

The use of trusts on death

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I. Introduction

The purpose of this paper is to discuss the use of trusts on death, and in particular the tax consequences of various structures that may be adopted in order to pass wealth down from one generation to the next. The older generation will wish to pass down as much wealth as possible to the younger – and as little as possible to the taxman – but does not necessarily want the younger generation to get all the money immediately, or to receive fixed amounts regardless of their circumstances and needs at the time of receipt.

The amendments made by the Finance Act 2006 ('FA06') to the Inheritance Tax Act 1984 ('IHTA 1984') generally limit the options for retaining flexibility over who should get what when while enjoying the various tax advantages the legislation confers on certain types of trust.

This paper considers the new rules with particular regard to trusts established on death, including by post-death variation or distribution. It considers first, the new categories of trust; second, what now forms part of a person's estate; then the taxation of the various categories; how the benefits and disadvantages of each might be weighed up in any particular case; and what can be done by post-death variations of wills and distributions from trusts. A number of practical points are made along the way, and a further point regarding the administration of mixed trusts is made at the end.

II. The new rules

First, a word on drafting. It must be said that the whole approach to the drafting of the new provisions is back-to-front. Scattered throughout the Inheritance Tax Act 1984 ('IHTA 1984') are instances where what appears to be the general rule is actually the exception, and what is written as an exception is in fact the general rule. As time

progresses and fewer and fewer pre-Budget Day trusts remain extant, the scope of what appears to be the general rule will gradually diminish. This is hardly in keeping with the aims of the Tax Law Re-Write project.¹ It makes the legislation much more difficult to read, and lends it a generally misleading impression.

Turning to the rules themselves, prior to the Finance Act 2006 inheritance tax provisions distinguished fundamentally between two types of trust, namely discretionary trusts and interest in possession trusts. The former were counted as part of no-one's estate, and were taxed simply as time passed so that on average each generation would pay the equivalent of one lot of inheritance tax.² The latter were counted as part of the estate of the beneficiary entitled to the interest in possession, and accordingly taxed in life and on death in the same way as anything else that formed part of a person's estate. A third major category, accumulation and maintenance trusts, was a hybrid of the two and received favourable tax treatment. Notwithstanding that such a trust would start off life as a discretionary trust, a transfer into it was potentially exempt,³ and there were no exit charges⁴ and decennial charges as the trust progressed.⁵

The Finance Act 2006 has, in short, restricted the category of accumulation and maintenance trusts entitled to favourable tax treatment, and restricted the tax treatment formerly given to all interest in possession trusts to only certain sub-

¹ To be fair, this has yet to reach inheritance tax, and the problem may be sorted out when it does.

² This was the theory, at least. On gift into trust, a lifetime rate of 20% was applied. A further 20% was charged over the following 33½ years, by means of the decennial charge. So 6% was payable in year 10; a further 6% in year 20; yet another 6% in year 30; and of the 6% in year 40, 2% was referable to the first 3½ years of the period since the last charge. So altogether 40% was charged over the period from commencement to year 33½. Of course, this was just the theory. The amount on which the charge was levied would not be the same each time, and in fact only 22 years have so far passed since this tax treatment was introduced in any event. There was also an additional charge on the trust, if he died within seven years of the gift into trust. In that event up to a further 20% of the value of the initial gift was payable.

³ IHTA 1984, section 3A(1)(c).

⁴ Provided transfers out were made to the correct beneficiaries: IHTA 1984, section 71(3) and (4).

⁵ See section 58(1)(b) of IHTA 1984.

categories of that class. Other interest in possession trusts, and accumulation and maintenance trusts that do not meet the new conditions, are now taxed as discretionary trusts. Once one has allocated a trust to the correct category, the tax treatment itself has, fundamentally, not changed. Nor has the meaning of the term 'interest in possession': it remains an immediate entitlement to income as it arises, net of expenses related to it.⁶ But an interest in possession is now merely a necessary, but not a sufficient, condition for certain tax treatment.

From this it is already clear that any tax planning that prior to 22nd March 2006 used discretionary trusts is still available; and indeed can be used with a broader range of trusts than before. What is restricted is tax planning that used to use interest in possession trusts and old accumulation and maintenance trusts.

