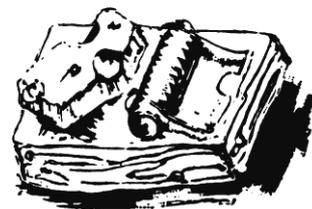


McKie & Co



Tax Trap: **SIMON McKIE**

The Sections 80 and 82 Anomaly

LT Excluded property; Inheritance tax; Life interests;
Trusts

A significant anomaly is identified and explored in the rules relating to trusts with an initial interest in possession for the settlor.

Section 80

Section 80¹ applies where a settlor or his spouse is beneficially entitled to an interest in possession in property immediately after it becomes comprised in a settlement. Where the section applies, the property is treated, for the purposes of Ch.III of Pt III, as not becoming comprised in a settlement at the time the trust is made but, rather, at the time when the property becomes held on trusts under which neither the settlor nor his spouse have an interest in possession. In that case it is treated as becoming comprised in a settlement (the Hypothetical Settlement) made by that one of them that was last entitled to an interest in possession in the property.

An “interest in possession” for this purpose is restricted to a “postponing interest” (an immediate post-death interest or a disabled person’s interest) but only if the first occasion on which the property became comprised in the settlement is on or after March 22, 2006.²

Section 82

Where s.80 applies, under s.82 the property will not be treated as excluded property unless the settlor of the actual settlement was not domiciled in the

¹ All references in this article are to Inheritance Tax Act 1984 unless otherwise stated.

² Section 80(4).

United Kingdom at the time that the settlement was actually made *and* the deemed settlor of the Hypothetical Settlement was not domiciled in the United Kingdom at the time he is deemed to have made that settlement. Section 82 also applies only for the purposes of Ch.III of Pt III.

Sections 80 and 82 together create a curious anomaly where, as is not uncommon, life interests for the settlor, or a life interest for the settlor with a succeeding life interest to the settlor's spouse, are succeeded by an absolute interest. Typically that absolute interest will be for the settlor's children. I shall illustrate the anomaly by reference to the facts set out in Example I.

Example I

On January 1, 2006 Mr Fillbarrel settled non-UK situs assets on trusts under which he was to have an initial life interest, with a succeeding life interest to his wife and an absolute interest in remainder to his son, Duffin. At the time the settlement was made and at the time of Mr Fillbarrell's death, Mr and Mrs Fillbarrel were resident and ordinarily resident in the United Kingdom but were not domiciled in a country of the United Kingdom nor were they deemed to be so domiciled under s.267. Mr Fillbarrell died on February 28, 2007. Mrs Fillbarrell died on March 31, 2009 when she was domiciled in England.

On Mr Fillbarrell's death

Mr Fillbarrell was treated as beneficially entitled to the property in which his interest in possession subsisted immediately before his death. Section 49 also applied to Mrs Fillbarrell's succeeding life interest because her interest was a transitional serial interest within s.49.³ So the deemed transfer of value immediately before Mr Fillbarrell's death arising under s.4 by reason of his death was exempt because the spouse exemption under s.18 applied.

Because s.49 applied to Mrs Fillbarrell's succeeding life interest she was treated as beneficially entitled to the property in which her interest subsisted.

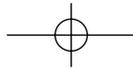
Mrs Fillbarrell's death

On Mrs Fillbarrell's death, her interest in possession came to an end. Under s.49, the trust property was deemed to form part of her estate immediately before her death with the result that the transfer of value, deemed by virtue of s.4 to take place immediately before her death, included the value of the settled property.

Section 48(3) applied because the settlor, Mr Fillbarrell was not domiciled in the United Kingdom at the time the settlement was made.⁴ Sections 80 and 82 did not

³ Sections 49(1A)(c) and 49C.

