

FOUNDATIONS AND UNITED KINGDOM INHERITANCE TAX¹

Robert Venables Q.C.²

0 What is a Foundation?

0.1.1 No Technical Meaning

The term “foundation” is not a term of art. It can mean different things to different people in different contexts. As in so many areas of life, clear thinking and detailed analysis of the nature of the beast is essential. The use of jargon should not be allowed to obscure the real question. Of every particular foundation it must be asked: “What is its nature and what are its characteristics?”

Foundations can be established as “foundations” under various proper laws, usually, but not invariably, pursuant to some enabling statute. Yet even two foundations formed under the same proper law - and under the same statute - can exhibit widely different characteristics, which could be crucial, especially in the tax planning context. It is therefore vital in every case to look at the substance rather than the name.

Conversely, some entities - to use a neutral word - which are not actually called “foundations” exhibit many the characteristics of foundations so-called.³ My article could therefore be equally relevant to them as it is to foundations so-called.

¹ This article is based on the author’s *The Taxation of Foundations* in the course of being published by Key Haven Publications. A cross reference which begins with an upper case capital letter, e.g. E.3.4, is to the corresponding part of that work.

² Chairman of the Revenue Bar Association 2001-05, Benchers of the Middle Temple, Fellow and Council Member of the Chartered Institute of Taxation, Chartered Tax Adviser, TEP. Author of *Non-Resident Trusts* (9th edition in preparation) *The Taxation of Trusts* 2009 (in preparation), *Inheritance Tax Planning* and numerous other works on trusts and tax, all published by Key Haven Publications.

³ Examples are the Liechtenstein *stiftung* (normally translated as “foundation”) *anstalt* (normally translated as “establishment”) and a “trust enterprise” provided it has legal personality.

0.1.2 Types of Foundation

In practice, a foundation will be a body corporate, a trust or, possibly, an unincorporated association. This article is concerned almost exclusively with foundations which are bodies corporate.

A trust may in general be called whatever the settlor wishes it. If I were to set up a conventional private trust for the benefit of my relatives, I could call it “The Venables Family Foundation”. Foundations which are trusts are more commonly established for purposes which are charitable and / or philanthropic. Again, they can in general be called whatever the settlor determines e.g. “The Morris-Venables Charitable Foundation”.⁴ The taxation of trusts is dealt with in other works. See, for example, my “The Taxation of Trusts Post Finance Act 2009” and “Non-Resident Trusts” 9th Edition, in preparation, both published by Key Haven Publications PLC.⁵ The taxation of those trusts which are United Kingdom charities is dealt with in Venables and Kessler *The Taxation of Charities*, published by Key Haven Publications PLC.⁶

An unincorporated association could possibly be called a “foundation”, although that would be unusual. Usually, although not invariably, such a foundation would be established for charitable or similar purposes. I do not in this article consider the taxation of foundations which are unincorporated associations. As a general rule, United Kingdom tax law treats unincorporated associations as if they were companies, i.e. in much the same way as bodies corporate. Hence, much of what I say in this article about foundations which are bodies corporate could also be highly relevant, *mutatis mutandis*, to foundations which are unincorporated associations.

It is just conceivable that a partnership⁷ could be called a foundation, although I have never come across that in practice. If so, the United Kingdom tax treatment

4 This is the name of a real trust which is established for purposes which are exclusively charitable under English law.

5 United Kingdom tax law employs the concept of a “settlement” in various contexts with its meaning varying according to the context. Depending on the context, not all trusts are “settlements” and not all “settlements” are trusts. A body corporate could amount to a “settlement” for one of these purposes, especially if it is a foundation. I therefore do discuss the tax treatment of “settlements” in this article.

6 The taxation of foundations which are established for purposes which are exclusively charitable under the law of some part of the United Kingdom is beyond the scope of this article.

7 including a limited partnership (as opposed to a limited liability partnership which will normally, according to the proper law under which it is formed, be a body corporate)

would be that of partnerships and their partners. That is beyond the scope of this article.⁸

It is theoretically possible, yet highly unlikely, that there could be something called a “foundation” which took none of the following forms. For example, it might be created out of nothing more than a contractual relationship. Not surprisingly, I have never in fact seen such a foundation. If one were to be created, it would be *sui generis* and its tax treatment would have to depend on its precise nature.

In practice, the type of foundation which is one is likely to encounter most is one which is, as a matter of private law, a body corporate. I shall refer to such a foundation as an “incorporated foundation”. In the remainder of this article, when I refer simply to a “foundation”, I shall in general be referring to an incorporated foundation. An incorporated foundation will usually be incorporated under some foreign proper law and will be resident (for United Kingdom tax purposes)⁹ outside of the United Kingdom. Usually, although not invariably, the relevant part of the proper law in question will be a statute which expressly facilitates the creation of a foundation (however called).

