THE PERPETUITIES AND ACCUMULATIONS ACT 2009

Victoria Spratt[1]

Last year saw the Perpetuities and Accumulations Act 2009 (the ‘new Act’) receive Royal Assent. The new Act has been 21 years in the making. The Law Commission first identified the need for reform in this area in 1989, and produced a report setting out ways in which the current law could be simplified in 1998, together with a draft Bill. This draft Bill was finally introduced under the new fast track procedure for non-controversial Bills proposed by the Law Commission last spring. The question is: was it worth the wait?

It is the first time the law in this area has been updated since the Perpetuities and Accumulations Act 1964 (the ‘1964 Act’), and the new Act is likely to be of interest to those who have or are considering creating private trusts either during their lifetime or under the terms of their Wills, or are considering entering into agreements relating to land, such as options, rights of pre-emption, future easements or restrictive covenants.

The new Act will come into force on 6 April 2010, and this article seeks, firstly, to set out the background to the Act and the intentions of the legislators, and, secondly, to examine the implications of the new Act, and in particular any tax implications.

The Present Position

The rule against perpetuities

The common law rule against perpetuities dates, in a form which we would recognise, from the seventeenth century, and Lord Nottingham LC’s decision in *The Duke of Norfolk’s Case.* The rule was intended to limit the extent to which a person could dictate the future use and ownership of property, and restrict the freedom of later generations of owners to deal with property, usually by means of private trusts.

1 Victoria Spratt, Hewitsons LLP.

Therefore, the rule against perpetuities provides that future interests in property created by a disposition must vest in the beneficiary of the disposition within a particular period. An interest 'vests' when the beneficiary and the size of the beneficiary's interest are ascertained, and any condition precedent (such as, the beneficiary attaining a particular age) has been met.

The rules vary depending on when the disposition in question was made. It is worth setting out the provisions governing dispositions at various times briefly, because the new Act is, for the most part, prospective in its effect, and the old rules will continue to apply to dispositions pre-dating 6 April 2010.

Dispositions before the 1964 Act:

For dispositions pre-dating the 1964 Act, the common law rules apply. These provide that any disposition of a future interest in property which may vest following the end of the perpetuity period is void from the outset, and the perpetuity period is:

- the duration of any life or lives in being at the date of the disposition, plus a further 21 years and, if applicable, two gestation periods; or

- if there are no lives in being, a period of 21 years.

The rule against perpetuities also applies to powers of appointment, as follows:

- Special powers of appointment, which include powers of advancement, are void unless they become exercisable and may only be exercised within the perpetuity period. The perpetuity period applicable for a special power of appointment is that which applies to the instrument which created the power.

- General powers of appointment, which can be exercised by the sole donee of the power in favour of the donee himself or his estate, are void unless they become exercisable during the perpetuity period. The perpetuity period applicable to an interest created by such a power is *not* that which applies to the instrument which created the power, but a new perpetuity period begins on the date of the exercise of the power.

The definition of a perpetuity period as the duration of a life or lives in being at the date of the disposition plus 21 years led to the development of the 'royal lives clause'. This allows for a perpetuity period to end 21 years after the death of the last survivor of the lineal descendants of a specified monarch who are living at the date of the disposition.

While any person could be included in such a clause, royal lives were often preferred for reasons of certainty, as the life and death of a monarch, and those of their descendants, tended to be better documented than those of the ordinary man in the street.

One problem with the common law rules is that if there is *any* possibility that the future interest may not vest during the perpetuity period, no matter how improbable that possibility is, the disposition is void from the outset.

This led to some odd deliberations and decisions by the Courts. For example, there was serious contemplation by judges of the possibility, in 1888, that a woman aged over 60 years might give birth to a child (*Re Dawson* (1888) 39 Ch. D 155), and then, in 1949, that a girl aged less than five years might give birth to a child (*Re Gaite* ([1949] 1 All ER 459).