A. The new categories of trust

So what are the new categories of trust? It may be noted that there is a certain hierarchy conferred by the legislation. So, if a trust satisfies the requirements not only for being a bereaved minors' trust but also for conferring an immediate post death interest, it falls into the former category and not into the latter.⁷ The categories of trust are described in that hierarchy here. It is (i) bereaved minors' trusts, (ii) interests in possession to which a person was entitled prior to 22nd March 2006, (iii) disabled persons' interests, (iv) immediate post-death interests, (v) transitional serial interests, and (vi) age 18-to-25 trusts.

It may also be noted that the categories are not in fact of trusts: each applies only to property subject to the trust or to interests in that property. Accordingly, a trust may fall into two categories at the same time, part of the property in the trust being subject to one category and part being subject to another. So, for example, if a trust is

⁶ See *Pearson v. Commissioners of Inland Revenue* [1980] S.T.C. 318.

⁷ IHTA 1984, section 49A(4)(a). This is because if an immediate post death interest trust falls within section 71A of IHTA 1984, it is precluded from being an immediate post death interest trust.

established on death, and some of the property in it satisfies the requirements for a trust for a bereaved minor and some does not, the former part will be subject to the bereaved minors provisions but the latter part will not. Equally, that latter part may for example come within the provisions relating to immediate post-death interests.

Having made those general remarks about the relationship of the categories to one another, the next matter is identifying the various categories of trust.

The first is a trust for a bereaved minor, being a person under 18 at least one of whose parents has died.⁸ The important method of establishment is under the will of a deceased parent.⁹ It is necessary that the beneficiary of the trust will, no later than on his 18th birthday, become entitled to the trust property and any income arising from it or that has been accumulated;¹⁰ that while the bereaved minor is alive and under 18, no settled property is applied for the benefit of any other beneficiary, and either he is entitled to all of the income or no income may be applied for any other beneficiary.¹¹

So the differences between this and an accumulation and maintenance trust are (i) the beneficiary must get all the capital no later than age 18 rather than merely an interest in possession by age 25, (ii) the beneficiary must be the child of the truster, whereas no connection was previously necessary¹² and (iii) the settlement must be created on death, whereas an accumulation and trust could be created also during life.

Then in the hierarchy comes an existing category, namely interests in possession created before 22nd March 2006, the day of the Budget announcing the changes.

⁸ IHTA 1984, section 71C.

⁹ IHTA 1984, section 71A(1)(b) and (2)(a). It counts also if it is established under the Criminal Injuries Compensation Scheme or under sections 46 and 47(1) of the Administration of Estates Act 1925. The latter provisions apply only in England, and in short create a trust wherever a minor child inherits on intestacy. That such a trust gets beneficial treatment does not give any advantage over the position in Scotland: under Scots law no trust is created in those circumstances, and so the assets go straight to the minor child and form part of his estate in the same way as an English trust created on intestacy.

¹⁰ IHTA 1984, section 71A(3)(a).

¹¹ IHTA 1984, section 71A(3)(b) and (c).

¹² Although if all the beneficiaries of an accumulation and maintenance trust shared a common grandparent, the trust could endure for longer than 25 years.

Section 49(1) of IHTA 1984 applies to such interests, with the effect that such interests are part of the beneficiary's estate,¹³ only so long as the beneficiary does not change on or after 22nd March 2006.¹⁴ It follows that there are neither exit nor principal charges: the mischief they were designed to prevent, namely wealth passing down generations without anyone paying inheritance tax, does not arise.

Three new categories of interests in trust come next.

In order of hierarchy, the first is a disabled person's interest.¹⁵ This is outside the scope of this paper.¹⁶ It is worth mentioning that includes both pre- and post-22nd March 2006 trusts for disabled persons.¹⁷ It may be emphasised that an interest in possession that is a disabled person's interest cannot be either an immediate post-death interest or a transitional serial interest.

The next is a trust subject to an immediate post-death interest. It should be noted that this category is one of interests in trusts, and the only type of interest that can fall within this category is an interest in possession. The category contains trusts effected by will or under the law relating to intestacy.¹⁸ The beneficiary must become entitled to the interest in possession on the death of the testator or intestate.¹⁹ The property the subject of the interest must not have been subject to the bereaved minors' rules, or to a disabled person's interest, at any time since the beneficiary acquired the interest in possession.²⁰ In short, this applies to interests in possession created on a death. It may

¹³ See IHTA 1984, section 5.

¹⁴ This is the effect of IHTA 1984, section 49(1A).