I have often reflected that non-charitable foundations which are bodies corporate established under the law of some part of the United Kingdom and are treated as resident in the United Kingdom for some, or all, United Kingdom tax purposes could have an interesting role to play in tax planning. Of course, we do not have any statute which in terms permits the formation of “foundations”. Yet such a foundation could take the form of, say, an English company limited by shares or by guarantee, which has the advantage of simplicity and familiarity.¹⁰

⁸ A limited liability partnership which is a body corporate formed under some foreign proper law will normally involve the same tax consequences, *mutatis mutandis*, as any other foreign body corporate. Hence, much of what is contained in this article could be highly relevant to such a foundation. The reader will be aware that Limited Liability Partnerships formed under the United Kingdom Limited Liability Partnerships Act 2000 receive special treatment for United Kingdom tax purposes. In general they are treated as if they were partnerships, rather than bodies corporate. Hence, the tax treatment of a foundation which was such a Limited Liability Partnership is as much beyond the scope of this article as is the tax treatment of a foundation which is a partnership proper.

⁹ The normal test of residence will be that of central management and control of the business of the foundation, rather than of the foundation itself: see *De Beers Consolidated Mines, Limited v Howe* (1906) 5 T.C. 198. In the case of a company with a share capital or a company limited by guarantee, the distinction is normally very clear. One is speaking of control at director level rather than at shareholder level. In the context of a foundation, which will not normally have shareholders or even members as such, the distinction may be less clear cut.

¹⁰ It could in theory be a corporation incorporated by royal charter, although the charter would be in practice be unlikely to be forthcoming if the objects of the foundation were not to be exclusively charitable, or at least philanthropic.

Although a foundation existing under some foreign law will normally be incorporated under a statute facilitating the creation of foundations (however called), it would also be possible to create a foundation under some other foreign statute designed primarily to facilitate the creation of, say, trading or investment companies e.g. the foreign equivalent of a company limited by shares created under one of the United Kingdom Companies Acts.

0.1.3 Characteristics of Incorporated Foundations

0.1.3.1 Introduction

Given that the term “foundation” is not a term of art and that the meaning of the word differs from context to context, it is impossible to lay down a definition of the term. In this section, I shall instead set out characteristics which one would usually expect to find (and usually does find) in an incorporated foundation. The absence of one such characteristic does not mean, however, that an entity could not properly be called a “foundation”. Conversely, it is possible that an entity could exhibit many of these characteristics, yet most people would hesitate to classify it as a foundation.

0.1.3.2 Primary Characteristics

0.1.3.2.1 Money-Making Activities

Virtually all foundations will have a fund of money which will be transferred to it, normally by the Founder, either by way of gift or wholly or partially in return for Founder’s Rights. It will be unusual (although not impossible) for a foundation to have a share capital. If it did, funds could be raised by an issue of share capital. I shall refer to this fund of money as its “endowment”.

One of the purposes of the foundation will normally be to hold and invest its endowment and to generate returns from it. A foundation of this type will thus be an investment company. A foundation could conceivably carry on a trade (or even a profession) although this is less usual. In that case it would, to that extent, be a trading company.

In the case of a company limited by shares, the holding and management of investments, or the carrying on a trade, will be a means to an end, namely the generation of profit for shareholders, rather than an end in themselves. It will normally be equally true of a foundation that the holding and management of investments, or the carrying on a trade will not be ends in themselves.

0.1.3.2.2 Final Purposes

0.1.3.2.2.1 Benefiting of Persons

What one might call the final (or ultimate or real) purpose of a foundation will often be to benefit persons, who will usually consist of include individuals, by either transferring cash or property to them or conferring benefits in kind on them. In that respect, it will in some ways resemble a private law trust. There could, however, be huge differences from a private law trust in terms of what duties are owed and to whom. In practice, it is much more common for foundations to resemble discretionary trusts rather than fixed-interest trusts, although there is no reason why that need be the case.¹¹

The final purpose of a foundation may be to benefit the Founder, in which case it will share characteristics of a company limited by shares, all the more so where the Founder retains valuable Founder's Rights (howsoever called).

0.1.3.2.2.2 Abstract Purposes

There is, however, another type of foundation which is established for final purposes (other than the benefit of persons), especially charitable or philanthropic purposes, which are ends in themselves. Such foundations are often referred to as "not for profit" foundations. A foundation established for such purposes will in some ways resemble a purpose trust. It may be preferable to a purpose trust in that a trust for the same purposes might well be invalid.¹² In other ways, it may resemble (more closely than a purpose trust) a company limited by guarantee. A company limited by guarantee, however, will always have at least one member and the members acting by a qualified majority or unanimously will usually¹³ be able to change the constitution, whereas a foundation will normally have no members as such.

