider dispersion of legacies the committee saw that it might have force where lingering traditions of primogeniture led testators to concentrate their legacies on single heirs, but this was not the tradition in Australia. The third reason was interesting in our present context. Avoidance was probably more easily controlled under an estate duty, 'particularly where the law permits the creation of discretionary trusts and other equitable interests.' So

⁵⁰ Liberal Democrats Policy Paper 75. Section 3.3

while my fourth reason may wilt just a little under Ross' fire it remains true that you have more of a choice than Asprey did.

We now come to what I regard as the central issue of the tax. Any discussion in the UK should focus on the important raw politics question – who is going to pay the tax? and, closely related, who is not? My own view on those sunny but cynical days, which become more common as I get older, is that much of the UK tax policy debate can now be boiled down to two elementary propositions. First, taxes should be simple. Secondly, they should be paid by other people. In designing one's estate and gift tax or wealth tax one can do a lot of shifting of loads. One of the oddities of the US repeal process is that the polls showed that 70% of the people wanted to remove a tax which was paid by only 2% of the people. Moreover many reform proposals increased the threshold beyond the point at which many of those featured as supporting the campaign would cease to be liable. Yet Graetz and Shapiro show how wrong it is to see the US debate in such terms – those seeking repeal said the tax was wrong even it applied only to other people.

In the United Kingdom the threshold for the tax year about to start – in accordance with sound principles - on 6th April 2007 is, as we have seen, £300,000 and the main rate is 40%. Oddly there is very little debate about the 40% rate .Once it bites it bites hard BUT a flat rate so no need to go in for equalisation of estates. There is much current agitation on the threshold . Many think it too low due to the increase in the price of houses. While the IHT threshold has increased by a third since 1997, average house prices have risen by much more; a threshold of about £400,000 would be needed to give parity in 2006-07 so the Chancellor's announcement last week of £350,00 for 2010 fall short. Perhaps happily, there have been few calls for the exclusion of the family home from the tax. Any such idea would draw criticism from Asprey⁵² and from me. We already have the problem of 'lock in' in our capital gains tax which not only exempts the deceased's only or main residence but also provides what the Americans call a 'step-up in basis' on death.

However, just as important as the level of the threshold is the number of times one can use it. As we saw earlier, the combination of a system of potentially exempt transfers, a high threshold, a seven year cumulation period for chargeable transfers , exemption for transfers between spouses and civil partners means that a clever family with wealth other than the family home can give quite a lot of wealth away and still not cross the threshold. This was

⁵¹ Lord Newby col 462

⁵² Asprey para 24.38

much like the old and derided estate duty; my own view is that a single credit on the old American model is preferable to a seven year cumulation period.

The £300,000 threshold is a vital part of planning and much effort is devoted to ensuring that the value of this £300,000 is not lost. The simple solution of giving the qualifying couple a transferable allowance so making a joint exemption of £600,000 is perhaps too simple.⁵³ In the recent House of Lords debate, it was suggested that unmarried siblings living together should be treated far more fairly, and so should relatives and others who give live-in care for the elderly and the infirm.⁵⁴ This is a rerun of arguments heard when the civil partnership legislation was going through in 2004; if people living together in same sex relationships should be given privileges analogous to those given to the married why not in these no less meritorious situations also? The European Court of Human Rights has just held the unmarried sisters who had lived together as such could not complain of unequal treatment under the Convention.⁵⁵ The majority held that the rules were within the margin of appreciation left to national authorities. However the majority was a slim one- 4-3.

Another way in which people ensure that they do not waste the zero rate bracket is that the first spouse or civil partner to die leaves the value of the nil-rate band, or part of it, in a mini discretionary trust. The objects of the trust are invariably the surviving spouse or civil partner, children and remoter issue. suggested that people with fairly modest estates would usually prefer all their assets to pass directly and absolutely to the surviving spouse or partner without the necessity for such a cumbersome and bureaucratic mini-discretionary trust regime. People find the whole process bureaucratic and incomprehensible- and not cost free.⁵⁶

Another way is enshrined in the statute. This is the rule which allows beneficiaries under a will (or intestacy) to vary the will within two years of the death. A variation meeting the statutory conditions is treated as having been made by the deceased and not by the beneficiaries.⁵⁷ There is an analogous provision for capital gains tax but not for income tax.⁵⁸ I sometimes call this the solicitors negligence relief provision. It achieves what the discretionary trust practice achieves at less cost but it does depend on your selected beneficiaries doing what is sensible.

