Extending Trust Periods

William Massey QC, of Pump Court Tax Chambers, explores the tax benefits of an extension of the trust period under the Variation of Trusts Act 1958, and the impact of the Perpetuities and Accumulations Act 2009

A matter of some importance to settlement trustees is the potential tax liability facing the settlement when it comes to an end. There are many settlements now in existence where the trust period will end within the next 30 years or so. Many of these settlements face adverse tax charges on termination. Here are a few examples.

- Old-style 'accumulation and maintenance' trusts which have passed seamlessly into the inheritance tax 'relevant property' regime bear an inheritance tax charge under IHTA 1984, s 64 every 10 years at rates currently up to 6% of the fund value, but no charges on the death of any beneficiary. Typically the trust fund, at the end of the trust period, will vest absolutely in one or more individuals. Not only does this give rise to an 'exit' charge (IHTA 1984, s 65) and possible CGT charge (TCGA 1992, s 71). It also results in the property becoming comprised in the estate of an individual and facing a potential charge at up to 40% on the individual's death.
- Life interest trusts where a qualifying (pre-22 March 2006) interest in possession subsists in the fund and where the fund is set to vest in the life tenant if he survives the trust period. In that case the trust fund faces a CGT charge under s 71 when the trust period ends.
- Discretionary trusts of 'conditionally exempt' property. Typically the property is exempted from the 10-year anniversary charge (IHTA 1984, s 79) on terms that the trustees give and abide by their undertaking for reasonable access to the public. In cases where the undertaking was given before 31 July 1998 the undertaking may have been limited to providing access by appointment and temporary museum exhibitions. If the trust comes to an end and a new exemption needs to be put in place, the terms of the undertaking now required, in the light of FA 1998, Sch 25, will be considerably more severe.
- 'Excluded property' settlements made by non-domiciled settlors, where the termination of the settlement will result in the property vesting in domiciled beneficiaries and forming part of their estates for inheritance tax purposes.

Keeping the settlement alive

Powers of appointment or advancement can in some circumstances be used to extend the life of a trust. They might, for example, be used to amend a beneficiary's contingent interest in capital on surviving the trust period by conferring a life interest with an absolute remainder to the beneficiary's child, thus deferring or avoiding the CGT charge. But any such power must be exercised in such a way as not to infringe the perpetuity rule applicable to the original settlement – *Pilkington v IRC* [1964] AC 612 at page 641 per Lord Radcliffe.

Powers of appointment or advancement can in some circumstances be used to extend the life of a trust

Another route to keep the property in trust is for the remainderman to resettle his interest on the trusts of a new settlement. This can be done without inheritance tax if the reversionary interest is 'excluded property' under IHTA 1984, s 48(1). But the adverse tax implications include:

- the possibility of an income tax 'POAT' (pre-owned assets tax) charge (FA 2004, Sch 15) on the assignor if he is a beneficiary under the resettlement
- a possible CGT charge under s 71 on termination of the first settlement
- a possible inheritance tax charge when the first settlement ends.

A third possibility is for the beneficiaries, under the rule in *Saunders v Vautier* (1841) 4 Beav. 115 (affirmed Cr & Ph 240), collectively to direct the trustees to hold the property on trust for them absolutely in agreed shares, or, if the trustees agree, on new trusts. They can only do so where all the possible and potential beneficiaries are in being, adult and have legal capacity. Where new trusts are created, the risk must be that a new settlement will be created, causing a deemed disposal for CGT purposes and possibly also an inheritance tax charge, so that the cure is worse than the disease.

The last possibility is to apply to the Court under the Variation of Trusts Act 1958, s 1 of which permits the Court to make an order, in the case of trusts arising under any will, settlement or other disposition, approving on behalf of (amongst others) any person with an interest in the trusts who by reason of infancy or other incapacity is incapable of assenting, any person who may become entitled, directly or indirectly, to an interest under the trusts, and any person unborn, an arrangement varying or revoking all or any of the trusts, or enlarging the powers of the trustees of managing or administering any of the property subject to the trusts. The Court has to be satisfied that the carrying out of the arrangement would be for the benefit of that person.

