

## CHAPTER 11

### OTHER TRUSTS FOR CHILDREN

#### 11.1 Definitions

There are two type of children's trust which have been given special inheritance tax treatment from 22 March 2006. These are:

- 1) trusts for bereaved minors; and
- 2) "Age 18-to-25" trusts.

##### *1) Trusts for bereaved minors*

[IHTA 1984,  
s.71A](#)

A trust for a bereaved minor is one in which property is either:

- (a) held on trust under the rules of intestacy; or
- (b) held on trust under the will of a deceased parent

for the benefit of a bereaved minor.

The terms of the trust must be that at the **age of 18** the bereaved minor will become **absolutely entitled to the trust property**, any income arising from it and any accumulated income. Until the beneficiary attains the age of 18, trust property may be applied by the trustees for the benefit of the bereaved minor.

A "bereaved minor" is a person who has not yet attained the age of 18 and at least one of whose parents has died. A parent includes a step parent.

[IHTA 1984,  
s.71C](#)

##### *2) "Age 18 to 25" trusts*

[IHTA 1984,  
s.71D](#)

An "Age 18-to-25" trust is one where:

- a) property is held on trust for the benefit of a person;
- b) who has not yet attained the age of 25; and
- c) at least one of whose parents has died.

The trust must be established under the will of a deceased parent (or step parent) of the beneficiary.

The terms of the trust must be that at the **age of 25** (at the latest), the beneficiary must become **absolutely entitled to the trust property**, any income arising from it and any accumulated income. Until the beneficiary attains the age of 25, trust property may be applied for the benefit of the beneficiary.

A trust cannot be an "Age 18-to-25 trust" if it falls within the definition of a trust for a **bereaved minor** or within the definition of an **immediate post death interest** (covered in the next chapter).

Either of these types of trust **can be created before or after 22 March 2006**. The IHT treatment simply depends on whether the trust satisfies the conditions set out in the legislation.

It may be possible for some pre-22 March 2006 trusts (e.g. "old" A&M trusts set up in the will of a parent) to be altered to come within the conditions, or such trusts may have been set up several years ago but now satisfy the conditions. We will consider this situation later on in this chapter.

### 11.2 Inheritance tax on trusts for bereaved minors

[IHTA 1984, s.71A](#)

The creation of a trust for a bereaved minor will be a **chargeable death transfer**.

Whilst the trust is in existence, there will be **no charge to inheritance tax**, for example there will be **no principal or exit charges**.

There will be **no IHT exit charge when property ceases to be held in the trust**, for example:

- (a) when the beneficiary attains the age of 18 or becomes entitled to trust property before that age; or
- (b) on the death of the bereaved minor before the age of 18; or
- (c) trust property being paid or applied for the benefit of the bereaved minor.

### 11.3 Inheritance tax on "Age 18 to 25" trusts

[IHTA 1984, s.71D](#)

The creation of an "Age 18-to-25" trust will be a **chargeable death transfer**.

Whilst the trust is in existence and the **beneficiary is under the age of 18 years**, there will be **no charge to inheritance tax**, for example there will be no principal or exit charges.

There will be no IHT exit charges when property ceases to be held in the trust **up to the beneficiary attaining the age of 18 years**.

If the trust continues **beyond the beneficiary attaining the age of 18**, there will be a **charge to inheritance tax** (an exit charge) on certain events.

However, "Age 18-to-25" trusts are **not liable to principal charges**.

Exit charges will arise on:

[IHTA 1984,](#)

- (a) the beneficiary becoming **absolutely entitled** to the trust property after age 18;
- (b) the **death** of the beneficiary, after age 18;
- (c) trust **assets being paid or applied** for the benefit of the beneficiary (i.e. a capital distribution) after the age of 18.

The amount of tax is:

$$\text{Chargeable amount} \times \text{Actual rate (\%)}$$

*Chargeable amount*

The "chargeable amount" is the "loss to the trust" on the event (after deducting any APR or BPR).

*Actual rate (%)*

We calculate the actual rate in a similar way to the way we calculate the actual rate for exit charges on discretionary trusts i.e.

$$\text{Effective rate} \times 30\% \times \frac{n}{40}$$

Where "n" = the number of complete quarters ending on the date of the chargeable event and beginning on the date when either:

- (a) the trust was created; or ) **whichever**
- (b) the beneficiary attained the age of 18 ) **is later**

The effective rate is calculated in the same way as for an **exit charge in the first ten years** of a discretionary trust.

