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1. The end of the road for pilot trusts?

(a) On 31 May 2013, HMRC published a consultation document entitled ‘Inheritance Tax: Simplifying Charges On Trusts – The Next Stage’. The main purpose of this paper was to outline ways in which 10-year anniversary and exit charge calculations for relevant property trusts (e.g. discretionary settlements) could be made more straightforward. As part of this process, HMRC proposed that the IHT nil rate band should be split equally between all relevant property trusts created by the settlor instead of continuing with the present system under which many settlements are entitled to a full IHT nil rate band of their own.

(b) This proposal was clearly intended to counter the established practice of setting up multiple pilot trusts to which substantial property would be added in due course – often on death – in order to minimise IHT charges on the trusts going forward. It should be noted that the Court of Appeal accepted such arrangements in *CIR v Rysaffe Trustee Company (CI) Ltd (2003)*. In addition, Para D26.6.1 of the GAAR Guidance confirmed that the use of pilot trusts was ‘not regarded as abusive’.

(c) However, the proposed idea did not go down well with most of the parties who commented on the document and when the notes from the 2013 Autumn Statement said:

‘The Government will consult on proposals to split the IHT nil rate band available to trusts with a view to delivering this change alongside simplification of the trust calculations in 2015.’

it was clear that some sort of rethink was in the offing.

(d) On 6 June 2014, there was an announcement of a further consultation document called ‘Inheritance Tax: A Fairer Way Of Calculating Trust Charges’. In effect, this was HMRC’s Plan B.

(e) The main details of this second proposal were that every individual would be entitled to a single ‘settlement nil rate band’ (SNRB) which was to be equivalent to the existing IHT nil rate band. Each settlor was responsible for deciding how this SNRB was to be shared between his trusts when it came to calculating the tax on a 10-year anniversary or exit charge in relation to those settlements. Broadly, this revised regime was only to apply to new trusts created on or after 7 June 2014 – thus trusts set up before 7 June 2014 were to be protected from these changes. Formal SNRB elections were needed which specified, in percentage terms, how much SNRB was to be allocated to each settlement.
Unfortunately, this plan, although in many respects a great deal more satisfactory than its predecessor, still did not find favour with the main professional bodies and other influential commentators. As a result, it also bit the dust and, on 3 December 2014, the Chancellor announced what became HMRC’s Plan C, the details for which were unveiled in the draft Finance Bill which followed the Autumn Statement. Although these provisions did not go into FA 2015, they can be found in Cl 11 and Sch 1 FB 2015.

The intention is to limit the advantages of multiple trusts by ensuring that, where value is added to two or more settlements simultaneously, the value of such additions will in future have to be taken into account for the purpose of calculating the IHT charges for 10-year anniversaries and exits. A new concept of ‘same-day additions’ has been introduced by S62A IHTA 1984. This occurs if the settlor of two or more settlements has added value of more than £5,000 to such trusts on the same day – note the special anti-fragmentation rule in S62B(3) and (4) IHTA 1984 to stop individuals avoiding the same-day addition provisions by transferring larger amounts to the trust, but in multiples of £5,000. Where this has happened in relation to taxable events arising on or after the date of Royal Assent to FB 2015 (expected to be towards the end of October 2015), the subsequently added value must be included in any trust tax calculation together with the initial value of the property in the other trust(s).

A comparison of the tax results under the current rules and under HMRC’s proposed alternative is set out below. The illustration looks at a 10-year anniversary charge and assumes that the present IHT rates and nil rate band remain in place for the time being.

**Illustration 1**

Christopher, whose cumulative total of chargeable transfers stood at £10,000, set up Pilot Trust A with £10 on 1 June 2015 and Pilot Trust B with another £10 on 2 June 2015. They are both discretionary settlements.

Christopher died on 1 January 2016 and his will instructed that £250,000 should be added to each trust.

