# VARIATION OF TRUSTS: EXTENDING THE ACCUMULATION PERIOD AND AMENDING BENEFICIAL INTERESTS

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A recent trust case that has important implications for tax practitioners is *Pemberton v Pemberton* [2016] EWHC 2345, a decision of His Honour Judge Hodge (sitting as a Judge of the High Court).

The application, brought by C as a beneficiary of a family settlement established by his grandfather Sir Francis Pemberton (Sir Francis) on 31 March 1968 (the Settlement), was for the Court's approval under the Variation of Trusts Act 1958 (VTA 1958) of a Scheme of Arrangement to:

- extend the accumulation and perpetuity periods of the Settlement to 125 years from the date of the Court's order;
- to confer additional administrative powers on the trustees;
- whilst preserving pre-existing interests in possession, to create reversionary life interests for certain spouses;
- to create, in substitution of the present trusts, discretionary trusts during the remainder of the extended Trust Period, for the benefit of, broadly, Sir Francis' grandchildren, remoter issue, their spouses and civil partners;
- to ensure that the Settled Land Act 1925 no longer applied.

**Jurisdiction**

Where the beneficiaries are all adults and ascertained it is possible to vary a settlement without the consent of the court. Where there are minor and unborn beneficiaries, the court has power by virtue of section 1(1) of the VTA 1958 to

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approve the variation of a trust on their behalf. However the court's powers are limited to varying arrangements rather than resettlement and will only be exercised where the benefit requirement is met, see for example *Re Holt's Settlement* [1969] 1 Ch 100.

## The rule against accumulations

The Perpetuities and Accumulations Act 2009 (PAA 2009) provides as follows:

***1 Application of the rule***

*(1) The rule against perpetuities applies (and applies only) as provided by this section.*

*(2) If an instrument limits property in trust so as to create successive estates or interests the rule applies to each of the estates or interests…*

*(6) If an instrument creates a power of appointment the rule applies to the power.*

***5 Perpetuity period***

*(1) The perpetuity period is 125 years (and no other period)*

*(2) Subsection (1) applies whether or not the instrument referred to in section 1(2) to (6) specifies a perpetuity period; and a specification of a perpetuity period in that instrument is ineffective.*

***11 Powers of appointment***

*(1) Subsection (2) applies to a power of appointment exercisable otherwise than by will (whether or not it is also exercisable by will).*

*(2) For the purposes of the rule against perpetuities the power is a special power unless—*

*(a) the instrument creating it expresses it to be exercisable by one person only, and*

*(b) at all times during its currency when that person is of full age and capacity it could be exercised by that person so as immediately to transfer to that person the whole of the interest governed by the power without the consent of any other person or compliance with any other condition (ignoring a formal condition relating only to the mode of exercise of the power).*

***13 Abolition of restrictions***

*These provisions cease to have effect—*

*(a) sections 164 to 166 of the Law of Property Act 1925 (c 20) (which impose restrictions on accumulating income, subject to qualifications);*

*(b) section 13 of the Perpetuities and Accumulations Act 1964 (which amends section 164 of the 1925 Act).*

***15 Short title, interpretation and extent***

*(5) The foregoing sections of this Act shall apply…only in relation to instruments taking effect after the commencement of this Act, and in the case of an instrument made in the exercise of a special power of appointment shall apply only where the instrument creating the power takes effect after that commencement.*

The effect of section 15 PAA 2009 is that where trustees exercise a special power of appointment given in an instrument executed before 6 April 2010 to transfer property from one English law trust to another English law trust, the perpetuity and accumulation periods of the transferor trust continue to apply even after the transfer of the property to the new settlement.

**Variation of Trusts Act**

It is, however, possible to change the perpetuity period (to 125 years) and to extend the accumulation period of the Settlements to that period with the approval of the Court on behalf of the minor and unborn beneficiaries under the Variation of Trusts Act 1958, see *Re Holt's Settlement* [1969] Ch 100 (AB D11). In that case, Megarry J approved an insertion of both a new accumulation period and a new perpetuity period under the Perpetuities and Accumulations Act 1964:

> *'Under an arrangement approved by the court the trusts … may be varied; and there is no limit other than the discretion of the court and the agreement of the parties, to the variation which may be made. Any variation owes its authority not to anything in the initial settlement but to the statute and the consent of the adults coming, as it were, ab extra … In my judgment, therefore, it is permissible to insert provisions deriving their validity from the Act of 1964 into an arrangement approved under the Act of 1958.'*

It was therefore submitted that it is possible to insert provisions in the Settlement deriving their validity from the 2009 Act.

**Capital gains tax issues**

In doing so, it is vital not to create a resettlement for CGT purposes. In *Allfrey v Allfrey* and others [2015] EWHC 1717 (Ch), Mr Cousins QC sitting as a Deputy of the High Court approved a variation incorporating a power to accumulate and extending the trust period and confirmed that such a variation did not amount to a resettlement:

> *'The intention was to supplement the provisions of the existing Settlement, thereby enhancing its operation. In my judgment, the arrangement quite clearly is to be described as a variation rather than a resettlement. The parties intended to continue the existing trusts, but with modifications. Although there is no single litmus test (per Hoffmann J in Swires v Renton), or bright line test (per Blackburne J in Wyndham v Egremont), the terms of the arrangement fall very clearly on the variation side of the line, and very clearly not on the resettlement side of it.'*
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> See also *DC* v *AC* [2016] EWHC 477 (Ch).