⁵³ It surfaced in the House of Lords debate Lord Burnett col 452

⁵⁴ Ibid.

⁵⁵ *Burden v United Kingdom* Applic 13378/05 2-7 STC 252

⁵⁶ Lord Burnett in House of Lords debate above.

⁵⁷ IHTA 1984 ss. 17 and 142

⁵⁸ TCGA 1992 s. 62 (6)

So, having established that the threshold is important let us try to see where it should be set. At once one has to say, as Asprey did, that no theory will actually give us the answer – this is raw politics.

Looking back at the 1970s and 80s one of the curious things is how almost overnight and right across the world ‘equity’ was routed as a key policy in favour of ‘economic efficiency’ and its close ally ‘neutrality’. The Asprey Committee were very clear that death taxes were a good thing 24.3 and 24.4 because they were redistributive. “though death taxes can never be simple taxes and though revenue from them will never be great compared with that from some other taxes, they have an essential role to play in the tax structure considered as a whole.

24.4. A death tax serves two main purposes. It serves to support the progressivity of the tax structure by the indirect means of a progressive levy on wealth once a generation. It also directly limits the growth of large inherited fortunes, a trend that most people would agree to have undesirable social consequences.”

Graetz and Shapiro suggest that there is a connection between the movement to get rid of the estate and gift tax and one to attack all progressive taxes.⁵⁹

In the United Kingdom such talk has gone out of fashion – we talk about ‘fairness’ instead which mostly consists of handing money out rather than gathering it in, apart from the annual talk of countering avoidance. One of my questions for today is whether the tide is turning. When I started writing this lecture in December this seemed far fetched. However I had not reckoned on the annual city bonus round in the City of London. In January quite some attention was given to the annual message of Mr Brendan Barber, the General Secretary of the Trade Union Congress (or TUC). The Trade Union movement, which was extremely active in the 1970s, was brought to heel by Mrs Thatcher and has been kept fairly muzzled by Mr Blair. So it was interesting that he should have got such an airing. He pointed out that City bonuses last year would total almost £9 billion. That would be enough to have given everyone at work in Britain a Christmas bonus of more than £350.⁶⁰

⁵⁹ Op cit p. 4

⁶⁰ He also pointed out that top pay had been increasing 17 times faster than average pay. He also talked about pensions. Directors of the UK's top 100 companies have amassed pensions worth nearly £1 billion between them, according to the TUC's Pensions Watch survey. On average they can retire at 60 on a final salary pension worth nearly £3 million. The largest directors' pension in each company is worth nearly £5 million (£4.9 million), over 40 times more than most staff pensions.⁶⁰ And this is at a time when many have been happy to cut the pensions of their own staff, and been ready to condemn the Government for not cutting the pension built up by public servants such as nurses and school meals staff.]

It is not just the trade union movement. In an interesting article in the Sunday Times for 17th February this year, entitled ‘Haves and have yachts’, Rachel Johnson refers to the ‘have yachts’ as having ‘sickeningly obscene sums of money.’ More interestingly she refers to a Halifax survey showing that only nine professions could afford private school fees in London in 2005 compared with 19 in 2000.⁶¹ I should add that a recent OECD survey showed that UK private schools have some of the best schools in the world.⁶² In a recent issue of Cosmopolitan which I read in the proverbial dentist’s waiting room VS Naipaul commented that when he was young what one had to do to ‘get ahead’ was to get an education; now one had to get money. Peter Hain, one time scourge of the South African Rugby authorities and now a senior member of Mr Blair’s cabinet, has called for restraint and for extra taxes, especially as some of these bonuses are funded by the profits of venture capital schemes which attract tax advantages.⁶³ What people wonder about is where the money came from and to what extent it comes directly or indirectly out of their pension funds or insurance policies – never in the field of human finance was so much taken from so many by so few.