¹⁵ IHTA 1984, section 49A(4)(b) (precedence over immediate post-death interests) and section 49C(5)(b) (precedence over transitional serial interests).

¹⁶ It may be noted that for an interest in possession to be a disabled person's interest, the beneficiary must be incapable of managing his own affairs, in receipt of attendance allowance or in receipt of disability living allowance including a care component at the highest or middle rate: IHTA 1984, section 89A(1). There are further conditions. This is an extremely specialist area.

¹⁷ See IHTA 1984, section 89B(1).

¹⁸ IHTA 1984, section 49A(2). Of course, the reference to intestacy does not apply in Scotland, since the Scots law of intestate succession does not create any trusts.

¹⁹ IHTA 1984, section 49A(3).

²⁰ IHTA 1984, section 49A(4) and (5).

be noted that all immediate post-death interests created before 22nd March 2006 fall also into the previous category. However, different provisions apply to them, albeit generally aimed at the same result, and so it is appropriate to consider them separately. The general availability of immediate post-death interests is likely to make them attractive to testators.

With immediate post-death interests may be discussed transitional serial interests: there is no overlap between these two categories. These are interests in possession created, whether on death or in life, prior to 22nd March 2006. The drafting of the conditions is unsatisfactory. But what appears to be intended is that where a trust was established before 22nd March 2006, and the trust property was subject to an interest in possession as at that date, the interest in possession will be a transitional serial interest provided the particular beneficiary acquired the interest between 22nd March 2006 and 6th April 2008.²¹ The category is extended where the interest is transferred after 5th April 2008 on the beneficiary's death to his spouse or civil partner.²² There are further rules relating to settled life policies.²³

The final category is age 18-to-25 trusts. This category is very much last gasp: it is available only for trusts that are not bereaved minor's trusts, existing accumulation and maintenance trusts,²⁴ disabled trusts, existing interest in possession trusts, and trusts where there is an immediate post-death interest or transitional serial interest.²⁵ It is essentially the same as a bereaved minor's trust, except that the trust property and income may stay in the trust until the beneficiary is aged 25: at that time, both must be

²¹ IHTA 1984, section 49C(2) to (4).

²² IHTA 1984, section 49D.

²³ IHTA 1984, section 49E. In addition, in terms of hierarchy all transitional serial interests come after bereaved minors' trusts and disabled person's interest: IHTA 1984, sections 49C(5), 49D(6) and 49E(5).

²⁴ Of course, this category will cease to be relevant in this context from 6th April 2008, because from that date it will apply only where the beneficiaries are entitled to the trust property at the latest at age 18: IHTA 1984, section 71(1)(a)

²⁵ See IHTA 1984, section 71D(5).

transferred out to the beneficiary.²⁶ In addition to establishment by will on death, one further method of bringing a trust within this regime is provided for. This is where an existing accumulation and maintenance trust ceases to be such.²⁷

At this stage it is worth noting that the existence of the hierarchy means that care must be taken when seeking to establish a particular type of trust. For example, if one seeks to establish an age 18-to-25 trust, one must ensure that the trust does not satisfy the conditions for falling into any of the categories that take precedence in the hierarchy. The most obvious one to avoid is an immediate post-death interest. The mistake is easy to make. Provided the beneficiary does not get an interest in possession when the testator dies, the trap is avoided. But when drafting a will one will not know what age the beneficiary will be when the testator dies. So, for example, one cannot grant the life interest as of a certain age. The trap is certainly avoided by simply not giving the beneficiary any interest in possession prior to the date on which he becomes entitled to the capital of the trust. But one other means of avoiding it may be to give the beneficiary a life interest at the later of (a) attaining a certain age and (b) (say) one month after the testator's death. However, it is not entirely clear from the legislation whether such an approach would operate so as to avoid the immediate post-death interest category.

B. What does, and what does not, form part of a person's estate

So much for the categories of trust. One might proceed with a brief look at what is included in a person's estate. Until 22nd March 2006, this was an easy question. A person's estate comprised everything that person owned, plus any interests in possession that person had, except for excluded property.

²⁶ IHTA 1984, section 71D. In particular, section 71D(1)(a) and (b) correspond to section 71C(a) and (b); section 71D(2) corresponds to section 71A(2); section 71D(6) corresponds to section 71A(3); section 71D(7) corresponds to section 71A(4); section 71D(8) corresponds to section 71A(5); and section 71D(9) corresponds to section 71A(6).

