



HM Revenue  
& Customs

# Inheritance tax: A fairer way of calculating trust charges

## **Consultation document**

Publication date: 6 June 2014

Closing date for comments: 29 August 2014

<b>Subject of this consultation:</b>	Simplifying the calculation of Inheritance Tax (IHT) charges on trusts at ten yearly intervals or when assets are transferred out of the trust and making fairer the way the nil-rate band is allocated as part of those calculations.
<b>Scope of this consultation:</b>	This is the third consultation on this subject. Draft legislation on the alignment of payment and filing dates and the treatment of retained income is included in Finance Bill 2014. This consultation focuses on changes to the way IHT trust charges are calculated and it also sets out proposals for the treatment of the nil-rate band where the settlor makes a number of settlements.
<b>Who should read this:</b>	The consultation will be of interest to settlors and trustees and practitioners involved in the administration of trusts.
<b>Duration:</b>	6 June 2014 – 29 August 2014.
<b>Lead official:</b>	Tony Zagara HM Revenue & Customs.
<b>How to respond or enquire about this consultation:</b>	Responses or enquiries should be made: <ul style="list-style-type: none"> <li>• By post to Tony Zagara, HMRC, Room G48/49, 100 Parliament Street, London, SW1A 2BQ</li> <li>• By e-mail to <a href="mailto:ihtandtrustsconsult.car@hmrc.gsi.gov.uk">ihtandtrustsconsult.car@hmrc.gsi.gov.uk</a></li> </ul>
<b>Additional ways to be involved:</b>	HMRC is willing to meet with interested parties to discuss this consultation. Please contact the e-mail address above if you would like to arrange a meeting.
<b>After the consultation:</b>	A summary of responses will be published after the consultation. Draft legislation will be published in the autumn.
<b>Getting to this stage:</b>	HMRC has previously consulted in this area: Inheritance Tax: Simplifying charges on trusts was published in July 2012 and Inheritance Tax: Simplification of trust charges – the next stage was published in May 2013.
<b>Previous engagement:</b>	HMRC has held meetings with representatives of professional bodies and with trustees and practitioners.

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**On request this document can be produced in Welsh and alternate formats including large print, audio and Braille formats**

# 1. Introduction

- 1.1 HMRC has previously published two consultation documents<sup>1</sup> setting out proposals on how the inheritance tax (IHT) treatment of relevant property trust charges could be simplified. Two of those proposals relating to retained income and the alignment of filing and payment dates are included in Finance Bill 2014 at Schedule 21. This further consultation focuses on simplifying the trust charge calculations for relevant property trusts and how the nil-rate band should be applied to such charges.
- 1.2 HMRC's policy aim is to achieve simplification and reform without jeopardising Exchequer revenue and to reduce unnecessary complexity and administrative burdens for trustees and practitioners where it is feasible to do so.
- 1.3 Most property settled on trust after 2006 is known as "relevant property". Trusts that include relevant property pay (IHT) on transfers ("exits") of such property out of the trust and on the trust's ten year anniversaries.
- 1.4 Property in the following types of trust doesn't count as relevant property:
  - interest in possession trusts with assets that were settled before 22 March 2006;
  - an immediate post-death interest trust;
  - a transitional serial interest trust;
  - a disabled person's interest trust;
  - a trust for a bereaved minor; and
  - an age 18 to 25 trust.
- 1.5 It is widely acknowledged that the calculations for ten year anniversary and exit charges for relevant property trusts can be complex and time consuming and HMRC recognises that the professional costs to prepare the calculations can be out of proportion to the amount of IHT due.
- 1.6 At present there are a number of factors that may need to be taken into account when calculating relevant property trust charges, including:
  - The chargeable transfers made by the settlor within the seven years before the date of the settlement.
  - The value of the settled property immediately after the settlement commenced.
  - The length of time for which each item of the settled property has been comprised in the settlement at the date of the charge (if less than ten years).

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<sup>1</sup> Inheritance Tax: Simplifying charges on trusts – published 13 July 2012  
Inheritance Tax: Simplifying charges on trusts – the next stage – published on 31 May 2013.

- The value of property which has left the settlement since the last ten-year charge.
- The prevailing rates of IHT at the date of the charge, the value of the property in the trust, and the amount of any reliefs available such as Agricultural or Business Property Relief.
- In some cases it may be necessary to take into account the historical value of property in related settlements made on the same day as the settlement subject to the IHT charge and the value of any other property in the settlement that is, for one reason or another, not chargeable to IHT.

1.7 Trustees and practitioners broadly support proposals that allow historical data in connection with previous lifetime transfers, related settlements and non relevant property to be ignored. The advantage being a reduction in administrative burdens in that trustees would only be required to know about transfers of property out of the trust and other trusts in the last ten years rather than having to be aware or find out about such events before that time.

1.8 However, simply removing the need to make adjustments that take those earlier events into consideration could lead to increased fragmentation of property across a number of settlements resulting in significant loss to the Exchequer. A third of the respondents to the July 2012 consultation suggested that the risk of fragmentation might be addressed by changing the way that the nil-rate band is applied when raising trust charges. This could also ensure fairness in the system as it would no longer be advantageous for a settlor to create multiple settlements.

1.9 The Government wants to ensure that there is consistency of treatment between those individuals who transfer their assets on death and those individuals who make lifetime transfers through the use of trusts. In the circumstances we believe that it is right that there should be one nil-rate band available for those individuals settling property into trust just as there is only one nil-rate band available to an individual transferring assets on death.

1.10 HMRC recognises the concerns expressed by trustees and practitioners about the impact such a change would have and in particular the practical difficulties associated with gathering information about other trusts involving different trustees and where the settlor is no longer alive. Many respondents to the May 2013 consultation commented that HMRC would be replacing one set of complexities with another and the additional record keeping requirements would mean an increase in administration burdens for practitioners and trustees alike rather than a reduction.