When the first 10-year anniversary charge arrived in June 2025, the value of the property in each trust was:

<table>
<thead>
<tr>
<th>Trust</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trust A</td>
<td>£340,000</td>
</tr>
<tr>
<td>Trust B</td>
<td>£340,000</td>
</tr>
</tbody>
</table>
There have been no exit charges.

*Current rules*

The IHT payable in connection with the 10-year anniversary charge on Trust A is calculated as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Christopher's chargeable transfers prior to Trust A</td>
<td>£10,000</td>
</tr>
<tr>
<td>Add: Value of Trust A property on 1 June 2025</td>
<td>£340,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>£350,000</strong></td>
</tr>
</tbody>
</table>

IHT at lifetime rates on the value of Trust A’s property is:

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>On 10,000 – 325,000 = 315,000 @ 0%</td>
<td>£–</td>
</tr>
<tr>
<td>On 325,000 – 350,000 = 25,000 @ 20%</td>
<td>£5,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>£5,000</strong></td>
</tr>
</tbody>
</table>

Thus:

\[
\frac{5,000}{340,000} \times 100 = 1.471\%
\]

On the assumption that the 10-year anniversary charge is wholly ascribable to the addition on 1 January 2016 (ie. the initial value settled is ignored), the number of quarters taken is 40 less the number of complete successive quarters prior to the addition – this comes to two. And so the fraction becomes 38/40ths.

The rate of IHT actually charged is:

\[
1.471\% \times 30\% \times \frac{38}{40} = 0.419\%
\]

Therefore, the trustees of Trust A must settle a liability of 0.419% x £340,000 = £1,425.

The 10-year anniversary tax calculation for Trust B is taken to be the same, ie. another £1,425.
Proposed alternative

The IHT payable in connection with the 10-year anniversary charge on Trust A is calculated as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Christopher's chargeable transfers prior to Trust A</td>
<td>10,000</td>
</tr>
<tr>
<td>Add:</td>
<td></td>
</tr>
<tr>
<td>Value of Trust A property on 1 June 2025</td>
<td>340,000</td>
</tr>
<tr>
<td>Value of same-day addition to Trust B</td>
<td>250,000</td>
</tr>
<tr>
<td>Initial value of Trust B</td>
<td>10</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>590,010</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>£600,010</td>
</tr>
</tbody>
</table>

IHT at lifetime rates on the chargeable value for Trust A is:

<table>
<thead>
<tr>
<th>Description</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>On $10,000 - 325,000 = 315,000 @ 0%</td>
<td>–</td>
</tr>
<tr>
<td>On $325,000 - 600,010 = 275,010 @ 20%</td>
<td>55,002</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>£55,002</td>
</tr>
</tbody>
</table>

Thus:

\[
\frac{55,002}{590,010} \times 100 = 9.322\%
\]

Making a similar assumption to the previous calculation, the rate of IHT actually charged is:

\[
9.322\% \times 30\% \times \frac{38}{40} = 2.657\%
\]

Therefore, the revised liability for the trustees of Trust A is $2.657\% \times £340,000 = £9,034$, with the same sum being due from the trustees of Trust B, ie. a more than sixfold increase.

(j) It should be noted that, if either of the settlements can be classified as a ‘protected settlement’, the new regime is not in point. S62C IHTA 1984 defines a protected settlement as a trust which commenced before 10 December 2014 where either Condition A or Condition B is met. Condition A is that there have been no transfers of value by the settlor on or after 10 December 2014 as a result of which the value of the trust property has increased. Thus a pre-10 December 2014 settlement to which there have been no subsequent additions is not caught. Condition B is met if:
IHT AND RELEVANT PROPERTY TRUSTS

(i) there has been a transfer of value by the settlor on or after 10 December 2014 as a result of which the value of the trust property has increased; and

(ii) that transfer took place on the death of the settlor before 6 April 2017 and it represented a ‘protected testamentary disposition’ – this means that the terms of the settlor’s will (even if changed on or after 10 December 2014) were, in substance, the same as they had been immediately before 10 December 2014.
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2. How to calculate exit and 10-year anniversary charges

Illustration 2 (exit charge)

On 14 June 2006, Oliver transferred cash and quoted shares, worth a total of £150,000, to a discretionary trust which he was setting up for the benefit of his nephews and nieces. Prior to that date, his cumulative total of chargeable transfers had been £294,500, following a chargeable lifetime transfer in January 2000.