In the case of a foundation established for final purposes, the line between those activities which are a means to an end and the end itself may often be more blurred than in the case of a foundation established to benefit persons. A foundation established to run a school may engage in no activity other than the running of the school and may simply be concerned to ensure that in doing so it breaks even. Such a foundation could also, however, have an endowment which is invested so the

11 I suspect that fiscal considerations play a large part in the decision to make most foundations discretionary.

12 For example, in English law, a trust for non-charitable purposes will, with limited exceptions be void, unless the trust can be construed as a trust for persons where the purposes are simply a means of benefiting those persons.

13 One notable exception in English law is where the company is established for exclusively charitable purposes. The consent of the Charity Commission will be required to any change of its objects clause.

income and gains can be used to defray some of the expenses of furthering its primary purpose. Here, the making and managing of the investments will not be an end in itself.

0.1.3.2.2.3 Blurring the Edges

Sometimes a foundation will exist both for the purposes of benefiting individuals and for abstract purposes which are ends in themselves. It could be that no discrete part of its funds or the income or gains thereof needs to be dedicated to either purpose.

Even a trust for an abstract purpose may confer indirect benefits on persons. Indeed, the Founder's intention will no doubt always be that his foundation will achieve that result, if only by improving men's souls. The distinction could be very important, however, if under the proper law beneficiaries are entitled to enforce the trust. If the purposes are, when properly construed, abstract purpose trusts, then a person who would or might be indirectly benefited by the performance of the purposes would not on that account be a beneficiary. To take a familiar example, an English charitable trust for the relief of poverty is regarded as an abstract purpose trust and a person could not claim to be a beneficiary and therefore seek to enforce the trust, e.g. by having defaulting trustees replaced, simply on the grounds that he was poor. The inability of persons who may benefit from a foundation to enforce its constitution may well be helpful to them in terms of United Kingdom taxation.

0.1.3.3 The Constitution

A foundation will normally have a "Constitution" which could take the form of one or two documents. Broadly speaking, the Constitution would perform the same role as the memorandum of association and articles of association of an English company limited by shares. It would be the document(s) the execution and registration of which with the competent authority would be one of the conditions of the foundation coming into being. They would set out the name, objects and powers of the foundation, prescribe its organs (e.g. board of directors) and their respective powers. The Constitution would usually provide for the manner in which it could be amended (if at all). It may also disapply, amend or extend rules of the proper law which are in the nature of default rules and which apply in the absence of any indication to the contrary in the Constitution.

The Constitution may be a public or a private document. It may be a mixture of the two. For example, in the case of a Jersey Foundation established under the Foundations (Jersey) Law 2009, a foundation must have a charter (which corresponds approximately to a memorandum of association of an English limited company) which is a public document, and regulations (which correspond approximately to the articles of association of an English limited company), which

are a private document. There is some leeway as to what provisions are contained in either.

0.1.3.4 *Dramatis Personae*

0.1.3.4.1 *The Founder*

A foundation will have to be created by, or on the instructions of, one or more persons, to whom I shall refer as “the Founder”. In my experience, there tends to be only one Founder. The scope of the Founder’s role varies enormously. At one extreme, he could be like a male dog whose contribution in caring for his offspring will be limited to assisting at their conception, so that once the Foundation is formed (and funded) he will cease to play any role in it.¹⁴ At the other extreme, the Founder could reserve to himself rights and powers, to which I shall refer as “Founder’s Rights”, which could vary enormously in content. They might involve his simply having in certain circumstances a power of veto over the actions of the Board (as to which, see below), rather in the same way that a Protector of a trust might be given powers of veto over exercise of certain powers by trustees. Or they might involve his having rights and powers akin to those of the sole shareholder of a company limited by shares. There is, of course, a whole spectrum in between.

In theory, the Founder’s Rights could be held by him either for his own use and benefit (as the rights and powers of a shareholder in a company limited by shares would normally be) or in a fiduciary capacity. In my experience, it is very rare to find the Founder’s Rights held in a fiduciary capacity. In my view, that is a pity, as arranging for the Founder’s Rights to be so held (whether under the Constitution of the foundation or by some other means) could be extremely useful in United Kingdom tax planning terms.

The individual¹⁵ who was the Founder could normally play other roles in relation to the foundation. There is no reason in principle, for example, why he should not be a Beneficiary (as to which, see below) or a member of the Board. However, he would not in that capacity be acting (or being benefited) as the Founder.

