

RUSSELL-COOKE SOLICITORS

**PRIVATE CLIENT  
DEPARTMENT**

**TRUSTS AFTER THE  
FINANCE ACT 2006**

## What is the Finance Act 2006?

- ♦ The Finance Act 2006 came in to force on the 19 July 2006 (with effect from the 22 March 2006).
- ♦ The Finance Act 2006 contained far-reaching changes to the Inheritance Tax treatment of trusts.

## How are Trusts classified?

- ♦ Trusts can be classified in a number of different ways and for different purposes.
- ♦ A common way of classifying trusts is for United Kingdom tax purposes.

## How were Trusts classified prior to the Finance Act 2006 ('FA06')

- ♦ Discretionary

*No beneficiary has a right to income, which can be paid out, as can capital, to potential beneficiaries at the discretion of the trustees. For UK inheritance tax ("IHT") purposes, capital does not belong to a beneficiary. The trust itself is subject to IHT at 6% above the relevant nil rate band, every 10 years. If capital is paid out it too can be subject to an additional IHT exit charge.*

*Gifts into discretionary trust are subject to immediate IHT at half the death rate i.e. at 20%. The rules are complicated and specific detailed advice is required.*

- ♦ Life Interest also known as Interest in Possession

*A Beneficiary has a right to income (although there may be power for this to be removed or changed). For IHT purposes, the capital is deemed to belong to the beneficiary and is subject to IHT on death.*

- ♦ Accumulation & Maintenance ("A&M Trusts")

*These trusts were purely a creature for IHT purposes. Although discretionary, they were not subject to the discretionary trust IHT regime, but treated as capital belonging to beneficiaries, provided that children of a common grandparent were entitled to an interest in possession (a right to income, and not necessarily the capital itself) by the time they attained the age of 25.*

- ♦ Revertor to Settlor Trusts.

*These lifetime trusts were purely a creature for IHT purposes. Although interest in possession, they were not regarded as being within the estate of the income beneficiary, but treated as capital belonging to the settlor. These were often created for the benefit of a poorer parent, and usually continued after the death of the income beneficiary for CGT reasons,*

- ♦ Bare Trusts

*Such trusts are not really trusts at all, since the capital and income does actually belong to the beneficiary. However, whilst a child is under 18, trustees may use capital or income for its benefit.*

## How has the landscape changed since 22 March 2006?

- ◆ Following FA06 a distinction must be made for new trusts between what is possible on death and during lifetime.

### Trust on Death:

- ◆ Discretionary Trusts

*Continue as before, currently unchanged. There may be income tax reasons for mandating income.*

- ◆ Life Interest Trusts

*It is still possible to create such trusts. They are now known as Immediate Post Death Interest (“IPDI”) trusts. An IPDI can continue after the death of the beneficiary for the surviving spouse or civil partner (“exempt partner”) of the beneficiary, but otherwise if the trust then continues it is then treated as being a discretionary trust and falls into what is now known as the relevant property regime.*

- ◆ Accumulation & Maintenance Trusts

*A&M trusts are no longer possible. However, trusts for bereaved minors who must inherit the capital absolutely at 18 are treated as IPDIs. Trusts for bereaved young people who must inherit the capital at 25 are treated as IPDIs whilst they are under 18 and then fall into the relevant property regime. All other trusts fall into the relevant property regime and are therefore treated as discretionary trusts immediately.*

- ◆ Bare Trusts

*Currently remain unaffected.*

### Lifetime Trusts:

- ◆ Discretionary Trusts

*Continue as before, currently unchanged. There may be income tax reasons for mandating income.*

- ◆ Life Interest Trusts

*It is no longer possible to create an old-style inter-vivos Life Interest Trust, even for spouses. Any such trust now made would be treated as discretionary and within the relevant property regime, **triggering an immediate charge to IHT at 20%**. Foreign trust structures such as US QDOTs and civil law Usufruits would also be subject to this charge for UK (and deemed) domiciliaries. There is a limited exception for trusts for disabled persons, which is of little practical benefit.*

- ◆ Accumulation & Maintenance Trusts

*It is also no longer possible to make these. Any such trust now created would be treated as discretionary and within the relevant property regime triggering an immediate IHT charge.*

- ◆ Revertor to Settlor Trusts

*These are not possible, either. If created, they also now have odd and often unpleasant CGT and income tax side effects.*

- ◆ Bare Trusts

*Currently remain unaffected, save for the income tax side effects if the anti avoidance revertor to settlor or minor children rules apply. They are still effective for CGT purposes for children whether or not minors.*

## What about Trusts already in existence on 22 March 2006?

- ◆ There are Transitional Rules which apply for such trusts and provide a measure of relief allowing Trustees to alter such Trusts before 6th April 2008 to bring them in line with the new regime.

- ◆ Existing Life Interest Trusts

*It is possible for IHT purposes, for a current life interest to be transferred to a different beneficiary (only once, save where an exempt partner becomes entitled) before 6/04/2008. Such a transfer is a potentially exempt transfer ("PET") for IHT and will be subject to IHT if the former life interest beneficiary dies within 7 years. After 5/04/2008 any such transfer will be regarded as a transfer into a discretionary trust/ relevant property regime.*

- ◆ Existing Accumulation & Maintenance Trusts

*Such trusts will fall into the discretionary trust/ relevant property regime as at 6/04/2008. Provided that the trust gives such powers, if the trust is amended so that the beneficiaries must become entitled to capital absolutely at 18, the trust will remain in the life interest regime. It may also be possible to convert the trust to an 18 to 25 Trust to reduce the exposure to the relevant property regime.*

There are particular issues for A&M Trusts with large gains, and it will probably be important not to pay out capital to children until after 5th July 2008 to obtain hold over relief.

### What steps do I need to take now?

- ◆ Review your Will. For those without a Will, it is now even more important to make one.
- ◆ Any previous tax planning involving the use of trusts, should be reviewed.
- ◆ Existing A&M Trusts should be reviewed well before 6th April 2008, to plan whether any action is necessary, possible or appropriate.
- ◆ Existing Life Interest Trusts should be reviewed to plan whether passing some or all of the life interest on to a younger beneficiary before 6th April 2008 may be appropriate.

### Warning

IHT has been radically changed with effect from 22nd March 2006. IHT will inevitably be amended again by the UK Government in the future. Any planning must be made with the knowledge that it must be kept under review and that in the future it may need to be amended and may be rendered less effective.

### How can Russell-Cooke Solicitors help?

- ◆ If you wish to review any existing trust, update a current Will or undertake estate planning then we are happy to advise you, in consultation or writing, as regards the options available to you.
- ◆ Our usual charging rates will apply and fees will be charged in accordance with the amount of time spent dealing with your instructions
- ◆ If you require further information or advice please contact any of the following:

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*This Information sheet is intended to provide general information about the Finance Act 2006 and related IHT planning issues. It is not intended to be comprehensive or to provide any specific legal and / or tax advice and should not be acted or relied upon as doing so. Professional advice appropriate to a specific situation should always be obtained.*

DATED 5 OCTOBER 2006