1.11 In the light of those responses, HMRC has looked critically at the approach outlined in the consultation and explored other ways in which the policy objective can best be achieved. This consultation sets out an alternative model for applying the nil-rate band in conjunction with a simplified method of calculating the ten-year and exit charges. It is split into several chapters:

- Chapter 2 summarises the original proposals set out in the May 2013 consultation for simplifying the calculation of the trust charges and applying the nil-rate band. It highlights the key problem areas identified in the responses and outlines HMRC's revised proposals for applying the nil-rate band.
- Chapter 3 sets out in detail how the revised model would work and considers the scope for simplification around IHT charges arising on 18 – 25 trusts.
- Chapter 4 sets out the summary of impacts in the Tax Impact Assessment.
- Chapter 5 lists the consultation questions.
- Chapter 6 provides information about the consultation process and how to respond to it.

## 2. Key areas of difficulty and HMRC's proposed solutions

- 2.1 This chapter briefly summarises the existing rules. It then sets out stakeholders' main concerns with the proposals featured in the May 2013 consultation, HMRC's response to those concerns and an outline of the new proposals for allocating the nil-rate band.

### Summary of the existing rules

- 2.2 Inheritance tax is charged at 40 per cent on the value of a deceased person's estate in excess of the nil-rate band threshold, currently £325,000. If an individual transfers assets into a trust those assets no longer form part of their estate, so would not be subject to inheritance tax when they die. To avoid a loss of tax, where the value of assets transferred to a trust exceeds £325,000 the excess is subject to an inheritance tax "entry charge" at a rate of 20 per cent. In addition, charges are also due at each ten-yearly anniversary of when the assets were put into the trust (the "periodic charge"), and an "exit charge" is payable when assets are taken out of the trust. The combination of the entry charge, ten-yearly anniversary charges and exit charge is roughly equivalent to imposing a 40 per cent inheritance tax charge once a generation.
- 2.3 Under the existing rules, the nil-rate band available to a trust is reduced to take account of other settlements made by the settlor on the same day and of any other transactions by the settlor which may have affected the settlor's IHT position. These adjustments are intended to reduce the scope for settlors to artificially reduce the IHT charges to which the trust assets would otherwise be liable through the use of multiple trusts each with its own unrestricted nil-rate band.
- 2.4 The current anti-fragmentation rule fails to prevent the risk of settlors fragmenting ownership of property across a number of different settlements. For example it is possible to side-step the rule by setting up multiple trusts on consecutive days each of which has the benefit of its own nil-rate band.

### *Periodic Charges*

- 2.5 A periodic charge is due on every tenth anniversary of the date on which property was first added to the trust if, broadly:
- the trust contains relevant property, and
  - the value of the relevant property contained in the trust is greater than the IHT nil-rate band available to the trust.

2.6 The IHT nil-rate band is reduced to take account of other chargeable transfers made by the settlor at or before the time the trust was set up. These adjustments are intended to reduce the scope for settlors to artificially reduce the IHT charges to which the trust assets would otherwise be liable.

2.7 Before trustees can begin to calculate the amount of any periodic charge they need to establish:

- the historic value (i.e. the value at the time of settlement) of any property in any other trusts (except wholly charitable trusts) that the settlor set up on the same date as the trust concerned; and
- the historic value of any chargeable transfers that the settlor made in the seven years before this trust was set up.

2.8 The calculation of the periodic charge is further complicated by the need to take account of assets that have not been relevant property for the full ten years preceding the charge and of assets that are not themselves relevant property but which are held in the trust. So trustees also need to establish:

- the current value of the relevant property in the trust;
- the value and dates of any transfers of relevant property out of the trust during the preceding ten years;
- the current value and dates of any additions of relevant property to the trust during the last preceding ten years; and
- the historic value of trust property that has not been relevant property at any time.

### *Exit Charges*

2.9 Exit charges are imposed on transactions or events that take place before the first ten-year anniversary of a trust, or between such anniversaries, to ensure that IHT cannot be avoided where relevant property ceases to be relevant property in advance of a periodic charge being imposed. An exit charge is a proportionate periodic charge with time-apportionment being calculated on a quarterly basis.

2.10 There are various reasons why relevant property may cease to be relevant property. It may occur when:

- a trust comes to an end;
- assets within the trust are distributed to beneficiaries;
- a beneficiary becomes absolutely entitled to enjoy an asset;
- an asset ceases to be “relevant property” (for example by becoming part of a charitable trust or a trust for a qualifying disabled person); and



- where the trustees enter into a non-commercial transaction that reduces the value of the trust.

2.11 As with the periodic charge, the calculation requires trustees to ascertain certain information. If the exit charge arises before the first periodic charge, trustees need to ascertain:

- the historic value (at time of settlement) of trust assets;
- the historic value (at time of settlement) of any property in any other trusts (except wholly charitable trusts) that the settlor set up on the same date as the trust; and
- the historic value of any transfers subject to IHT (whether into trusts or not) that the settlor made in the seven years before this trust was set up.

2.12 If the exit charge arises after the first periodic charge, trustees need to establish

- the value of relevant property at the date of the periodic charge;
- the historic value (at time of settlement) of any property in any other trusts (except wholly charitable trusts) that the settlor set up on the same date as the trust;
- the historic value of any transfers subject to IHT (whether into trusts or not) that the settlor made in the seven years before this trust was set up; and
- the value of any additions at the time the addition became relevant property.

## Summary of the original proposals

2.13 HMRC proposed that the settlor's previous lifetime transfers should be ignored in determining the available nil-rate band for the purposes of calculating the hypothetical transfer on exit charges and ten year anniversary charges. This would avoid the problems and associated costs of having to obtain historic records and valuations.

2.14 Non-relevant property and property in related settlements would also be ignored for the purposes of the calculation of ten-year and exit charges as this relies on establishing the initial value and obtaining historical records. The advantage of these modifications would be that trustees would only be required to know information regarding exits from the trust and other trusts in the last ten years rather than potentially very old information.

