CHAPTER 10

ACCUMULATION AND MAINTENANCE TRUSTS

10.1 Definition

In this chapter we shall look at accumulation and maintenance trusts ("A&M" trusts) concentrating in particular on inheritance tax implications. Income tax and CGT on A&M trusts are covered in other chapters.

An A&M trust was a **special type of discretionary trust** which could have been set up before 22 March 2006. The definition of an A&M trust was contained in s.71 IHTA 1984.

IHTA 1984, s.71

For a trust to have qualified as an accumulation and maintenance trust, one or more of the beneficiaries must have become entitled either to an **interest in possession or to a share of the capital** of the trust **at an age not exceeding 25**.

Therefore under an A&M arrangement, at or before their 25th birthday, the beneficiary must either have become entitled to a share of the income of the trust, or must have received a distribution of the capital assets. The trust deed could have given the beneficiary a right to income or capital before his or her 25th birthday, but this **right to either income or capital could not have been deferred beyond 25**.

A&M trusts were **commonly set up by grandparents** as a means of conferring benefit on their grandchildren without giving those children an absolute right to income or capital until they are old enough, and responsible enough, to look after the property.

If the trust, created before 22 March 2006, failed to satisfy s.71 IHTA 1984, it was **not** be treated as an accumulation and maintenance trust and was instead treated as a **discretionary trust**. The effect of it being treated as a discretionary trust was to bring the settlement within the exit and principal charge regime.

10.2 Section 31 Trustee Act 1925

For trusts subject to English law, Section 31 of the Trustee Act 1925 is very important. Under s.31 TA 1925, a beneficiary of an A&M trust will **legally become entitled to an interest in possession at the age of 18 unless the trust explicitly states otherwise.**

For example, assume that a grandparent set up an A&M trust for his grandchildren, under which the beneficiaries become entitled to the capital of the trust at age 40. If the trust deed was silent on this point, Section 31 of the Trustee Act applied and the beneficiaries became **legally entitled to a share of the income of the trust at age 18**. TA 1925, s.31

If the settlor felt that aged 18 was too young for a beneficiary to become entitled to what could be a significant amount of income, S.31 could have been excluded such that the right to income was deferred until age 25.

If S.31 TA 1925 takes effect, the trust is a discretionary trust until the beneficiary reaches the age of 18 and thereafter effectively becomes an interest in possession trust until the beneficiary takes his share of the trust capital at age 40.

10.3 IHT effects

If a settlor wished to create an A&M trust **before 22 March 2006**, it was very important that the conditions of s.71 IHTA 1984 were satisfied because otherwise the settlor had created a discretionary trust.

The **advantage of an A&M arrangement** over a discretionary trust, was that on the **creation** of the trust the settlor made a **potentially exempt transfer** rather than a chargeable lifetime transfer. IHT would therefore only be charged if the settlor died within 7 years. IHTA 1984, s.3A

An A&M trust was a special sort of discretionary trust with IHT advantages. When **property left** an A&M trust, there was **no exit charge**. Therefore capital distributions may have been made to beneficiaries free of inheritance tax. Similarly there were **no principal charges** on A&M trusts. IHTA 1984, s.58(1)(b)

This has **changed from April 2008** as we shall discuss below.

10.4 Changes to A&M trusts from 6 April 2008

FA 2006, Sch 20 Para 3

Major changes were to be made to the IHT position of A&M trusts with effect from 6 April 2008.

No new A&M trusts can be created on or after 22 March 2006 and be given the IHT advantages previously offered by S.71 IHTA 1984.

If a settlor creates a trust after March 2006 which (for example) gives beneficiaries a right to income at 25 and a right to capital at 30, this will be treated as a **discretionary trust**.

Therefore the creation will be;

a) a chargeable lifetime transfer; and
b) the trust will be subject to exit and principal charges.

Between March 2006 and April 2008 A&M trusts had three choices;

1) **Do nothing** – in this case the trust **continued to be treated as an A&M trust until 6 April 2008**. At that point it fell into the discretionary trust regime. From April 2008, the trust assets are treated as "relevant property" and are subject to exit and principal charges. Trustees could have avoided this by distributing assets to beneficiaries and winding up the trust before 6 April 2008;

2) **Alter the terms of the trust** – if the terms of the trust were amended such that the **beneficiaries become entitled to the CAPITAL of the trust at age 18**, the trust will continue to be treated as an "old" A&M trust. Therefore there will be **no exit charge when capital is distributed** to the beneficiaries at age 18 or earlier (even if this is after April 2008). There will also be no principal charges.

