TECHNICAL RELEASE

TAXGUIDE 10/15 (TECH 13/15TAX)

INHERITANCE TAX AND TRUSTS:
TRUST VARIATIONS AND RESETTLEMENTS

Guidance note agreed with HMRC, published on 27 October 2015

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INTRODUCTION

i. This TAXGUIDE 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 in relation to a pre-2006 interest in possession trust, a new interest in possession would be created. The view taken by HMRC as set out in this 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

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

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BACKGROUND

It is possible that where the terms of a trust are varied, as distinct from resettled, that an interest in possession that pre-dated FA 2006 might come to an end and that a new non-qualifying interest in possession might come into existence. The distinction between a variation and a resettlement considered in the case of Wyndham v Egremont [2009] EWHC 2076, which involved an application to vary the terms of a longstanding settlement under the Variation of Trusts Act 1958. The trustees held a substantial landed estate that was held in trust for George Wyndham for life. The trustees applied to the court to make a number of changes including postponing the vesting date. The questions then arose whether the court could approve a variation to the perpetuity period and whether the changes proposed amounted to a variation rather than a resettlement.

One of the factors that Blackburne J had to consider was whether the arrangement would have adverse tax consequences that might outweigh the benefits of making the proposed changes. The concern was whether, on the ground that they give rise to a resettlement, the variations to the trust might be said to give rise to a “deemed disposal” under s 71(1) of the Taxation of Capital Gains Act 1992 or might lead to adverse consequences for inheritance tax (IHT) or Stamp Duty Land Tax purposes. Blackburne J considered this not to be the case because he considered that no resettlement took place. He accepted that this view could not bind HM Revenue and Customs who were approached with a view to commenting on a joint opinion of counsel to the effect that the variations of the pre-arrangement trusts effected by the arrangement would not give rise to adverse tax consequences but who declined to be joined to the proceedings or to comment one way or the other on counsels' opinion or otherwise to make any representations.

Questions raised by STEP/CIOT and answers from HMRC in relation to FA 2006 Schedule 20

The question of whether the exercise of trustee powers might cause a pre-existing qualifying interest in possession to come to an end was considered in Question 6 of the Questions raised by STEP/CIOT and answers from HMRC in relation to FA 2006 Schedule 20 (revised October 2008). Unfortunately, the analysis (which is set down in full below) that the IIP did not terminate in all circumstances, was not put to HMRC. Although a ‘third possibility’ that the IIP did not terminate at all, was noted by STEP when republishing the correspondence in 2008, albeit to date HMRC has given no published view on this.

“Question 6

There are two possible interpretations of the above and we should be grateful if HMRC could confirm which view they take.

Option 1

The exercise of the trustees' powers in this way creates a new interest in possession for A immediately on exercise of the power of advancement which therefore takes effect as the 'current interest' or 'transitional serial interest'. Any successive interest in possession after A's interest in possession has ended cannot then be a transitional serial interest. The property will be taxed as part of A's estate on his death if he dies with the transitional serial interest. He continues to have a transitional serial interest until termination at 45 or earlier death.

Option 2
A's new interest only arises when A attains the age of 30. Until then he has a pre-Budget qualifying interest in possession.

The new interest cannot take effect as a transitional serial interest at all since on the above facts it will arise after April 2008. Until 30 A will have a pre-Budget interest in possession on the basis that nothing has changed until he reaches 30. Only from 30 will he take a new non-qualifying interest so the settled property will then become relevant property. There will not be an entry charge for A at 30 of 20% due to IHTA 1984 s 53(2).

If A dies before reaching 30, then on this analysis his pre-Budget interest will not previously have ended and therefore if his spouse takes an interest in possession this is a transitional serial interest or if his children take interests in possession before 2008 these will be transitional serial interests.

Does the answer to whether option 1 or option 2 applies depend on whether the advancement is drafted in such a way that it extends the interest in possession from 30 without restating A's existing interest in possession until then? Or would any variation of A's interest in possession be regarded as a transitional serial interest from the date of the variation even if the variation only took effect in the future.

HMRC Answer

We consider that A's original IIP (until 30) will have 'come to an end' when the trustees exercised their power of advancement and been replaced by a new IIP (until 45), which will therefore qualify as a TSI. A's interest is expressed as an entitlement to capital contingent on his attaining 30. It seems reasonable to regard the exercise of the TA 1925 s 32 power as immediately bringing this interest to an end and replacing it with a new one.

