TECHNICAL RELEASE

TAXGUIDE 09/15 (TECH 12/15TAX)

INHERITANCE TAX AND TRUSTS:
UPDATE ON FINANCE ACT 2006 - AGREED CORRESPONDENCE WITH HMRC
Guidance note agreed with HMRC, published on 27 October 2015

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For more information, please contact ICAEW Tax Faculty: taxfac@icaew.com

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INTRODUCTION

i. This TAXGUIDE is an update of TAXGUIDE 1/07 which is now withdrawn and includes a number of additional queries that were answered by HMRC and now have been included in the revised text. To make matters clear the additional questions have been highlighted in the text.

ii. As originally published the TAXGUIDE was concerned with a number of questions that were associated with the introduction of the changes following the Finance Act 2006. Tax Faculty asked HMRC for clarification on how the legislation would work in practice. The issues were raised in a letter dated 6 October 2006 to HRMC who responded on 17 November 2006.

iii. A number of additional questions in relation to questions 9, 13 and 14, transitional serial interests (new questions 19(a) and (b)) and immediate post death interests (new question 20) were put to HMRC by the Tax Faculty on 25 January 2007 to which responses were received on 11 May 2007 from HMRC. This updated Guidance Note includes these supplementary questions and HMRC's answers.

iv. This TAXGUIDE should be read in conjunction with TAXGUIDE 10/15. This also deals with a further legacy question concerning the changes introduced by FA 2006. It considers the case of Wyndham v Egremont and whether when trustees exercise their enlarged powers of advancement under s.32 Trustees Act 1925 to defer the vesting of capital, a new interest in possession would be created. The view taken by HMRC as set out in that TAXGUIDE, is that a new IIP will not be created in all circumstances and it very much depends on how the trustees exercise their powers

v. This memorandum reproduces the relevant text of the correspondence, with HMRC's responses

INHERITANCE TAX AND TRUSTS:
SCHEDULE 20, FINANCE ACT 2006

TEXT OF CORRESPONDENCE

When we discussed Schedule 20 with you and your colleagues earlier this year, you expressed the view that you wanted such meetings to become part of a continuing dialogue, with which we entirely agreed. Accordingly, as mentioned in the telephone conversation … on 4 October, we thought it would be helpful now to let you have some points which we think need to be covered in the guidance that you propose on Schedule 20. We look forward to seeing the draft and letting you have our comments on it.

Our points are as follows:

1. New Section 49 (1A) relates to an interest in possession in settled property to which an individual becomes beneficially entitled on or after 22 March 2006. If A has an interest in possession in settled property that exists on 21 March 2006, and on 19 September 2006 the settlor settles say £10,000 in cash on terms that the funds are to be held on the same interest, is this within s49(1A) or effectively outside it and remaining within section 49(1)? As far as we can see, A still has the same interest in possession in terms of the settlement he had before 22 March 2006: but perhaps your view is that the property in which the interest subsists is not the same as it was before 22 March.

HMRC response

A has a new IIP in £10,000, which is subject to the "relevant property" rules. The transfer by the settlor is immediately chargeable. But A's original IIP retains its pre-Budget treatment.

2. In the same example, assume that the property in which A's interest subsists is burdened by a debt due to the settlor B and that after 22 March 2006 B waives the debt. This does not appear to change the property to which A is beneficially entitled as the property in which the interest subsists has not altered although there has been an increase in the value of the settled property. Please confirm that in this case the whole of A's interest remains within the pre-22 March 2006 rules.

HMRC response

A has an additional IIP to the extent of the waived debt, with the same consequences as outlined in response to question 1) above.

3. We read Section 49C to mean that it is possible for a transitional serial interest to arise even where at 22 March 2006 that interest does not at present exist separately. An example would be where a trust on 22 March contained IIPs for both A and B, and before 6 April 2008 the trustees appointed the interest of A on to life interest trusts for C & D and the interest of B on to life interest trusts for E and F.

HMRC response
We can confirm this.

4. Assume an A&M trust was created on 1 June 1987 and B obtained a life interest in the fund on 20 August 2006 at age 25. It appears arguable that the property in which his interest subsists became relevant property on 20 August 2006 as it is no longer in s71 and so there is a periodic charge on 1 June 2007 which would be pro-rated under section 66(2) to exclude a charge for the period during which the property was not relevant property. When one of our members put this point to you at the Finance Bill open day on 5 May 2006, you said that the relevant property rules will apply only as from 6 April 2008. Please confirm that you take the view that there are no circumstances where relevant property charges can arise before 6 April 2008.