3) **Alter the terms of the trust** – if the terms of the trust were amended such that **beneficiaries become entitled to the CAPITAL of the trust at age 25,** the trust will be treated like an "Age 18-to-25" trust. There will be limited exit charges when capital is distributed between the ages of 18 and 25. There will be no principal charges. We will look at "Age 18-to-25" trusts in Chapter 11.

The latter changes were the subject of much criticism from the professional bodies as it encouraged trustees to distribute potentially substantial assets to beneficiaries at an age when many may not be responsible enough to deal with them.

Many trustees therefore opted to do nothing and have accepted IHT charges post April 2008.

10.5 Calculating exit charges

Exit charges on capital appointments after April 2008 are computed as for discretionary trusts; i.e. based on:

i. the initial value of the trust;
ii. the initial value of a related trust;
iii. taking into account the settlor's transfers in the 7 years prior to creation.

However when calculating the number of completed quarters to arrive at the actual rate of tax we take: IHTA 1984, s.68(3)

i. the number of quarters that have elapsed between the date of commencement and the date of the exit charge; then

ii. deduct the number of quarters during which the trust assets have not been relevant property.

Therefore a distribution from an "old" A&M trust shortly after 6 April 2008 will give rise to a small actual rate (and a low IHT charge).

Illustration 1

Mr Smith created a qualifying A&M trust in June 2002 for his young grandchildren.

The trust provides for the beneficiaries to be given a right to income at age 21 and to capital at age 30. The assets settled in 2002 were cash and quoted securities worth £750,000. Mr Smith had made no previous transfers.

In July 2010, the trustees made a capital distribution of £100,000 to a beneficiary. The beneficiary met any IHT arising.

Calculate the IHT payable by the beneficiary on the capital appointment in July 2010.

Solution

The creation of the A&M trust in 2002 was a PET.

No lifetime tax was payable, therefore the initial value of the trust was £750,000.

Exit charge July 2010:

	£
Initial value	750,000
Less: nil band 2010/11	(325,000)
	425,000
Notional IHT @ 20%	85,000
Effective rate: $\frac{85000}{750000} \times 100$	11.333%
Actual rate: $11.333\% \times 30\% \times \frac{32 - 23}{40}$	0.765%
Exit charge: £100,000 x 0.765%	£765

W: Quarters June 02 – July 10 = 32
Quarters June 02 – April 08 = 23

10.6 Calculating principal charges

Principal charges are computed as for discretionary trusts; ie based on;

i. the current value of relevant property in the trust;
ii. the initial value of a related trust;
iii. taking into account the settlor's transfers in the 7 years prior to creation; and
iv. taking account of chargeable distributions out of the trust in the last 10 years.

Again, when calculating the number of completed quarters to arrive at the actual rate of tax we take: IHTA 1984, s.66(2)

i. the number of quarters that have elapsed between the date of commencement and the date of the principal charge (ie, 40);
ii. then deduct the number of quarters during which the trust assets have not been relevant property.

Illustration 2

Continuing from Illustration 1, the value of the trust assets in June 2012 is expected to be £1.2m.

Assume a nil band in 2012/13 of £325,000.

Calculate the principal charge in June 2012.

The answer is as follows:

	£	£
Value of trust in June 2012		1,200,000
Nil band 2012/13	325,000	
Less: trust distributions in last 10 years	(100,000)	(225,000)
		975,000
Notional IHT @ 20%		£195,000
Effective rate:		
$\frac{195000}{1200000} \times 100$		16.25%
Actual rate: $16.25\% \times 30\% \times \frac{40 - 23}{40}$		2.072%
Principal charge: 2.072% x £1.2m		£24,864

10.7 Exit more than 10 years after the commencement of the trust

As for discretionary trusts, this charge is based on the effective rate as at the most recent 10-year anniversary of the trust. IHTA 1984, s.69

However, this is not practical in situations where there was no principal charge levied at the time of the 10 year anniversary - i.e. where the 10 year anniversary fell before 6 April 2008 such that the trust assets were not relevant property at that point.

