

Pilot trusts and S81 IHTA 1984 (Lecture P1288 – 19.22 minutes)

S81 IHTA 1984 is an anti-avoidance section which is headed 'Property moving between settlements'. The legislation prevents a person from obtaining a tax advantage by switching property between discretionary trusts. This is achieved by providing that such property remains comprised in the first trust. Accordingly, property cannot be moved out of a discretionary trust into another one with a different 10-year anniversary date with the intention of avoiding an imminent 10-year charge. Similarly, property cannot be transferred from a fund with a high cumulative total into a different fund with a much lower one.

Illustration

Gerald put property into a life interest trust for his children in June 2009, but the trustees have the power to transfer all or any of the fund into what the trust deed refers to as a 'qualifying settlement' (defined as any trust from which the children can benefit).

In October 2014, the trustees exercised this power and transferred the entire fund into a discretionary trust which Gerald had established in February 2002.

The transferred property is treated for IHT purposes as remaining comprised in the June 2009 settlement. Hence the first 10-year anniversary charge on it was in June 2019.

Note that there is no equivalent rule for other taxes which may therefore result in the transfer giving rise to a CGT charge. This CGT liability could not be held over unless the trust assets fall within S165 TCGA 1992. As a matter of trust law, the transferred assets merge with whatever property was already in the February 2002 settlement.

A potential problem for a wealthy client who has created a multiplicity of pilot trusts is that, once the main assets have been added to, say, the 20 trusts, there will be an ongoing requirement for 20 tax returns to be submitted each year and the trusts are likely to incur 20 sets of trust management expenses. These costs will undermine the IHT advantage of holding assets with 20 separate nil rate bands. By subsequently merging all the 20 trusts into a single global entity, the best of all worlds is achieved:

- one tax return will be needed on an annual basis and there will be a single set of running costs; but
- when an exit or a 10-year anniversary charge arises, the trustees will benefit from 20 nil rate bands.

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