- 2.15 HMRC proposed that a simple rate of 6% of the chargeable transfer should be used in the calculation of ten-year and exit charges, rather than the lengthy calculations to determine the effective rate and settlement rate.
- 2.16 To alleviate the risk that settlors might seek to fragment ownership of property across a number of trusts to maximise the availability of reliefs or exempt amounts, it was proposed that the nil-rate band should be split by the number of relevant property settlements created by the same settlor.
- 2.17 In order to arrive at the most equitable solution and to prevent settlors from re-arranging their affairs to avoid the charge, the splitting of the nil-rate band would not be limited to settlements existing at the time the trust concerned was created or the settlements existing at the time of the charge. Therefore:
- For the first ten year charge the nil-rate band would be split between all relevant property settlements made by the settlor and in existence at any time between the date the trust concerned was set up and the time of the charge. This would include any settlements which had been wound up before the date of charge.
  - For subsequent ten year charges the nil-rate band would be split between all relevant property settlements made by the settlor and in existence at any time between the date of the previous ten year anniversary and the date of the current charge.
  - For exits before the ten year anniversary, it was proposed that the nil-rate band should be split between all relevant property settlements in existence at any time during the period the trust concerned commenced to the date of exit.
  - For exits after the ten year anniversary, the nil-rate band would be split between all relevant property settlements taken into account for the purposes of calculating the IHT charge at the last ten year anniversary plus any in existence since the ten year anniversary to the date of exit.
- 2.18 The proposals would apply to all existing settlements from the date the new legislation was implemented and to any new trusts created thereafter.

## Areas of concern

### *Information gathering*

- 2.19 Stakeholders raised concerns with the proposal to split the nil-rate band. They argued that it would require the trustees of each settlement, at every chargeable occasion, to ascertain the number of relevant property settlements in existence during (broadly) the previous ten years. Two difficulties were identified: First, the information gathering exercise, rather than being conducted once only, would need to be conducted more frequently, with obvious time and cost consequences. Secondly, it would be very difficult for any set of trustees to know with certainty how many other trusts may have been created by the settlor or in

existence during the appropriate period. Respondents pointed out that there may be different sets of trustees, the settlor may have died, lost capacity or otherwise be inaccessible. Consequently, they doubted whether any trustee, properly advised, could in future sign an IHT return, given the lack of certainty over its accuracy.

### *HMRC response*

2.20 HMRC acknowledges the concerns raised and as a result we have developed an alternative model for applying the nil-rate band which shifts the administrative burden away from trustees and on to the settlor. The new rules would mean that each settlor is entitled to a “settlement” nil-rate band (SNRB) which is separate from and unconnected with their own personal nil-rate band. They will decide how their SNRB is to be allocated between the settlements they create and be responsible for providing that information to trustees. SNRB will be the same as and will change in line with the IHT nil-rate band. The revised model is explained in more detail in chapter 3.

### *Existing trusts*

2.21 Stakeholders objected to the tax treatment of existing trusts being overturned in such a way as to bring many formerly non reportable and non chargeable settlements into charge. Many stakeholders felt that the proposed division of the nil-rate band unfairly penalises sensible and moderate estate planning which up until now has been acceptable to HMRC. Respondents said that it would be unfair to retrospectively impose charges on arrangements put in place with due regard to HMRC rules and settled legal principles.

### *HMRC response*

2.22 HMRC is aware that many trusts have been created for legitimate purposes based on current rules. We also recognise that some smaller trusts would be brought into charge if rules allocating the nil-rate band were applied to these trusts. In view of this, the new rules would apply only to:

- new settlements made after 6 June 2014;<sup>2</sup>
- additions of property/funds to existing trusts made after 6 June 2014;  
or
- where changes made after 6 June 2014 to existing settlements result in relevant property coming into being, for example where an interest in possession settlement created before 22 March 2006 amends the terms of its trusts to become a relevant property trust.

### *The rate of tax charged*

2.23 Stakeholders pointed out that the introduction of a standard 6% charge in the way proposed would involve a double charge on exits in the previous ten years.

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<sup>2</sup> Anti forestalling provision – see paragraphs 2.37 – 2.38

### *HMRC response*

2.24 Under the current regime the nil-rate band is reduced by the amount of any distributions but this reduction is used only as part of the calculation of the “settlement rate” – there is no double charge because the ten-year charge is only on the amount that remains relevant property on the ten year anniversary. There is no proposal to change this approach. HMRC is still of the view that a simple rate of 6% of the chargeable transfer should be used in the calculation of ten-year and exit charges.

### *Self assessment of charges*

2.25 Stakeholders felt that given that trustees are personally liable for the tax, it was unacceptable for HMRC to require trustees to self-assess in complex areas such as this unless comprehensive and efficient online calculators are provided.

### *HMRC response*

2.26 By removing the need for historical data much of the complexity is taken out of the calculations and we believe a requirement on trustees to “self assess” the tax due supported by toolkits and further guidance, would not be too burdensome and is consistent with the requirements HMRC places on other taxpayers.

### *Renewable nil-rate band*

2.27 Many stakeholders expressed the view that if HMRC was concerned about the use of “pilot” trusts, the nil-rate band could be split between relevant property settlements made by the settlor and in existence at any time between the date the first trust commenced and the seven year anniversary of that date. Any trusts established more than seven years apart would be discounted. Many respondents saw this option as a way of ensuring an equivalent treatment for individuals who give their property away and individuals settling property into trust.

### *HMRC response*

2.28 HMRC does not see this as a viable option mainly because the same practical issues would arise in terms of trustees’ and practitioners’ administration burdens as they would still be required to gather information about all the settlor’s settlements and keep necessary records (albeit over a shorter period). Furthermore, whilst HMRC accepts that wherever possible there should be parity of treatment between property held absolutely and settled property, it is not a principle that can be applied in all circumstances. The questions that need to be considered therefore relate to how best to achieve the aim fairly, reasonably and without creating opportunities for avoidance.

