

Immediate Post Death Interests

The Immediate Post Death Interest (IPDI) trust should be well known among Will Writers as it is a great protective tool in the estate planning kit. This month's CPD paper will aim to cover the finer details of the IPDI so Will Writers can strengthen their understanding of what they do and how they work.

KEY TERMS

Some key terms to start:

- Life tenant – The person who is granted the life interest in the trust
- Remainderman – The beneficiary who has the remainder interest. Who the trust fund will pass to when the life interest ends.

WHAT IS AN IPDI?

The IPDI was introduced by the Finance Act 2006, which inserted s49A into the Inheritance Tax Act 1984.

An IPDI is an Interest in Possession (IIP) trust that meets the conditions set out in s49A:

1. The trust is created by will or under the intestacy rules.
2. The life tenant becomes beneficially entitled to the interest on the death of the testator or intestate.
3. The property is not held on either a Bereaved Minor's Trust or Disabled Person's Trust at any point.

Now let's take a more detailed look at these conditions:

1. Trust created by will or under intestacy rules

The trust must be effected by will, i.e. the will must contain the settlement. There is no restriction on how many IPDIs a testator may create by will, so it is possible to use these trusts to protect different parts of the estate for different people if desired.

The condition makes reference to the interest arising on intestacy. Since 1 October 2014 an IPDI can no longer arise on an intestacy. Under the previous intestacy rules a statutory IPDI arose if the deceased died leaving a spouse and children and an estate over £250,000 as the surviving spouse would take all personal chattels, the statutory legacy of £250,000 and a life interest in half of what remained. Under the current intestacy rules the surviving spouse takes an absolute interest in the half that remains instead.

2. Life tenant becomes beneficially entitled on the death of the testator or intestate

The interest must arise immediately on the death of the testator (or intestate in the case of deaths before 1 October 2014). Hence the name *Immediate* Post Death Interest.

What if there is a survivorship clause? It isn't uncommon for a standard survivorship clause to be included in a will so that the spouse only becomes entitled to the interest if they survive by 28 days. On the surface it looks like this would fall foul of this immediacy condition, as the spouse is taking the interest if they survive by a certain period and not actually immediately on the testator's death. Thankfully the IHTA 1984 provides for this situation by effectively reading-back. Section 92 provides that the interest taking effect at the end of the survivorship period shall be treated as though it had taken effect immediately from the testator's death:

92 Survivorship clauses.

(1) Where under the terms of a will or otherwise property is held for any person on condition that he survives another for a specified period of not more than six months, this Act shall apply as if the dispositions taking effect at the end of the period or, if he does not survive until then, on his death (including any such disposition which has effect by operation of law or is a separate disposition of the income from the property) had had effect from the beginning of the period.

(2) Subsection (1) above does not affect the application of this Act in relation to any distribution or application of property occurring before the dispositions there mentioned take effect.

This condition means that successive life interests cannot be IPDIs:

Example: Dave's will leaves his estate to his wife Holly on an IIP trust for life, with remainder to his daughter on a further IIP trust, and after her to her own issue. On Dave's death the interest that arises for Holly meets the requirements to be an IPDI. On Holly's death the daughter's IIP is not an IPDI because her interest did not arise immediately on the death of the testator. Her IIP will not be a qualifying interest in possession so will be taxed subject to the relevant property regime.

3. Property cannot at any time be held on Bereaved Minor's or Disabled Person's Trusts

Where there is an overlap between an IPDI and a BMT or Disabled Person's Trust the non-IPDI will take precedence. This makes sense for the BMT as these types of trust are subject to a special charging regime, but is arguably less obvious for Disabled Person's Trusts as these are taxed the same as IPDIs

WHAT IS AN INTEREST IN POSSESSION?

Interesting there is no statutory definition of an Interest in Possession (IIP) despite how frequently the term pops up, even in tax legislation.

The meaning of IIP was clarified in the House of Lords case of *Pearson v IRC* [1981] AC 753. In this case an IIP was defined as a 'present right to present enjoyment'. This encompasses:

- The right to receive trust income as it arises and not at the discretion of the trustees.
- The right to use or occupy any trust property.