The Variation of Trusts Act route: the Wyndham case

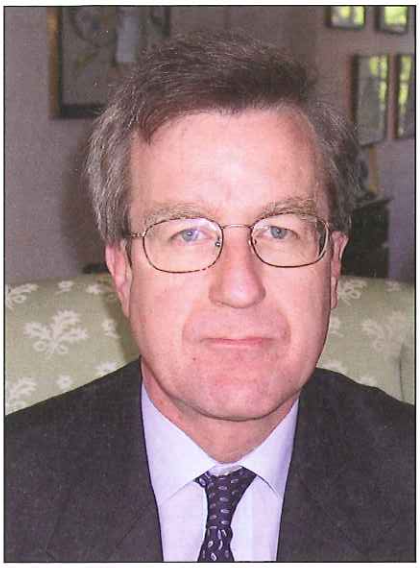
The use of this route to extend a trust

period was recently illustrated in *Wyndham v Egremont* [2009] EWHC 2076 (Ch). The effect of the variation sanctioned by the High Court (Blackburne J) was to extend the permissible life of the settlement by possibly as much as 100 years or more, without creating a new settlement for CGT purposes and without terminating a qualifying interest in possession for inheritance tax purposes. The trust fund in question was held in trust for a beneficiary (G) for life, the capital being held for G absolutely if alive on the 'vesting day' (defined as the day on which expires 20 years from death of last survivor of George V's issue alive in May 1940). There was power for the trustees to transfer to/apply the trust fund for the benefit of G as they thought fit. In default, the funds were to be held in trust for G's children or remoter issue as G should appoint; and subject to these terms and trusts, the funds were to be held for G's eldest or only son (or failing that the eldest son of G's eldest son) living on the vesting day, with an ultimate default trust for G or his estate absolutely. The tax problem perceived by the trustees was that the vesting day was likely to fall in G's lifetime, giving rise to a deemed disposal under s 71 and substantial CGT charge.

The variations proposed, and sanctioned by the Court, were to alter the definition of the vesting day to the day on which expires the period of 21 years from the death of the last survivor of George V's issue and G's great grandfather's issue *now* living (at the date of the Court order), to remove G's interest in capital contingent on his surviving the re-defined vesting day, to substitute trusts in remainder as to capital (and the income in the meantime) in favour of that one of G's male issue in the male line who shall be living on the (re-defined) vesting day and then hold the barony. Crucially, the ultimate default trust for G or his estate remained.

The benefits taken into account by the Court were the elimination of the risk of G taking all at a young age, the deferral of the vesting day by a very substantial period and avoidance of the impending CGT liability, and the benefit to G's heirs in not (except on final vesting of capital) becoming entitled to capital or an interest in capital with an inbuilt CGT charge.

The Court reminded itself that it only has power to vary the trusts of a settlement: it cannot effect a new settlement (*Re Holt* [1969] 1 Ch 100 at 117 and *Re T's Settlement* [1964] Ch 158 at 162). It therefore considered the



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question: 'Is there a new settlement?' Guided by the terms of the well-known test of Lord Wilberforce in *Roome v Edwards* [1982] AC 279 at 292-3, Blackburne J held (at paragraph 20 of his decision):

'With that guidance in mind I have no doubt that the alterations to the pre-arrangement trusts contained in the arrangement which I have approved constitute a variation of those trusts and not a resettlement. The trustees remain the same, the subsisting trusts remain largely unaltered and the administrative provisions affecting them are wholly unchanged. The only significant changes are (1) to the trusts in the remainder, although the ultimate trust in favour of George and his personal representatives remains the same, and (2) the introduction of the new and extended perpetuity period ... The concern here is whether, on the ground that they give rise to a resettlement, the variations to the trust, principally the extension of the trust period, might be said to give rise to a 'deemed disposal' under section 71(1) of the Taxation of Capital Gains Act 1992 or might lead to adverse consequences for inheritance tax or stamp duty land tax purposes. I propose to take this very shortly because, in my view, the approach of Lord Wilberforce in *Roome v Edwards* (cited earlier) is in point. I do not consider, for the reasons already summarised, that the arrangement does give rise to a resettlement ...'