Dispositions governed by the 1964 Act:

The 1964 Act tried to put a stop to the sort of nonsense which could result from the common law rules, by introducing some practical presumptions about child-bearing ages, and also a new perpetuity period of not more than 80 years from the date of the disposition, as an alternative to the common law perpetuity period. However, it also provided for a 21 year period to apply to certain interests, such as options.

A number of useful saving provisions for dispositions which might otherwise fall foul of the perpetuity rule were also introduced by the 1964 Act including the ‘wait and see’ rule.

For dispositions and for powers of appointment where there is a possibility that the disposition may contravene the rule against perpetuities, the court may in some instances ‘wait and see’ whether it does so. If the end of the perpetuity period is reached and the property has vested, then the disposition is valid. If not, the gift becomes void, and any remainder provisions take effect.

Further saving provisions related to class closing and the acceleration of expectant interests.

The rule against excessive accumulations of income

This rule is considerably more recent that that relating to perpetuities, and has always been statutory. Under the preceding common law, the only restriction on accumulating income was that a direction to accumulate income should not breach the rule against perpetuities. Effectively, income could be accumulated for the entirety of the relevant perpetuity period, but for no longer.

However, a well known banker, Peter Thellusson, created a trust under his Will in 1796 which prompted the first statutory restriction on excessive accumulations, in the form of the Accumulations Act of 1800, otherwise known as the 'Thellusson' Act.

Thellusson's trust had an accumulation period which would continue for the lifetimes of all of his children, grandchildren and great-grandchildren living at the time of his death. It also contained provisions requiring his Trustees to accumulate income at a compound interest. The Will was challenged by Thellusson's widow and three sons as being 'morally vicious', but the disposition was held to be valid by the court of first instance and the House of Lords.

Parliament, which included Thellusson's three sons as Members at the time, was deeply concerned that such wealth might be amassed by the trust that it could compromise the power of the state, and so the Accumulations Act of 1800 was enacted. Therefore, the restriction placed on accumulations of income is clearly political in its origins.

However, in England and Wales at least, the rule has continued, and accumulations of income are now governed by section 164 of the Law of Property Act 1925 and section 13 of the 1964 Act. The statutory periods of accumulation are as follows:

- the life of the settlor;
- a period of 21 years from the death of the settlor or testator;
- the duration of the minority of any person or persons living or in gestation at the date of the death of the settlor or testator;
- the duration of the minority of any person or persons who under the terms of the instrument containing the direction to accumulate income would, if of full age, otherwise be entitled to that income;
- a period of 21 years from the date of the disposition; and
- the duration of the minority of any person or persons in being at the date of the disposition.

The first four of these are contained in the Law of Property Act 1925, and the remaining two were added by the 1964 Act. The person making the disposition can choose which of these six periods will apply to the disposition and, after the statutory period has elapsed, surplus income generated by the trust fund must be paid to the beneficiaries of the trust.

A direction to accumulate income for a period in excess of the periods permitted by statute is void to the extent that it exceeds the statutory period, and a direction to accumulate income for a period in breach of the rule against perpetuities renders the direction wholly void.

Problems with the current rules

As the details briefly set out above show, the most obvious problem with the current rules regarding both perpetuities and accumulations of income is their complexity, and the uncertainty caused by some elements of the rules.

There are also problems brought about by the creep of the rules regarding perpetuities and accumulations of income to areas outside that of private trusts, such as:

- the way in which the rule against perpetuities has extended to commercial arrangements, such as options, rights of pre-emption and future easements, which can be a positive hindrance to development;
- the confusion over the applicability of the rule against perpetuities to pension schemes, some of which are exempted from the rule against perpetuities by statute, and some of which are not, and the way in which the rules apply to nominations of benefits or advancements under a pension scheme; and
- whether the rule against excessive accumulations applies to accumulations by pension trusts created by individuals.

The new Act seeks to address the problems, but to what extent does it succeed?