2.29 The charges imposed on property entering and leaving discretionary trusts are intended as a means of providing a degree of parity with the charges on property held absolutely as it passes down the generations. In our view the comparison between individuals giving property away and settlors putting assets into trust is not a fair reflection of this aim. The broad aim of the relevant property trust

charges is to ensure the equivalent of a full IHT charge is paid on property once in every generation (30 years). Individuals who make outright gifts of their property have no say in what happens to it as it is distributed back into the wider economy or in the hands of others. In contrast, property settled in discretionary trusts can be left undistributed for up to 125 years so where property continues to remain undistributed, the maximum charge after the initial 30 year generation would be 6% every ten years.

- 2.30 To illustrate the point further, under current rules, a couple aged 40 could transfer property into a separate discretionary trust every seven years (£3.25 million by age 75 assuming the nil-rate band remains at £325,000) saving £1.3 million in IHT. In this scenario the next generation avoids any IHT charges altogether because of the previous generation's use of multiple nil-rate bands.

#### *Division of the nil-rate band*

- 2.31 A key point made by respondents to the May 2013 consultation was that simple division of the nil-rate band would be unacceptable. They suggested that the settlor should be able to make an election to apportion the nil-rate band on a pro-rata basis to account for the level of funds held in each trust or in accordance with the market value of the relevant trusts at the time of the relevant event.

#### *HMRC response*

- 2.32 HMRC has considered this principle further and we agree that when considering how the nil-rate band should be divided between settlements created by the same settlor, he or she should be given the flexibility in the method of allocation to prevent wasting any unused nil-rate band.

#### **New Proposals**

- 2.33 We propose a revised model for applying a nil-rate band available to relevant property trusts based on a statutory requirement that the settlor must make an election that sets out how they wish their "settlement nil-rate band"(SNRB) to be allocated between the settlements they have made. The election would enable the settlor to specify, in percentage terms, but subject to certain conditions, how much of their SNRB should be allocated to each trust. The responsibility for deciding how their SNRB should be allocated and for notifying the trustees would rest entirely with the settlor who would also be responsible for ensuring that they did not allocate more than a single nil-rate band. Over-allocation would result in sanctions against the settlor and the recovery of any tax underpaid. But there would also be sanctions against the trustees if it was established that the SNRB allocated by the settlor had been overstated or over-claimed by the trustees as a result of their careless or deliberate actions.
- 2.34 The revised proposal shifts the administrative burden away from trustees and provides them with the certainty they need when calculating trust charges. If the settlor fails to inform the trustees of the amount of SNRB to be allocated to a settlement by the time an event gives rise to a tax charge, the trustees would be obliged to calculate any IHT due on the basis that no SNRB is available.

- 2.35 Given that the fundamental premise of the revised model is that the responsibility for determining how the SNRB is allocated lies with the settlor, it follows logically that any new rules would apply only to new settlements or additions to existing settlements etc. Existing settlements (settlements made on or before 6 June 2014) would retain the nil-rate band available to them under the current rules but would also benefit from the simplified calculation method using the standard rate of 6%.
- 2.36 By simplifying the regime, HMRC would require trustees to “self assess” the tax due. Changes would be made to the IHT 100 form to accommodate this with a “tax due” box at the end of the return. Responsibility to enter the amount due would rest entirely with the trustee. The requirement for trustees to self calculate would be supported by toolkits and further guidance.
- 2.37 HMRC recognises that the public consultation on these proposals will highlight the advantage that will accrue to existing settlements and may encourage the creation of new settlements in the run up to change. Settlers could see this as a window of opportunity to take advantage of the current rules and maximise the amount of nil-rate band to set against funds settled into trust as they seek to benefit from both the current legislation and a new SNRB under these proposals. This would defeat, to a large extent, our policy objective of having only one nil-rate band available for property held in trust.
- 2.38 Consequently the Government considers it necessary to make an anti-forestalling provision. So, the new legislation will only have effect in respect of the calculation of IHT charges from 6 April 2015 but it will apply to ,
- new settlements made after 6 June 2014;
  - additions of property/funds to existing trusts made after 6 June 2014; or
  - where changes made after 6 June 2014 to existing settlements result in relevant property coming into being such as an interest in possession settlement created before 22 March 2006 which amends the terms of its trusts to become a relevant property trust.

This means that the settlor will need to allocate their new SNRB to such settlements on or after 6 April 2015 so that future relevant property charges can be calculated correctly. For the avoidance of doubt, any tax charges arising before 6 April 2015 but in respect of settlements or additions etc made after 6 June 2014 will be calculated in accordance with the current rules.

- 2.39 The following chapter sets out in more detail how the revised model would work.

## 3. The revised model

3.1 The revised model for applying a nil-rate band available to trusts is based on a statutory obligation on settlors requiring them to make an election that sets out how they wish their SNRB to be allocated between the settlements they have made.

### The Election to allocate nil-rate band to a settlement

- The election would be made in writing by the settlor on a form prescribed by HMRC before any SNRB can be allocated to a settlement.
- It would specify how much SNRB is allocated to each settlement in percentage terms so that any future increase (or reduction) in the IHT nil-rate band will automatically feed through.
- The form would be signed and dated by the settlor and it would be the settlor's responsibility to provide a copy to the trustees showing the amount of SNRB allocated to the trust, so that the trustees can accurately calculate IHT due for periodic or exit charges. By signing the form the settlor is declaring that the SNRB percentage allocated to the settlement is within the maximum allowable.
- The date on which the election is made can be flexible. It can be made when a new settlement is made or at any time up to the due date for payment of the first charge. However, it is envisaged that most settlors are likely to make an election and an allocation of the SNRB when the trust is set up.
- The allocation of the SNRB to a settlement can be amended or withdrawn until the point of the payment date for the first charge. But once the allocated SNRB has been used in the calculation of an exit or ten year anniversary charge, the allocation of the SNRB to that trust cannot be reduced.
- If property is subsequently added to the trust, a further election can be made provided the settlor has SNRB available. So even in cases where a trust may have already incurred a first charge, the percentage of SNRB can be increased (if available to the settlor) when additional funds/property are transferred into that trust. Settlors would also be able to allocate any available SNRB against additions of property into existing trusts (trusts created on or before 6 June 2014).
- Trustees would need to be able to provide evidence to HMRC of the amount of SNRB allocated to them. Keeping a copy of the election would meet this requirement.
- If no election is made to allocate SNRB to the trust, then the trustees must calculate the charge on the basis that none is available.