**Interests of minor and unborn beneficiaries**

In order to obtain the consent of the Court it was also necessary to show that the extension of the accumulation period (and the perpetuity period) of the Settlement was in the interests of the minor and unborn beneficiaries: see *Wright v Gater* [2012] STC 255, including asking the question "*[Would] a prudent adult motivated by intelligent self-interest and [after] sustained consideration of the [proposed trusts and powers and the circumstances in which they may fall to be implemented], be likely to accept [the proposal]*?"

In the Pemberton case, the Settlement was created by Sir Francis as settlor as (in respect of the land settled) a strict settlement under the Settled Land Act 1925 (SLA 1925). The beneficiaries with present interests in possession were C, his father Anthony, his son Henry and his two daughters, Jemima and Rose. One other minor beneficiary Harriette. The minor children's revocable interests in possession in certain of the settlement funds were to continue.

All other interests of minor, unborn or unascertained beneficiaries on whose behalf the court was being asked to approve the arrangement were mere objects of discretions, whose interests could be destroyed by the exercise of non- fiduciary powers vested in certain beneficiaries of full age and capacity who consented to the variation and were parties.

It followed that no minor, unborn or unascertained beneficiary would be worse of as a result of the proposed variation. The variation was for the benefit of the family as a whole and thus for each member of it. Persons would continue to be objects of discretionary powers reposed in the trustees. The settlement will have undergone a much needed overhaul and its potential life will have been expanded enormously. This was very important as the settlement enjoys considerable inheritance tax and capital gains tax advantages which could not be replicated in any new settlement.

C explained that if the proposed arrangement were not to be approved his intention would be to exercise his existing powers to create as near as may be new trusts as near as may be to those of the proposed arrangement. He would provide that discretionary trusts would take effect subject to the existing IIPs and to new reversionary life interests which he would create with the proposed extended class of objects. This would be far less satisfactory than if the arrangement were to be approved as the perpetuity period would not be set running afresh, the trust would still be governed by the Settled Land Act, and neither the trustees nor the tenant for life or other persons having the powers of the tenant for life would have the proposed extended administrative powers.

The extension to the perpetuity and accumulation periods was a significant benefit for the minor beneficiaries for two main reasons:

- It provided them with the opportunity to benefit from the trust throughout their lifetimes without any unavoidable capital gains tax exposure.
- It would remove doubt over the validity of certain aspects of the existing trusts of which the trustees have been advised and which are said to have arisen as a result of historic drafting errors.

The additional administrative powers would enable the trustees to carry out their duties with the flexibility that more modern settlements provide.

The creation of reversionary interests in favour of the adult beneficiaries' spouses was in the interests of the minor beneficiaries as it provided the opportunity or trust assets to pass to them, which was the trustees' intention, potentially free of inheritance tax. What was intended is that use would then be made of the facility to make potentially exempt transfers.

The inclusion of remainder interests for the minor beneficiaries' future spouses was also in their interests as it provided the opportunity for some family assets to pass further down the family line before being subject to capital gains tax or inheritance tax.

The creation of discretionary trusts in remainder following the various life interests provided for the assets to remain in trust from a much longer period than was currently the case.

The question "*[Would] a prudent adult motivated by intelligent self-interest and [after] sustained consideration of the [proposed trusts and powers and the circumstances in which they may fall to be implemented], be likely to accept [the proposal]"* should be answered in the affirmative. His Honour Judge Hodge said:

> *'For all of those reasons Mrs Hardy invites the court to exercise its powers to approve the arrangement in the form of the agreed draft order. For the reasons unanimously advanced by Mr Venables and Mrs Hardy, with the informed support of Mr Kessler and Mr Marre, I am entirely satisfied: (1) that it is for the benefit of the minor beneficiaries, the unascertained beneficiaries and the unborn potential beneficiaries for the court to approve this arrangement, and (2) that in the exercise of its discretion, the court should do so. This is not a case where there is any attempt to take advantage of any illegitimate form of tax avoidance or evasion. Insofar as fiscal considerations are relied upon, they properly fall on the side of legitimate tax mitigation. An important consideration in the present case is the precarious nature of the minor beneficiaries'' interests to the extent that they are going to be affected by the arrangement. In that sense, the position of the minor beneficiaries will be improved; and it cannot be said that there has been any loss of any legitimate or valuable bargaining counter or chip.'*

**Costs**

As regards costs, there were two alternatives. First there could be an order that the costs of all parties come out of the estate, namely the settlement. The justification for that approach was that all parties recognised that the litigation was for the benefit of the settlement and those interested in it, and therefore the costs should come out of the trust fund. The other approach would be to say that as the author of the proposed variation, the claimant should bear the costs of all parties. His Honour Judge Hodge came to the following conclusion:

> *'I have not found this a particularly easy matter. The claimant has had to bring this matter to court in order to secure the variation because the court needed to give its approval under the 1958 Act. Nevertheless, the claimant is the author of the variation. He is the principal beneficiary under the settlement, and he appears to be the only person with liquid funds available to pay the costs of this litigation. In those circumstances it is difficult to see why he should not bear the costs of this litigation.'*

He was therefore minded to make an order that the claimant pay the costs on the indemnity basis of all parties.