⁴ Section 48(3)(a).



apply for this purpose because they apply only for the purposes of Ch.III of Pt III which applies only to property which is relevant property. Property to which s.49 applies is not relevant property.⁵

Immediately upon Mrs Fillbarrell's death, the trust property was held by the trustees for Duffin absolutely. Under general principles it was therefore held on trust. As soon as Duffin's absolute interest arose, however, the property ceased to be settled property within s.43 because the property was no longer, "held in trust for persons in succession or for any person subject to a contingency".⁶

As the property held on trust by the trustees ceased to be settled property within s.43 on Mrs Fillbarrell's death, one might have thought that s.80 could not apply. Section 80, however, applies where an interest in possession for a settlor or his spouse has existed in property immediately after it has become comprised in a settlement. Where this condition is satisfied:

" . . . the property shall for the purposes of this Chapter be treated as not having become comprised in the settlement on that occasion; but when the property or any part of it becomes held on trusts under which neither of those persons is beneficially entitled to an interest in possession, the property or part shall for those purposes be treated as becoming comprised in a separate settlement made by that one of them who ceased (or last ceased) to be beneficially entitled to an interest in possession in it".

The distinction between "trust" and "settlement"

It will be noticed that where s.80 applies the property is treated as becoming comprised in the settlement:

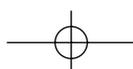
" . . . when the property or any part of it becomes held on trusts under which neither of those persons [the settlor and his spouse] is beneficially entitled to an interest in possession . . .".

So the event which triggers the application of the section is the property becoming held on trusts under which neither the settlor nor his spouse has an interest in possession, whether or not those new trusts amount to a settlement within s.43. The only requirement for there to be a settlement under s.43 is for there to be a settlement immediately on the property first being settled.

It has been argued that, in the context of s.80, the "trusts" referred to in s.80 must be trusts under a settlement within s.43. There is nothing in the wording of the

⁵ Sections 49(1A) and 58(1B).

⁶ Section 43(2)(a).



section, however, to suggest that that is the case. It appears that the draftsman has deliberately adopted the words “settlement” and “trust” because their meanings are not co-extensive. Indeed, the whole scheme of the application of IHT to trusts depends upon “settlement” being a more limited term than “trust”. It is very deliberately limited by the statutory definition in s.43.

Normally, where the application of the IHT legislation to an interest under a trust is to be limited to an interest arising under a settlement, the draftsman expressly limits the relevant provision in that way. For example, s.47 defines a reversionary interest as, “a future interest *under a settlement*” [emphasis added]. Section 51 applies, “[w]here a person beneficially entitled to an interest in possession in *settled property* [emphasis added] disposes of his interest . . .”. Section 49A applies, “[w]here a person . . . is beneficially entitled to an interest in possession in *settled property*” [emphasis added]. If the, “trusts under which neither of . . . [the settlor or his spouse] . . . is beneficially entitled to an interest in possession” referred to in s.80 were intended by the draftsman to be restricted to trusts under a settlement within s.43, one would have expected the draftsman to refer to “held on the trusts of a settlement”.

Application of the section 80 deeming

Immediately, on Mrs Fillbarrell’s death, therefore, it is arguable that s.80 would have the result that the property is to be treated, but only for the purposes of Pt III Ch.III, as becoming comprised in a settlement settled by Mrs Fillbarrell. The question is, what is the effect of that? The deeming provision in s.80 does not provide that the property is to be treated as continuing to be settled property. So it might be argued that the effect of s.80 is that the property would be settled property (and therefore relevant property) only for an instant. If that were correct, the property would immediately thereafter cease to be relevant property because it would not be property, “held in trust for a person in succession or for any person subject to a contingency . . .”. Because the property would have been relevant property only for an instant there would be no charge under s.65⁷.

On the other hand, it might be argued that, if the property is deemed to be comprised in a settlement, it must remain comprised in that settlement until an event occurs to remove it. That event might be thought to occur when the trustees transfer the assets to the absolute owners. In that case, if the transfer took place more than three months after the relevant death, there would be an exit charge under s.65. Because of ss.80 and 82, the foreign situs assets would not be excluded property in respect of that charge. What is more, in calculating the rate of tax at which the charge was made, one would apply ss.80 and 82 to the hypothetical chargeable transfer under s.68(4) so that the foreign situated property in the

⁷ See subs.(4).

settlement immediately before Mrs Fillbarrell's death would not be treated as excluded property for that purpose.

Concluding observation

At a time when HMRC are increasingly anxious to collect the maximum tax interest and penalties in respect of inheritance tax, it is important for taxpayers to know whether a charge can arise in these circumstances. It would be interesting to know HMRC's view.