



TAX PLANNING THROUGH TRUSTS OR ALTERNATIVE STRUCTURES

EXPLORING THE ESSENTIALS

TRAPS TO AVOID

Overview

1. This lecture attempts to pinpoint the principal dangers when arranging a person's assets in a manner designed to take them out of that person's estate whilst retaining some or all of the benefits of those assets.
2. Most of the topics are understood in the context of trusts and indeed are aimed at planning of this kind. However, most are also applicable to other arrangements and so remain "traps to avoid" in this kind of planning

Topics

3. These notes cover:
 - *Gifts with Reservation*
 - *Pre-Owned Assets*
 - *Capital Gains and Income Tax "settlor interested" settlements*

GIFTS WITH RESERVATION

4. A gift with reservation exists where:

"An individual disposes of any property by way of gift and either:

- (a) possession and enjoyment of the property is not bona fide assumed by the donee at or before the beginning of the relevant period; or
- (b) at any time in the relevant period the property is not enjoyed to the entire exclusion, or virtually to the entire exclusion, of the donor and of any benefit to him by contract or otherwise;

and in this section "the relevant period" means a period ending on the date of the donor's death and beginning seven years before that date or, if it is later, on the date of the gift."

5. Where property is subject to a reservation it is property that the donor is "treated for the purposes of the 1984 Act as property to which he was beneficially entitled immediately before his death"
6. The concept of GWRs is not aimed solely at settlements or trusts and so is not dependent upon the definition of a settlement or of an "arrangement" (contrast CGT and IT "settlor interested" settlements). This means that any property that is not "fully" given away can be the subject of a gift with reservation.



7. The key to identifying whether a GWR exists is to identify the property that is the subject matter of the gift because only then can it be considered whether the donor has reserved a benefit in it. For example:
 - A donor who gives away 50% of land to a trust whilst retaining the other 50% has not thereby created a settlement (see the definition in IHTA 1984 s 43(2)(3)) and neither is there a GWR because of the retained ownership.
 - Provided he enjoys no benefit from the land given away (e.g. by living in the property) there is no GWR.
8. That has important implications for gifts into trust. In particular:
 - A gift into a settlement in which the donor retains an interest for life or for a lesser period is not a gift with reservation because it is a gift only of the residue (see Simon's Para I3.416).
 - Similarly, a settlement for life where the donor reserves the right to the remaining capital is not a reservation of benefit in the life interest, see IHTM 14392.
9. Assuming that the property has been given away in such a way that the donor might be taken to have reserved an interest or enjoyed some interest it is necessary to consider whether that has happened. This is essentially a two stage process. The first question is whether the form of the gift means that the donor has some interest that prevents the donee enjoying the property to his/her exclusion. The second question is whether the donor has actually been so excluded. The reason for the second question is that the GWR legislation does not depend solely upon the strict terms of the trust but upon the actual position "on the ground".
10. That raises quite difficult questions in the case of settlements and obliges donors and trustees to be very vigilant. A discretionary settlement in which the donor is a beneficiary of the settlement is a clear example of a reserved interest and will lead to a GWR. There are, however, a number of more difficult (and more contentious) circumstances where the donor may, without being a beneficiary, find that the Revenue claim that an interest has been reserved. In particular:
 - The possibility of the donor being added as a beneficiary or receiving a benefit in some other way (e.g. occupation of trust property) is very likely to amount to a reservation of interest. This makes "excluded beneficiary" clauses very important.
 - The fact that the settlor (or his spouse) is a trustee of the settlement is immaterial because they are bound by their fiduciary duties (IHTM 14394).
 - Benefit (or possible benefit) by a spouse is a very difficult issue. Prima facie, the fact that a spouse receives a benefit is not a reservation of benefit. However, there is the clear possibility of the donor receiving a benefit indirectly as a result of this gift and this means that care will be needed in monitoring how trust distributions are actually made. HMRC say that if any benefit is "shared by the donor" a GWR will exist (IHTM 14339) although it is not clear what such "sharing" will amount to.
 - Where shares of a company are given to a settlement it will be necessary to consider how the company is actually operated. If the company is controlled by the trust's voting interests a directorship in favour of the donor raises clear issues, as do non commercial loans or other benefits in their favour. In respect of directorships HMRC say that they will consider whether the director's fees are part of a "commercial arrangement" (IHTM 14395), i.e. whether or not the settlor is being paid normal fees and in a normal way for work actually done for the company. In practice this may be very difficult to determine.