HMRC response
The "relevant property" rules apply in this scenario from 20 August 2006. S.71 ceases to apply from that time, and s.71(4) continues to operate so that there is no charge when B takes their IIP. But the IIP does not qualify as an "immediate post-death interest" or "transitional serial interest" and, assuming that it does not meet the conditions for a "disabled person's interest", will therefore be "relevant property" going forward. This will mean a pro rata periodic charge on 1 June 2007, as you suggest**.**

5. Section 71D sets out conditions which have to be satisfied in order for property that was within s71 on 22 March 2006 to qualify for a slightly more favourable regime as a result of changes to the trust made before 6 April 2008. Clearly there will be many A&M trust where the trustees would want to move into this regime. It is likely that these trusts will have fairly common dispositive powers so that the shares of beneficiaries can be altered before any of the beneficiaries concerned obtain an interest in possession. Please confirm that the existence of this power will not prevent s71D being satisfied.

HMRC response
We have taken you to have in mind here the sort of situation where:

- an existing A&M trust is modified so that B1, B2 and B3 will take absolutely at 25 and, if more than one, in equal shares; but
- before that age – or before they take a beneficial interest in possession at 18, if the trust allows – the trustees can amend it again so that, for example, B1 takes ½ and B2 and B3 take ¼ each.

We can confirm that the existence of this sort of power will not, on its own, prevent s.71D from being satisfied.

6. Please confirm the position is the same if a beneficiary obtains an interest in possession in the transitional period up to 6 April 2008, in circumstances where the trust would otherwise have qualified as an 18-25 trust but for the existence of such a power as was described in the point above.

HMRC response

We can confirm this.

7. It is likely to happen that in such A&M trusts the trustees receive income which can be applied for the maintenance of the beneficiaries who have not yet obtained an interest in possession but which is not segregated into an individual pot of income for each beneficiary. Please confirm that the existence of this power will not prevent the trust meeting the requirements of s71D.

HMRC response

We can confirm this.

8. Please confirm that the position is not altered if in such a trust a beneficiary obtains an interest in possession in the transitional period but the trustees have used this power to preserve a global pot of income.

HMRC response

We can confirm this

9. Since what is now s71D was not introduced into the Finance Bill until June, it is likely that in some trusts where the trustees would wish to enter into the s71D regime, they will have exercised the powers discussed in points 5 to 8 above after 21 March 2006. Please confirm that such exercises will not cause the trust to fall outside s71D.

HMRC response

The first thing to bear in mind is that s.71D does not apply to property to which s.71 applies (s.71D(5)(b)). So, if powers have been exercised in such a way that do not prevent s.71 from continuing to apply, but will prevent s.71D from applying in due course, it may be possible for the trustees to exercise them again before 6 April 2008 to overcome those difficulties.

If the sort of power referred to in paragraphs 5 and 6 is exercised at any time after s.71D applies to property, then the trust may or may not fall outside s.71D as a result.

For example, if it is exercised in the way that we have imagined in our answer to paragraph 6, we consider that the trust would still come within s.71D because the trust property would still be held for persons who will, on or before attaining the age of 25, “become absolutely entitled to the settled property etc.” (s.71D(6)(a)).

However, we consider that a trust in the position where anyone who is not currently benefiting can nevertheless become entitled would not meet the requirements of s.71D(6).

So, for example, if the default trusts were for B1, B2 and B3 equally and the trustees revocably exercised the power to appoint to B1 and B2 equally, we consider that s.71D would no longer be satisfied (in respect of the trust as a whole), unless a future exercise of the power cannot benefit B3.

If the trusts on which the settled property is held fall within s.71D, we think that it is unlikely that the exercise of a power to preserve a global pot of income for beneficiaries who have not yet obtained an interest in possession will result in s.71D ceasing to apply. This is on the basis that income that the trustees have not, in their discretion, applied for maintenance etc is effectively held as accretion to the trust property and on similar trusts.

Additional Question 9

Your reply to this question appears to have wider application than simply to those cases where trustees of accumulation and maintenance (A&M) settlements are seeking to convert them to 18-to-25 trusts.

