

Planning with related settlements (Lecture P1394 – 20.08 minutes)

For IHT purposes, S62(1) IHTA 1984 confirms that trusts are treated as 'related settlements' if they:

- are made by the same settlor; and
- commence on the same day.

Note that it does not matter whether the trusts are discretionary or interest in possession settlements.

As an anti-avoidance measure, S66(4)(c) IHTA 1984 prescribes that, when determining the quantum of a 10-year anniversary charge, the initial value of any related settlement must be taken into account. By virtue of S68(5)(b) IHTA 1984, this is also the case when calculating an exit charge prior to a trust's first 10-year anniversary. The purpose of these provisions is to discourage the creation of two or more trusts simultaneously. This problem is easy enough to circumvent during someone's lifetime. However, if a testator establishes in his will a life interest trust for his brother and a discretionary trust for his grandchildren, the two trusts will be treated as related settlements under the IHT legislation.

In this context, the impact of S80 IHTA 1984 should not be overlooked. For example, if one of the two settlements is a life interest trust for the deceased's surviving spouse with remainder on a discretionary trust for their children, that trust is deemed to arise on the *termination* of the spouse's life interest. In other words, the two trusts will not have been created on the same day. However, for 10-year anniversary charge purposes, the surviving spouse's trust will still be deemed to commence on the date when the trust property was first settled (S61(2) IHTA 1984).

It is customarily argued that the deliberate creation of related settlements should, if possible, be avoided, given that the rules involve a 'sharing' of the IHT nil rate band.

Despite this, if the value of the intended trust property is likely to escalate over the next few years, there can be a useful advantage in deliberately creating, say, two or three discretionary trusts rather than just one. This has become of greater interest following the enactment of the anti-pilot trust legislation in 2015 (Ss62A – 62C IHTA 1984).

Example

Mark, whose cumulative IHT total stands at nil, wishes to settle property worth £240,000 on discretionary trusts.

Assume that, in 10 years' time, this property has quadrupled in value to £960,000 and that no distributions of capital (i.e. exit charges) have been made.

Using current lifetime rates, the IHT payable in connection with the first principal charge will be:

If one trust is created the IHT on £960,000 is:

	£
On 325,000 @ 0%	–
On 635,000 @ 20%	<u>127,000</u>
	<u>127,000</u>

This gives rise to an effective IHT rate of 13.229% ($127,000 / 960,000 \times 100$)

The IHT liability on the 10-year anniversary is £38,102 ($13.229\% \times 30\% \times 960,000$).

If two equal trusts are created, the chargeable 10-year anniversary amount in each case will be:

	£
Value of discretionary trust property	480,000
Add: Initial or historic value of related settlement	<u>120,000</u>
	<u>600,000</u>

The IHT on £600,000 is:

	£
On 325,000 @ 0%	–
On 275,000 @ 20%	<u>55,000</u>
	<u>55,000</u>

The effective IHT rate is 9.167% ($55,000/600,000 \times 100$).

The IHT liability for each trust is therefore £13,200 ($9.167\% \times 30\% \times 480,000$).

This makes a total sum payable of £13,200 + £13,200 = £26,400 compared with £38,102.

If three equal trusts are created, the chargeable 10-year anniversary amount in all three cases will be:

	£	£
Value of discretionary trust property		320,000
Add:		
Initial value of first related settlement	80,000	
Initial value of second related settlement	<u>80,000</u>	
		<u>160,000</u>
		<u>480,000</u>

The IHT on £480,000 is:

	£
On 325,000 @ 0%	–
On 155,000 @ 20%	<u>31,000</u>
	<u>31,000</u>

The effective IHT rate will be 6.458% ($31,000/480,000 \times 100$).

The IHT liability for each trust is therefore £6,198 ($6.458\% \times 30\% \times 320,000$).

This makes a total sum payable of £6,198 + £6,198 + £6,198 = £18,594 compared with £26,400.

The key point which makes the multi-trust arrangement work is that IHTA 1984 only requires the (lower) *initial value* of any related settlement to be taken into account rather than the current value of that trust property.

Contributed by Robert Jamieson