²⁷ IHTA 1984, section 71D(3) and (4).

The general rule remains that one's estate includes all property to which one is beneficially entitled, save for excluded property.²⁸ But apart from the rule about excluded property, there are now a number of exceptions. The legislation is not happily drafted, although its meaning is tolerably clear.

Perhaps the easiest way in practice to work the issue out is as follows. Start off with all the assets a person actually owns. These are still in. Next, gather all the interests in possession to which he is entitled. From that gathering take out any to property subject to the bereaved minors or age 18-to-25 rules.²⁹ All other interests in possession acquired before 22nd March 2006 are then kept in.³⁰ Look then at interests in possession acquired on or after 22nd March 2006. Keep in disabled person's interests, immediate post-death interests and transitional serial interest.³¹ Discard the rest. So the estate includes interests in possession acquired before 22nd March 2006, except bereaved minors and age 18-to-25 property, plus disabled person's interests, immediate post-death interests and transitional serial interests.

This makes sense, if one regards bereaved minors' trusts and age 18-to-25 trusts as the new accumulation and maintenance trusts, and disabled person's interests, immediate post-death interests and transitional serial interests as the new interests in possession.

C. The charges to tax

Having identified the categories of trust that now exist, and what is and what is not included in a person's estate, the next question is as to how tax is charged on the different trusts.

As mentioned above, the actual tax treatment has not changed, once trusts have been allocated to the new categories.

²⁸ Basically, foreign property of non-UK domiciled individuals and trusts, plus certain UK property beneficially owned by such individuals: IHTA 1984, section 6, unchanged by FA 06.

²⁹ IHTA 1984, section 5(1)(a)(i).

³⁰ See IHTA 1984, section 49(1) in conjunction with section 5(1)(a)(ii) and (1A).

³¹ IHTA 1984, section 5(1)(a)(ii) and (1A)(e)(i) to (iii).

Bereaved minors' trusts and age 18-to-25 trusts can be created only on death, in which case there is no entry charge beyond standard inheritance tax on death,³² and pursuant to the Criminal Injuries Compensation Scheme, in which case there is again no entry charge.

The structure of the legislation relating to bereaved minors' trusts and age 18-to-25 trusts indicates that the general rule is that they suffer an exit charge, but that there are some exceptions to the rule. In practice, however, the rule is likely to be exception, and the exception the rule.³³ So, there is an exit charge where property ceases to be trust property or where the trustees make a disposition whose result is to reduce the value of the settled property.³⁴ The charge is not applicable if the property is appointed to the beneficiary before age 18 or dies below that age.³⁵ Nor is it applicable if the trust is a bereaved minors' trust and ceases to be so because the beneficiary becomes 18,³⁶ or is an age 18-to-25 trust and becomes a bereaved minors' trust.³⁷ Usually, one of these four exceptions to the charge will apply.³⁸ The exit charge is charged at the rate of 0.25% of the drop in value for each of the first forty complete quarters in the relevant period, 0.20% for each of the next forty complete quarters, and 0.15% for each of the following forty quarters.³⁹ Accordingly, the exit

³² There may be entry charges on additions to such a trust by a party during life; but in that event the bereaved minors' regime will not apply to the added property.

³³ The same might be said about the draftsman's approach to exit charges on accumulation and maintenance trusts: see IHTA 1984, section 71(3) and (4).

³⁴ IHTA 1984, section 71B(1) and section 71E(1). This corresponds to the exit charge under the relevant property regime: see IHTA 1984, section 64. There is no charge where the drop is on account of costs or expenses; a payment that will be income of any person for the purposes of income tax, or would be if that person were UK resident; a payment not intended to confer gratuitous benefit; or the grant of an agricultural tenancy. Section 71B(3) in conjunction with section 70(3) and (4), and section 71E(3) and (4).

³⁵ IHTA 1984, section 71B(2) and section 71E(2).

³⁶ IHTA 1984, section 71B(2).

³⁷ IHTA 1984, section 71E(2)(c).

³⁸ Similarly to the position that used to obtain in relation to accumulation and maintenance trusts: IHTA 1984, section 71(3) and (4).