The comments are very helpful in that it appears fixed shares of capital and of income are not necessary provided that no new beneficiaries can be added. Similarly the mere existence of flexible powers to alter shares prior to a beneficiary attaining an interest in possession or absolute entitlement, or the existence of a global pot of income for the purposes of maintenance, would not itself disqualify the trust from 18-to-25 status. This is subject to the proviso that at any point in time the existing beneficiaries are collectively absolutely entitled to the whole of the capital and income.

HMRC response

And to the proviso, as you note above, that it is not possible for someone who is not currently benefiting to become entitled in future.

As the wording of s71D(6)(a) is virtually identical to that of s71A(3)(a) can we assume that you consider the position to be the same where a Trust for a Bereaved Minor (TBM) is concerned? And similarly can you confirm that your response to question 9 applies equally to new TBMs, and new 18-to-25 trusts, as well as to cases where trustees seek to convert an existing A&M trust to a s 71D trust?

HMRC response

We can confirm this, subject to our previous comment.

10. While it will not be of importance for most people, the guidance should cover whether a natural father who does not have parental responsibility can create a TBM or aged 18 to 25 trust. Where a child's mother and father are not married the father does not automatically have parental responsibility and will only have such responsibility if he obtains an order from the court, he and the mother agree he should have such responsibility via a parental responsibility agreement, he obtains a residence order, is appointed a guardian or on or after 1 December 2003 the father and mother jointly register or re-register the child's birth. It has been suggested that by mentioning parental responsibility section 71H could mean that a natural father who did not have parental responsibility could not create such a trust in his will.

Our reading of the legislation is that section 71H adds to (saying the people specified "shall be taken to have been a parent") rather than restricts the categories of people who can create TSIs and aged 18 to 25 trusts (allowing, for example guardians to create such trusts). As such under the basic rule a natural father who does not have parental responsibility would be able to create such a trust in his will as he was the parent of the child. It would be helpful if HMRC clarified the point in the guidance.

HMRC response
We agree with your interpretation of the legislation.

11. Please confirm that Section 49C will apply in a case such as the following. A trust exists at 22 March 2006 in which A has a life interest with remainder to B. There is an existing trust in which B's children have interests in possession at 22 March 2006. If B settles his remainder interest on that trust now and A's interest comes to an end in February 2008, we believe that Section 49C should apply to make the interests of B's children transitional serial interests.

HMRC response
We do not consider that the interests of B's children will qualify as "transitional serial interests".

S.49C begins from the point of view of the "current interest". Condition 1 requires that "the settlement" in which that interest subsists "commenced" before 22 March 2006.

It goes on to require that, immediately before that date, the property "then comprised" in the settlement – i.e. the same settlement – was subject to the "prior interest".

The new interests of B's children arise under a different settlement (albeit one which happens to hold, after A's IIP ended, the property that comprised the earlier one) and will not, therefore, qualify as TSIs.

12. The extension of the charging provisions in Section 66 IHTA to existing A&M trusts requires the trustees to know the history of chargeable transfers made by the settlor in the 7 years before the settlement commenced. In very many cases these will not be available because it was not necessary to keep the history of transfers into A&M's for any future purposes once those transfers became fully exempt. Please confirm that in such circumstances where the trustees do not know the relevant history the CTO will provide information on request and if they have none the trustees should calculate the charge on the basis that the cumulative total is nil. This point needs to be dealt with in legislation.

HMRC response
We do not intend there to be a specific relaxation of the rules – and we doubt there will be significant problems here in practice.

We are dealing here with the tiny minority of people who have set up multiple lifetime settlements of a sort that might become chargeable under Schedule 20, and on a scale where there is some prospect that IHT would be due. It is highly likely – if the need arises – that those responsible for such trusts will have perfectly adequate records for all of them, and will have no difficulty in meeting any requirements that may flow from Schedule 20.

But trustees are not expected to do the impossible – if they truly do not know of any other settlements made by the same settlor, and have made reasonable enquiries without revealing any, then they are perfectly entitled to make their IHT returns on the basis of whatever information they do have, and to pay IHT accordingly.

We can also confirm that, where Capital Taxes have information about the settlor's chargeable transfers, we will provide it on request.

13. S49A deals with immediate post death interests. Please confirm that you take the view that an IPDI can be created for a minor if the provisions of s31 of the Trustee Act 1925 are not disapplied. S31 provides that where a child is a minor the income has to be accumulated and only reasonable payments may be made for the child's maintenance, education and benefit. Please confirm that this will not prevent conditions 2 and 4 in new s49A being satisfied.

