

the knowledge

Just as the financial services industry is getting to grips with the changes made to the inheritance tax (IHT) treatment of trusts on 22 March 2006, HM Revenue & Customs (HMRC) introduce another twist.

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grin and bare it? – another BN25 surprise



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Colin Jelley explains the recent issues surrounding the IHT treatment of bare trusts created for minors.

Considering the radical nature of the changes introduced in BN25, and the lack of consultation, it is not surprising that another unintended consequence has come to light. HMRC have now received legal advice that gifts to a bare trust with a minor as beneficiary, might be considered a chargeable lifetime transfer (CLT) rather than a potentially exempt transfer (PET).

This would have ramifications for all types of savings established for minors, including bank accounts and regular savings schemes for mutual funds. You would be forgiven for thinking you had missed this point following the issue of BN25 and the subsequent Finance Act 2006, as it had stated that bare trusts are not affected by the changes.*

defining bare trusts

To determine whether a trust is treated as a bare trust or not, one needs to examine s43(2) Inheritance Act 1984. This provides that:

‘Settlement’ means any disposition or dispositions of property, whether effected by instrument, by parol [verbally] or by operation of law, or partly in one way and partly in another whereby the property is for the time being –

- (a) held in trust for persons in succession or for any person subject to a contingency, or
- (b) held by trustees on trust to accumulate the whole or part of any income of the property or with

power to make payments out of that income at the discretion of the trustees or some other person, with or without power to accumulate surplus income or

- (c) charged or burdened with the payment of any annuity or other periodical payment payable for a life or any other limited or terminable period.

Anything which is not a settlement would be considered a bare trust. Prior to the 22 March 2006, it was agreed with HMRC that a gift to an absolute trust for a minor was treated as a PET. However, HMRC have now received advice from their solicitor that absolute trusts for minors are not bare trusts.

'the opportunities to demonstrate knowledge in this area will certainly add value to your business'

what has changed?

It appears that HMRC Solicitors believe that there are two hurdles that need to be overcome in clarifying what is, or is not, a bare trust. The first point relates to trust income and the second point relates to the beneficiary's ability to demand satisfaction of their interest.

HMRC have confirmed that their solicitors view is that where s31(2) Trustee Act applies, it is arguable that it would be a 'trust to accumulate the whole or part of any income' within s43(2) IHTA 1984. Even where s31 is not applied by the trust instrument, it seems that the solicitor's view is that, due to the legal incapacity of the minor, the beneficiary is unable to demand satisfaction of their interest in the income and thus the income would still in fact need to be accumulated.

It is worth noting that the Life Offices Association (the predecessor of the Association of British Insurers) corresponded on a related subject with the Inland Revenue some 30 years ago. LOA asked for the Revenue's view on whether a gift to an absolute trust for a minor could qualify for the small gifts exemption, despite the requirement of what is now s20 IHTA 1984 that it is only available for outright gifts. They responded that they would not 'take the point'. HMRC do not seem to be changing their approach in this area, which is welcome, but somewhat confusing.

what could this mean to you and your clients?

If HMRC guidance confirms their current thinking a bare trust created for a minor would be deemed a CLT and would potentially suffer entry, exit and ten yearly periodic charges. Using a bare trust would normally avoid these tax charges - but at the cost of flexibility for the trustees. The irony here is that clients have potentially sacrificed the flexibility, but will still have to pay the tax. Another anomaly is that if the minor is domiciled in Scotland they acquire legal capacity at age 16, whereas a minor domiciled in England does not do so until age 18.

Following HMRC's 'view', expressed in ABI circular TDG 1/07, HMRC has made further statements confirming that this is the basis of their legal advice, but that it *may not* be the final outcome. HMRC are still considering before issuing final guidance on this matter and until the position is known it is best to err on the side of caution.

As we approach tax-year end, the first anniversary of BN25 and another Budget, the fall-out from the Government's ill considered changes is still having an impact. Nevertheless, the opportunities presented by all of these changes to demonstrate knowledge in this area will certainly add value to your business and save a lot of tax for your clients where trusts are involved in the advice process.

what are the practical consequences of this uncertainty?

There are two main issues that you and your clients need to address.

- What disclosure is required?
- Should tax be paid?

The IHT100 forms do not need to be received until 12 months after the gift - but tax due must be paid within six months. The two questions above highlight the real issues which could now arise. However, if the gift is below the NRB, and no CLTs have been made in the preceding seven years, then there will be no IHT entry charge to pay.

HMRC has yet to state when the reporting thresholds will be extended from the current £10,000 to a more realistic six figure sum, so it might be worth holding off reporting until as late as possible. As ever we will keep you updated in future issues of **informer** and the **informer e-newsletter**.

*Source: HMRC 'Rules for Trusts Q&A', 2006.

This document is based on Skandia's interpretation of the law and HM Revenue & Customs practice as at 31 January 2006. We believe that interpretation is correct, but cannot guarantee it. Tax relief and the tax treatment of investment funds may change.

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