One can hear the tumbrils of envy beginning to rumble. Other voices remind us not only that the rich are mobile (so that the option of taxing the rich is not viable) but also that deregulation and lower taxes since 1986 have made London a world renowned super-cluster attracting a highly talented (but also highly mobile) workforce.⁶⁴ The sound of tumbrils makes way for the hissing gold-laying geese.

Mr Brendan Barber went on to say that there was a moral dimension. “Should we not be worried that there is growing group of people who are rich enough to float free from the rest of society?...” He would have been further worried had he known that The Sunday Times Rich List for 2007, listing the richest 1,000 people in Britain, will probably start at assets of over £60m and that 30,000 people have assets of £5m or more.⁶⁵ So I think there are many reasons for thinking about the taxation of property on death at this time.

⁶¹ News Review section; see also the results of a poll in the Sunday Telegraph complaining of the unequal increase in wealth since Mr Blair came to power.

⁶² OECD Programme for International Student Assessment (PISA) divided state schools from private schools in 31 countries; UK independent school came top of the 62, quoted in Bosanquet and others UK Growth and Opportunity the Need for Fundamental Review, Reform, March 2007, para 4.10

⁶³ Secretary of State of Northern Ireland since 2005 and for Wales since 2002.

⁶⁴ Bosanquet and others above (two notes) paras 5.20 and 2.26

⁶⁵ 25th February 2007 News Review Section Woods The New Victorians

Moral arguments can be raised about the deleterious effects of receiving money at a young age, that they reduce the will to succeed in the world of work and encourage unseemly and improper behaviour on the part of those who press relatives to leave them money.⁶⁶ These are arguments as much against the institution of inheritance as for a tax on death and so go wider than I need; it may argue for a progressive tax on death but I can see it is stronger if the system chosen taxes the donee. I also appreciate that a transfusion of wealth can be life saving; all of us can probably remember someone announcing when a surviving relative died “oh good, now I can get a divorce.”

In the UK today parents can feel many calls on their generosity. They may pay fees for school and fees at university, they may support their children’s maintenance during these periods. They may also help the young to buy a house while at university. We are now back to those figures about the costs of private education. But we are also right back in the middle of the raw political debate – I don’t see Brendan Barber’s members wanting to enable grandparents to help their grandchildren’s private school fees.

If the threshold is one main point of controversy, the PET system, reinforced as it is by a seven year cumulation period for transfers which are not PETS is another. It breaks one of Asprey’s key principles that one should not be encouraged by tax considerations to give up the security of wealth during one’s lifetime.⁶⁷ Harold Wilson’s jibe that estate duty was tax on those who were unlucky or did not like their children can have a sinister ring if the frail do not do what the children want, as witnessed by recent reports of the sometimes criminal behaviour of family members as witnessed while visiting residents in care homes . One can cite King Lear – “Meanwhile we shall express our darker purpose. “Give the map there Know that we have divided in three our kingdom tis our fast intent to shake all cares and business from our age, conferring them on younger strengths, while we unburdened crawl towards death.”⁶⁸ One might say “Unburdened but eventually much hurried.” Lord Burnett observed that it remains a most unpleasant characteristic of the tax that the elderly often have to endure far too much pressure to gift assets early, leaving them financially and emotionally vulnerable. How far IHT is responsible for this and how far other factors, such as the system of assessing means for care homes, is for reflection. In the UK those entering care homes will usually be required to pay fees if they have the necessary capital - until it is reduced to £20,000. However the person can give wealth away until the need for care arises.

⁶⁶ Lord Campbell Savours House of Lords debate col455

⁶⁷ Para 24.21

⁶⁸ Act 1 Scene 2

A quite distinct problem is whether the tax is stable.⁶⁹ Again I cite Lord Burnett who said he had met a number of individuals who, through fear of a change in the tax regime, had been persuaded to gift business assets and had found to their horror that the donees who had inherited those assets far too early have squandered and destroyed businesses.⁷⁰ Every year some paper carries an alarmist story a few days before the budget that such and such a rule might be changed - for example the two year variation rule. I do not believe that those behind the 2006 changes appreciated the destabilising effect of what they were doing. When I asked someone whether I could rely on the two year rule remaining unchanged; he said 'of course'. I am sure that one year earlier he would have said the same for A and M settlements.