It doesn't matter if the trust doesn't produce any income, as long as the terms of the trust mean that should any income arise the life tenant would be entitled to receive it. This is often the case where the testator's residence is left on an IPDI trust for the survivor. In most cases this will not produce any income for the life tenant as they will be occupying the property as their main residence, however should they later move out of the property, e.g. into residential care, the property could be rented out and the life tenant would then be entitled to receive the rental income.

A trust may include overriding powers that would have the effect of ending the IIP if exercised. The presence of these powers does not prevent the trust initially being considered an IIP, however if the overriding powers are exercised the IIP will be brought to an end, either in full or in part, so will no longer qualify as an IIP. A common example of this is the Flexible Life Interest Trust, where once the overriding powers are exercised the IIP is replaced by a discretionary trust.

Example: Samuel's Will gives Gloria a life interest in his residuary estate with his children as remaindermen. The trust grants the trustees an overriding power of appointment. Until they exercise this power Gloria will have an IIP in the trust fund.

Although the term 'life interest' is often used interchangeably with 'interest in possession' an IIP is not required to carry on for the life tenant's whole life.

IHT TREATMENT

In IPDI is a qualifying IIP for IHT purposes. s49(1) IHTA 1984 provides that qualifying IIP trusts are treated for IHT purposes as though the assets belonged to the life tenant, rather than being taxed under the relevant property regime:

49 Treatment of interests in possession.

(1) A person beneficially entitled to an interest in possession in settled property shall be treated for the purposes of this Act as beneficially entitled to the property in which the interest subsists.

The following are *qualifying* IIPs:

- An IIP to which an individual became entitled to before 22 March 2006
- An IIP to which an individual became entitled to after 22 March 2006 and which is:
 - An IPDI
 - A disabled person's interest; or
 - A transitional serial interest

(s59 IHTA 1984)

During the life of the life tenant there will be no anniversary or exit charges. It is also important to note that as the assets passing to the IIP are treated as passing to the life tenant, if the life tenant is a spouse or civil partner of the testator they will benefit from the s18 IHTA 1984 spouse exemption and the assets will pass to the IIP IHT free.

At the end of the trust there will be differing IHT treatment depending on whether the IIP ends on the death of the life tenant or on some event prior to the life tenant's death.

If the IIP ends during the life tenant's lifetime they are treated for IHT purposes as though they had made a gift of the trust assets. If at the end of the IIP the assets pass to a relevant property trust the life tenant is treated as making a chargeable lifetime transfer, this would be at the lifetime rate of 20%. If instead the assets pass to an individual absolutely or to a disabled person's trust the life tenant will be treated as making a potentially exempt transfer (PET). The usual PET rules apply, so the life tenant must survive the transfer by 7 years for it to become exempt. If they die within 7 years of the end of the IIP there will be an IHT charge, though this may be reduced by taper relief if they have survived the transfer by at least 3 years.

Taper relief is available at the following rates:

Years between gift and death	Rate of relief
less than 3	0%
3 to 4	20%
4 to 5	40%
5 to 6	60%
6 to 7	80%
7 or more	100%

If the IIP ends on the life tenant's death the value of the assets in trust are aggregated with the life tenant's own estate for IHT purposes and taxed at 40%. The life tenant will have their own unused NRB to offset against this, as well as any unused NRB from a late spouse or civil partner.

Residence Nil Rate Band (RNRB)

If the IIP holds real property we must consider how this affects the RNRB. Availability of the RNRB depends on the relationship of the life tenant to the testator, as well as the relationship of the beneficiaries to the life tenant and the terms on which the property is passing.

If the life tenant of the IIP is a direct descendant of the testator then the RNRB will be available on the testator's death. If the life tenant is not a descendant then the RNRB will not be available on the testator's death, but may be available on the life tenant's death.

The RNRB will be available where the IIP ends on the life tenant's death and the trust property passes either absolutely or on disabled person's trusts to direct descendants **of the life tenant**. If the property passes to beneficiaries who are not direct descendants of the life tenant or passes to a relevant property

trust, then no RNRB will be available. Remember that step-children are treated as direct descendants of the life tenant, but the children of an unmarried partner are not.

The life tenant will have their own RNRB as well as the unused RNRB of a deceased spouse or civil partner available to them.

Where the life tenant and testator were not married or civil partners less options will be available. If the testator had children from a previous relationship and the property passes to these at the end of the IIP no RNRB will be available as the beneficiaries are not direct descendants of the life tenant. Even if the property were passing to the life tenant's children or remoter issue, the life tenant would have only their own RNRB available to them.

