International charitable trusts and IHT exemption

COMMENTARY BY SIMON ATKINSON, 8 NOVEMBER 2019

The Supreme Court, in the recent decision of Routier v Revenue and Customs Commissioners (No 2) [2019] UKSC 43, [2019] 3 WLR 757, has provided valuable guidance as to the scope of s. 23 of the Inheritance Tax Act 1984 (which exempts gifts to charities from IHT). The case is a welcome decision for private clients and their estate planners wishing to support international charitable causes while simultaneously benefitting from reduced liability to inheritance tax.

Briefly, the facts of Routier were these. Beryl Coulter died in October 2007 domiciled in Jersey. By her will, which was governed by Jersey law, Mrs Coulter provided that the residue of her UK estate was to be held on trust ("the Coulter Trust") for the purpose of building homes for the care of elderly people resident in St Ouen in Jersey.

At the time of Mrs Coulter’s death there was in force a treaty between the UK and Jersey regarding the exchange of information about income tax but it was not until 2009 that a further treaty came into force which included provision for the exchange of information about IHT.

On 29 May 2013 HMRC determined that Mrs Coulter’s gift of her residuary estate did not qualify for relief under s. 23. This was because, HMRC said, the Coulter Trust was initially governed by Jersey law and, on a proper construction of s. 23, relief was limited to trusts governed by the law of a part of the UK. A Jersey-law trust was thus outside s. 23.

The executors appealed this determination to the High Court but lost: [2015] PTSR 60. The executors further appealed to the Court of Appeal. The executors argued that Rose J’s construction of s. 23 contravened EU law, submitting that it amounted to an unlawful restriction on the free movement of capital between member states and third countries under article 63 of the TFEU (article 56EC as was then in force). In September 2016 the Court of Appeal held that, subject to consideration of the EU law issue, the appeal would be dismissed: [2016] EWCA Civ 938. In October 2017 a differently constituted Court of Appeal, having heard argument on the EU law issue, dismissed the appeal: [2017] EWCA Civ 1584. The executors appealed to the Supreme Court.

It was common ground at the appeal that the purposes of the trust were exclusively charitable under English law. The principal issues for determination were: whether Jersey formed part of the UK for the purposes of article56 EC; and, if not, whether the refusal of relief under IHTA s. 23 was contrary to EU law.

As to the first issue, it was HMRC’s contention that article 56EC had no application to the facts of the case on the basis that movement of capital between the UK and Jersey ought to be regarded as an internal transaction taking place within a single member state: [5]. Article 63 TFEU (article 56EC as was) prohibits restrictions on the movement of capital between member states and between member states and third countries; it does not apply to movement of capital within a single member state.

The Supreme Court – in a single judgment given by Lords Reed and Lloyd-Jones, with whom the others agreed – rejected HMRC’s argument on the first issue (as had the Court of Appeal). The Supreme Court considered that CJEU case law provided a systematic and consistent approach to resolving the question of whether a territory of a member state was to be regarded as part of that member state or a third country; the issue was context specific and would depend on whether the
relevant provisions of the EU rules applied to that territory. Since the EU rules on free movement of capital did not apply to Jersey, it was to be considered a third country for the purpose of transfer of capital from the UK. Accordingly, article 56EC applied to the transfer of capital from the UK to Jersey: see [35]-[38].

Having resolved the first issue against HMRC the second issue – viz. whether the refusal of relief under IHTA s. 23 was contrary to article 56EC – had to be considered. The Court of Appeal, in upholding HMRC’s original determination, had applied the decision of the House of Lords in Camille and Henry Dreyfus Foundation Inc v Inland Revenue Comrs [196] AC 39. In that case (which as the Supreme Court noted had been decided long before the UK’s entry into the EEC) their Lordships had held that the phrase “trusts established for charitable purposes only” in s. 37 of the Income Tax Act 1918 had to be interpreted as being implicitly limited to trusts governed by the law of some part of the UK. Since IHTA s. 272 provided that “charity” and “charitable” were to have the same meaning as the Income Tax Acts and since s. 989 of the Income Tax Act 2007 defined “charity” in the same way as the Income Tax Act 1918 had, the Court of Appeal held that the judicial gloss applied in the Dreyfus case applied to IHTA s. 23.

The Court of Appeal recognised that s. 23 could not conform with EU law if the restriction in Dreyfus applied without qualification. The Court did, however, consider that such a restriction could be justified if one interpreted s. 23 as containing an implied right for HMRC to verify information about an overseas charity by means of a mutual assistance agreement. Since there was no such agreement in force between the UK and Jersey at the date of Mrs Coulter’s death this meant that relief was not available in the case of the Coulter Trust.

The Supreme Court rejected the Court of Appeal’s conclusion. The Supreme Court observed that neither IHTA s. 23 nor ITA s. 989 made relief in respect of trusts in third countries conditional upon there being a mutual assistance agreement in place; there was no basis for implying such a condition into the statutory language. IHTA s. 23 should simply be construed in accordance with its express wording: there was nothing in s. 23 which confined the scope of the relief to trusts governed by the law of a part of the UK. That being so, the judicial gloss given to IHTA, s. 23 in Dreyfus could not survive in situations where EU law applied. Accordingly, the Coulter Trust qualified for relief under IHTA, s. 23.

The Supreme Court’s decision is to be welcomed. It makes clear that IHTA s. 23 is to be interpreted in accordance with its express language and that, at least in cases where European law applies, there is no restriction on its application to charitable trusts governed by the law of part of the UK. The ghost of Dreyfus can be put to rest, at least (perhaps) until Brexit…

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