If HMRC or as I suspect, the Treasury could have found a more rational policy and a more rational way of implementing it, we would all be better off. As it is they are, or at least ought to be, ruining the wider effects of their legislation. Condemned by the House of Lords for incompetence and accused by members of the profession of lying, they have forfeited trust, they have undermined the stability of the system and left a feelings of raging injustice among those now called on to pay the periodic charges on interest in possession trusts.

If you were designing a tax system from scratch you might be worried about generation skipping transfers. Asprey recognises it as an issue but did not find a neat solution.⁷¹ FA 2006 finds a rather drastic solution but if again we face the question whether an imperfect solution is good enough; we come back to the point that while FA 2006 penalises transfers to grandchildren through trusts it does not penalise outright transfers. The practical effect is that the tax system is encouraging donors to do things which are not in their best interests, and I do not just mean financial interests, of the family as a whole. My concern therefore is that what drives the FA 2006 is not just hostility to the trust but also hostility to the family as distinct from the individuals who comprise it. I do not think that is good policy.

So where are we now?

I do not see the present government abolishing IHT – it raises significant sums of money but usually only when people die. The recent and prolonged increase in the price of

⁶⁹ See Kessler op cit p.9 who also cites Taxation and Democracy Sven Steinmo Yale UP p. 44

⁷⁰ House of Lords 1 February 2007 col 452

⁷¹ “24.15. No extension of the tax base can ensure that all wealth is taxed at least once a generation. The law cannot forbid a grandfather leaving his property to his grandchildren when their parents are still living. Generation-skipping of this kind could be dealt with indirectly by provisions that would make tax on the grandfather's estate depend on the difference in age between himself and his grandchildren, but such provisions would be complicated and could produce some unexpected and probably unwelcome consequences.”

houses will mean relentless increases in wealth and so in IHT without too much fuss. Gordon Brown shows no wish to abolish IHT. The odd thing perhaps is that the government paid relatively little attention to the tax until recently. The recent House of Lords debate showed little appetite for change.

We have a tax which yields significant sums of money. Although it is sometimes derided as 'only £3.6bn' one ought to ask whether, if people were offered a choice between keeping IHT and paying an extra one 1p on the income tax, they would choose to keep IHT. I think it is clear that majority would since only a small minority pay the tax;

We have a tax with a number of features which cause concern. It encourages people to give away money when they should not. It enables some people, i.e. those with enough liquid assets to give them away, when others, whose wealth is in a home, cannot. The 2004 income tax charge and other changes make it more difficult still. A large single exempt sum combined with an integrated lifetime and death tax is therefore preferable to the system of cumulation. When we worry about justice we also have to worry about Robert Venables' point that the very rich who can afford the relevant fees and costs can find perfectly lawful ways round the rules, which means, as he himself says, that they can consult Robert.

We have a tax which affects a significant number of people. The Revenue like to say that only 38,000 estates attracted tax in 2005-06. If one multiplies that by, say, 33 one gets a generation figure of just over 1.25m. over 33 years. The figure of 38,000 will rise if one takes account of those who will pay the tax if the threshold increases in the way it has over the last 10 years. One also has to consider those who do not feature in the 38,000 because they live long enough to avoid being unlucky, and so bring their wealth down to a level which attracts no tax. One has to take account of those who do not feature in the 38,000 who do not feature in the 38,000 because they give enough of their money away at the right time, because they love their children and so bring their wealth down to a level which attracts no tax. All these people may well incur expenses paying for a tax they do not pay. Graetz and Shapiro have a lovely story about one supporter of the repeal who had arranged his affairs so as to have no significant tax liability in prospect but who deeply resented the \$150,000 he had to spend each year on life insurance to fund potential estate tax liabilities.⁷² That apart, all my exemplars will have had to think about the tax even though they do not pay any; many of these will have incurred expense in legal advice and/or will drafting. If it means that more

⁷² Op cit p 16.

people think about their wills – and tell the young what they intend – that may be a good thing.