0.1.3.4.2 *The Assignee*

The Founder’s Rights may or may not be transmissible to a third party, to whom I shall refer as “the Assignee” (of the Founder’s Rights). They may be transmissible

¹⁴ Indeed, a foundation could conceivably be established pursuant to the provisions of an individual’s will.

¹⁵ While foundations have traditionally been established by individuals, I believe there is considerable scope in tax planning terms for their being established by others, in particular trustees and corporations.

collectively or individually. They may be transmissible *inter vivos* or by testamentary disposition or both.

0.1.3.4.3 The Board

The affairs of a foundation will need to be run by one or more persons, to whom I refer as “the Board”. The role of the Board will be very similar to that of the board of directors of a limited liability company. Precisely because there are no members, the Board will usually have much greater real power than the board of directors of a limited liability company. The latter will normally be answerable to the member of the company in general meeting and will normally be capable of being removed by them. The members can normally also overrule or at least reverse decisions of the directors. And they will usually have the power to change the constitution of the company. In a foundation, therefore, the key decisions will normally be made by the Board, unless the constitution provides otherwise.

0.1.3.4.4 The Guardian

In the case of some foundations, there will need to be appointed a guardian. For example, under the Foundations (Jersey) Law 2009 article 13, a foundation must have a “Guardian”. The Guardian must take such steps as are reasonable in all the circumstances to ensure that the “council” of the foundation (i.e. the Board) carries out its functions.¹⁶ He is given certain powers to that end. He may require its council to account to him for the way in which it has (a) administered the foundation’s assets; and (b) acted to further the foundation’s objects. The guardian is in effect a “Person with Standing”,¹⁷ who can apply to the Royal Court if the council fails to account or if the result of its accounting shows misfeasance. The regulations of a Jersey foundation may give its guardian the power to approve or disapprove any specified actions of its council, although the Law does not spell out the consequence of approval or disapproval.

The Guardian of a Jersey foundation is in some ways like the Protector of a trust and in some ways like the “enforcer” of a Jersey non-charitable purpose trust. Yet in other ways, he is *sui generis*.

0.1.3.4.5 The Beneficiaries

A foundation can have, but need not have, “Beneficiaries.” In the whole area of the law of foundations, it is this question of Beneficiaries which gives rise to the

¹⁶ The effective sanction if he fails to discharge this duty is not obvious. He is intended to keep watch over the Council, but who is entitled to keep watch over the Guardian? As Juvenal said, “*Quis custodiet ipsos custodes?*”.

¹⁷ See 0.1.3.4.6.

greatest difficulties. The difficulty is usually a practical one of knowing what, if any rights, the Beneficiaries of a foundation have.¹⁸

A logically anterior question is determining what is meant by the term “Beneficiary”. I shall use the word in its widest sense to mean a person who can lawfully be benefited by the Foundation (acting through one or more of its organs). Some may wish to use the word in a narrower sense as meaning those who have legal rights to be so benefited or at least to require the organs of the Foundation to act in such a way that they may be benefited. I prefer to give it a wider meaning and then to distinguish between (a) those Beneficiaries who have legally enforceable rights and (b) those who do not. If the term “Beneficiary” is reserved for the former, there is no obvious word to describe the latter.

In the case of a trust, the law is, after all these centuries, tolerably well fixed. If the terms of a trust are to pay the income of the trust fund to A during his life, A has a right to have the income paid to him and has, in addition, various subsidiary rights, in particular a right to ensure that the trustees properly perform their duties of management and investment and do not otherwise depart from the terms of the trust. Even a discretionary beneficiary who is a mere object of a power of appointment reposed in trustees can ensure that the trustees do not exercise their discretion improperly or fail to exercise a discretion they are obliged to exercise (one way or another); he will further normally have standing to ensure that the trustees do not otherwise depart from the terms of the trust and he may well have a right to information about the trust and its operation. Yet, even in the case of a foundation which apparently mirrors a trust, it is far from clear that the Beneficiaries will have any corresponding or, for that matter, any rights.

Let me explain the position with some analogies. Suppose I give a sum of money to my steward and tell him that he can distribute it in his discretion amongst any child under the age of 16 living in our village. Let us suppose there are twenty such children. All twenty children will be Beneficiaries of my largesse in the sense in which I have used the term, yet unless and until they are actually given money by my steward, they have no right to anything, not even a right to require my steward to exercise his discretion at all. If my steward does nothing with the money or even if he gives it all to his girlfriend (who is over 16), they will have no right to complain. If, before my steward has distributed the money, I change my mind and order him to give it back to me, he will be compelled so to do. All he has is a mere authority from me. If he acts on that authority before it is countermanded, I cannot complain, yet otherwise he is still holding my money and owes no obligation to the Beneficiaries or any third party.