The relevant proforma is reproduced below:

	£	£
Initial value of trust property		A
Initial value of related trust		<u>B</u>
		C
Nil band at date of exit charge	D	
Less: Settlor's chargeable transfer in 7 years before creation of trust	<u>(E)</u>	
Nil band remaining		<u>(F)</u>
		<u>G</u>
Notional IHT (G x 20%)		<u>NT</u>
Effective rate: = $\frac{NT}{C} \times 100$		<u>ER (%)</u>

**Illustration 1**

Andrew died on 31 May 2007. He had made chargeable transfers of £165,000 in the seven years before his death. The value of Andrew's estate at his death was £440,000 on which IHT of £122,000 was paid out of residue.

In his will he left his estate on trust for his son, James, (born on 1 August 1990). The terms of the trust are that James will receive the trust property absolutely at the age of 25.

On 1 August 2015, the value of the trust property will be £500,000.

**Assuming that the nil rate band in 2015/16 is £400,000, calculate the charge to tax when James reaches the age of 25.**

James becomes 18 on 1 August 2008. S.71D IHTA applies to the trust since it was created on 31 May 2007. The later of the two dates is therefore 1 August 2008.

He becomes 25 (and entitled to trust capital) on 1 August 2015.

There are 28 quarters between 1 August 2008 and 1 August 2015.

The calculation is:

	£	£
Initial value of trust property £(440,000 - 122,000)		318,000
Nil band at date of charge (2015/16)	400,000	
Less:		
Settlor's chargeable transfers in 7 years before death	<u>(165,000)</u>	<u>(235,000)</u>
		<u>83,000</u>
Notional IHT (83,000 × 20%)		<u>16,600</u>
Effective rate $\frac{16600}{318000} \times 100$		<u>5.22%</u>
Actual rate:		
$5.22\% \times 30\% \times \frac{28}{40}$		<u>1.096%</u>
Amount of tax is:		
£500,000 × 1.096%		<u>£5,480</u>

The maximum rate of tax that can apply to the chargeable amount is:

$$20\% \times 30\% \times \frac{28}{40} = 4.2\%$$

This is because property can only be held in an "Age 18-to-25" trust (after a beneficiary has attained the age of 18) for a **maximum of 7 years (28 quarters)**.

#### 11.4 Accumulation & maintenance trusts

Where an old A&M trust gives a beneficiary a right to the CAPITAL of the trust at age 25 or earlier, any exit charges after 5 April 2008 will be **computed using the rules for "Age 18-to-25" trusts**.

This treatment will be beneficial because:

- 1) exit charges are always calculated using the **initial value** of the trust assets when the trust was originally created (even if the trust is more than 10 years old at the date of the exit charge); and
- 2) there are **no principal charges** for "Age 18-to-25" trusts.

Before April 2008, A&M trustees could have amended the terms of the trust to give beneficiaries the right to capital at age 25 (or earlier). This would have brought these trusts within the Age 18-to-25 regime and reduced the future IHT exposure.

Remember that **not all A&M trusts gave a right to capital at age 25**. Some give an interest in possession at 25 and a right to capital at a later age.

Pre 2006 A&M trusts which satisfy the definition of an "Age 18-to-25" trust will come within s.71D from either:

- |  |   |                  |
|--|---|------------------|
| (a) the beneficiary attained the age of 18; or | ) | <b>whichever</b> |
| (b) 6 April 2008                               | ) | <b>is later</b>  |

Remember that any capital appointments from A&M trusts before 6 April 2008 were not chargeable to IHT.

#### Illustration 2

Jacob died on July 1997 leaving £1.2m on trust for his two children, Kirsten and Leo, in equal shares. The residue of the estate (£2m before tax) was left to his wife, Molly. IHT of £656,667 on the death estate was paid out of the residue. Jacob had made no lifetime transfers.

The terms on the trust are that each of the beneficiaries will become entitled to a half share in the trust assets at age 25. Kirsten was born on 1 January 1983. Leo was born on 1 August 1986. S.31 Trustee Act 1925 is excluded, so neither of the beneficiaries has a right to income until capital is distributed.

No capital distributions were made until such time as Kirsten became 25 in January 2008. The trust assets were valued at £1.4m at that point and a distribution of £700,000 (made up of cash and quoted shares) was made to Kirsten in January 2008.

It is anticipated that the remaining trust assets (cash and quoted shares) will be worth £850,000 in August 2011. The IHT nil band in 2011/12 will be £325,000.