I am not at all sure I know what to think about the effect of the tax on savings. Fortunately I can find comfort from the research published by Gale and Perozek. They show that once the savings patterns of children are brought into account – they save harder because they get less if there is estate tax – the tax may actually encourage savings. However the argument is finely balanced and it is probably best just to say that there is little or nothing in this point to cause us to say that having an estate tax undermines saving.⁷³ I also share their company in dismissing complaints about double Taxation.⁷⁴

Some will say that if IHT generates lots of (wasted) work why not leave it to CGT? Alan Auerbach in his IFS Annual Lecture last year pointed out that a death tax can hit all wealth not just wealth having measurable capital gain; in turn this makes for a more uniform return on savings.⁷⁵ Secondly, “estate taxes hit not only intentional bequests but also unintentional bequests that arise when individuals hold assets to protect themselves against possible expenses but die without incurring such expenses.”

I think we are close to very difficult questions about the rights of the citizen or subject versus those of the state.⁷⁶ If one has a substantial amount of wealth why should one not be free to spend it taking holidays on the best floating country clubs I know I refer of course to the cruise vessels Hebridean Spirit and the Hebridean Princess. Certainly in the UK and, I assume, here also in Australia, people are going to live longer and, all too often, worse. The statistical predictions for patients suffering from dementia are bad enough but many people short of dementia will need full time caring. Public funds to help pay for care of people in their own homes, a means- tested benefit, is likely to run out in a few years. Should the tax system encourage people to hang on to their money to cover such expenses? It certainly should not encourage them to do the opposite which is what the present regime does.

Should we require people to save for these expenses as we do for pensions? This is of course what people think they are doing by paying their taxes - should

⁷³ See op cit above X , Chapter 5 above v. x and Comment by Gordon op cit pp 260 et seq.

⁷⁴ Op cit

⁷⁵ Future of Capital Income Taxation Fiscal Studies 2006 vol 27 399 at 417

⁷⁶ For a major work defending the role of taxes see Murphy and Nagel’s The Myth of Ownership (Oxford) 2002 esp chapter 7 on Inheritance.

they be taxed again? Or should we demand that those who are still taxpayers – who are of course our children or grandchildren - should pay? These are very real problems of inter generational equity. We cannot simply say that ‘society’ should pay.

Or should we devise a tax system which avoids the present trap? One way of doing it is to reverse all our thinking and not tax estates on death at all but decide to tax those acts of disposition – gifts. We might tax them at the standard VAT rate to equate with other forms of spending or we might tax them at a much high progressive rate. However Ross’ tax – the UK’s CTT – might also have a role to play. If a donor has reached the maximum rate of tax, it may make little difference whether to keep the money for one’s own use or to pass it to the children. These are, I confess throw away remarks at the end of a lecture and clearly need more thought but I am happy to leave them before you .

I think, as Ross did, that these taxes can help the progression of a tax system. I think a system without some such tax is an unfair system. I do not accept that having the tax is equivalent to grave robbery. What I do have difficulty with is in finding the right concepts and principles with which to conduct the discussion. For the moment let us accept that it is good to be reminded that tax is to do with people. Neither finer points of double tax treaties, nor the boundary between debt and equity , nor even the decisions of the European Court of Justice have as much impact on our fellow citizens. Finding the right concepts is like finding the difference between good and evil or between right and wrong – and tax theorists do not like absolute principles. Ross himself would, I believe, have relished the role. In his early appointments at Tasmania and Perth he had strong interests in jurisprudence. How we miss him.

So we have some questions:

Do we accept progressive taxation?

Do we think death taxes are a good way of achieving progression?

At what level should the threshold be set – i.e. Who should pay the tax?

Do we like the idea behind the 2004 and 2006 changes of making tax avoidance less of a one way street?

What is the right way to tax trusts?

Am I right to dismiss arguments based on savings effect ?

Is a tax with holes better than no tax? Was Chesterton right?

Ross will be listening carefully to your answers.