¹⁸ The difficulty exists even in the case of a sophisticated law such as the Jersey (Foundations) Law 2009. See G.1.10.3.

Now substitute for myself a body corporate, such as a foundation. It may empower persons to act on its behalf to give away its assets. It will it empower them directly or indirectly by means of its Constitution. If designated persons act in accordance with its Constitution, any disposal of its assets they make will be valid and binding on the foundation. For example, the Board could be empowered to dispose of its annual income amongst such one or more members of a class of persons, e.g. descendants of a given person, as it in its discretion thinks fit. Yet unless there is something more, the Constitution of the foundation merely acts as an authority to the designated persons and does not confer any rights on any of the class of persons beyond, of course, a right to retain what, if anything, they are validly given on behalf of the foundation. In short, the foundation is fulfilling the same role as myself and the designated persons, such as the Board, the role of my steward. The position is in law just the same. The questions of capacity of the foundation to make gifts and of the authority of others to make gifts on its behalf are just the same as in the case of gifts by an individual acting through the agency of another individual. Yet because these matters are dealt with in the constitution of the foundation, they may obscure the fact no legally enforceable rights are conferred on the potential donees.

0.1.3.4.6 Persons with Standing

There may exist in relation to a foundation “Persons with Standing”. These are persons who are entitled to bring proceedings before the courts to enforce the Constitution of the foundation.

Much may depend not only on who is a Person with Standing but what proceedings they are entitled to bring and what orders the courts are entitled to make in such proceedings. The Foundations (Jersey) Law 2009 is very instructive in this regard.¹⁹

0.1.3.4.7 The Members

A foundation will not normally have “members” so-called and will not usually have persons who are in fact members although not so called. It may be, of course, that rights could be conferred on a Founder which put him very much in the same position as the members of a company with a share capital or limited by guarantee.

0.1.3.4.8 Other Persons

A foundation may have:

a “Winder Up”²⁰

an “Amender”²¹

¹⁹ See G.1.9.

²⁰ Note: this is RV’s terminology. See G.1.11.

a “Sanctioner”²²

one or more “Delegates”²³

Each of these possibilities exists under the Foundations (Jersey) Law 2009.

0.1.4 Non-Fiscal Uses of Foundations

A foundation can be used for a variety of purposes.

It could be used to establish a charity.

It could also be used as an alternative to a trust for purposes which were not exclusively charitable. In many jurisdictions, such trusts are often void, whereas there need be no doubt about the validity of a foundation.

It could be used as an alternative to a trust for individuals.

The fact that it is a body corporate has several advantages, particularly as compared with a trust. No other person will normally be liable for its debts. Hence, it can offer the same advantages as a company limited by shares or by guarantee. It has perpetual succession, notwithstanding any change from time to time in its personnel, and in particular in the Members of its Board or the person entitled to the Founder’s Rights (if any). It can sue and be sued in its own name.

A foundation can in principle be a trading company or an investment company.

1 General Observations

Inheritance tax was originally called “capital transfer tax” and was introduced by Finance Act 1975.²⁴ It is essentially a tax on lifetime gifts made by individuals and on the estates of deceased individuals. However, there are special rules dealing with “settlements” and “close companies”.

21 Note: this is RV’s terminology. See G.1.12.

22 Note: this is RV’s terminology. See G.1.13.

23 Note: this is RV’s terminology. See G.1.14.

24 Its name was changed in 1986, to make it more misleading.

The inheritance tax code, although originally very well drafted,²⁵ was enacted in an age when foundations of the type with which we are now concerned either did not exist or were below the radar of the United Kingdom Commissioners of Inland Revenue.²⁶ It is thus not surprising that the United Kingdom inheritance tax code did not contain any express mention of them. What is perhaps more surprising is that in the last thirty-four years no changes have been made to the legislation with foundations in mind. The result is that it is necessary to enquire how the provisions of the code apply to them, if, indeed, they apply at all.²⁷

One possibility is that for inheritance tax purposes a foundation might be both a “settlement” and a “close company”²⁸ and that there could thus in principle be double charges to tax, one under Inheritance Tax Act 1984 Part III (Settlements) and the other under Inheritance Tax Act 1984 Part IV (Close Companies). Yet even if a foundation is a “settlement” or a “close company” that does not mean that it will necessarily give rise to a charge to inheritance tax under either (or both) of these Chapters.

2 The Funding of a Foundation

2.1 The Problem

In this Chapter, I shall assume that the foundation is being funded by the Founder. However, in general, the position should be no different if funded by a person other than the Founder.