- If the settlor should die, the personal representatives would have two years to make an election to either allocate SNRB to settlements created by Will or to make sure that the deceased's SNRB has been fully allocated between settlements made during their lifetime and on death.
- If HMRC later discovered that too much SNRB had been claimed by the personal representatives, the claim would be reduced in the chronological order of the elections made.
- Penalties may be in point against a settlor, and in certain circumstances, against trustees, who over-claimed the SNRB.

3.2 The following examples give an indication of how the revised model may work in practice. For convenience, the examples assume the IHT nil-rate band remains at £325,000 throughout.

### Example 1:

#### First ten year anniversary (TYA) charge

Trust 1 settled in 2016 (Mr Smith), who allocated 50% of his SNRB to the settlement.

Value of settled property in 2026	£500,000
Less allocated SNRB (50%)	£162,500
Value subject to tax	£337,500
Charge at 6%	<b>£20,250</b>
Settlement rate (20,250/500,000)	4.05%

### Example 2:

#### Exit charge after ten year anniversary

3.3 The effective rate of an exit charge after a TYA is based on the rate that applied at the most recent TYA and adjusted for the number of quarters that have elapsed since that TYA. It would also reflect any changes in the nil-rate band since the TYA as set out in the existing legislation. Any additions of relevant property to the trust fund between the TYA and an exit charge would be taken into account as an addition to the value of the relevant property and the settlement rate recalculated to establish the rate to be applied to the exit charge.

The trustees decide to pay £50,000 to one of the beneficiaries of Mr Smith's settlement 5 years after the ten year anniversary

Value of relevant property at date of TYA	£500,000
Exit of £50,000 5 years after ten year anniversary	£50,000



Settlement rate from ten year anniversary	4.05%
Charge on exit (£50,000 x 4.05%) x 20/40	<b>£1,012.50</b>

3.4 The next two examples cover the situations where Mr Smith adds property/funds to the trust and where he chooses to allocate further SNRB that is available to him; and show the effect that this would have on the exit charge.

### Example 2A

The trustees decide to pay another £50,000 to one of the beneficiaries of Mr Smith's settlement in 2031, 5 years after first ten year anniversary. £100,000 was added to the settlement in 2028.

Value of relevant property at date of first TYA	£500,000	
Addition to relevant property	£100,000	£600,000
Less allocated SNRB (50%)		£162,500
Value subject to tax		£437,500
Charge at 6%		£26,250
Settlement rate (26,250/600,000)		4.375%
Charge on exit (50,000 x 4.375%) x 20/40		<b>£1,093.75</b>

### Example 2B

The trustees decide to pay another £50,000 to one of the beneficiaries of Mr Smith's settlement in 2031, 5 years after first ten year anniversary. £100,000 was added to the settlement in 2028 and Mr Smith increased the SNRB allocated to this settlement to 75%

Value of relevant property	£500,000	
Addition to relevant property	£100,000	£600,000
Less allocated SNRB (75%)		£243,750
Value subject to tax		£356,250
Charge at 6%		£21,375
Settlement rate (21,375/600,000)		3.562%
Charge on exit (50,000 x 3.562%) x 20/40		<b>£890.50</b>

### Example 3:

#### Exit charges in the first ten years

3.5 Exit charges within the first ten years of a trust being set up would be calculated based on the settlement rate and then adjusted for the number of quarters the property was in the trust. The settlement rate<sup>3</sup> would be calculated at three tenths of the effective rate of tax on a hypothetical chargeable transfer. The hypothetical transfer is made up of the total of the historic value of the property comprised in the settlement immediately after it commenced and the value (at the date of addition) of any added property. The SNRB allocated by the settlor to the trust is deducted from this figure.

Trust 2 settled in 2017 (Mrs Smith), who allocated 50% of her SNRB to the settlement. She added £100,000 to the settlement in 2018 and the trustees decide to pay £50,000 to one of the beneficiaries of Mrs Smith's settlement in 2022, 5 years after the date of settlement

Value of relevant property at date of settlement	£750,000	
Additions of relevant property (2018)	£100,000	£850,000
Less allocated SNRB 50%		£162,500
Value subject to tax		£687,500
Charge at 6%		£41,250
Settlement rate (41,250/850,000)		4.853%
Charge on exit (£50,000 x 4.853% x 20/40)		<b>£1,213.25</b>

3.6 The following examples show how the exit charge for trust 2 would be calculated where further SNRB is allocated to the settlement and the effect of further exits on the ten year anniversary charge.

#### Example 3A

Mrs Smith increased the SNRB allocated to the settlement at the time of the addition in 2018 and the trustees decide to pay £50,000 to one of the beneficiaries of Mrs Smith's settlement after 5 years.

Value of relevant property at date of settlement (2017)	£750,000	
Additions of relevant property (2018)	£100,000	£850,000

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<sup>3</sup> The calculation is based on 3/10 of the lifetime rate of inheritance tax (half death rates), currently 20%. So the maximum rate is 6% (as for TYA charges).