³⁹ IHTA 1984 section 71B(3) and section 71G(3) respectively, in each case in conjunction with section 70(6). The legislation continues with a decreasing rate for another 20 quarters, but in practice one can

charge is never likely to exceed 21% of the drop in value.⁴⁰ The relevant period is that starting on the day the property in question entered the trust and ending the day before the exit.⁴¹ The starting point of the relevant period can be earlier: in particular, where an age 18-to-25 trust converts to a bereaved minors' trust, the rate of exit charge for the bereaved minors' trust is calculated from the day the property entered the age 18-to-25 trust. Having said that, there is no exit charge on such a conversion:⁴² the rule is anti-avoidance.

There is a special rule if trust property is appointed to a beneficiary of an age 18-to-25 trust after his 18th birthday but on or before his 25th, or if the beneficiary of such a trust dies while in that age range.⁴³ In that event, the exit charge is calculated in the same way as for relevant property trusts, save that the quarters are counted from the day the beneficiary turned 18 or, if later, the day the property entered the trust. Accordingly, one takes the decrease in value of the trust property;⁴⁴ one multiplies this by 0.3 times the number of complete quarters elapsed since the beneficiary's 18th birthday up to the day before the exit, divided by 40;⁴⁵ and one multiplies this by the 'settlement rate'. The settlement rate is the effective rate of tax of a chargeable transfer equal to the initial value of the trust, any additions to the trust since its establishment, and the value of any related settlement, assuming that chargeable transfer were made on the day of the exit by a person who had made chargeable transfers in the previous seven years equal to whatever chargeable transfers the settlor

stop already after the first three sets of forty quarters. This is because 120 quarters is 30 years, and an age 18-to-25 trust is unlikely to last that long.

⁴⁰ That is, 10% for the first ten years, 8% for the next ten years, and then 3% for the last five years. The maximum rate possible is 30%, but this presupposes a relevant period of 50 years.

⁴¹ IHTA 1984, section 71B(3) and section 71G(3) in conjunction with section 70(8), as amended by those two sections for their purposes.

⁴² IHTA 1984, section 71E(2)(c).

⁴³ IHTA 1984, section 71F(1).

⁴⁴ IHTA 1984, section 71F(4).

⁴⁵ IHTA 1984, section 71F(5). One excludes quarters throughout which the all or part of the chargeable amount has been excluded property: section 71F(6).

made in the seven years leading up to the date the trust was established, and tax were charged at the lifetime rate.⁴⁶ It may be noted that a tax saving is made if the beneficiary becomes entitled to the trust capital two days before his 25th birthday, rather than on his 25th birthday.

So if trust property is appointed to a beneficiary on or before his 18th birthday, there is no exit charge; if trust property in an age 18-to-25 trust is appointed to a beneficiary between the ages of 18 and 25, there is an exit charge of up to 4.2%; and if trust property otherwise leaves the trust, and this is likely to be unusual, there is an exit charge, in practice of up to 21%.

One further benefit of these types of trust over trusts subject to the relevant property regime⁴⁷ is that there is no decennial charge.⁴⁸

So far as disabled person's interests, immediate post-death interests and transitional serial interests are concerned, these form part of a person's estate: see above. Accordingly, there are no exit or decennial charges.

All other trusts are subject to exit and decennial charges, by virtue of being subject to the relevant property regime.⁴⁹

III. Weighing up the advantages and disadvantages

Having set out the inheritance tax charges that apply to the various types of trust, the question becomes whether, in any particular case, the flexibility of a discretionary trust is worth the inheritance tax charges it brings. However, it may not even be said as a general rule that it is better to create a discretionary trust than to risk incurring the exit charges that apply to an unauthorised de-settlement out of a bereaved minors' trust or an age 18-to-25 trust. This is because this will depend on the value of the

⁴⁶ IHTA 1984, section 71F(7) to (9).

⁴⁷ For which see IHTA 1984, sections 58 ff.

⁴⁸ For the decennial charge, see IHTA 1984, sections 64, 66 and 67.

⁴⁹ See IHTA 1984, sections 58 and 64 to 69.

unauthorised disposal, and, more fundamentally, on whether it is possible to achieve the same goal by making an authorised disposal on the understanding that the authorised beneficiary will then pass value to the unauthorised one.⁵⁰

But in practice it may be that most parents will be happy for their children to receive capital at age 25. At this stage in life, some maturity and financial nous are likely to have been attained. So it may be worth accepting the risk of a tax charge of up to 4.2%⁵¹ in return for keeping the capital safe until the child has reached that age.