Settlements. PETs and IIPs

11. A settlement for IHT means:

"any disposition or dispositions of property, whether effected by instrument, by parol 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 (otherwise than for full consideration in money or money's worth paid for his own use or benefit to the person making the disposition) with the payment of any annuity or other periodical payment payable for a life or any other limited or terminable period..."

Unlike other definitions this is (more or less) expressed in terms of a trust so that other arrangements (e.g. companies and partnerships) will not fall easily within it.

12. Prior to the FA 2006 it was possible to create lifetime IIPs with the result that the person with the IIP was treated as if he owned the property. Thus the donor could:

- Give property to a settlement where a third person had an IIP. That would be a PET by the donor and the property would be treated as part of the estate of the third party.
- Give property to a settlement in which he retained an IIP. That was a "nothing" for IHT since it continued to be treated as within the donor's estate.

In that way property within a settlement might never enter the relevant property regime. For example, if in either of the above cases the beneficiaries on the cessation of the IIP were entitled absolutely the settlement would end once the IIP did.

13. The FA 2006 made it impossible to create qualifying interests in possession in lifetime settlements. Thus, following the Finance Act 2006 a lifetime gift into trust is either:

- An absolute gift and so a PET. To be a PET the gift must be absolute, i.e. the donee must receive the property for himself and without conditions (although it is possible for a donee to receive a share or a part of the gift without it being a settlement).
- A settlement and so a chargeable transfer.

14. Thus, the effect of removing the possibility of creating an interest in possession is to make it much harder for a donor to make a gift into trust:

- (a) with conditions that will nevertheless be treated as an absolute gift (a PET); or
- (b) whilst retaining an interest so that the property is treated (intentionally or not) as remaining within his estate (a "retained" IIP).



GWR and Settlements

15. A chargeable transfer may cause no immediate payment of IHT if it, together with other chargeable transfers does not exceed the donor's nil rate band. So there will be instances where it is better for the gift to be a chargeable transfer rather than remaining within a "retained IIP".
16. The absence of qualifying IIPS therefore makes the GWR considerably more important in the context of settlements. In the above example, Tim is not treated as owning the property because he has a IIP but it will be taxed as part of his estate if his interest is a GWR.
17. It also needs to be remembered that, unlike IIP settlement, the GWR has no other tax effect. So a home given away whilst the donor remains living in it is treated as the property of the donor whilst he/she lives in it but as the donee's for CGT purposes - meaning PPR is not available.

Double Charges Relief

18. A transfer into a relevant property settlement will be an immediately chargeable transfer and there will be exit and ten year charges. If the donor has reserved a benefit then it will at the same time be treated as being comprised in his estate. The GWR legislation does not prevent the relevant property rules applying, as the IIP rules did.
19. Thus, there may be a charge both on the transfer into the settlement and on the donor's death. Moreover, if the donor's death causes the property to cease to be settled there will be a charge both under the GWR provisions and the relevant property provisions.
20. These double charges are mitigated by the double charges regulations, although these (unsurprisingly) ensure that HMRC gets the highest available charge. Essentially two calculations are made, one with the chargeable transfer and ignoring the GWR and one with the GWR and ignoring the chargeable transfer. HMRC takes the highest sum. If the latter HMRC gives credit for any tax paid in the donor's lifetime for the chargeable transfer.

GWR and Terminations of IIP

21. The GWR provisions apply to "gifts". Thus, the legislation cannot apply to any transaction that does not take the form of a gift. The most commonly used instance was that of the termination of an interest in possession
22. HMRC clearly felt that the above example was "unacceptable" tax avoidance and so have now closed the "loophole". The new section 102ZA FA 1986 says:

"(1) Subsection (2) below applies where:

- (a) an individual is beneficially entitled to an interest in possession in settled property,
- (b) either:
 - (i) the individual became beneficially entitled to the interest in possession before 22nd March 2006, or
 - (ii) the individual became beneficially entitled to the interest in possession on or after 22nd March 2006 and the interest is an immediate post-death interest, a disabled person's interest or a transitional serial interest, and
- (c) the interest in possession comes to an end during the individual's life.



(2) For the purposes of:

- (a) Section 102 above, and
- (b) Schedule 20 to this Act,

the individual shall be taken (if, or so far as, he would not otherwise be) to dispose, on the coming to an end of the interest in possession, of the no-longer-possessed property by way of gift.