The IHT payable in connection with the creation of the trust (assumed to be paid by the trustees) was:

<table>
<thead>
<tr>
<th>Gross</th>
<th>IHT</th>
</tr>
</thead>
<tbody>
<tr>
<td>£</td>
<td>£</td>
</tr>
<tr>
<td>b/f</td>
<td></td>
</tr>
<tr>
<td>294,500</td>
<td>1,900</td>
</tr>
<tr>
<td>14.6.06</td>
<td></td>
</tr>
<tr>
<td>Discretionary trust</td>
<td>150,000</td>
</tr>
<tr>
<td>Less: Exemptions:</td>
<td></td>
</tr>
<tr>
<td>Annual (06/07)</td>
<td>(3,000)</td>
</tr>
<tr>
<td>Annual (05/06)</td>
<td>(3,000)</td>
</tr>
<tr>
<td></td>
<td>144,000</td>
</tr>
<tr>
<td></td>
<td>£438,500</td>
</tr>
</tbody>
</table>

The initial value of this trust is £150,000 – £28,800 = £121,200. In other words, it is the actual value of the property which started off within the discretionary trust regime. If, instead, Oliver had transferred land and buildings (worth £300,000) used by an unquoted trading company which he controlled, the calculation of the tax on this transfer would have been identical, after taking into account 50% business relief. However, the initial value of the trust would have been the much higher figure of £300,000 – £28,800 = £271,200.

On 22 April 2016, the trustees made an absolute appointment of quoted shares worth £200,000 in favour of Oliver's nephew, Patrick.

Patrick agreed to pay the tax which is computed as follows (using 2016/17 lifetime rates):

<table>
<thead>
<tr>
<th>Initial value</th>
<th>IHT</th>
</tr>
</thead>
<tbody>
<tr>
<td>£</td>
<td>£</td>
</tr>
<tr>
<td>b/f</td>
<td></td>
</tr>
<tr>
<td>294,500</td>
<td>–</td>
</tr>
<tr>
<td>121,200</td>
<td>18,140</td>
</tr>
<tr>
<td>£415,700</td>
<td>£18,140</td>
</tr>
</tbody>
</table>
This gives a rate of:

\[
\frac{18,140}{121,200} \times 100 = 14.967\% 
\]

The rate of tax actually payable is:

\[
14.967\% \times 30\% \times \frac{39}{40} = 4.378\% 
\]

Thus the IHT paid by Patrick amounts to 4.378\% \times £200,000 = £8,756.

Illustration 3 (10-year anniversary charge)

Queenie set up a discretionary trust on 20 May 2005 at a time when her cumulative lifetime total was £43,000. In the 10 years since then, the trustees have made capital appointments of trust property amounting to £170,000.

The first 10-year anniversary charge for Queenie’s discretionary trust arose on 20 May 2015 and the property still in the settlement on that date was worth £240,000. The IHT due in respect of this 10-year anniversary would be computed as follows:

\[
\begin{align*}
\text{Queenie’s chargeable transfers prior to trust} & : \quad 43,000 \\
\text{Add: Exit charges} & : \quad 170,000 \\
\text{Add: Value of discretionary trust property} & : \quad 240,000 \\
\hline
\text{Total} & : \quad £453,000 \\
\end{align*}
\]

IHT at 2015/16 lifetime rates on the value of this discretionary trust property is:

\[
\begin{align*}
\text{On } 213,000 - 325,000 = 112,000 & @ 0\% \quad - \\
\text{On } 325,000 - 453,000 = 128,000 & @ 20\% \quad 25,600 \\
\hline
\text{Total} & : \quad £25,600 \\
\end{align*}
\]

Thus:

\[
\frac{25,600}{240,000} \times 100 = 10.667\% 
\]

The rate actually charged is:
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10.667% x 30% = 3.2%

Therefore, the trustees must settle an IHT liability of 3.2% x £240,000 = £7,680. However, on 2 April 2016, the trustees make a further appointment of property worth £50,000. The rate of IHT ascribable to this transaction is:

3.2% x 3/40 = 0.24%

Thus the tax on the appointment (assumed to be payable by the beneficiary) will be 0.24% x 50,000 = £120.