The New Act

The first point to make is that the new Act is almost entirely prospective, and fails to sweep away the complexity and uncertainty of the old rules, which will continue to apply to dispositions made before 6 April 2010. Given the duration of trusts in particular, it is going to be necessary to be familiar with the old rules for some time yet.

However, the new Act does make some significant improvements in terms of simplifying the rules post 6 April 2010.

In relation to the rule against perpetuities, the new Act provides for a single period of 125 years to be the perpetuity period for all dispositions made after 6 April 2010, notwithstanding any contrary intention expressed in the instrument effecting the disposition (s.5 P&AA 2009).

However, interests created so as to vest in a charity, and interests or rights arising under a relevant pension scheme, but not including interests or rights arising as a result of a letter of nomination or an advancement, are stated to be excepted from the application of the rule against perpetuities (s.2 P&AA 2009).

In addition, the new rules will not apply to a disposition arising:

- under a Will executed before 6 April 2010, even if the Testator dies after that date; and

- under the exercise of a special power of appointment to which the old rules apply (s.15 (1) P&AA 2009).

The new Act also:

- retains most of the saving provisions of the 1964 Act, including the ‘wait and see’ saving provision (s.7 P&AA 2009), together with the class closing rule (s.8 P&AA 2009), acceleration of expectant interest (s.9 P&AA 2009), and provides for determinable interests to become absolute in some circumstances (s.10 P&AA 2009);

- by implication, provides that the rule against perpetuities will no longer apply to options, rights of pre-emption, future easements or restrictive covenants (s.1 P&AA 2009); and

- clarifies the application of the rule against perpetuities where a letter of nomination or an advancement has occurred in relation to death benefits arising from relevant pension schemes, by stating that the relevant perpetuity period commences on the date when the member joined the pension scheme (s.6(3) P&AA 2009).

In addition, where a common law perpetuity period has been used in a disposition before 6 April 2010 (such as a ‘royal lives clause’), but the trustees believe that it is ‘difficult’ or ‘not reasonably practicable’ for them to ascertain whether the relevant lives in being have ended, the new Act allows the Trustees to ‘opt-in’ to the new rules. If they do so, a perpetuity period of 100 years shall apply to the instrument (s.12 P&AA 2009).

In relation to accumulations, the rule against excessive accumulations of income is abolished from 6 April 2010, except in the case of charities (ss.13 P&AA 2009). This means that we revert to the common law position, where an instrument may specify any period up to the perpetuity period of 125 years as the applicable accumulation period.

However, for charities, the previous 21 year period will still apply (s.14 P&AA 2009), in order to ensure that funds held by charities are applied for the public benefit within a reasonable time of receipt. This does not, of course, preclude the administrative retention of income by charities in the form of reserves, provided that the grounds for retention are reasonable (e.g. for a repair fund).

Implications of the New Act

The restriction of the rule against perpetuities to successive estates and interests in property and to powers of appointment, the clarification of certain areas of uncertainty, and the simplification of the rule itself are all significant improvements on the current position.

It is regrettable that the existing complexity and uncertainty will persist for dispositions pre-dating the new Act, as the common law rules and the 1964 Act rules continue to run alongside the new rules. However, the caution with which both the Law Commission and legislators viewed the possibility of the retrospective application of the provisions of the new Act to pre-existing trusts is understandable.
The abolition of the rule against excessive accumulations of income brings the law in England and Wales back into line with that of several other common law jurisdictions, some of which never adopted such a rule, such as Jersey, and others of which adopted such a rule only to repeal it subsequently. This newly reacquired ability to accumulate income for the duration of the perpetuity period puts England and Wales in the same position as Guernsey, the Bahamas and the Cayman Islands in this respect.

For would-be settlors:

For those seeking to create new trusts, either during their lifetimes or by Will, there is much good news in the new Act, and no doubt many will seek to take advantage of the longer perpetuity period and the abolition of the rule against accumulations of income.

As the new Act specifically provides for dispositions under Wills executed before the commencement date to be subject to the rules of the 1964 Act, even if the Testator should die after 6 April 2010, those who have already executed a Will containing a trust subject to the old rules may well want to make a new Will after the commencement date, or perhaps republish their current Will, so that the trust takes effect under the new rules.