(3) In subsection (2) above "the no-longer-possessed property" means the property in which the interest in possession subsisted immediately before it came to an end, other than any of it to which the individual becomes absolutely and beneficially entitled in possession on the coming to an end of the interest in possession.

23. The result is that where an interest in possession is terminated but the person with that IIP retains some interest in the settlement, or continues to benefit from the property that was in the settlement, they will have a GWR.

24. The legislation applies only to the specific loophole. It remains the case that an arrangement that can be described as not being a gift will not be caught by the GWR legislation.

GWR and Foreign Settlements (Excluded Property)

25. Foreign property that is placed into a settlement whilst the settlor is non-UK domiciled is excluded property and the settlement is known as an excluded property settlement. The settlement will continue to be an excluded property settlement even if the settlor subsequently becomes UK domiciled. This is therefore a common way for wealthy persons coming to the UK to ensure that their foreign assets are beyond the reach of UK IHT.

26. Clearly, if the settlor can be said to have reserved a benefit in the settlement and so be taxed as if the property were in his estate that will have a significant impact upon the above. The position was reasonably simple, but has become rather confused:

- In correspondence with the Law Society in 1986 HMRC confirmed that the excluded property rules "trumped" the reservation of benefit rules so that a settlement in foreign property in which the settlor retained a benefit was not taxable provided the settlor was non-uk domiciled when the settlement was created.
- It is pretty clear, therefore, that where a settlor dies with a reservation of benefit in an otherwise excluded property settlement there will not be an extra charge on the settlement.
- However, the HMRC manual (IHTM 14396), whilst saying this, gives an example that is precisely the opposite:

"The donor, who is domiciled in Australia, puts foreign property into a discretionary trust under which he is a potential beneficiary. He dies five years later domiciled in the UK and without having released the reservation. The property is subject to a reservation and is therefore deemed to be part of the donor's death estate. Refer any cases where this is the situation to Litigation"

- In the above example HRMC are probably bound by their earlier correspondence and they seem to have said so. However, the manual also includes an example where the reservation ceases during the settlor's lifetime:

"However, had the donor in the above example attained UK domicile after the gift and then released the reservation during his lifetime, it is arguable that the release would have been a PET, chargeable on the death within seven years. In effect,



the property ceased to be excluded property at the time the reservation was released. The release would thus have triggered a charge which would not have arisen had the release not been made"

- Ominously:

"Refer any case where you consider that there is such a charge, or any enquiries about the possibility of a charge, to Litigation."

27. It is pointed out in Chamberlain and Whitehouse's book that the exclusion of a donor from benefit includes every capital distribution from the trust to a person other than the donor, so potentially meaning that every distribution made after the donor acquired a UK domicile will become chargeable.

PRE-OWNED ASSETS

28. If the donor has successfully avoided a gift with reservation it remains possible that he will be subjected to a charge to income tax under the pre-owned asset legislation.
29. The POA charge has heads of charge: land, chattels and "intangible property comprised in settlement where the settlor retains an interest". These heads of charge are all distinct and intangible property is defined to mean "any property other than chattels or interests in land".

Land

30. Land has the same meaning as in the IHTA 1984. The definition in the IHTA 1984 states that land "does not include any estate, right or interest or right by way of mortgage or other security".
31. The charge applies where an individual ("the chargeable person") occupies any land and where either the disposal condition or the contribution condition are met as respects that land (FA 2004 Sched 15 para 3(1)).
32. There is no definition of occupation. It is expected to be interpreted as meaning physical occupation. It will apply to any occupation and there is no de minimis exception, so even occupation through the storage of items may fall within it. Notwithstanding this the Revenue Technical Guidance suggest that they will ignore some limited examples of occupation or use, such as limited social visits or temporary stays.
33. The disposal condition is that:
 - At any time after 17 March 1986 the chargeable person owned an interest in the land occupied ("the relevant land") or in other property the proceeds of the disposal of which were (directly or indirectly) applied by another person towards the acquisition of an interest in the relevant land; and
 - The chargeable person has disposed of all, or part of, his interest in the relevant land or the other property, otherwise than by an excluded transaction. (Para 3(2)).

A disposition which creates a new interest in land out of an existing land out of an existing interest in land is to be taken to be a disposal of part of the existing interest.