One further general point is that a trust may be mixed. Accordingly, it would be possible to create a trust such that, for example, the beneficiary should become entitled to a relatively small proportion of capital on attaining age 18, perhaps the type of amount that would enable university fees to be funded throughout a degree, or would finance a gap year. The property subject to that provision would constitute a bereaved minors' trust. The rest of the capital could be protected until age 25, and that would be subject to the age 18-to-25 regime.

The other possibility in cases of death planning is to confer an interest in possession immediately on death on a particular beneficiary. Such an interest will not come within the relevant property regime, and so there will be no exit or decennial charges. The property in which the interest exists will fall within the beneficiary's estate, and on the cessation of his interest he will be regarded as making a transfer of value. But again, if this is the aim one must be careful draft so as not to fall within the bereaved minors rules. This is more difficult. Those rules apply in all cases where a bereaved minor will be entitled to capital at age 18, even if he is entitled to income before then. Accordingly, one would have to delay entitlement to capital beyond age 18: not necessarily a bad thing.

⁵⁰ Of course, in this context other issues arise, and in particular the fiduciary obligations of trustees.

⁵¹ Less, if the testator dies, and the property enters the trust, after the child's 18th birthday, or the child becomes entitled to capital before age 25.

IV. Section 142 variations / section 144 dispositions

Issues arise in relation to existing wills where testators have died in the past two years, and some planning opportunities are available.

First, section 142 is unchanged in its terms. So, in short, a disposition of property comprised in an estate may be varied, or the benefit conferred by such disposition be disclaimed, within two years of the death.⁵² This is whether or not the estate has already been distributed.⁵³ This option is unavailable for a variation or disclaimer for any consideration apart from a related variation or disclaimer in respect of some other part of the same estate.⁵⁴ One can use a variation to override a trust, provided the property ceases to be held for the trust beneficiary within two years of the death.⁵⁵ One other limitation is important in the context of trusts: one cannot vary a disposition of property included in a person's estate only on account of his having an interest in possession in it.⁵⁶

So what can be done under this provision? So far as the new rules are concerned, the issue is whether existing dispositions, whether absolute or into trust, can be varied so as to come within one of the new categories of trusts and interests.

One can vary a pre-Budget day settlement so as to make it into a bereaved minors' trust or an age 18-to-25 trust. This is because, although the effect of the variation is backdated to the date of death, these provisions apply also to property settled prior to 22nd March 2006.⁵⁷

It appears that one could also convert a pre-Budget day trust into a pre-Budget day accumulation and maintenance trust, although this is not so clear. The regime is

⁵² IHTA 1984, section 142(1).

⁵³ IHTA 1984, section 142(6).

⁵⁴ IHTA 1984, section 142(3).

⁵⁵ IHTA 1984, section 142(4).

⁵⁶ IHTA 1984, section 142(5). Property included in the estate also on account of having been the subject of a gift with reservation is also excluded from the possibility of variation or disclaimer.

⁵⁷ IHTA 1984, sections 71A(1) and 71D(1).

restricted to property in respect of which it 'applied ... immediately before 22nd March 2006' and 'has applied ... at all subsequent times up to the particular time'.⁵⁸

But the effect of a variation is that IHTA 1984, presumably including these conditions, is to apply 'as if the variation had been effected by the deceased'. If the variation had been effected by the deceased, the accumulation and maintenance regime would have applied to the property immediately before and at all times since Budget day, and so the temporal conditions are satisfied. Of course, this provides protection only until 6th April 2008, unless by then the conditions of the trust are changed so that the beneficiary becomes absolutely entitled at age 18.

The same type of argument applies in relation to conversion to an immediate post-death interest. In other words, a variation now of the will of a testator who died before 22nd March 2006 may be used to create an immediate post-death interest that satisfies the requirements for such an interest to exist.

Of course, the more general difficulty with seeking a variation is that all the relevant beneficiaries must agree: this is not always easy to achieve.

By contrast with the rules on variations, changes have been made to section 144 of IHTA 1984, corresponding to the principal changes to the Act. This provision allows for tax-free distributions from discretionary trusts⁵⁹ established by will. Where an event occurs within the two years after the testator's death that would give rise to an exit charge,⁶⁰ then there is in fact no exit charge, and for all purposes of IHTA 1984 the will is treated as having provided that on the testator's death the property in

⁵⁸ IHTA 1984, section 71(1A).

⁵⁹ For this purpose, the category includes old accumulation and maintenance trusts, provided there is no interest in possession in the property the subject of the event.