The longer perpetuity period will be useful for those settlors concerned about the possibility of the third generation receiving its shares of the trust fund while still too young to handle the responsibility.

The abolition of the rule against accumulations of income will be particularly helpful for those planning to create discretionary settlements and other trusts which are subject to the relevant property regime for Inheritance Tax purposes, where Trustees will find it a useful tool in their planning for ten year anniversary charges and exit charges.

For existing Trustees:

As a result of the prospective application of the new Act, Trustees and settlors of existing trusts will find themselves mostly unaffected by the new Act.

For those involved in the administration of existing trusts, one aspect of the new Act may have disappointed: the provision that any disposition made in exercise of a special power of appointment created before the commencement date of the new Act will be subject to the rules against perpetuities and excessive accumulations of income applicable to the instrument which created the special power of appointment. A problem for some Trustees now, and for many more over in the coming decades, will be the termination of trusts created following the 1964 Act, which are subject to the statutory 80 year perpetuity period. The termination of a trust can result in some unpleasant tax consequences. For example:

- some life interest trusts subject to the old Inheritance Tax regime, where the beneficiary has acquired a pre-22 March 2006 interest in possession and will attain a vested interest in the capital of the trust fund at the end of the perpetuity period a s.71 Taxation of Chargeable Gains Act 1992 ('TCGA 1992') Capital Gains Tax charge on any gains made during the lifetime of the trust can occur; and

- for trusts subject to the relevant property regime, including some Accumulation and Maintenance trusts which partially or entirely fell into the relevant property regime for Inheritance Tax purposes on 22 March 2006, the absolute vesting of the capital of the trust fund in one or more beneficiaries at the end of the perpetuity period may not only result in a s.71 TCGA 1992 Capital Gains Tax charge on any gains made during the lifetime of the trust (although holdover relief may be available under s.260 TCGA 1992) but also an exit charge for Inheritance Tax purposes under s.65 Inheritance Tax Act 1984.

In addition, in both cases, and in trusts of 'excluded property' created by non UK domiciled Settlors, where assets may vest in UK domiciled beneficiaries at the end of the perpetuity period, the property which vests will form part of the beneficiary's estate for Inheritance Tax purposes, and may be subject to the 40% Inheritance Tax charge in due course on their deaths.

Therefore, some Trustees may be looking for ways to prolong the lives of their trusts. Although special powers of appointment can be useful for this, there is a problem in that any such exercise of a special power of appointment cannot infringe the perpetuity rule applicable to the instrument which created the special power of appointment.

The provisions in the new Act relating to the exercise of special powers of appointment created before the new Act's commencement date are contrary to the recommendation of the Law Commission in their 1998 report, that the new Act's 125 year perpetuity period and provisions relating to accumulations of income should apply to interests created in the exercise of a special power of appointment created before 6 April 2010.

If the Law Commission's recommendation had been followed, this may have provided a way to extend the duration of some existing trusts, and their accumulation periods. It would, however, perhaps have led to the strange result of trusts with two applicable perpetuity periods, where the exercise of a power did not deal with the entirety of the trust fund.

Concern over possible unforeseen consequences for existing vested interests led the House of Lords to amend the Law Commission's draft Bill, and so existing Trustees must look elsewhere for ways to extend the lives of their trusts if they wish to do so. One possibility for such Trustees is provided by the case of *Wyndham v Egremont* [2009] EWHC 2076 (Ch), in which an application was made to the Court under s.1 of the Variation of Trusts Act 1958 for the variation of trusts relating to a fund established under the provisions of a settlement created by Lord Egremont in 1969. Briefly, the facts were as follows:

- The fund contained the major part of the Wyndham family estate, including the family seat and a large amount of land at Petworth in Sussex, and was worth many millions. The estate is connected with the baronies of Egremont and Leconfield.