34. The contribution condition is that at any time after 17 March 1986 the chargeable person has directly or indirectly provided, otherwise than by an excluded transaction, any of the consideration given by another person for the acquisition of (a) an interest in the relevant land, or (b) an interest in any other property the proceeds of the disposal of which were (directly or indirectly) applied by another person towards the acquisition of an interest in the relevant land.

35. The charge applies by treating an amount equal to the "chargeable amount" as income of the chargeable person, chargeable to income tax (para 4(1)). The chargeable amount is based upon the appropriate rental value which is determined using the following formula:

$$\frac{R \times DV}{V}$$

R is the rental value of the land during the year of assessment or the part of a year of assessment where the conditions for charge are met. **DV** is the value of the land disposed of, or such part of it as can reasonably be attributed to the property originally disposed of or to the consideration provided by the chargeable person. **V** is the value of the relevant land at the valuation date.

36. In other words, the chargeable amount is a proportion of the property's rental value, that proportion being determined by the extent of the person's former ownership or contribution.

Chattels

37. Chattel means any tangible movable property other than money. It will therefore include a valuable painting or car but will not include a bank account.

38. The charge applies where the individual ("the chargeable person") is in possession, or has the use of, a chattel whether alone or together with other persons and the disposal or contribution condition is met as respect the chattel.

39. There is little assistance on the meaning of "possession and use". Examples of possession will include the hanging of a painting in the chargeable person's home and examples of use will include the driving of a car by the chargeable person. The Revenue Technical Guidance, as with land, states that it will ignore limited or occasional use and an example is given of a car used to give occasional lifts (less than three times a month) to the chargeable person in contrast to the chargeable person being taken to work every day in the car (part 4.6).

40. The disposal condition is that, at any time after 17 March 1986, the chargeable person had (whether alone or jointly with others) owned (i) the chattel or (ii) any other property the proceeds of the disposal of which were (directly or indirectly) applied by another person towards the acquisition of the chattel, and the chargeable person disposed of all or part of his interest in the chattel or other property otherwise than by an excluded transaction

41. A disposition which creates a new interest in land in a chattel out of an existing interest in a chattel is to be taken to be a disposal of part of the existing interest.

42. The contribution condition is that at any time after 17 March 1986 the chargeable person had directly or indirectly provided, otherwise than by an excluded transaction, any of the consideration given by another person for the acquisition of (a) the chattel, or (b) any other property the proceeds of the disposal of which were (directly or indirectly) applied by another person towards the acquisition of the chattel.



43. The charge applies by treating an amount equal to the "chargeable amount" as income of the chargeable person, chargeable to income tax (para 4(1)). The chargeable amount is based upon an "appropriate amount" which is based upon a notional rate of interest payable on the value of the chattel. So the appropriate amount is determined using the following formula:

$$\frac{N \times DV}{V}$$

N is the amount of the interest that would be payable for the taxable period if interest were payable at the prescribed rate on an amount equal to the value of the chattel at the valuation date. **DV** is the value of the chattel disposed of, or such part of it as can reasonably be attributed to the property originally disposed of or to the consideration provided by the chargeable person. **V** is the value of the chattel at the valuation date.

44. In other words, an amount of interest is calculated on the chattel's value and the amount subject to tax is then a proportion of that interest, that proportion being determined by the extent of the person's former ownership or contribution.

Excluded Transactions – Land and Chattels

45. The pre-owned asset charge applies to the extent to which the chargeable person meets the disposal or contribution condition in respect of the land occupied or the chattel possessed or used. Excluded transactions are disposals or contributions which are ignored for determining whether and to what extent the conditions are met. Different exclusions apply to the different conditions.

46. For the disposal condition there five excluded transactions:

- The "full consideration" exclusion, where the disposal, subject to any express reservations, was made on the terms of an arm's length transaction.
- A spouse exemption, where the disposal was to the chargeable person's spouse or civil partner.
- A disposal by way of gift in which the property became settled and the settlor or his spouse are beneficially entitled to an interest in possession.
- The disposal was for the maintenance of the family
- The disposal is an outright gift to an individual and is exempt by virtue of the provisions on annual exemptions and small gifts.

47. For the contribution condition the provision of consideration for the acquisition of any land or chattel will be an excluded transaction in five circumstances. These differ from the disposal condition above in that there is no full consideration exemption but there is a "seven year" exemption where the consideration constituted an outright gift of money by the chargeable person to the other person and was made at least seven years before the earliest date on which the chargeable person met the contribution condition.