Illustration 4 (added property)

Simon set up a discretionary trust on 16 August 2009 with cash of £750,000. He had a cumulative total for IHT purposes of £235,000 as a result of a chargeable transfer made in 2005.

On the assumption that no annual exemption was available, the IHT payable in connection with the creation of Simon’s discretionary trust (assumed to be payable by the trustees) was:

<table>
<thead>
<tr>
<th>Gross</th>
<th>IHT</th>
</tr>
</thead>
<tbody>
<tr>
<td>£</td>
<td>£</td>
</tr>
<tr>
<td>b/f</td>
<td>235,000</td>
</tr>
<tr>
<td>Discretionary trust</td>
<td>750,000</td>
</tr>
<tr>
<td>£985,000</td>
<td>£132,000</td>
</tr>
</tbody>
</table>

This calculation, using 2009/10 lifetime rates, runs as follows:

<table>
<thead>
<tr>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>On 235,000 – 325,000 = 90,000 @ 0%</td>
</tr>
<tr>
<td>On 325,000 – 985,000 = 660,000 @ 20%</td>
</tr>
<tr>
<td>£132,000</td>
</tr>
</tbody>
</table>

The remaining cash was then invested in a portfolio of quoted stocks and shares.

On 8 January 2017, when the settled property included 12,000 ordinary shares in Thomas plc, Simon added a further 120,000 ordinary shares in Thomas plc to the trust and paid the IHT himself. The IHT value for these quoted shares was then 300p per share.
The IHT payable in connection with this addition was (again no annual exemption was available):

<table>
<thead>
<tr>
<th></th>
<th>Gross</th>
<th>IHT</th>
<th>Net</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>£</td>
<td>£</td>
<td>£</td>
</tr>
<tr>
<td>b/f</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>8.1.17</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Discretionary trust (120,000 x 300p)</td>
<td></td>
<td>360,000</td>
<td></td>
</tr>
<tr>
<td>Grossed up</td>
<td>368,750</td>
<td>8,750</td>
<td></td>
</tr>
<tr>
<td></td>
<td>£368,750</td>
<td>£8,750</td>
<td>£360,000</td>
</tr>
</tbody>
</table>

**Note:** Simon’s earlier chargeable transfers have dropped out under the seven-year rule. His cumulative net transfer of £360,000 exceeds the 2016/17 nil rate band of £325,000 by £35,000, the gross equivalent of which is £35,000 x 100/80 = £43,750. The tax payable is therefore £43,750 – £35,000 = £8,750 and the gross chargeable transfer is £360,000 + £8,750 = £368,750.

On 1 May 2019, the trustees appointed 66,000 ordinary shares in Thomas plc (now valued at 360p per share) to Ursula absolutely. She was one of the discretionary beneficiaries and she agreed to pay any tax due.

The initial value of the property originally settled is £750,000 – £132,000 = £618,000. The initial value of the addition (which must also be taken into account when calculating the exit charge – see S68(5)(c) IHTA 1984) is £360,000. The exit charge tax is computed as follows:

<table>
<thead>
<tr>
<th></th>
<th>IHT</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>£</td>
<td></td>
</tr>
<tr>
<td>b/f</td>
<td>235,000</td>
<td>–</td>
</tr>
<tr>
<td>Initial value of settlement</td>
<td>618,000</td>
<td></td>
</tr>
<tr>
<td>Initial value of addition</td>
<td>360,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>978,000</td>
<td>177,600</td>
</tr>
<tr>
<td></td>
<td>£1,213,000</td>
<td>£177,600</td>
</tr>
</tbody>
</table>