INCOME AND CAPITAL GAINS TAX TREATMENT

Income Tax

The life tenant is entitled to the trust income, so this is normally taxed on the basis that it belongs to them. The trustees may either receive the income and then pay it to the life tenant or mandate the income so that the life tenant receives it directly.

If the income is mandated to the life tenant, the trustees will not pay the income tax due and do not declare it when completing their trust and estates tax return. Instead, the life tenant is responsible for declaring the income on their personal tax return and paying the income tax themselves.

If the income is paid to the trustees they will pay the income tax at the following rates:

- 7.5% on dividends
- 20% on other income

The trustees declare the income in the trust and estates tax return, pay income to the life tenant net of tax and allowable trust expenses, and providing them with a certificate of tax deducted (Form R185). The life tenant must declare the net income they have received on their personal tax return and must pay tax at their personal rate. As this takes into account their personal allowances they may either need to pay more tax or may receive a refund.

Capital Gains Tax (CGT)

If the IIP holds real property and this is being used as the main residence of the life tenant, then the trust will benefit from Private Residence Relief (PRR) if the trustees dispose of the property so there will be no CGT to pay.

If the trustees dispose of any other assets there may be CGT to pay on the difference between the sale value and the value the trustees acquired them at, which will be the probate value in the case of an IPDI.

If the life tenant surrenders their life interest in lifetime this will be a disposal for CGT purposes and will give rise to a CGT liability upon the trustees, unless the IIP is over only the life tenant's residence.

If the IIP ends on the life tenant's death there will be no CGT to pay. The acquisition value will also be uplifted to the new market value on the life tenant's death.

Where there is CGT to pay, trustees will pay at a rate of 20%. If the disposal is of real property that does not qualify for PRR they must pay CGT at a rate of 28%. Trustees have an annual allowance of half what an individual is entitled to, currently £5,850 (2018/19).

TYPICAL USES OF IPDIs

IPDIs are typically used to provide an income for a person and protect the capital for further beneficiaries until the life tenant dies or no longer needs that income. The most common use of an IPDI is a 'life interest', though they may be limited to a shorter period such as for a set number of years or until the life tenant remarries reaches a certain age.

A common form of IPDI is to grant a surviving spouse an IIP in the family home; this is often referred to as a Protective Property Trust or PPT. This allows the life tenant to live in the property and receive all of the income as it arises if there is any.

It is also common to leave the residue of the estate on flexible IPDI trusts for the surviving spouse. This has the benefit of ring-fencing the capital of the trust, protecting it should the survivor become bankrupt, remarry, or require residential/nursing care in future. They also allow for incredible flexibility by allowing the trustees to terminate the IIP, either in full or in part, when appropriate to make provision for other classes of beneficiary.

Flexible IPDIs are also useful in IHT planning for the survivor, allowing the trustees to make small terminations of the IIP making use of the life tenant's annual exemption. Any transfers of capital to the other beneficiaries are treated as PETs by the life tenant, so even if amounts exceeding the annual exemption are transferred they will be tax free if the life tenant survives 7 years.

A life tenant of an IIP is entitled to income but not capital. That said, where the life tenant is a spouse or civil partner many settlements will include an express power to pay capital to them to provide greater flexibility. This offers greater provision for the life tenant, as a right to income alone may not be sufficient in the case of an emergency.

An IIP with no power to pay capital may not be considered 'reasonable financial provision' under the Inheritance (Provision for Family and Dependents) Act 1975, depending on the nature of the IIP. An IIP in the family home along with a life interest that produces a sufficient income has been considered reasonable financial provision in the past (*Re Krubert* [1997] Ch 97). If the IIP is in assets that produce no income or very little income and the life tenant has limited means of their own, then the IIP may not be considered reasonable financial provision.

CONCLUSION

Hopefully this month's paper has provided some clarity on what constitutes an IPDI, how they are treated for tax purposes, and their common uses. As ever we encourage further reading on the subject.

Important Reminder:

These notes are produced solely for the benefit of SWW members when completing the May CPD test to gain 1 hour of structured CPD towards their annual quota. The notes do not represent legal advice and no reliance can be made on the content of the notes in any or individual specific client circumstances. Having read the notes members should cement their understanding by considering further reading around the subject – cases details can be found by searching the case references using BAILII or GOOGLE.