- The 'vesting day' of the trust was defined as the day on which should expire the period of 20 years from the death of the last survivor of the issue, whether children or more remote, of His late Majesty King George V living on 20 May 1940.

- The only living beneficiary would become entitled to an absolute interest in the capital fund if he was living on the vesting day.

- The last of the Royal lives in being under the definition of the vesting day was, at the date of the decision, 72 years old and the sole living beneficiary was only 26 years. Therefore, the capital was most likely to vest in the beneficiary during his lifetime.

The proposed arrangement was intended to ensure that the ancestral home at Petworth should continue to be attached to the relevant baronies and devolve for as long as possible down the senior male line, and to defer, by an extension of the applicable trust period, the tax charges which would arise on the termination of the pre-arrangement trusts, and which could only be met by selling a significant part of the ancestral lands. The Capital Gains Tax which would be payable was estimated to be in the region of £3 million.

With a view to achieving these aims, the modifications proposed included:

- the redefinition of the 'vesting day' as the day on which expires the period of 21 years after the death of the last survivor of the issue of His late Majesty King George V and the issue of the sole living beneficiary's great-grandfather, the Fifth Baron Leconfield, living on the date of the order approving the arrangement;
- the deletion of the contingent capital trust in favour of the sole living beneficiary; and
- the substitution for the pre-arrangement default trust in favour of the sole living beneficiary's son or grandson of a default trust of the fund in favour of that one of the sole living beneficiary's male issue in the male line who shall be living on the new vesting day, and then hold the baronies.

Mr Justice Blackburne considered the benefits to the unborns in this situation to be clear. Firstly, the modifications removed the possibility that the sole living beneficiary, being alive on the pre-arrangement vesting day, would take all, leaving nothing for the unborns. Secondly, the postponement of the vesting day would defer the charge to Capital Gains Tax by a very significant period.

This variation was also concluded not to constitute a resettlement, which would have had serious Capital Gains Tax consequences for the trust, being a 'deemed disposal' under s. 71 TCGA 1992, as the Trustees remained the same, the subsisting trusts remained largely unaltered, and the administrative provisions were unchanged.
Moreover, it was specifically noted in the decision that it is well established that an arrangement under s. 1 of the Variation of Trusts Act 1958 allows the court to approve a variation which includes a new perpetuity period applicable to the trust in question, whether by reference to the 1964 Act or the common law, and, if appropriate, a new accumulation period.

It seems most likely that the court would consider itself to have the same power to vary the perpetuity period and position regarding accumulations of income of a trust by reference to the new Act, once in force. In the absence of any provisions in the new Act to assist, existing Trustees who face a substantial tax charge on the termination of their trust may wish to consider an application under s.1 of the Variation of Trusts Act 1958 to seek to take advantage of the new provisions.

Summary

The Perpetuities and Accumulations Act 2009 is broadly to be welcomed as an attempt to simplify this area of law, although it fails to remove the complexity and uncertainty of the current law, which will continue to be applicable to dispositions predating the commencement date of the new Act, 6 April 2010.

From this commencement date, a perpetuity period of 125 years will apply to all dispositions regardless of any statements to the contrary in the instrument effecting the disposition, and the rule against excessive accumulations of income will be abolished.

The provisions of the new Act may assist those planning to create trusts either during their lifetimes or by Will after the commencement date.

It is almost entirely prospective in effect, and the only provision which may assist existing Trustees is found in s. 12, which provides that, if the perpetuity period for an existing disposition is defined by reference to lives in being under the common law, and there is sufficient uncertainty over the lives still in being, the Trustees are allowed to ‘opt-in’ to a new perpetuity period of 100 years.

However, existing Trustees may still be able to seek a new perpetuity period of 125 years and a new accumulation period if an application is made to the courts under s.1 of the Variation of Trusts Act 1958, as it is well established that the court may provide for a new perpetuity period and accumulation period by reference to the statutory or common law periods, and there is no reason to believe the situation will change when the new Act comes into force.