⁶⁰ This includes all exit charges under chapter III of Part III of IHTA 1984, so exit charges, in practice, on property leaving discretionary trusts (section 65), temporary charitable trusts (section 70), accumulation and maintenance trusts (section 71), employee trusts and newspaper trusts (section 72). Section 144 expressly provides that the decennial charge should still apply; the reason for this is that the exemption applies to 'property settled by ... will', and this would include property added to an existing trust that was to suffer a decennial charge within the next two years.

question should be held as it in fact was held after the exit that would have given rise to the charge. This treatment is not available, however, where an interest in possession has existed in the property in question at any time since death (for deaths before 22nd March 2006), or (for deaths on or after 22nd March 2006) an immediate post-death interest or a disabled person's interest has existed in it during that period.⁶¹

On its face this seems to enable property subject to existing accumulation and maintenance trusts, at least in certain circumstances, to be transferred into bereaved minor's trusts or age 18-to-25 trusts. But this is prevented by section 81 of IHTA 1984: it provides that where the event is a transfer into another trust, the property shall be deemed to continue to be subject to the first trust.⁶²

The new rules provide for an exception for this, for deaths after 22nd March 2006. So, if the event within two years after death has the effect that the property is held under a trust that, if established by will, would have created an immediate post-death interest, or would have been a bereaved minor's trust or an age 18-to-25 trust, IHTA 1984 applies as if the will had established the relevant type of interest in or trust over the property, and no exit charge⁶³ arises in respect of the event.⁶⁴ The exception is not available if an immediate post-death interest or disabled person's interest has subsisted in the property between the testator's death and the relevant event.⁶⁵

This means that one can still establish a nil-rate band discretionary trust by will and then decide after the testator's death whether the circumstances make it appropriate for one of the new types of interest or trusts to be set up.

⁶¹ A transitional serial interest pre-supposes that an interest in possession has already existed: IHTA 1984, section 49C(2) and 49D(2).

⁶² IHTA 1984, section 81(1).

⁶³ It must be noted that the same trap applies under the new rules as applied (and applies) under the old for alterations within three months after death, on which there would be no exit charge: see *Frankland v. Commissioners of Inland Revenue* [1997] S.T.C. 1450.

⁶⁴ IHTA 1984, section 144(3) and (4).

⁶⁵ Similar amendments have been made to section 72 of the Taxation of Chargeable Gains Act 1992: see paragraphs 29 ff. of Schedule 20 to FA06.

The effect of the section is extended to estates of persons who died before 22nd March 2006, subject to the additional requirement that no sort of interest in possession existed between the testator's death and 22nd March 2006.⁶⁶

V. Practical problems

The new legislation doubtless creates many practical problems, apart from the obvious fact that it makes it more difficult to retain flexibility over who gets what when and at the same time avoid tax charges.

The only one I should like to mention at this point arises in relation to mixed trusts. It is perfectly possible for part of a trust to fall within the bereaved minors' regime, and for part of it to constitute an immediate post-death interest. The practical problem for the trustees will be to ensure that the parts are kept clearly separate, so as to avoid any risk that, for example, the question of whether the requirements to be a bereaved minors' trust must be satisfied in relation to all the trust property. If that risk materialises, it is likely that none of the trust will come within this regime. It may be that in practice equal amounts of the initial fund should be used to purchase distinct investments in the same vehicle: otherwise, the risk arises that beneficiaries will see different returns on their part of the trust property, and that this leads to complaints against the trustees.

VI. Conclusion

Unless and until inheritance tax is abolished,⁶⁷ it will be necessary to advise clients on what steps they can take to minimise the tax burden. But the Government is intent in restricting opportunities for avoiding this tax, even regardless of whether there are other, good reasons for choosing certain structures such as delaying inheritance until age 25. This reflects other areas of taxation where anti-avoidance legislation can apply

⁶⁶ IHTA 1984, section 144(5) and (6).

⁶⁷ For a recent suggestion that it should be, see The Tax Reform Commission, *Tax Matters: Reforming the Tax System*, 2006.

to *bona fide* commercial transactions, where the structure of those transactions has been arranged so as to minimise a tax burden.⁶⁸ In short: clients must plan for death; long live the tax adviser.

⁶⁸ See, for example, rules on treatment of the purchase by a company of its own shares as a capital distribution: Income and Corporation Taxes Act 1988, sections 219 ff.