NB: As regards HMRC's view on whether a charge arises on the creation of the TSI (or other interest in possession) in these circumstances see warning posted on STEP website on 24th September 2007 and see also section 140 of Finance Act 2008 which has now removed any suggestion that there could be a charge where A is given a new IIP before October 2008. Note also that there is a third view i.e. that no new IIP arises at all if A's entitlement to capital is deferred because his entitlement to income is not as such affected. Much may depend on how the power is exercised and whether it is an advancement or an appointment."

Query raised by the Tax Faculty with HMRC IN 2014

"We thought it might help if we rehearsed the different ways that a power to defer a capital vesting can be exercised, because the answer would seem to be different depending upon how the power is exercised.

It seems to us that such a power can be exercised in one of three ways:

(a) by creating a ‘new’ interest in possession (IIP) from the date of exercise in substitution for the ‘old’ IIP;
(b) by leaving the ‘old’ IIP in place up to the original date of vesting, and creating a new successive interest in possession from that original date onwards, or
(c) leaving the ‘old’ IIP in place throughout the entire original and deferred period and merely deferring the right to vesting of capital to a later date.

We think the following example shows the point: Trustees hold the capital and income of the trust fund in trust for A contingently on attaining age 30, where A has reached age 18 before 22 March 2006 and s.31 Trustee Act has not be excluded. The net effect is that A has acquired an IIP on attaining 18, since he has the right to the income of the Trust Fund. If he reaches age 30, he will continue to have the right to the income, and also to the underlying capital.

The Trustees could, by exercising a power of advancement

(a) Create new trusts under which the trust fund is then immediately held as to capital and income in trust to pay the income to A until age 60 or earlier death, with capital and income at 60 if he survives until then; this would seem to create a new IIP from day one;
(b) Create new trusts under which the trust fund is to be held, subject to the existing trust of income until A reaches 30, in trust if A reaches 30 to pay the income to A until age 60 or earlier death, with capital and income at 60 if he survives until then; we think this creates a new IIP from age 30;
(c) Create a new trust under which, subject to the existing trust in respect of income, the right to capital (but not income) at age 30 is replaced by a right to capital contingently on A reaching age 60. We don't think this creates a new IIP. What happens here is that A remains entitled to the income after as well as before age 30, according to the terms of the original trust.

Of course, whether the answer is (a) (b) or (c) will depend on the precise wording of the instrument under which the power is exercised.

Where we seem to have got to is that STEP and CIOT wrote to you in relation to Schedule 20 Finance Act 2006 and you answered a question raised by STEP and CIOT on this (Question 6). The answer suggests that when trustees exercised their enlarged powers of advancement under s.32 Trustees Act 1925 to defer the vesting of capital, a new IIP would be created. Unfortunately, the analysis that the IIP did not terminate at all in such circumstances, was not put to HMRC. Although STEP had, when republishing the correspondence in 2008, noted as a 'third possibility' that the IIP did not terminate at all, HMRC has given no published view on this. As it stands the HMRC guidance contradicts the view taken in the Wyndham v Egremont tax case.

The concern we come across occasionally is that some people think they do not still have an existing (pre 22 March 2006) IIP but in reality they do, or vice versa, and some (where the advance was before 6 October 2008) may think they have acquired a 'transitional serial interest' but in reality they have not, or vice versa. Publication of clear guidance would certainly be very helpful, and remove a lot of this confusion."

Agreed notes of meeting with HMRC dated 21 July 2015

"Reference was made to the Wyndham case which involved an application to Court for the extension of perpetuity period. It is possible that there could be a new interest in possession if the period changed which give rise to relevant property. However the question was that if there was a continuing interest would this be treated as a variation and hence a continuing IIP?

Q6 of STEP correspondence covers queries as to when did an IIP interest comes to an end, but there is a further possibility in that the interest did not come to an end if the effect of any change was simply to postpone the occasion in which capital vested and the income entitlement simply continued uninterrupted; the question is whether the interest comes to an end? Is it a TSI, an old IIP or relevant property? Have the actions of the trustees caused the trust to come to an end? It depends!

HMRC'S response was that it depends. If it is classed as a resettlement then the IIP has to come to an end. If it is a variation then it is not a resettlement. This is accepted by HMRC as a general proposition, albeit as a matter of common sense, the less the terms of the original trust are altered the more likely that it will simply be treated as a variation rather than as a resettlement. If there is a variation it does not necessarily mean that the IIP continues, again it will depend on the changes to the terms. In general terms the analysis in the examples provided by the Tax Faculty was agreed and HMRC was happy for it to be published."

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)