HMRC response

The Inland Revenue Press Notice dated 12 February 1976 on interests in possession said:

> "An interest in possession in settled property exists where the person having the interest has the immediate entitlement (subject to any prior claim by the trustees for expenses or other outgoings properly payable out of income) to any income produced by that property as the income arises: but…a discretion or power, in whatever form, which can be exercised after income arises so as to withhold it from that person negatives the existence of an interest in possession. For this purpose a power to accumulate income is regarded as a power to withhold it, unless any accumulations must be held solely for the person having the interest or his personal representatives."

On that basis – which remains our view – we consider that a gift to a minor absolutely could be an IPDI, but a gift to 'A for life', where A is a minor, could not. In the second situation, accumulations will be held for A only if he or she attains age 18 (s.31(2) Trustee Act 1925). Otherwise, they will be held as an accretion to the capital, rather than for A or his estate. Consequently, a gift to 'A for life', where A is a minor, does not create an interest in possession in settled property during A's minority and cannot therefore be an IPDI.

We are consulting our solicitors on a number of points around trusts for minors, including the effect, if any, of excluding s.31(2) Trustee Act, and we will make draft guidance available on this as soon as possible.

Additional Question 13

> We note that you are clarifying a couple of aspects with your solicitors. However, we consider that those issues are not relevant where s.31 Trustee Act 1925 has been excluded and the trustees are put under a positive obligation to distribute the income to the child's

parents on behalf of the child or to the child direct. In such circumstances it would seem to us that the trust would qualify as an IPDI. Obviously this will imply that the testator is unconcerned that the child has direct access to the income concerned. In such a case, the trustees act as bare trustees (at different ages in England and Scotland) in view of the child's inability to give a valid receipt but the income is clearly that of the child despite the legal formality. Please confirm your agreement that this will qualify as an IPDI.

HMRC response

Firstly, our reply to question 13 stated that, in our view, a gift by will to a minor absolutely could be an IPDI. As you know, we have since taken further legal advice on a number of points around absolute trusts for minors. Our view as a result of that advice is that such a trust is not a settlement for IHT purposes (and we have written separately on this subject to the ICAEW and other rep bodies). It follows, therefore, that the trust property is not settled property for IHT, so that an absolute trust for a minor simply would not fall to be regarded as either a trust for a bereaved minor under s.71A or an IPDI under s.49A.

Turning to a gift by will to 'A for life', where A is a minor, our previous answer referred to the Inland Revenue Press Notice dated 12 February 1976, which said that any discretion or power to withhold income negatives the existence of an interest in possession. We agree that, if a gift

- vests an income interest immediately in a minor;
- imposes a requirement on trustees to distribute all the income to the beneficiary (or the parent/guardian on his behalf); and,
- to remove any doubt, expressly excludes the application of s.31 Trustee Act 1925,

it could give the child an interest in possession within our 1976 guidance and thus an IPDI.

14. It is not uncommon for trustees to exercise their powers to give the life tenant a general power of appointment that he or she can exercise in their will. Suppose there is a pre-22 March IIP for a parent with a successive life interest for the children and the trustees use their wide powers of appointment to give the life tenant a general power which the life tenant exercises through their will. If the result of the appointment is that the trust assets pass on terms which would otherwise qualify as either an IPDI, trusts for bereaved minors, or an 18-25 trust please confirm that the exercise of such power will allow the requirements of those respective sections to be met. As far as we can see it is the case that the trust has been effected by will for the purposes of s49A or established under the will of the deceased parent for the purposes of s71A or s71D.

HMRC response

We can confirm this

Additional Question 14

Thank you for your reply. Could you please confirm the exercise through a will of a general power of appointment (no matter how or when it was created) can create an immediate post death interest (IPDI), a TBM and an 18-to-25 trust?

HMRC response

We can confirm this, on the basis, broadly speaking, that having a general power of appointment is tantamount to owning the property. To create a TBM or an age 18-to-25 trust, the person with the power must, of course, be a parent of the beneficiary. And for TBMs, age 18-to-25 trusts and immediate post-death interests, the power must, as the question proposes, be exercised through the will of the person who holds it.