As this is an article on foundations, rather than inheritance tax, I shall assume that the reader is familiar with the basic concepts of inheritance tax and has at least a rudimentary grasp of how it works.²⁹

While there is an infinite variety of permutations, the funding of a foundation will from an inheritance tax perspective fall into one of two main categories. Either the Founder’s estate will be diminished in value by the funding or it will not. That said,

²⁵ The same cannot be said of amendments made to it over the years, particularly under Chancellor Brown.

²⁶ So far as I am aware, the only foundations capable of being created in 1975 were “stiftungen” or other entities (in particular “anstalten” or “establishments”) created under the law of Liechtenstein.

²⁷ One of the perceived advantages of foundations is that they may “fall between the cracks” of the inheritance tax legislation, as indeed, of other United Kingdom fiscal legislation.

²⁸ It will undoubtedly be a “company”.

²⁹ See, for example, my *Inheritance Tax Planning*, published by Key Haven Publications PLC.

if it is diminished in value, it might be diminished to such a negligible extent that, for all practical purposes, it might be considered not to be diminished at all.

If money or property is transferred to the Foundation for no consideration or for an inadequate consideration, e.g. by endowment or capital contribution, then the estate of the Founder will *prima facie* be reduced in value and the amount of the reduction will *prima facie* be the value of the money or property transferred. Unless the Founder can rely on various defences, which, if he is domiciled or deemed for inheritance tax purposes to be domiciled, in the United Kingdom, will be normally not be in point, he will make a transfer of value for inheritance tax purposes and the value transferred will be the amount of the resultant diminution of the value of his estate.³⁰ If, however, the Founder obtains valuable rights as a result of the transfer or if rights he already has become more valuable as a result of the transfer, then, to that extent, his estate will not be diminished in value.

If the Founder's estate is not diminished in value, there will be no question of his being exposed to any immediate charge to inheritance tax in respect of the funding. However, in performing this calculation, consideration must be given as to whether the Foundation may constitute a "settlement" for inheritance tax purposes. If it does, then various rights the Founder has against it may be deemed not to form part of his estate for various inheritance tax purposes. See in particular Inheritance Tax Act 1984 section 5(1) and (1A) (interests in possession), section 47A (settlement powers), 55A (purchased settlement powers) and section 55 (Reversionary interest acquired by beneficiary). While it is possible that a "reversionary interest" owned by an individual may constitute excluded property,³¹ this will not normally be relevant in this context as (a) a reversionary interest will constitute part of the individual's estate and (b) if that individual is a settlor of the settlement, the reversionary interest will not normally constitute excluded property.³²

If the Founder's estate is diminished in value by the funding, he will, as noted, normally thereby make a transfer of value.³³ That will normally involve a charge to inheritance tax only if the transfer of value is a chargeable transfer of value.³⁴ It would not be a chargeable transfer of value if it were not a transfer of value at all, if it were an exempt transfer of value or if it were a potentially exempt transfer (which

³⁰ See Inheritance Tax Act 1984 section 3(1).

³¹ See Inheritance Tax Act 1984 section 48(1) and (2).

³² Inheritance Tax Act 1984 section 48(1)(b).

³³ Perhaps the likeliest exception in practice is where the Founder is neither domiciled nor deemed for inheritance tax purposes to be domiciled in the United Kingdom and the money or property gifted or transferred is situated outside of the United Kingdom or otherwise constitutes "excluded property": see Inheritance Tax Act 1984 section 3(2) and 6.

³⁴ See Inheritance Tax Act 1984 section 3(1).

did not become a chargeable transfer of value by the death of the Founder in the next seven years). Even though it were in principle a chargeable transfer of value, the value transferred might be reduced, possibly even to nil, if some relief, such as agricultural property relief or business property relief, were available.

If the transfer of value were an exempt transfer of value, there would again be no question of his being exposed to any immediate charge to inheritance tax in respect of the funding. It is, however, unlikely, although not impossible, that the transfer of value will be an exempt transfer of value. One example could be where the estate of his spouse was increased in value to a commensurate extent e.g. because the spouse owned valuable rights as against the foundation.

If it were is a potentially exempt transfer, that could give rise to a charge to inheritance tax at a rate of (for 2009/10) up to 40% of the value transferred if the Founder died in the next seven years. It is, however, unlikely, although not impossible, that the transfer of value will be an exempt transfer of value, in whole or even in part. It is in particular a moot point whether Inheritance Tax Act 1984 section 3A(2)(b) would preclude the transfer of value from being a potentially exempt transfer.³⁵

If the transfer of value is a chargeable transfer of value, that could well give rise to an immediate charge to inheritance tax at a rate (for 2009/10) of up to 20% of the value transferred with an additional rate of up to 20% being chargeable should the Founder die in the next seven years.