The IHT at 2019/20 lifetime rates on the combined initial values is £177,600. This gives an initial rate of:

$$177,600/978,000 \times 100 = 18.16\%$$

To the extent that the exit charge comes out of the property originally settled, the initial rate is multiplied by 30% and then by the number of complete successive quarters which have elapsed since the start of the trust – this comes to 38 – divided by 40.
However, to the extent that the exit charge comes out of the addition, the number of quarters taken is 38 less the number of complete successive quarters prior to the addition – this comes to 29 – and so the fraction becomes 9/40ths.

The IHT payable on the distribution of 66,000 ordinary shares in Thomas plc (valued at $66,000 \times 360p = £237,600) to Ursula is:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Out of property originally settled</strong></td>
<td>£1,118</td>
</tr>
<tr>
<td>$18.16% \times 30% \times 38/40 \times 237,600 \times 12,000/132,000$</td>
<td></td>
</tr>
<tr>
<td><strong>Out of addition</strong></td>
<td>£2,648</td>
</tr>
<tr>
<td>$18.16% \times 30% \times 9/40 \times 237,600 \times 120,000/132,000$</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>£3,766</td>
</tr>
</tbody>
</table>

**Note:** The capital appointment to Ursula is deemed to come pro rata from the property originally settled on 16 August 2009 and from the addition on 8 January 2017.
3. Planning points

(a) Nil rate band trusts

Although the transfer of property to a discretionary trust will be a chargeable lifetime transfer rather than a potentially exempt transfer (PET), this fact is of little consequence if the amount settled does not cause the settlor’s nil rate band to be exceeded – no IHT will be due. If the settlor survives the seven-year waiting period, the transfer falls out of his cumulative total and this will have precisely the same effect as it would if the transfer were a PET. If he dies within seven years, IHT taper relief is of no benefit since it merely reduces the subsequent tax liability and not the value transferred. Thus nil rate band trusts are particularly suitable vehicles for assets such as land with development potential or shares in a new family company which currently have a low value but which are expected to grow appreciably over the next few years. If it is thought desirable, such a trust can always be broken just before the first 10-year anniversary at no IHT cost.

(b) Illustration 5

On 20 April 2015, Hazel, whose total of chargeable transfers is £60,000, settled shares in an unquoted trading company which were worth £250,000 on a discretionary trust for the benefit of her nephews and nieces.

The creation of this settlement is not a chargeable occasion because of the availability of 100% business relief. However, the initial value of the settled property is £250,000.

In the event of the trustees deciding to make an absolute appointment of these shares (now valued at £2,200,000) to one of Hazel’s nephews some eight years later, there will again be no IHT charge because the rate of tax which would be applied to this appointment is that produced by aggregating the initial value of the trust property with Hazel’s chargeable transfers made in the seven years prior to the settlement – this rate will be 0%. Even if it were not, there would still be no tax to pay as long as relief at 100% remained available.

(c) An added bonus of nil rate band trusts is that, under S260 TCGA 1992, holdover relief is available – because of this, discretionary trusts have been widely used for CGT deferral purposes.

(d) Illustration 6

Ian, who has made no chargeable transfers, has owned some shares in a quoted plc for a number of years. These shares are
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currently worth £300,000 and, if Ian sold them today, he would be liable to CGT on a gain of £220,000.

If Ian made an outright gift of these shares to his adult son, the transaction would rank as a PET and, provided that Ian survived the gift by seven years, it would be treated as a non-event for IHT purposes. Unfortunately, however, he would be unable to hold over the gain on this disposal and so there would be a substantial CGT bill to pay.

An alternative strategy is for Ian to establish a non-settlor interested discretionary trust and to transfer the plc shares into the settlement. Although this would be a chargeable transfer, there will be no IHT, given that Ian’s nil rate band has not been exceeded. In addition, the gain of £220,000 could be held over by making a claim under S260 TCGA 1992.