Therefore, in these instances, when calculating the effective rate at the 10-year anniversary, we use the **value of the trust assets at the date those assets became relevant property**. IHTA 1984, s.69(3)

Therefore we **value the trust assets as at 6 April 2008** (not at the date of the 10-year anniversary). This value is net of APR or BPR. No tax relief is available for any valuation costs incurred.

Quarters are again adjusted to deduct the number of quarters during which the trust assets have not been relevant property.

Illustration 3

Mr Brown created an A&M trust for his two grandchildren in December 1995 with cash of £500,000. Mr Brown's only previous chargeable transfer had been £144,000 to a discretionary trust in May 1993.

The trust provides for the beneficiaries to be given an interest in possession at age 25 and a right to trust capital at age 30.

The trusts assets were worth £800,000 in December 2005 and £900,000 in April 2008.

The trustees intend to make a capital distribution of £475,000 (then being 50% of the estimated value of the trust) on the occasion of the eldest beneficiary's 30th birthday on 31 January 2012.

Calculate the exit charge in January 2012.

There will be an exit charge in January 2012.

The exit charge is calculated in the same way as it would be for a discretionary trust, ie by reference to the effective rate as at the date of the principal charge.

The trust commenced in December 1995, so the first 10 year anniversary is December 2005. There was no principal charge in December 2005 as the trust assets were not within the relevant property regime at that point.

Therefore the effective rate is based on the value of the trust assets at the time those assets became relevant property (ie at **6 April 2008**). The trusts assets were worth £900,000 in April 2008.

The exit charge in January 2012 will be:

	£	£
Trust assets in April 2008		900,000
Nil band 2011/12	325,000	
Less: settlor's "clock" b/f	(144,000)	
Less: chargeable distributions in 10 years before December 2005	(NIL)	
		(181,000)
		719,000
Notional IHT @ 20%		143,800
Effective rate: $\frac{143800}{900000} \times 100$		15.978%
Actual rate: $15.978\% \times 30\% \times \frac{24 - 9}{40}$ (W)		1.797%
Exit charge: £475,000 x 1.797%		£8,536

(W) Quarters December 2005 - January 2012 24
Quarters December 2005 – April 2008 9

Note:

Where the 10 year anniversary **does** give rise to a principal charge, any subsequent exit charges will be based on the value of the trust at the principal charge date.

For example, assume an A&M trust was set up in 2001. The 10 year anniversary falls in 2011 (i.e. after April 2008) and a principal charge will arise. A capital appointment is made in 2013 giving rise to an exit charge. The exit charge will be calculated using the value of the trust at the date of the principal charge in 2011.

Example 1

Mr Brown created an A&M trust for his two grandchildren in December 1994. He had made no previous transfers.

The trust provides for the beneficiaries to be given an interest in possession at age 25 and a right to trust capital at age 30.

The trustees made a capital distribution of £495,000 on the occasion of the eldest beneficiary's 30th birthday on 31 January 2008.

The trusts assets were worth £875,000 in December 2004 and £500,000 in April 2008.

On 2 April 2012, the younger beneficiary will become 30 and thereby entitled to the remainder of the trust assets. The trust is expected to be worth £600,000 in April 2012.

Assume a 2011/12 nil band of £325,000.

Calculate the exit charge in April 2012.

Answer 1

Exit charge in 2010 based on the effective rate in December 2004. Effective rate calculated using the value of the trust as at 6 April 2008.

	£	£
Value at April 2008		500,000
Nil band 2011/12	325,000	
Less: Settlor's "clock" b/f	(nil)	
Less: chargeable distributions in the last 10 years	(nil)	
		(325,000)
		175,000
Notional IHT @ 20%		35,000
Effective rate $\frac{35000}{500000} \times 100$		7%
Actual rate: $7\% \times 30\% \times \frac{29 - 13}{40}$ (W)		0.84%
Exit charge: £600,000 x 0.84%		**£5,040**

(W) Quarters December 2004 – April 2012 29
Quarters December 2004 – April 2008 13

Note:
The transfer in January 2008 is not a chargeable transfer since it is before 6 April 2008.