Intangible Property and Settlor Interested Trusts

48. Intangible property means any property other than chattels or interests in land and so includes a wide range of assets, including shares, life assurance policies, bank accounts and money.

49. The charge on intangible property has no real similarity to the charge applied on land or chattels. In essence, it applies to intangible property held in a settlement in which, for income tax purposes, the settlor is treated as being interested and so is taxed upon the income thereof. An income tax charge is then applied on an amount of notional interest earned on the value of the property less any income or capital gains tax paid on that property.



50. In order for the charge to apply the following conditions need to be met:

- The terms of the settlement, as they affect any property comprised in it, are such that any income arising from the property would be treated by virtue of section 624 of ITOIA 2005 as income of a person who is for the purposes of Chapter 5 of Part 5 of that Act as the settlor. Section 624 of ITOIA 2005 treats income as the income of a settlor when the settlor has an interest in it and a settlor has an interest if there are any circumstances in which the property or any related property is payable to or for the benefit of the settlor or the settlor's spouse/civil partner or will or may become so payable. A settlor means any person by whom a settlement was made.
- Any such income would be treated even if section 625(1) of ITOIA 2005 did not include a reference to the spouse/civil partner of the settlor.
- The property in the settlement is or includes intangible property which is or represents property which the chargeable person settled or added to the settled property after 17 March 1986 ("the relevant property").

51. Where the charge applies an amount equal to the "chargeable amount" is treated as income of the chargeable person chargeable to income tax. The chargeable amount in relation to the relevant property is N minus T where:

N is the amount of the interest that would be payable for the taxable period if interest were payable at the prescribed rate on an amount equal to the value of the relevant property at the valuation date.

T is the amount of income tax or capital gains tax payable by the chargeable person in respect of the taxable period by virtue of various provisions of the Income and Capital Gains Tax legislation.

52. In other words, the intangible property is ascribed a value, on which interest is then charged. The sum for interest is reduced by any income or capital gains already paid on the property and the resulting sum is subjected to income tax.

53. There are no excluded transactions in respect of intangible property in settlor interest trusts.

Exemptions from Charge

54. As an income tax charge, the pre-owned asset charge applies to property that meets the relevant conditions whether or not it would form part of the person's estate for IHT purposes. The exemptions from charge are the means by which the charge is "pegged" to the IHT regime. They work by excluding property that would be subject to the charge if and to the extent that the property, or property which derives its value from the property and is not substantially less in value than the property, forms part of the chargeable person's estate or would fall to be so treated by reason of the GWR rules.

55. The exemption includes property that would form part of a person's estate by reason of the GWR rules but for subsection (4) of paragraph 102B of the FA 1986. That exemption applies where the donor disposed by way of gift of an undivided share of an interest in land and shares occupation of the land with the donee without receiving any benefit provided by or at the expense of the donee for some reason connected with the gift

56. The exemption also applies where property would form part of a person's estate by reason of the GWR rules but for the exemption in section 102C(3) and para 6 of Schedule 20 of FA 1986. This applies where the property is occupied by the donor following an unforeseen change in circumstances.



De Minimis Exception

57. No charge to income tax arises where, in any year of assessment, the aggregate of, in the case of land, the rental value of the land or in the case of chattels and intangible property the chargeable amount does not exceed £5,000. Once the value is exceeded tax is charged on the whole sum, there is no nil rate band.
58. The legislation includes no provision for discounting or ignoring occupation, possession or use that is de minimis or limited in extent. Once property is occupied, possessed or used the whole of the property, to the extent that it meets the disposition or contribution condition, is subjected to the charge.

Electing into GWR

59. It is possible for any person to whom the income tax charge applies to elect that the property to which the pre-owned asset charge applies shall not fall be subject to that charge but shall be treated as property subject to a gift within reservation, so that it is treated as property to which he is beneficially entitled to on his death and if at any time the reservation ceases he will be treated as having made a potentially exempt transfer of the property.
60. The use of the election has a particular peculiarity in that the person who acquires a greater liability for tax has no say in its making. The effect of the election is to make inheritance tax payable in respect of the relevant property and the person who is primarily liable for that tax is the owner of the property. The election, however, is made not by the owner but by the individual, who is being charged income tax. No consent is required from the owner of the property..