Whether the transfer gives rise to a transfer of value or not, it is always possible that the property the subject matter of the funding (or property representing it from time to time, under the rules contained in Finance Act 1986 schedule 20) could be property subject to a reservation in relation to the donor and thus possibly give rise to a charge, or an increased charge, to inheritance tax on his death.

2.2 No Diminution in Estate of Founder

2.2.1 Founder Enjoys Valuable Rights In or Over Foundation

There will be no diminution in the estate of the Founder as a result of the funding of a foundation if the Founder's rights are so extensive that they are equal in value to the money or property transferred to the foundation. While that could be the case, it is perhaps unlikely to be the case if the foundation were being created predominantly for United Kingdom tax planning purposes, as the Founder's rights which would need to be retained probably have to be so extensive as to make the planning largely ineffective for inheritance tax, capital gains tax and income tax purposes.

³⁵ A transfer to a trust may be less problematic than a gift to a foundation in this respect.

That said, in sophisticated planning, there might be much to be said for a foundation to be created in such a way that the Founder initially had very valuable Founder's Rights (howsoever called), even though that in itself would not be tax-efficient, as it might prevent the Foundation itself constituting a "settlement" for certain capital gains tax and income tax purposes and facilitate possible (but not pre-ordained) future tax planning.

2.2.2 Strategies Involving No or Low Transfer of Value

A more promising route is to use various strategies which were very common before the introduction of potentially exempt transfers by Finance Act 1986. These strategies have also had a new lease of life since the 2006 Budget Speech, in which it was announced that most gifts to settlements would not in future qualify either as exempt transfers of value or as potentially exempt transfers of value.³⁶

These vary from the vanilla to the sophisticated. A vanilla strategy might involve taking advantage of the normal expenditure out of income exemption³⁷ or relying on the availability of 100% agricultural property relief or business property relief. Or it might involve transferring an asset with little current value yet which might grow in value. In a "start-up" situation, the inheritance tax (or, for that matter, the capital gains tax, problems of funding a foundation) are likely to be of very little consequence.

Where it is not possible to transfer assets with minimal value, the Founder might consider selling such assets to the foundation at a market value price, in principle payable immediately, but on credit. Provided the terms of the sale were properly structured, that could avoid any charge to inheritance tax on the sale or on the Founder in fact leaving the purchase price outstanding and not claiming any interest. Stamp duty, stamp duty land tax and similar taxes, whether levied by the United Kingdom or other jurisdictions, would need to be borne in mind. This strategy would not overcome any charge to capital gains tax on the transfer. The existence of the loan might bring also into play certain anti-avoidance provisions which would not otherwise have been a problem. These should be carefully considered and, where practicable, steps taken to circumvent them.

Where a asset already has considerable value, it might be possible to engage in value-freezing or value-reducing techniques which would enable an existing asset to be carved up into two assets. One, which would currently not have much value, could be gifted or sold on credit to the foundation, and the other retained by the Founder. In the course of time, the asset transferred would increase in value

³⁶ See my *The Taxation of Trust Posts Finance Act 2009*, currently in preparation and to published by Key Haven Publications PLC.

³⁷ See Inheritance Tax Act 1984 section 2(1).

whereas the asset retained would either remain static in value or even reduce in value.

More sophisticated strategies still are beyond the scope of this article.

3 Is A Foundation A “Settlement”?

3.1 Importance of the Question

It is possible that a foundation might constitute a “settlement” for inheritance tax purposes. Or, usually more pertinent, its property could constitute “settled property”. If it does, that may expose the property and the foundation as its “trustee” to various charges to tax on settled property, levied by or as a result of Inheritance Tax Act 1984 Part III.

Even if a foundation is a “settlement” that does not mean that it might not also be a close company and involve potential charges to inheritance tax under Inheritance Tax Act 1984 Part IV.³⁸

If a foundation is a “settlement” that could have also have other repercussions. For example, interests in or rights with respect to the Foundation or its assets or income vested in an individual might not be comprised in the estate of that individual for inheritance tax purposes. See, for example, particular Inheritance Tax Act 1984 section 5(1) and (1A) (interests in possession), section 47A (settlement powers). Moreover, a “reversionary interest” may constitute excluded property: Inheritance Tax Act 1984 section 48.