Less allocated SNRB 75%	£243,750
Value subject to tax	£606,250
Charge at 6%	£36,375
Settlement rate (36,375/850,000)	4.279%
Charge on exit (£50,000 x 4.279% x 20/40)	<b>£1,069.75</b>

### Example 3B

The trustees decide to pay £200,000 to another beneficiary of Mrs Smith's settlement after 7 years

Charge on exit 200,000 x 4.279 x 28/40	<b>£5,990.60</b>
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- 3.7 If by the time of the ten year charge, the whole of the SNRB allocated to the trust has been consumed by exits from the trust, the ten year charge would be calculated on the basis that there is no SNRB available and the tax would be calculated on a straight 6% of the value of the relevant property.

### Example 4

#### Ten year anniversary charge (trust 2)

Trust 2 settled in 2017 by Mrs Smith

Value of settled property at TYA in 2027		£600,000
Less allocated SNRB (75%)	£243,750	
Less exit charges	£250,000	£0
Value subject to tax		£600,000
Charge at 6%		<b>£36,000</b>
Settlement rate (36,000/600,000) x 100		6%
Charge on original funds 500,000 x 6%		<b>£30,000</b>
Charge on funds added in 2018 100,000 x 6% x 36/40		<b>£5,400</b>

#### Ten year anniversary at year 20

- 3.8 Continuing with the example above, if there were no further exits between year 10 and year 20, there will, as now, be nothing to deduct from the SNRB allocated to Mrs Smith's trust (in this case 75%) at the time of the next ten year charge so the full amount of SNRB will be available again to set against the charge at year

20. Because the SNRB is allocated in percentage terms and is linked to the IHT nil-rate band, the restored SNRB would also take into account any increases in the nil-rate band.

### In summary

- The calculations remain broadly similar to what happens now but remove the historical baggage from the calculation.
- Under the new system – related settlement & excluded property drops out.
- We will stick with the current position of using 40ths.
- Trustees would “self assess” the amount of IHT payable in respect of ten year anniversary and exit charges.
- HMRC will continue to provide agents support through guidance and on-line tool kits to help them work out figures and tax due.

### Additions to existing settlements under the new rules

3.9 From 7 June 2014 any new funds added to trusts in existence at that date would be treated as a separate fund within the settlement. For the purposes of calculating ten-year and exit charges HMRC would work from the original settlement commencement date and apply the 40<sup>ths</sup> rule for the length of time the new funds had been relevant property as that is how the process currently operates.

3.10 Even though the settlor may have created settlement(s) before the new rules come into force, each settlor will have a new SNRB to allocate to funds settled after 6 June 2014. The settlor can allocate more SNRB, if there is any available, where additions are made to trusts created after the new legislation is in force, or additions that are treated as a separate fund are made. They have the flexibility of withdrawing the SNRB allocated to that settlement provided a charge has not yet arisen.

3.11 If a person settles property on relevant property trusts already established by another, this would be treated as two separate settlements and two separate settlors as now. The second settlor would be entitled to their own SNRB provided it was clear that it was their own property that was being settled. So they too would have to make an election for an allocation of SNRB against the settlement of property they have settled on the trust originally established by the first settlor.

### Death of the settlor

3.12 The death of a settlor may give rise to a number of issues to be considered to ensure that the best use is made of their SNRB.

3.13 If the settlor had made no relevant property settlements during their lifetime, but had included a relevant property settlement in their Will, their personal representatives would be able to allocate a full SNRB to the settlement(s) made by Will. They would have two years to make those allocation(s).

- 3.14 If, however, the settlor had allocated all their SNRB to relevant property settlements made after 6 June 2014, there would be none to allocate to any such settlements made by Will.
- 3.15 If the settlor had made a number of settlements during their lifetime, but had not allocated any SNRB or had only partially allocated SNRB, the personal representatives would be able to make that allocation on behalf of the settlor, which would include allocating any balance of SNRB to settlements made by Will.
- 3.16 Other types of trusts will not be affected as they are not relevant property trusts. Nor will this affect any flat rate charges that apply.

**Q1 Are there any other provisions that would need to be made for when a settlor dies that have not been covered in this section?**

**Trusts that are wound up**

- 3.17 If a settlement is wound up and money paid out absolutely, that will incur an exit charge and the funds will be in the beneficiaries' hands. Should the beneficiaries resettle that property themselves, there would be an entry charge and the beneficiary would be able to allocate part of their SNRB to their settlement. Since any one settlor is entitled to have £325,000 set against the total property that they have settled; it would be reasonable for the original settlor to be able to re-allocate the SNRB that has become available as a result of the settlement being wound up, to other settlements that they have made.
- 3.18 However, we don't want to create a situation where winding up a trust and re-allocating SNRB creates a favourable position which, if it were not for the additional SNRB, would be subject to a charge. Therefore the re-allocation can only be done if the whole of the trust is wound up. Once it has been wound up there is no problem with re-allocating the available SNRB to any other trust (new or in respect of an addition to an existing settlement).
- 3.19 If the settlor has died and the trustees wind up a trust, the SNRB allocated to that trust cannot be reallocated to another trust created by the same settlor. The SNRB allocated to the trust that is wound up is lost as the settlor has died.

**Transfers between existing settlements under the new regime**

- 3.20 Any transfers between existing settlements will be subject to s81 IHTA 1984 and will be treated as still remaining comprised in the first settlement and the rules appropriate to that first settlement will continue to apply to funds concerned.

**Change of trust purpose/beneficiaries under the new rules**

- 3.21 **Relevant property trusts to interest in possession.** There is no change here from the current rules. The settled property has remained relevant property, so the SNRB allocated to the settlement should remain allocated to it, subject to the rules about reallocation if no charge has arisen.