SETTLOR INTERESTED

Capital Gains Tax

Implications – UK Resident Settlements

61. The definitions of a "settlor interested" trust are different for capital gains tax and for income tax and a trust may be settlor interested under either definition whilst there is no reservation of benefit (typically where the settlor has not interest but his wife or children do).
62. Prior to the "flat" 18% rate the principal implication of a trust being settlor interested was that gains would be chargeable to the settlor and taxed at his highest "slice" of gains. Those provisions will be abolished by the Finance Bill so for the future gains will be charged on the trustees irrespective of an interest in the settlor, unless received by the settlor as a beneficiary.
63. This will still leave the unavailability of hold over relief for settlor interested settlements.
64. It is perhaps also worth bearing in mind that any alteration in the flat rate of tax would presumably bring the old provisions back, in some form or another. Therefore, when drafting any settlement it will still be worth having an eye on the old rules.

Definitions

65. A settlor is defined, for the purposes of section 77 and 78 by section 79(1) "a person ... in relation to a settlement if the settled property consists of or includes property originating from him" and references to property originating from a settlor are references to "property which the settlor has provided directly or indirectly for the purposes of the settlement, property



representing that property, and so much of any property which represents both property so provided and other property as, on a just apportionment, represents the property so provided" (s79(3)).

66. In addition there is a definition, in section 68A, of a settlor, which applies where "the context otherwise requires". This is:

(1) In this Act, unless the context otherwise requires:

(a) "settlor" in relation to a settlement means the person, or any of the persons, who has made, or is treated for the purposes of this Act as having made, the settlement, and

(b) a person is a settlor of property which:

- (i) is settled property by reason of his having made the settlement (or by reason of an event which causes him to be treated under this Act as having made the settlement), or
- (ii) derives from property to which sub-paragraph (i) applies.

(2) A person is treated for the purposes of this Act as having made a settlement if:

(a) he has made or entered into the settlement, directly or indirectly, or

(b) the settled property, or property from which the settled property is derived, is or includes property of which he was competent to dispose immediately before his death, and the settlement arose on his death, whether by will, on his intestacy, or otherwise.

(3) A person is, in particular, treated for the purposes of this Act as having made a settlement if:

(a) he has provided property directly or indirectly for the purposes of the settlement, or

(b) he has undertaken to provide property directly or indirectly for the purposes of the settlement.

(4) Where one person (A) makes or enters into a settlement in accordance with reciprocal arrangements with another person (B), for the purposes of this Act

(a) B shall be treated as having made the settlement, and

(b) A shall not be treated as having made the settlement by reason only of the reciprocal arrangements.

67. The lengthy definition is not obviously different from the rather shorter one in section 79(1).

68. A settlor is interested in a settlement if:

- Any property which may at any time be comprised in the settlement, or any derived property, is or will, or may become, payable to or applicable for the benefit of the settlor, his spouse, civil partner or dependent children in any circumstances whatsoever; or
- Any of the settlor, spouse, civil partner or dependent children enjoys a benefit deriving indirectly or directly from the property which is comprised in the settlement or from any derived property.



- Note that the first condition is to do with the terms of the settlement whereas the second is concerned with actual benefit from property within the settlement.
- The first condition does not apply if dependant living children are excluded (from April 06), the settlor and the settlor, spouse and dependent children enjoy no actual benefit and either:
 - (a) the property can become payable or applicable for the benefit of the spouse/civil partner in the event of bankruptcy/ assignment/ death of parties to a marriage settlement or death of a child who became beneficially entitled while aged not over 25; or
 - (b) some person is alive and under the age of 25 and during his life any property cannot become payable or applicable for the benefit of the settlor or his spouse except in the event of that person becoming bankrupt or assigning or charging his interest in the property.

Deeds of Variation

69. Although deeds of variation (and disclaimer) are treated for IHT purposes and CGT as if the variation was contained in the deceased's Will/Intestacy a settlement created by the variation will nonetheless be regarded as settled by the person who would have otherwise received the varied legacy or benefit.

Holdover Relief and PPR

70. Hold over relief is not available if there is a disposal into any trust into which the settlor is interested.

71. Should a trust become settlor interested held over gains can be clawed back. There is reason to believe that this applies to all held over gain, including in respect of property in which the settlor is not interested or of which he is not the settlor.

72. If hold over relief is claimed it is not possible to claim main residence relief (TCGA s 226A).

Foreign Settlements

73. Where a settlement:

- Is one where the trustees are not UK resident or ordinarily resident;
- Is a "qualifying settlement";
- The settlor is interested in the settlement;
- The settlor is domiciled and either resident or ordinarily resident in the settlement

Chargeable gains accrue to the settlor and are treated as forming the highest part of the amount on which he is chargeable to gains for that year ("the settlor charge").

