The Personal Tax Planning Review

A SOLUTION TO THE SECTION 31 TRAP?

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It is common for settlements to provide that property is to be held upon trust for X at 21 or 25. Unless excluded, section 31 of the Trustee Act 1925 applies to such a settlement to give X an interest in possession when he attains 18. TCGA 1992 section 260(2)(d) provides that a disposal qualifies for hold-over relief:

> " ... if it is made otherwise than under a bargain at arm's length and —
>
> ...
>
> (d) by virtue of subsection (4) of section 71 of [IHTA 1984] (accumulation and maintenance trusts) does not constitute an occasion on which inheritance tax is chargeable under that section."

Since X has an interest in possession when he becomes absolutely entitled, section 71(4) would not apply: see section 71(1)(b). Therefore, hold-over relief from CGT under section 260 would not be available on the deemed disposal by the trustees of the assets to which X becomes absolutely entitled.

One way in which this problem has been dealt with is for the trustees to exercise the power of advancement under section 32 of the Trustee Act 1925 (sometimes extended over the entire trust fund) to extend the term of X's interest in possession. However, this merely postpones the problem. A better solution, if it were possible, would be to create an A & M trust which qualifies under section 71, so that hold-over relief would be available when X reaches 21 or 25.

It seems to me that, if this is possible at all, it can only be achieved where there are at least two beneficiaries of the trust under 25. The first suggestion is to exercise the power under section 32 of the Trustee Act 1925 to give the trustees a discretion over the income from X's shares to pay the income for the

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maintenance, education or benefit of X and one or more other beneficiaries under 25. If this were a valid exercise of the section 32 power then it would create a trust which fell within section 71 as no interest in possession would subsist in the trust property and the income would all be applied for the maintenance, education or benefit of a beneficiary under 25.

There is a question-mark, however, over the validity of this purported exercise of the section 32 power. In my view, an attempt by trustees to create discretionary trusts or powers over income would contravene the well-known principle "*delegatus non potest delegare*". In *Re Morris's ST* [1951] 2 All ER 528, the Court of Appeal held that a power which provided for an appointment "in such manner in all respects" as the trustees should appoint did not authorise the creation of discretionary trusts over income. Section 32 authorises payment or application "in such manner" as the trustees may in their absolute discretion think fit. *Re Morris* was followed by Cross J in *Re Hunter's WT* [1963] Ch 372. In that case, the learned judge pointed out that a discretionary trust could not be said to be for the separate benefit of a particular appointee. This casts doubt on whether an appointment on discretionary trusts could properly be described as being for the "advancement or benefit" of X as required by section 32.

In *Pilkington v IRC* [1964] AC 612, in a famous passage, Viscount Radcliffe said:

> "I am unconvinced by the argument that trustees would be improperly delegating their trust by allowing the money raised to pass over to new trustees upon a settlement conferring new powers on the latter. In fact I think the whole issue of delegation is here beside the mark. The law is not that trustees cannot delegate: it is that trustees cannot delegate unless they have authority to do so. If the power of advancement which they possess is so read as to allow them to raise money for the purpose of having it settled then they do have the necessary authority to let the money pass out of the old settlement into the new trusts. If, on the other hand, their power of advancement is read so as to exclude settled advances, cadit quaestio."

I agree with *Underhill* (15th ed 1995) at p 704, that in this passage Viscount Radcliffe was simply addressing whether there was an improper delegation simply because the trust property was to be transferred to trustees of a separate settlement. He was not addressing delegation in the sense of giving new powers to the trustees to choose between beneficiaries.

It is true that the new settlement in *Pilkington* contained protective trusts (which in turn contain discretionary trusts) and that Viscount Radcliffe said that there was no reason to exclude the exercise of the section 32 power in the case before the House. However, it was simply not argued that the existence of the protective trusts caused any problem. *Morris* was not cited in *Pilkington*. Further, Pilkington was not considered relevant in *Hunter,* although the latter case was heard a month after the House of Lords gave judgment in *Pilkington.* Both *Morris* and *Hunter* were discussed and applied by Megarry J in *Re Hay's ST* [1982] 1 WLR 202 without any suggestion that their authority had been affected by *Pilkington.* Indeed, Megarry J went on to cite Viscount Radcliffe in *Pilkington* for the proposition that trustees cannot delegate unless they have authority to do so. As a result, my view is that it is extremely doubtful whether the section 32 power permits the creation of discretionary trusts over income.

An alternative approach would be for X to enter into a Deed giving the trustees a discretion to pay the income to which he is entitled under section 31 to himself or any other beneficiaries under 25. This would effectively be a settlement of X's income on discretionary trusts. However, the effect would be that the trust capital would not be held upon trusts which fall within section 71. X has removed his interest in possession in the property and the income must now be paid for the maintenance, education or benefit of beneficiaries who are all under 25. It seems to me that, in applying the section 71 tests, one is not limited to looking at the terms of the original settlement. One must look at all provisions which affect the income, in order to discover upon what trusts the income is held at any particular point in time. X will have destroyed his interest in possession by giving the trustees a discretion over his income, since it no longer belongs to him as it arises. Therefore, section 71 will apply. This seems to be a more promising way of obtaining hold-over relief than the section 32 route.