

## Wills, trusts and estates post Finance Act 2006

The Finance Act 2006 has completely destroyed the careful structure of the previous inheritance tax provisions relating to trusts. In doing so, it introduced a dichotomy between trusts set up under wills and those set up in lifetime, with a further subdivision for trusts set up by a parent under a will and those set up by some other relative by will. The result is a tangle of complex rules with many hidden traps which will undoubtedly catch out many practitioners in the future. It will be imperative to have complete mastery of the subject before embarking on any alterations to existing trusts and before drafting anything but the simplest of wills. To illustrate this, try your hand at answering the questions below regarding trusts set up under wills yet to take effect.

1. If a parent sets up an accumulating trust fund for one of his children under his will, it is crucial that the child must receive his legacy outright at the latest by the age of 25 if there are to be no inheritance tax charges in the first 18 years of the trust. True or false?
2. Nil rate band will trusts are still good planning, but under the new regime, given that interests in possession not taking effect from the date of death are outside the category of immediate post death interests, is it safe to give the surviving spouse an interest in possession in the nil rate band trust a few months after the date of death?
3. The Revenue has now apparently given nil rate band will trusts official blessing according to published notes by a representative body, so is it safe to put a share of the home into the trust?
4. If you leave a fund in trust for a beneficiary for life, can he or she pass that interest on to his or her spouse at any time as an exempt transfer?
5. What is wrong with a trust for a person's widow for life or until remarriage and then on age 18-25 trusts for their children?
6. An immediate post death interest has all the same rules that applied to interests in possession before 22 March 2006. True or false?
7. If you set up a trust fund for your surviving spouse, will there be capital gains tax holdover relief when it terminates?
8. A parent's will can leave a legacy fund in trust for an infant child, with the income belonging to the child in the meantime. When the child become entitled to have investments in the fund transferred into his or her name, can any accrued gains be held over?

The answers to the above questions are now set out below:

1. False, it is permissible for the trustees to have power to advance the funds on new trusts for the child which can extend beyond the child's 25<sup>th</sup> birthday.
2. No it is not safe to do this as section 144, IHTA 1984 will operate to turn the interest into an immediate post death interest thus destroying the tax advantage of the nil rate band will trust.
3. The problem is that a share of a property held in trust is unlikely to qualify for capital gains tax main residence exemption.
4. No.

5. A chargeable transfer will arise if the widow agrees to the termination of her life interest during her lifetime. If the trust for the children is a bereaved minors' trust, the transfer will not be chargeable but instead it will be potentially exempt.
6. No they do not follow all the pre 22 March 2006 rules; for example if the interest is terminated in favour of other continuing trusts, a chargeable transfer will arise instead of a potentially exempt transfer as previously.
7. If the interest of the spouse is terminated in his or her lifetime, no general capital gains tax holdover relief will be available, but only holdover for business assets.
8. Yes if it is a trust for the child absolutely at age of 18 but no if the child's entitlement is at a later age.

### **Existing trusts**

Most existing trusts will benefit from a review over the next year to establish whether it will be beneficial to make any changes to them. For example, before 6 April 2008 there is the opportunity to replace an existing interest in possession with another such interest in favour of a different beneficiary. It will therefore be worth considering whether or not it would suit the circumstances to replace the existing life tenant with a younger life tenant who will then benefit from the pre 22 March 2006 regime for the rest of his or her life. After April 2008 there will be only a very limited opportunity to continue the former inheritance tax regime for trusts, as in broad terms all new interests in possession under lifetime trusts will fall under the relevant property regime which previously applied only to discretionary trusts.

### **Accumulation and maintenance trusts**

It will be even more important to review all existing accumulation and maintenance trusts before 6 April 2008. After that date, many such trusts will have treatment as discretionary trusts and will become liable to periodic inheritance tax charges. It will, however, be possible to avoid this result by suitable amendment to the trusts before April next year.

In some cases it may be preferable to allow the trust to go into the discretionary trust regime for inheritance tax purposes; only a detailed review on a case by case basis will establish the appropriate action for the trust concerned.

### **Discretionary trusts**

Although the rules relating to discretionary trusts themselves have not changed, the new regime has an impact on planning with these trusts as well. For example, it was previously a useful technique in appropriate cases to appoint a temporary interest in possession in all or part of the trust in order to deal with potential ten yearly charges. This no longer achieves its purpose as any new interest in possession will not be recognised for inheritance tax purposes.

Given the distinction between will trusts and lifetime trusts, plus the complex interaction with inheritance tax business property relief and capital gains tax holdover reliefs, any review of existing structures needs great care and

expertise, and Parmentier Arthur Tax Services Limited are well placed to carry this out on your behalf.

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