- 3.22 **Relevant property trusts to charitable trusts.** There is no exit charge on property ceasing to be relevant property and becoming held for charitable purposes and there is no charge on a charitable trust. No SNRB would be needed against the settlement. If the change to charitable status is permanent this is effectively the same as winding up a relevant property trust and therefore in these circumstances, the SNRB can be re-allocated.
- 3.23 **Vulnerable beneficiary trusts:** These trusts should not be affected by this measure. Similar to a charitable trust, if a relevant property trust has effectively been ended because the vulnerable beneficiary is deemed to have a qualifying interest in the possession, the SNRB can be re-allocated to another relevant property trust. But it would mean that if the vulnerable beneficiary dies there would be no automatic return to the SNRB for any remaining residual beneficiaries. The settlor would need to make a choice about whether to re-allocate that part of their SNRB if the settlement ceased to be a relevant property settlement.

### The nil-rate band for existing trusts

- 3.24 Under the current rules the nil-rate band available to a settlement upon creation is adjusted to take into account any previous lifetime chargeable transactions. If there were no such transactions in the previous 7 years the trust would have the benefit of a full nil-rate band upon its creation. Any transfers out of the trust would affect the calculation of the periodic charge and reduce the nil-rate band accordingly. The nil-rate band is restored to the original amount when the settlement commenced if there are no further transfers out of the trust between ten year anniversaries.
- 3.25 The following example illustrates the impact that retaining the nil-rate band and the changes summarised at paragraph 3.8, will have on existing trusts.

### Example 5

Mr Jones created two relevant property trusts on 1 February 2008, settling £300,000 in each. He had made no lifetime chargeable transfers in the previous 7 years. The trustees of trust No.1 made payments to beneficiaries in February 2012 of £100,000 and in February 2016 of £50,000.

Exit charge in February 2012

Historic value of relevant property	£300,000	
Historic value of related settlement	£300,000	
Assumed transfer		£600,000
Less Nil-rate band		£325,000
Value to determine rate of tax		£275,000
Tax at 20%		£55,000
Effective rate of tax (55,000/600,000) x 100		9.167%

Reduced to 3/10ths	2.75%
<b>Charge on exit (£100,000 x 2.75% x 16/40)</b>	<b>£1,100</b>

Exit in February 2016

Historic value of relevant property	£300,000
Less Nil-rate band	£325,000
Value subject to tax	Nil

(Without the changes proposed, the exit charge in 2016 would have been £50,000 x 2.75% x 32/40 = £1,100).

### Ten year anniversary charge

Value of relevant property at 1 February 2018		£200,000
Less Nil-rate band	£325,000	
Less exit charges	£150,000	£175,000
Value subject to tax		£25,000
Charge at 6%		<b>£1,500</b>
Settlement rate (1500/200,000) x 100		.75%

(Without the changes proposed, the ten year charge in 2018 would have been

Value of relevant property	£200,000	
Historic value of related property	<u>£300,000</u>	
Assumed transfer		£500,000
Less Nil-rate band	£325,000	
Less exit charges	£150,000	£175,000
Value subject to tax		£325,000
Tax at 20%		£65,000
Effective rate of tax (65,000 x 500,000) x 100		13%
Reduced to 3/10ths		3.9%
<b>Charge on ten year anniversary (200,000 x 3.9%)</b>		<b>£7,800</b>

- 3.26 If any distributions were made between the first ten year anniversary and the next ten year anniversary these would also be charged using the settlement rate of 0.75%, adjusted to account for any increases in the nil-rate band, and the value of the exits in that period would reduce the nil-rate band available at the time of the second ten year anniversary.
- 3.27 However, if there were no further transfers between ten year anniversaries, the value of the nil-rate band at the second ten year anniversary would be restored to the value when the trust was first created, adjusted for any increases in the nil-rate band. Using the above example, this would be £325,000.
- 3.28 If an existing trust has a nil-rate band available in the sum £75,000 on creation of the trust and the IHT threshold increases to, say, £500,000, the trust's new nil-rate band will be £250,000. When an existing trust is wound up, the nil-rate band available to it is lost.
- 3.29 From 6 April 2015 all settlors will have the benefit of a full SNRB to allocate for any new settlements regardless of how many existing trusts they have and the nil-rate band(s) that those trusts have to take forward under the new rules.
- 3.30 SNRB will only be available to individuals; relevant property settlements created by a company will no longer be entitled to a nil-rate band and, subject to relief for periods when the settled property is not relevant property, tax will be charged at the full 6% rate.
- 3.31 Companies cannot make a transfer of value and as a result the value of the nil-rate band is never reduced to account for the settlor's previous lifetime cumulative transfers, so each settlement created by a company gets the full nil-rate band, no matter how many settlements the company makes. It would not make sense to allow this to continue as it would not only run contra to the proposed new rules but would also open up the opportunity for manipulation and avoidance.

**Q2 Are there any other features of the existing rules that should be retained under the new rules?**

**Q3 Are there any aspects of the proposed new rules for allocating the SNRB or calculating the IHT charges that could be improved?**

**Q4 Are there any aspects of the existing rules that would no longer be necessary under the new rules?**

**Q5 Are there any other impacts for example on cost or equality that should be taken into account?**

### **Scope for further simplification**

- 3.32 In conducting this review and through its analysis of previous consultation responses, HMRC has identified one other area where simplification might be useful.



### *Age 18-to-25 trusts*

3.33 Finance Act 2006 introduced a new category of “age 18 - 25 trusts”. A trust of this kind can generally only be set up under:

- the Will (or intestacy) of a deceased parent, including where this is deemed to have happened – for example, following a Deed of Variation that satisfies the conditions set out in the IHT legislation;
- the Criminal Injuries Compensation Scheme.

3.34 However it was possible for some Accumulation & Maintenance trusts created before 22 March 2006 to be amended to fall within these provisions.

3.35 On or before attaining the age of 25, the person must become absolutely entitled to the settled property, any income arising from it, and any income that has arisen from the property and been accumulated before that time.

3.36 If the provisions are satisfied then no charge to tax arises where:

- the beneficiary becomes absolutely entitled to any of the settled property on or before their 18th birthday, or
- any property is applied for the maintenance of the beneficiary before they turn 18, or
- the bereaved minor dies before they turn 18.

