Business Inheritance Tax and Trusts: Where are we now?

Inheritance tax and trusts | Tax voice

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Harriet Brown provides an answer to the question so many have asked

Introduction

Since 2006 the use of trusts in inheritance tax planning has become progressively more difficult, and less beneficial. This does not, however, mean that trusts are useless in inheritance tax planning. In this article I discuss some of the ways that trusts can still be useful.

Qualifying Interests In Possession

The benefit of a discretionary trust would, absent the provisions of the Inheritance Tax Act 1984 ("IHTA"), be that property in it should not form part of any individuals estate. IHTA deals with this in two ways: the relevant property regime (which applies charges to property held in many types of trust on the tenth anniversary of the trust and when property leaves the trust) and through treating property in which there is a qualifying "interest in possession" ("IIP") as forming part of the estate of the person beneficially entitled to it.

A trust that has a qualifying IIP in it should not be within the relevant property regime. The major change in 2006 was that the categories of qualifying interests in possession were significantly cut down. The following now constitute the main categories of qualifying IIPs:

- those to which an individual became beneficially entitled before 22nd March 2006;
- an immediate post-death interest;
- a disabled person's interest; and
- a transitional serial interest.

Thus in most cases, it is no longer possible to create a new interest in possession, and this means that the majority of trusts will come within the relevant property regime. Immediate post death interest trusts (IPDIs) are IIPs that are in a settlement effected by will or intestacy, the holder of the interest became beneficially entitled to the interest in possession on the death of the testator/intestate, section 71A (trusts for bereaved minors) does not apply to the property in which the interest subsists, the interest is not a disabled person's interest, and the last condition has been satisfied at all times since the holder of the interest became beneficially entitled to the interest in possession. Thus it remains possible to create an IPDI.

Both a disabled person's interest and a transitional serial interest arise as a matter of circumstances and so while they remain useful in situations where these circumstances exist, they are not useful in planning more generally.

Thus trusts in general planning are no longer as useful as they were previously.

Pilot Trusts

While trusts have long been used in succession planning and for many other reasons where tax is not the primary driver behind the trust, trusts have also been used in more aggressive tax planning and tax avoidance. One such usage was that of pilot trusts.

Under the previous rules for taxation of relevant property trusts the calculation of periodic and exit charges on trust property took into account the settlor’s aggregated chargeable transfers in the seven years prior to (but not on) the date of

commencement (IHTA 1984, s. 66(5)). Where, however, property was added to a settlement at a later date, the aggregated chargeable transfers taken into account was those falling in the seven years prior to (but not on) the date of the addition when that is greater (IHTA 1984, s. 67(3)(a)).

Pilot trusts exploited these provisions because where property was added to two or more existing settlements on the same day, those additions were not taken into account for the purpose of calculating the aggregate chargeable transfers on the others (IHTA 1984, s. 67(3)(b)(i)). Therefore subsequent charges were calculated without reference to same-day additions. The additions were not brought into account as “related settlements” under IHTA 1984, s. 62, because the settlements commenced on an earlier date.

IHTA, section 62A – 62C (inserted by the Finance (No. 2 Act) 2015) have addressed this means of planning. These provisions introduce rules to ensure that where property is added to two or more settlements on the same day and after the commencement of those settlements, the value of the added property together with the value of property settled at the date of commencement (that is not already in a related settlement) will be brought into account in calculating:

- the rate of tax for the purposes of ten year charges under section 66;
- for exit charges before the first ten-year anniversary under section 68; and
- for exit charges between anniversaries under section 69 for and for the charge on 18/25 trusts under section 71F.

While there are some exceptions to the new aggregation rules in IHTA, sections 62B and 62C (which protects certain settlements that commenced before 10 December 2014 from the new rules), the opportunities to use pilot trusts to avoid or reduce inheritance tax have been greatly reduced.

Foreign-Domiciled Settlors

One way in which trusts remain useful is for foreign domiciled settlors. This is because property that is not situated in the UK and which was settled at a time when the settlor was not domiciled in any part of the UK, will be outside the relevant property regime. Thus offshore trusts used to hold non-UK situate property that is settled by non-UK domiciled settlors still provide an opportunity to reduce charges to

inheritance tax.

The downsides to using such trusts tend, however, to come from taxes other than inheritance tax. In practice such trusts are created during the settlor's lifetime – rather than on death – and consequently, there is a number of potential difficulties with the settlor or the settlor's family accessing the property in the trust. Such issues include the transfer of assets abroad regime in the Income Tax Act 2007, Part 13, the charges arising under the Taxation of Chargeable Gains Act 1992, sections 86 and 87 and (possibly) making remittances where the remittance basis is in point.

This should not act as a deterrent to the use of trusts in the case of a foreign domiciled settlor, but competent advice should always be taken when dealing with such trusts.

Finally, in this respect, it is important to remember the rules for deemed domicile (IHTA, section 267) and that the proposed introduction of deemed domicile rules for income tax, is also intended to amend the inheritance tax deemed domicile rules and consequently, whether or not someone is deemed domiciled in the UK for inheritance tax purposes will also require careful consideration.