**You are required to:**

- 1) Briefly explain the IHT implications of the above;
- 2) Calculate any IHT which will become payable by the trustees on Leo's 25<sup>th</sup> birthday;
- 3) Advise on any steps which could be taken to reduce any tax liabilities.

1)

The residue of the estate passing to Jacob's wife Molly was an exempt transfer for IHT.

The children's trust set up in Jacob's will was an accumulation and maintenance trust as the beneficiaries had either an IIP or a right to capital by age 25. The trust is therefore within S.71 IHTA 1984 until 5 April 2008, so the distribution to Kirsten in January 2008 did not give rise to an IHT exit charge. There was also no principal charge on the 10-year anniversary of the trust in 2007.

The remaining trust for Leo will satisfy the definition of an "Age 18-to-25 trust" (S.71D IHTA) from April 2008 because property is held on trust for the benefit of a person who not yet attained the age of 25.

2)

The distribution of assets to Leo on his 25<sup>th</sup> birthday in August 2011 will therefore give rise to an exit charge.

This will be calculated as follows:

	£	£
Initial value of trust property (7/97)		1,200,000
Nil band at date of charge (2011/12)	325,000	
Less:		
Settlor's chargeable transfers in 7 years before death.	<u>(NIL)</u>	<u>(325,000)</u>
		<u>875,000</u>
Notional IHT (£875,000 × 20%)		<u>175,000</u>
Effective rate: $\frac{175000}{1200000} \times 100$		<u>14.583%</u>
Actual rate:		
$14.583\% \times 30\% \times \frac{13}{40}$ (Note)		<u>1.4219%</u>
Amount of tax is:		
£850,000 × 1.4219%		<u>£12,086</u>

*Note:*

Period runs from 6 April 2008 (date S.71D started to apply) until 1 August 2011 (date of distribution).

$$6.4.08 - 1.8.11 = 13 \text{ quarters}$$

The quarters start to run from the date that S.71D starts to apply being 6 April 2008. Until 5 April 2008, the trust is an A&M trust, and is therefore subject to S.71 (not S.71D)

3)

Rather than waiting until his 25<sup>th</sup> birthday, the assets of the trust could be distributed sooner. This would reduce the number of quarters in the calculation of the actual rate of tax to apply to the asset.

**Example 1**

Julia died on 15 August 2009. She did not make a will. Her only living relative was her daughter, Lisa who was born on 13 January 1995. Julia's death estate is valued at £500,000.

**Which of the following statements is FALSE?**

- a) There will be no inheritance tax payable on Julia's death
- b) There will be no inheritance tax payable if Lisa dies in 2010.
- c) There will be no inheritance tax payable if the trustees advance capital to Lisa in 2011.
- d) There will be no inheritance tax payable when Lisa becomes absolutely entitled to trust property on 13 January 2013

**Example 2**

Emma died on 30 September 2009. In her Will, she left her entire estate on trust for the benefit of her son William absolutely at the age of 25. William was born on 2 July 1986.

Emma's chargeable estate was valued at £625,000. She made no lifetime transfers.

The trust assets will be worth £600,000 in July 2011.

**Calculate any IHT payable when William attains the age of 25. Assume an IHT nil band in 2011/12 of £325,000.**



**Answer 1**

The answer is A.

The creation of a trust for a bereaved minor is a chargeable death transfer.

The other events are all ones on which there is no inheritance tax payable under s.71B(2) IHTA 1984.

**Answer 2**

	£
Estate	625,000
Less: nil band 2009/10	<u>(325,000)</u>
Taxable	<u>300,000</u>
 IHT @ 40%	 <u>120,000</u>
 Initial value of trust property: £(625,000 - 120,000)	 <u>505,000</u>

The distribution of assets to William on his 25<sup>th</sup> birthday in July 2011 will therefore give rise to an exit charge.

This will be calculated as follows;

	£	£
Initial value of trust property		505,000
Nil band at date of charge	325,000	
Less:		
Settlor's chargeable transfers in 7 years before death	<u>(NIL)</u>	<u>(325,000)</u>
		<u>180,000</u>
 Notional IHT (£180,000 × 20%)		 <u>36,000</u>
Effective rate: $\frac{36000}{505000} \times 100$		<u>7.129%</u>
Actual rate:		
$7.129\% \times 30\% \times \frac{7}{40}$ (Note)		<u>0.374%</u>
 Amount of tax is:		
£600,000 × 0.374%		<u>£2,244</u>

*Note:*

S.71D applies from 30 September 2009 as this is an "Age 18-to-25" trust and William is over 18 at that point.

The quarters will run from 30.9.09 to 2.7.11, which is 7.