15. Please confirm that where there is not a general power of appointment but the holder of the power has the ability to exercise the power in his will and can either appoint the trust property out absolutely or appoint it onto trust for the beneficiaries that the latter can similarly create an IPDI trust for a bereaved minor or 18-25 trust. Again we consider this satisfies the requirements of the legislation but we would appreciate your confirmation.

HMRC response

We have taken you to be referring here to special powers of appointment. If that is the case, any trusts created by the exercise of the power will be treated as being effected by the donor of the power. As a result, they could not meet the conditions for an IPDI, since the beneficiary will not have become beneficially entitled to any interest in possession on the death of the testator (s.49A(3)). And the donor of the power will have to have been a parent of the beneficiaries to whom the property is appointed – and the power will have to have been given away in the donor's will – for any new trust to fall within s.71A or s.71D.

16. Please confirm that where a will leaves property to a settlement that was in existence before the date of death of the testator that this will qualify as an IPDI under Section 49A. We are aware that HMRC accept that Section 142 can apply to a variation of a will to pass property to an existing settlement and it would be consistent with that view to agree that such a disposition under a will can constitute an IPDI.

HMRC response

We can confirm this.

17. Under s46A(4) if an individual pays a premium on a life assurance policy held in an existing IIP trust at 22 March 2006, the payment is treated as a potentially exempt transfer. Please confirm that the amount that is deemed to be a potentially exempt transfer is the whole amount of the premium and that the amount of the PET does not have to be calculated by reference to the increase in value of the policy held in the IIP trust.

HMRC response

We can confirm this.

18. The same point arises under s46B(5) in respect of a payment by an individual for a policy which is held under an existing trust within s71.

HMRC response

We can confirm this.

Additional question 19 (Transitional serial interests)

19 (a)

We would like to clarify with you what changes to a trust interest you consider might be sufficient to terminate a pre-22 March 2006 interest in possession (IIP) and cause a transitional serial interest to arise.

By way of background, we are aware that you consider that a TSI will arise where trustees exercise a power of advancement under the terms of a pre-22 March 2006 trust, postponing the date on which capital will vest and thereby extending the duration of the IIP concerned.

We would like to establish if you consider that an IIP will only be considered to have come to an end where there is some change made to the interest held by the beneficiary concerned, as distinct to some changes in relation to the administrative or dispositive powers held by the trustees.

For example one of our members has been dealing with a case where trustees wanted to sell shares in the private company they owned, but unfortunately their powers were not adequate for this purpose if the transaction was undertaken in one particular way. There was a power of advancement which was sufficiently wide enough to alter the administrative powers but concern was expressed as whether the IIP interest could be said to change as a result.

We consider that the administrative powers of the trustees would change, rather than the beneficial interest, so the IIP interest should continue unaffected.

HMRC response

We agree.

It would be very useful for you to let us know your views, and also whether you consider that there is a distinction between cases where trust deeds are altered as a result of an application to the Court, and where the trustees make the changes using provisions under the trust instrument itself.

HMRC response

We do not think so.

19 (b)
It would also be useful to have your confirmation that where a pre-Budget 2006 IIP is altered post 5 April 2008, and is treated as coming to an end, a chargeable life time transfer

may ensue. It would be very useful if you could clarify this aspect as it is likely to become increasingly important for the future.

HMRC response

As we see it, there will be an immediately chargeable transfer where the IIP that arises after 5 April 2008 does not meet the conditions to be a transitional serial interest under s.49E or a disabled person's interest.

Additional Question 20: Immediate post death interest

20
We would like to clarify the position where an Immediate post death interest (IPDI) for a spouse is established using a general power of appointment exercised by will and the IPDI trustees exercise their wide powers of appointment to terminate the spouse's IIP in favour of a trust for the children of the deceased settlor, which qualifies as a TBM or a 18-to-25 year trust. Can you please confirm that you accept that a TBM will be treated as having come into existence, established by the deceased?

HMRC response

We can confirm this, on the basis that the trustees' power referred to can be properly characterised as a special power of appointment. In other words, the power which the trustees can exercise can be said to be "established under the will of a deceased parent" (s.71A (2)(a) and s.71D (2)(a)) through the exercise of the general power conferred on the parent.

APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.

2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.

3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.

4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.

5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.

6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.

7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.

8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.

9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.

10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see icaew.com/en/technical/tax/tax-faculty/~/media/Files/Technical/Tax/Tax%20news/TAXGUIDEs/TAXGUIDE-4-99-Towards-a-Better-tax-system.ashx)