If, say, one year later, the trustees decide to appoint the shares, which are now valued at £360,000, to Ian’s son, there will be:

(i) no IHT to pay because the entry to the trust was zero-rated; and

(ii) no CGT to pay because a further holdover claim under S260 TCGA 1992 can be made.

As a result, the shares end up in Ian’s son’s hands, but without giving rise to either an IHT or a CGT charge. And there is no stamp duty either.

(e) Minimising IHT charges

One possible planning step which can be taken before a 10-year anniversary charge is to reinvest the trust funds in assets qualifying for 100% business or agricultural relief. This is not always a straightforward solution, given that it may involve realising gains on existing assets, and the qualifying period of ownership for the relevant relief must of course be observed. The alternative strategy of borrowing against the trust property and investing the borrowed funds in suitable exempt assets such as AIM shares has been stymied by the provisions in FA 2013.

(f) Where exit charges are concerned, it is instructive to compare the tax position of an exit charge before the first 10-year anniversary and an exit charge after a 10-year anniversary. With the former, let us suppose that a settlor puts relevant business property worth £2,000,000 into a discretionary settlement. There will be no entry charge because of the availability of 100% business relief. However, if, after seven years, the shares are sold for, say, £3,500,000 and the cash (net of any CGT liability) is then
distributed to one or more of the trust beneficiaries, there will be a
tax charge based on the trust's 'initial value', ie. £2,000,000. The
fact that the original settled property qualified for 100% relief is
neither here nor there.

(g) Contrast the position if the property remained in the trust and was
worth, say, £5,000,000 at the time of the first 10-year anniversary.
The IHT payable on that occasion would be nil because the trustees
will be entitled to 100% business relief. If the company was sold
two years later for, say, £7,200,000 and the sale proceeds (net of
CGT) were distributed in cash, the rate of tax on that capital
appointment would be 0% because, under S69 IHTA 1984, the tax
charge in these circumstances looks back to the rate paid on the
last 10-year anniversary.

(h) Planning with related settlements

It may still be appropriate to consider the possibility of using related
settlements, ie. settlements made on the same day by the same
settlor (S62(1) IHTA 1984), in a tax planning context. As an anti-
avoidance measure, the legislation prescribes that, when measuring
the chargeable value of any relevant property trust transaction, the
initial value of any related settlement must also be taken into
account (Ss66(4)(c) and 68(5)(b) IHTA 1984). Therefore, it is often
argued that the deliberate creation of related settlements should be
avoided. However, if the value of the intended trust property is likely
to escalate over the next few years, there can sometimes be an
advantage in consciously creating, say, two discretionary trusts
rather than just one.

(i) Illustration 7

Mark, whose cumulative total of chargeable transfers stands at nil,
wishes to settle property currently worth £200,000 on discretionary
trusts.

Assume that, in 10 years' time, this property is worth £760,000 and
that no distributions of capital have been made.

Using 2015/16 lifetime rates, the IHT payable in connection with the
10-year anniversary charge will be:

If only one trust is created

The effective rate will be:

\[
\frac{87,000}{760,000} \times 100 = 11.447\%
\]

The actual IHT liability is therefore:
If two equal trusts are created

The chargeable 10-year anniversary amount in each case will be:

\[
\begin{array}{l}
\text{£} \\
\text{Value of discretionary trust property} & 380,000 \\
\text{Add: Initial value of related settlement} & 100,000 \\
\hline
\text{£480,000} \\
\end{array}
\]

The effective rate will be:

\[
\frac{31,000}{480,000} \times 100 = 6.458\%
\]

The actual IHT liability for each trust is therefore:

\[
6.458\% \times 30\% = 1.937\% \times 380,000 = £7,361
\]

This makes a total sum payable of £7,361 + £7,361 = £14,722, compared with £26,098.

