

7 December 2007

IHT PLANNING FOR TRUST LIFE TENANTS

ACT BEFORE APRIL 2008

The Finance Act 2006 introduced radical changes to the inheritance taxation of trusts. The Act includes transitional rules for life interests which were in existence on 22 March 2006. Inheritance tax (IHT) planning opportunities are available, but **only until 5 April 2008**. It is therefore essential that all trustees of life interest trusts review their settlements and consider whether they need to take action.

Life Interest Trusts

A life interest which was in existence on 22 March 2006, continues to attract "old regime" treatment.

- The life tenant is treated as if he owned the capital in which he has an interest;
- there will be no inheritance tax charges as long as his interest continues;
- if his life interest continues until his death, there will potentially be an inheritance tax (IHT) charge as usual (subject to successive life interest for spouse - see below);
- a transfer of capital to the life tenant will have no inheritance tax effect. The trustees will be treated for CGT as if they had sold the trust assets at market value. The gain arising cannot be held over;
- an appointment of capital to another beneficiary outright will be a potentially exempt transfer by the life tenant. There will be no IHT provided the life tenant survives for seven years. There may be a CGT charge; and
- an appointment to other beneficiaries in trust will be treated as a gift by the life tenant. There will be an immediate charge to IHT at 20% (subject to the opportunity outlined later in this news release - Pre-April Transitional Serial Interests) and there may be further tax if the life tenant dies within seven years. There will be no CGT.

The transitional rules provide planning opportunities through the creation of "Transitional Serial Interests" (TSIs).

Successive Life Interest for Spouse

If the life tenant's spouse becomes entitled to a life interest on the **death** of the tenant, the spouse's life interest will be a TSI. This is not limited to deaths before 6 April 2008. A life interest for the spouse arising during the life tenant's lifetime on or after 6 April 2008 will **not** be a TSI.

A TSI will be treated as an old style interest in possession. This means that inheritance tax can be deferred until the death of the survivor of the life tenant and his spouse. It also provides opportunities for future tax planning during the surviving spouse's lifetime.

TSI treatment applies whether the spouse's interest is written into the settlement from the outset or is appointed using powers under the trust.

Trustees should actively consider whether to appoint a spousal TSI where possible.

Pre-April Transitional Serial Interests

An opportunity exists for trustees to "transfer" a part or all of the current life tenant's interest in possession to one or more other beneficiaries before 6 April 2008.

If a pre-22 March 2006 life interest is replaced by a new life interest in favour of, say, the original life tenant's children or even grandchildren, the interests of the children or grandchildren will be TSIs and will be entitled to old regime treatment for as long as they last. The TSI's tax treatment will be as set out above for the original life tenant.

Provided the existing life tenant survives for seven years, an appointment will defer an IHT charge for at least another generation.

The trustees could use income arising during an appointee's minority for his maintenance and education but any retained income must be handed over when the beneficiary reaches the age of 18. He would, of course, be entitled to the income from that point onwards.

The appointment of a TSI would not trigger a CGT charge.

The succession of an interest can qualify only once for TSI treatment. The appointment of a successive interest to the current life tenant's spouse and an appointment to other beneficiaries before April 2008 are therefore alternative options, unless the original interest is divided accordingly.

Act Now!

We recommend that existing life tenants of trusts administered by Praxis should consider this planning opportunity with their UK tax advisers and contact their Client Engagement Director on +44 (0) 1481 737600 to decide whether any action should be taken before 6 April 2008.

Praxis Fiduciaries Limited

PO Box 296
Sarnia House
Le Truchot
St Peter Port
Guernsey
GY1 4NA

Tel: +44 (0) 1481 737600
Fax: +44 (0) 1481 710511

Email: info@praxisfiduciaries.com
www.praxisfiduciaries.com