3.37 However, a charge to tax will arise where:

- provisions set out in the IHT legislation cease to apply to the settled property where the beneficiary becomes absolutely entitled to it between 18 and 25, or
- the beneficiary dies over 18 but under 25. Also, a charge to tax will arise in all other circumstances where the relevant provisions set out in the legislation cease to apply to any settled property.

3.38 The calculations of IHT due in these circumstances presently mirror the rules for relevant property trusts. For example the legislation refers to a settlement rate calculated by reference to a postulated chargeable transfer, involving the settlor’s previous chargeable transfers, related settlements, historic values etc. There does not seem to be any good reason why the method for calculating tax for 18-25 trusts should not be reformed in the same way and at the same time as the changes proposed for the relevant property trust rules.

**Q6 Should the simplified method for calculating ten year and exit charges proposed for relevant property trusts be extended to trusts that fall within the charging provisions for 18-25 trusts?**

## 4. Tax Impact Assessment

### Summary of Impacts

<b>Exchequer impact (£m)</b>	2014-15	2015-16	2016-17	2017-18	2018-19
	Negligible	Negligible	Negligible	Negligible	Negligible
	This measure is expected to have a negligible impact on the Exchequer up to 2018-19.				
<b>Economic impact</b>	The measure is not expected to have any significant economic impacts				
<b>Impact on individuals and households</b>	The measure will impact on individuals settling funds into trusts. Individuals will in future have a single nil-rate band that can be allocated to trusts they create during the course of their lifetime. Once 100% of the IHT nil-rate band has been allocated any trusts created subsequently will incur IHT periodic and exit charges without the benefit of any nil-rate band deduction.				
<b>Equalities impacts</b>	The people affected by this measure will be in those groups which are represented in more wealthy populations. The Government has no evidence to suggest that the measure will have any adverse equalities impacts.				
<b>Impact on businesses and Civil Society Organisations</b>	Trust businesses may see a reduction in administration burdens as a result of settlors having to elect for how they want the nil-rate band allocated to each trust they set up. The reform of the multiple trusts rule could increase the number of trusts liable to ten-yearly or exit charges. The numbers of trusts currently needing to undertake a ten-yearly charge calculation each year is around 1000. A more detailed evaluation of the impact of these changes will be informed by this further consultation.				
<b>Impact on HMRC or other public sector delivery organisations</b>	Simplification will result in some efficiencies for HMRC in undertaking and checking trustees' calculations, but these will not be significant. Settlor's allocation of the nil-rate band would need to be monitored but this would form part of routine risk assessment activity.				
<b>Other impacts</b>	The measure will benefit small businesses (firms with fewer than 20 employees) as a result of the reduction in complexity and administration burdens. The measure will have no impact on wider areas such as privacy, carbon assessment, health impact assessment, rural proofing or other environmental issues. The impacts on sustainable social and economic development are negligible.				

## 5. Summary of Consultation Questions

**Q1 Are there any other provisions that would need to be made for when a settlor dies that have not been covered in this section?**

**Q2 Are there any other features of the existing rules that should be retained under the new rules?**

**Q3 Are there any aspects of the proposed new rules for allocating the SNRB or calculating the IHT charges that could be improved?**

**Q4 Are there any aspects of the existing rules that would no longer be necessary under the new rules?**

**Q5 Are there any other impacts for example on cost or equality that should be taken into account?**

**Q6 Should the simplified method for calculating ten year and exit charges proposed for relevant property trusts be extended to trusts that fall within the relevant charging provisions for 18-25 trusts?**

## 6. The Consultation Process

This consultation is being conducted in line with the Tax Consultation Framework. There are 5 stages to tax policy development:

- Stage 1 Setting out objectives and identifying options.
- Stage 2 Determining the best option and developing a framework for implementation including detailed policy design.
- Stage 3 Drafting legislation to effect the proposed change.
- Stage 4 Implementing and monitoring the change.
- Stage 5 Reviewing and evaluating the change.

This consultation is taking place during stage 2 of the process. The purpose of the consultation is to seek views on the detailed policy design and a framework for implementation of a specific proposal, rather than to seek views on alternative proposals.

### How to respond

A summary of the questions in this consultation is included at chapter 5.

Responses should be sent by 29 August 2014, by e-mail to [ihandtrustsconsult.car@hmrc.gsi.gov.uk](mailto:ihandtrustsconsult.car@hmrc.gsi.gov.uk) or by post to: Tony Zagara HM Revenue & Customs, Room G48/49, 100 Parliament Street, London SW1A 2BQ

Telephone enquiries: Tony Zagara 03000 585265 (from a text phone prefix this number with 18001)

Paper copies of this document or copies in Welsh and alternative formats (large print, audio and Braille) may be obtained free of charge from the above address. This document can also be accessed from [HMRC Inside Government](#). All responses will be acknowledged, but it will not be possible to give substantive replies to individual representations.

When responding please say if you are a business, individual or representative body. In the case of representative bodies please provide information on the number and nature of people you represent.

### Confidentiality

Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004.

If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public

authorities must comply and which deals with, amongst other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Revenue and Customs (HMRC).

HMRC will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

## Consultation Principles

This consultation is being run in accordance with the Government's Consultation Principles.

The Consultation Principles are available on the Cabinet Office website:  
<http://www.cabinetoffice.gov.uk/resource-library/consultation-principles-guidance>

If you have any comments or complaints about the consultation process please contact:

Oliver Toop, Consultation Coordinator, Budget Team, HM Revenue & Customs, 100 Parliament Street, London, SW1A 2BQ.

Email: [hmrc-consultation.co-ordinator@hmrc.gsi.gov.uk](mailto:hmrc-consultation.co-ordinator@hmrc.gsi.gov.uk)

Please do not send responses to the consultation to this address.