Qualifying interests in possession: Restating the problem

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Is it possible to taint an interest in possession, thereby losing its transitional protection under the Finance Act 2006 and triggering adverse inheritance tax consequences? Can this be done by merely restating the interest without a change of beneficiary? This article explores these questions in light of the recent case of *Ware v. Ware* [2021] EWHC 694 (Ch).

A. Summary of the statutory regime

Where assets are held subject to a trust, the starting point in determining whether inheritance tax ("**IHT**") is payable is to ask whether at least one beneficiary has a qualifying interest in possession ("**QIIP**") in the settled property. If there is at least one such beneficiary then the property settled under the trust in which the beneficiary has a QIIP will at least generally be treated for IHT purposes as forming part of that beneficiary's estate, to be taxed upon their death or on termination of their interest during their lifetime.

If and to the extent that there is no beneficiary with a QIIP then (again generally) a number of IHT charges will be applied to the trust under "**the 'relevant property' regime**". The applicable charges include (i) a charge payable every 10-years over the life of the trust, (ii) an 'exit' charge whenever capital is distributed, and (iii), most notably, a 20% 'entry' charge whenever assets are made subject to the trust.

Following amendments introduced by the *Finance Act 2006* ***("the FA 06")***, there are broadly (for IHT purposes) four groups of interest in possession that qualify as a QIIP under the *Inheritance Tax Act 1984* ***("the IHTA")***, *Sections 59, 49* and as follows:

First, a saving provision was effectively included for any interest in possession to which a beneficiary had become entitled prior to 22 March 2006.

Second, three further sets of transitional provisions were also included across the *IHTA, Sections 49B-E* for interests in possession that arose before 22 March 2006 and passed thereafter in the period before, to and/or after 6 October 2008 ('transitional serial interests'; the conditions for each are different).

Third, the new regime does not apply to an interest in possession for the benefit of a 'disabled person' as defined in the *IHTA, s89B-89C* (and see the *Finance Act 2005, Schedule 1A* for the definition of 'disabled person') (a 'disabled person's interest').

Fourth, the regime does not apply to an interest that arises as a result of a will or intestacy, to which the beneficiary became entitled upon the death of the testator or instate (an 'immediate post-death interest', per *IHTA, Section 49A*).

These four bases for a QIIP are not the whole story and the detailed provisions of *the IHTA* and other related legislation repay careful reading. In particular, it should be noted both that (a) even where there *is* a QIIP, that can cease to be the case, without a substantive change of income beneficiary; and (b), even if there is *no* QIIP, a trust may nonetheless still avoid the application of the relevant property regime to the extent that property so held falls outside of the definition of 'relevant property' in the *IHTA, Section 58* (such as 'excluded property' under the *IHTA, Section 48*).

B. The risk posed by a restatement

That an interest can cease to be a QIIP is to at least some degree uncontroversial: the *IHTA, Section 49(1)* provides for this expressly. The focus of this article is the position that appears to have been adopted by HMRC (and which has been adopted in at least one recent first instance decision of Master Clark) as to the breadth of the circumstances in which property will be said to have been re-settled (or, alternatively subject to a new non-qualifying interest in possession) so as to fall outside of the first of the four bases to qualify as a QIIP above.

On this view, any amendment of a trust (including by the exercise of a power of appointment or advancement) that includes a restatement of an interest in

possession will have the effect of removing its status as a QIIP. That is so even if the amendment merely sets out the interest without any substantive alteration to it, with the substantive amendments instead addressing e.g. the interests in remainder. On this view, the effect of any such restatement will be to create a new interest in possession, which – long after 2006 – will not be a QIIP. This would typically trigger a lifetime inheritance tax charge and a gift with a reservation, together with entry into the relevant property regime – the worst of all worlds.

That this is HMRC's interpretation of the legislation has been at least alluded to for some time. An example can be seen in the answer given (concerning an exercise of the statutory power of advancement) to question 6 of the questions put to HMRC by STEP and CIOT as to the changes introduced to the *IHTA* by the *FA* 2006. The relevant example, question and answer (most recently updated on 3 October 2008) are not reproduced here and can be found on *Practical Law*.

A clearer warning can be seen from the recent decision of Master Clark in ***Ware v. Ware*** [2021] EWHC 694 (Ch); [2021] S.T.I. 1296; [2021] P. & C.R. DG6. By two testamentary trusts created by a 2005 deed, a father's interest in the family home and his residuary estate were to be held for life for his wife ('the mother'), with the remainder to their only son (or to his issue by substitution), subject to overriding powers of appointment. In 2013, advice was sought as to the effect of the son pre-deceasing the mother, to ensure that the mother could remain in the property in that event. It was advised that a number of amendments should be made to the trusts to achieve this by way of the exercise of a power of appointment; so as to add additional default beneficiaries. In doing so, new 2013 deeds of appointment restated how the interests in possession were held pursuant to the 2005 deed.

HMRC did not participate in the hearing in ***Ware***, nor tender any evidence or submissions, save to request that the Court be referred to a number of authorities. Nonetheless, all parties appear to have proceeded on the basis that the effect of the 2013 deeds restating the interests was (i) to terminate the pre-2006 interests, (ii) to create new interests in their place that did not qualify as QIIP, and (iii) which new interests were subject to the relevant property regime and the charges it levies.

Indeed, Master Clark found to that effect at paragraphs 33 to 36 of her judgment and accordingly, whether or not the above was or remains HMRC's view, there is now at

least one first instance authority[1] that this is the proper interpretation of these statutory provisions. Master Clark then went on, at paragraphs 37 to 56 of her judgment, to grant rectification of the 2013 deeds so as to avoid the outcome above. See also, to some degree similarly, ***RBC Trustees v. Stubbs*** [2017] EWHC 180 (Ch); [2017] 2 P. & C.R. DG5, in particular at ¶¶28, 34, 58, per Rose J.

C. How to mitigate the risk in practice in the circumstances

The general advice in such circumstances has to be to draft deeds of appointment or advancement in a way that does not restate or otherwise set out an existing interest in possession again, unless, for example, a change of substance to that is intended. This can be done relatively easily by omitting mention of the interest in the deed and to instead merely provide that the previous trust(s) continue(s) to apply, subject (only) to the (following – setting those out) particular amendments.

D. The law going forwards

Was the decision in ***Ware*** (at least largely confined to the single paragraph 33) correct on this point? The remainder of this article poses three counterarguments.

First, tax is supposed to be charged as to substance and not form: at least insofar as that is established under the ***Ramsay*** principle of statutory construction. Indeed, somewhat ironically, it is typically HMRC taking this position.

Second, by way of an example, that focus on substance over form is reflected in the approach taken by HMRC in *Statement of Practice 7 of 1984* as to the CGT implications of the exercise of a power of appointment or advancement.

Third, that approach is also reflected in the VTA authorities as to whether there has been a variation or a resettlement, as summarised in ***Wyndham v. Egremont*** [2009] EWHC 2076 (Ch); [2010] 1 P. & C.R. DG9 at paragraphs 17-24, per Blackburne J. It is notable that a variation can avoid being classified as a resettlement, despite having the effect that a new perpetuity period applies thereafter to the trust.

[1] The status of Masters' decisions as precedent is the subject of an upcoming article by Michael Ashdown.

E. Conclusion

In the circumstances, a prudent draftsperson will avoid the risk of an IHT charge by drafting around the problem. It is suggested however that ***Ware*** may not be the last word on this subject and that its reading of the law may not be the better one.

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