74. Following the revised treatment of residence and domicile the "beneficiary charge", whereby beneficiaries are charged for gains remitted to the UK, in section 87 TCGA is to be revised to include sums received by non-UK domiciliaries. However, the exemption for non-UK domiciled settlors will still apply to the section 86 "settlor charge".



Settlors

75. For foreign settlements a settlor is defined by Sched 5 paragraph 7 as "a person ... in relation to a settlement if the settled property consists of or includes property originating from him. However, the definition in TCGA 1992 s68A (above) apparently also applies (*Coombes v Revenue and Customs Commissioner* [2007] All ER(D) 324).

Qualifying Settlements

76. Since 1998 all non resident trusts are "qualifying settlements".

Settlor Interested

77. A settlor has an interest in a settlement if "relevant property" or "relevant income" is or will or may become applicable for the benefit of or payable to a "defined person" in any circumstances whatever or any defined persons enjoys a benefit directly or indirectly from any relevant property or relevant income.

78. Relevant property is property originating from the settlor and relevant income is income originating from the settlor.

79. The list of "defined persons" is now lengthy and arguably includes all the persons a settlor might reasonably wish to benefit with his/her money:

- (a) the settlor,
- (b) the settlor's spouse or civil partner;
- (c) any child of the settlor or of the settlor's spouse or civil partner (child includes stepchild);
- (d) the spouse or civil partner of any such child;
- (da) any grandchild of the settlor or of the settlor's spouse [or civil partner];
- (db) the spouse or civil partner of any such grandchild;
- (e) a company controlled by a person or persons falling within paragraphs (a) to (db) above;
- (f) a company associated with a company falling within paragraph (e) above.

80. However, the trust is not settlor interested if:

- The property can only become payable or applicable in the event bankruptcy/ assignment/ death of parties to a marriage settlement or death of a child who became beneficially entitled while aged not over 25; or
- Some person is alive and under the age of 25 and during his life any property cannot become payable or applicable for the benefit of the settlor or his spouse except in the event of that person becoming bankrupt or assigning or charging his interest in the property

Income Tax

81. Income tax is charged to settlors upon income of the trust:

- Where the settlor retains an interest;
- Where income is paid to relevant children of the settlor
- Where capital sums paid to the settlor are treated as income of the settlor under either ITOIA 2005 ss 633 and 641.



Settlor and Settlement

82. The definition of a settlement is very wide, "any disposition, trust, covenant, agreement, arrangement or transfer of assets".. A settlor means "any person by whom the settlement was made and includes a person who has provided funds directly or indirectly".

83. It is obvious that the definition is wider than merely trusts or similar arrangements. However, HMRC have expressed decidedly contentious views about what will and will not constitute an arrangement within it. Their numerous examples include gifts to spouses, partnerships, share issues and dividend waivers. This view has taken something of a knock following *Garnett v Jones* in the House of Lords ([2007] UKHL 35) but legislation is expected to reaffirm their view.

84. This means that many alternatives to trusts that might have been thought to avoid the problems created by the settlor interested legislation will in fact fall within it. It also means that some decidedly innocent arrangements will also be caught.

Settlor Interested

A settlor is treated as having an interest in property if there are any circumstances in which the property or any relevant property:

- Is payable to the settlor or the settlor's spouse or civil partner;
- Is applicable for the benefit of the settlor or the settlor's spouse or civil partner, or
- Will, or may, become so payable or applicable.

85. As for CGT the above does not apply if:

- The property can only become payable or applicable in the event of bankruptcy/ assignment/ death of parties to a marriage settlement or death of a child who became beneficially entitled while aged not over 25; or
- Some person is alive and under the age of 25 and during his life any property cannot become payable or applicable for the benefit of the settlor or his spouse except in the event of that person becoming bankrupt or assigning or charging his interest in the property.

Payments to Relevant Children

86. A relevant child means a minor child who is unmarried or not in a civil partnership. Any income paid to or for the benefit of the child is taxable as the settlor's alone. There is a limited exception for income under £100.

Capital Sums

87. These provisions essentially mean that (i) payments of capital made to a settlor will be taxed as if they were income if there were income of that amount available in the trust and (ii) payments of capital made by companies connected to the settlement to the settlor are also taxed as income of the settlor.