These notes refer to the Finance Act 2010 (c.13) which received Royal Assent on 8 April 2010

FINANCE ACT 2010

EXPLANATORY NOTES

INTRODUCTION

Section 53: Interests in Possession

Summary

1. Section 53 provides that where an interest in possession in a trust is purchased then for inheritance tax (IHT) purposes it will be treated as part of the purchaser's estate.

Details of the Section

2. Subsection (2) amends section 3A of the Inheritance Tax Act 1984 (IHTA), which provides for certain transfers to individuals to be potentially exempt from IHT.

3. Subsection (2)(a) removes the reference to a charge under section 52 of IHTA being treated as a potentially exempt transfer. (Section 52 of IHTA provides for there to be an IHT charge where an interest in a settlement that is treated as part of a person's estate comes to an end.)

4. Subsection (2)(b) inserts new subsection (6A) into section 3A of IHTA. This re-instates the position that a transfer of value under section 52 will be potentially exempt, but provides for an exception to this where the section 52 charge arises in respect of an interest that is treated as part of a person's estate under new section 5(1B) of IHTA. This means that, for example, where the trust comes to an end and the capital is paid out, the transfer of value will be immediately chargeable to IHT.

5. Subsection (3) amends section 5(1)(a)(ii) of IHTA so that interest in possessions defined in new section 5(1B) of IHTA will be excluded from the general provision that interest in possessions are not treated as part of a person' estate.

6. Subsection (3)(b) inserts new subsection (1B) into section 5 of IHTA, so that it includes a new category of interest in possessions that will be included as part of a person's estate. These are interests to which a UK domiciled person is entitled and that the person acquired that interest in an arm's length transaction (as defined in section 10 of IHTA).

7. Subsection (4) provides for consequential amendments to other provisions so that they include interests in possession as defined in new section 5(1B) of IHTA.

8. Subsection (4)(a) provides that the person who has a section 5(1B) interest will be treated as being beneficially entitled to the property underlying that interest by virtue of section 49(1A) of IHTA. This means that, for example, on death, they will be treated as if they owned the property in which their interest subsisted.

9. Subsection (4)(b) amends section 51(1A) of IHTA, which provides that where a person disposes of an interest in possession it is not a transfer of value, but IHT charges may arise under section 52 of IHTA. This provision applies only to certain categories of interest in possession, which are extended to include section 5(1B) interests.

10. Subsection (4)(c) amends section 52(2A) and (3A) of IHTA which provide for IHT charges when an interest in possession comes to an end during the beneficiary's lifetime. The charges only apply to certain interests in possession; these are extended to include section 5(1B) interests. This means, for example, that if a person gives their interest away or their interest comes to an end, then there is an IHT chargeable event.

11. Subsection (5) amends section 57A(1A) of IHTA, which provides for relief where an interest in possession is included as part of a person's IHT estate if within two years of their death the property in which they had their interest becomes held in a trust that has been approved as a heritage maintenance fund. The relief is extended to interest in possessions that will be treated as part of a person's estate under section 5(1B).

12. Subsection (6) amends section 100(1A) of IHTA, which deems there to be a disposition for IHT purposes if there is a change in a close company's share capital (where an individual is entitled to certain categories of interests in possession.). This is extended to interests in possession that will be treated as part of a person's estate under section 5(1B).

13. Subsection (7) amends section 101(1A) of IHTA, which treats the participators of a close company as being entitled to an interest in possession in any settled property held by the company. This applies only to certain categories of interest in possession, which are extended to interests that will be treated as part of a person's estate under section 5(1B).

14. Subsection (8) amends section 102ZA(1)(b)(ii) of the Finance Act 1986. This provides for the gifts with reservation rules to apply to a person with certain categories of interest in possession, which are extended to include interests that will be treated as part of a person's estate under section 5(1B).

15. Subsection (9) is a consequential amendment as a result of the changes in section 1(2).

16. Subsection (10) provides that these amendments will have effect only for interests in possession to which a person becomes entitled on or after 9 December 2009.

Background Note

17. An interest in possession is an interest in which a beneficiary has the right to any income arising on the property in a trust. Changes made to the trust rules in 2006 mean that most interest in possessions are now included in the relevant property regime. Broadly, IHT charges arise on relevant property:

    - at 20 per cent on assets put into trust which exceed the IHT nil-rate band (with a further charge of up to 20 per cent if the person dies within seven years of making the transfer);
    - at 6 per cent every ten years on the value of the trust assets over the nil-rate band (the "periodic charge"); and
    - an "exit charge" when funds are taken out of trust between ten-year anniversaries at a rate based on the time since the last "periodic charge".

18. HM Revenue & Customs (HMRC) became aware of arrangements that sought to avoid any IHT charges on assets that are put into a trust. The arrangement was designed to allow individuals who would normally be chargeable to IHT on transfers in to trust to purchase an interest in a trust that had not been subject to UK IHT charges when property had originally been transferred in to it.

19. The section provides that where an interest has been purchased at full value then that interest will be treated as part of a person's estate. Where a person puts funds in to a trust in the normal course of events the normal IHT charges will apply, and the changes in new section 5(1B) will not apply. If a person purchases an interest in a trust other

than at arms length then section 10 of IHTA will not apply and there will be a transfer of value in the normal way.

20. Where new section 5(1B) applies to treat the interest as part of a person's estate the property in the trust will still be part of the relevant property regime.

21. Some interests in possession are already treated as part of a person's estate – for example, a disabled person's interest. This section does not affect any such interests.