It is clear from the passage cited that the inheritance tax question: 'Is there a new interest in possession as a result of the variation?' was fully considered. It was important, because a termination of G's existing interest in possession would have given rise to an inheritance tax charge under IHTA 1984, s 52 (which would have been unprotected by IHTA 1984, s 53(2)). Since there was no re-settlement, G's initial interest in possession remained intact, so that no inheritance tax charge arose.

The effect of the variation sanctioned by the High Court (Blackburne J) was to extend the permissible life of the settlement by possibly as much as 100 years or more, without creating a new settlement for CGT purposes and without terminating a qualifying interest in possession for inheritance tax purposes

Types of trust where extension of trust period under the Variation of Trusts Act 1958 may be helpful

The types of trust where the Court's approval under the Act will be helpful include the following.

- Old-style accumulation and maintenance and other discretionary trusts where the Court may be asked to approve a variation to extend the trust period, and also to add an immediate power to accumulate. The advantages include: retaining the 6% 10-yearly IHT charge rather than forcing the fund to pass out of trust; enabling income to be retained by the trustees to meet the 10-yearly IHT charge; and deferring the time at which the trust fund passes to the estate of an individual.
- Qualifying life interest settlements where the settlement may end during the life tenant's life (as in *Wyndham* itself). The advantages include: deferring (and possibly avoiding altogether) a charge under s 71; enabling a surviving spouse to acquire, by exempt transfer on the life tenant's death, a transitional serial interest (under IHTA 1984, s 49D) on the death of the qualifying life tenant.
- Trusts of conditionally exempt property. The advantages include

continued exemption from inheritance tax without the need to undertake enhanced access and publicity obligations.

- Non-domiciled settlors' settlements. The advantages include an extension of 'excluded property' status.

The effect on variation of trusts of the new Perpetuities and Accumulations Act 2009

The Perpetuities and Accumulations Act 2009 was enacted on 12 November 2009 and comes into force on 6 April 2010. In relation to interests under instruments taking effect (in the case of wills, only those executed and taking effect) on or after 6 April 2010 the existing common law and statutory perpetuity periods are replaced with a single statutory perpetuity period of 125 years, and the rule against excessive accumulations is repealed. The exception is any instrument made in exercise of a special power of appointment (including a power of advancement and any other power to create a beneficial interest in property without receiving valuable consideration) if the instrument creating the power was made before 6 April 2010 (s 15(1)(b) of the Act).

If new trusts/powers are created under an order approving a variation made after 5 April 2010, the perpetuity period applying to the trust interests/ powers created under that variation will, it seems, be the new 125-year period and the rule against excessive accumulations will not apply in relation to the income accruing in right of such new interests. *Re Holt* (where Megarry J approved a variation substituting a perpetuity period only permitted under the Perpetuities and Accumulations Act 1964 in a pre-1964 settlement) is a useful precedent. The Court addressed the issue specifically (at page 120):

'The power [of appointment or advancement] is conferred by the settlement, and the person exercising the power can do so only within pre-ordained limits. The power indeed 'belongs' to the old settlement, if I may respectfully adopt the language of Lord Radcliffe in the *Pilkington* case. Under the Act of 1958, there are no such limits. The property, as it seems to me, is freely disposable.'

Referring to the Perpetuities and Accumulations Act 1964 he went on:

'It seems to me that the arrangement, coupled with the order of the court, constitute an "instrument", or, since the singular includes the plural, "instruments", which take effect after July 15, 1964. Whether the documents are regarded as separate instruments or as together constituting one composite instrument, the effect is produced by the complex of documents; and what takes effect after July 15, 1964, is the result of this complex of documents. In my judgment, therefore, it is permissible to insert provisions deriving their validity from the Act of 1964 into an arrangement approved under the Act of 1958.'

Wyndham v Egremont raises the possibility of a variation of an existing settlement under the Variation of Trusts Act 1958 introducing a new 125-year perpetuity period and a power to accumulate income for the whole of the new period, without creating a new settlement, in circumstances where the interests under the original settlement are not exhausted (as in *Wyndham* itself) and the trusts in default remain.

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