(j) Consecutive trusts

A variant on the situation illustrated above might be to create the two trusts on consecutive days. In these circumstances, the related settlement rules would not apply, but, when the trust created second was being taxed, the settlor’s previous cumulative total of chargeable transfers would be higher by the amount charged on the occasion of the first trust’s creation.

(k) Illustration 8

Applying this to Mark’s settlements, the 10-year anniversary charge for the first trust (now worth £380,000) would be computed as follows:

(i) The effective rate will be:

\[
\frac{11,000}{380,000} \times 100 = 2.895\%
\]

(ii) This gives an actual IHT liability of:
The 10-year anniversary charge for Mark’s second trust would have to take into account Mark’s cumulative total of £100,000 (it is assumed that no exemptions were available) following the creation of the first trust. Thus:

\[
\begin{align*}
\text{Settlor’s chargeable transfers prior to second trust} & \quad \mathbf{\£100,000} \\
\text{Add: Value of property on 10-year anniversary date} & \quad \mathbf{\£380,000} \\
\hline
\text{\£480,000} \\
\end{align*}
\]

Using 2015/16 lifetime rates, the IHT on £380,000 is:

\[
\begin{align*}
\text{On } 100,000 \text{ -- } 325,000 & = 225,000 \times @ \ 0\% & \quad \text{\£} \\
\text{On } 325,000 \text{ -- } 480,000 & = 155,000 \times @ \ 20\% & \quad \quad \quad \quad \quad \quad \quad \quad \text{31,000} \\
\hline
\text{\£31,000} \\
\end{align*}
\]

The effective rate is:

\[
\frac{31,000}{380,000} \times 100 = 8.158\%
\]

The actual IHT liability is:

\[
8.158\% \times 30\% = 2.447\% \times 380,000 = \mathbf{\£9,299}
\]

This makes a total sum payable of £3,302 + £9,299 = £12,601 (which is even lower than the tax liability in the previous illustration).

(l) Reversionary leases and settled property

The development of reversionary lease arrangements was closely associated with the IHT planning schemes which gave rise to *Ingram v CIR (1999)*. This case was won by the taxpayer in the House of Lords, but the then Chancellor promptly tightened up the reservation of benefit rules in FA 1999 and this was followed some years later by the pre-owned asset income tax legislation.

(m) Note that reversionary leases (like *Ingram* schemes) involve what is usually referred to as a shearing operation. Also, where residential property is in point, there are often CGT problems in the event of a sale of the property – hence these arrangements are best suited to
cases where it is envisaged that the property will be retained within the family and never sold.

(n) One difference is that, with Ingram, it was necessary first to carve out a lease and then to gift the encumbered freehold reversion, whereas reversionary lease arrangements represent a single-stage transaction merely requiring the grant of a lease.

(o) Nowadays reversionary lease arrangements commonly use commercial or industrial property. Consider the illustration below.

(p) Illustration 9

William has owned the freehold of a let commercial property for many years. It is currently worth £1,000,000. William, who is aged 72, would like to keep the rent for, say, the next 15 years but give away the capital value.

He therefore grants a reversionary lease (vesting after 15 years) to a settlement for his adult children. He retains the rent (given that he is the freeholder) and the property’s value on the transfer to the trust will be heavily depleted because of the deferral. The value settled, in these circumstances, is unlikely to be more than £325,000.

Because William has used a trust, CGT holdover relief under S260 TCGA 1992 will be available. And, by virtue of S102A(5) FA 1986, there should be no reservation of benefit given that William has owned the property for more than seven years.

(q) HMRC have confirmed that reversionary lease arrangements are still effective provided that the seven-year defence mentioned in (p) above is available (see Para IHTM44102 of the Inheritance Tax Manual).

(r) What about the pre-owned asset regime? The position here is that, if the property which is subject to the reversionary lease is occupied by the disponor, there will be a pre-owned asset charge. However, where the property is rented out (as is the case with William in (p) above), there is no charge – it is William’s tenant, and not William, who is occupying the property.