3.2 Is a Foundation a “Settlement” and its Property “Settled Property”?

3.2.1 The Statute

Inheritance Tax Act 1984 section 43 (Settlement and related expressions) provides:

- “(1) The following provisions of this section apply for determining what is to be taken for the purposes of this Act to be a settlement, and what property is, accordingly, referred to as property comprised in a settlement or as settled property.
- (2) “Settlement” means any disposition or dispositions of property, whether effected by instrument, by parol or by operation of law, or partly in one way and partly in another, whereby the property is for the time being-

- (a) held in trust for persons in succession or for any person subject to a contingency, or
- (b) held by trustees on trust to accumulate the whole or part of any income of the property or with power to make payments out of that income at the discretion of the trustees or some other person, with or without power to accumulate surplus income, or
- (c) charged or burdened (otherwise than for full consideration in money or money's worth paid for his own use or benefit to the person making the disposition) with the payment of any annuity or other periodical payment payable for a life or any other limited or terminable period,

or would be so held or charged or burdened if the disposition or dispositions were regulated by the law of any part of the United Kingdom; *or whereby, under the law of any other country, the administration of the property is for the time being governed by provisions equivalent in effect to those which would apply if the property were so held, charged or burdened.*

- (3) ... [A lease of for life]
- (4) [Scotland]
- (5) [Northern Ireland]"

Although the charges to inheritance tax under Inheritance Tax Act 1984 Part III are in fact levied on settled property, the crucial point is to determine if there is a "settlement". For the definition of "settled property" is dependent on that: see section 43(1).

3.2.2 The Draughtsman's Lapse

An initial observation is needed. In everyday English the word "settlement" can refer to

- (a) a historic act which, broadly speaking, involves a disposal of property which creates a "settlement" in sense (b) or
- (b) to the state of affairs resulting from that historic act.

The draughtsman of the Inheritance Tax Act 1984 adopts a definition of "settlement" of type (a) (being a disposition of property with attains a certain result)

which he then goes on to ignore virtually every time he uses the word “settlement”, as he is in most contexts clearly using the word in its second sense! A foundation is no more a “disposition of property” than is a trust. Yet on that account it could still rank as a “settlement”.

3.2.3 Foundation Not Involve a Trust

I apprehend that the assets of a foundation will never be subjected to a trust.³⁹ For a foundation is the beneficial owner of its assets. Hence, taken by themselves, limbs (a), (b) and (c) of section 43(2) would not be in point.

3.2.4 Disposition Regulated by Foreign Law

Do the words “or would be so held or charged or burdened if the disposition or dispositions were regulated by the law of any part of the United Kingdom” make any difference? I think not. First, a transfer of assets to a foundation could in any case be a disposition regulated by the law of part of the United Kingdom. For example, if a Founder who is domiciled and resident in England makes in England a transfer of cash situate in England to a foundation (albeit one owing its existence to some foreign proper law), the disposition would, I apprehend by governed by United Kingdom law. If it were, then these words would not be in point.

I have always supposed that what these words were intended to catch was e.g. a gift of real property situate in a civil law jurisdiction, such as France, whereby A was to enjoy the right to occupy the property during his life but subject to that it was to belong to French law is immeasurably poorer than English law.⁴⁰ In particular, it has no law of trusts worthy of the name. It is, however, possible to give real property situate in France to B subject to what we would call a life interest in favour of A.⁴¹ It seems to me that in such circumstances there would be a “settlement” for

³⁹ Conversely, rights in or over a foundation might well be held in trust, and such a strategy might, in appropriate cases, result in some very effective tax planning.

⁴⁰ French law was, until the Revolution, by and large Roman law - the law of the original Fascists. It was essentially a law imposed by an absolute monarch on a an enslaved people. Its most significant reform was undertaken by the Tyrant of Corsica - yet another dictator. It is essentially prescriptive: you may do whatever the State says you may and nothing else. By contrast, the law of England was created by and for a free people. The courts adopted the customs of the people and recognised what the people had created. The rule in England was that everything was permitted unless there was some express rule to the contrary. It was in such a climate that the law of trusts and the law mercantile evolved. Hence, the infinite superiority of English law to that of the other, less happy, nations of Europe (with the obvious exclusion of the Republic of Ireland, which, for good or ill, was governed for much of its recent history by the English). Indeed, the main failings of English law have been introduced in recent years, during which we have been governed, or misgoverned, depending on one's point of view, by foreigners from a Civil Law jurisdiction.

⁴¹ The life interest is known as a “usufruit” (the English translation is “usufruct”) and the reversion the “nue propriété” (the bare legal title).

inheritance tax purposes, because if the disposition were governed by the law of England it would (since 1926) necessarily have to take the form of a trust falling with section 43(2)(a).⁴²

It is the words which I have italicised which are more problematic: “or whereby, under the law of any other country, the administration of the property is for the time being governed by provisions equivalent in effect to those which would apply if the property were so held, charged or burdened”. What on earth does this mean?

To simplify the case, let us ignore section 43(2)(c). In practice, I have never come across a trust which is a settlement purely because it satisfies section 43(2)(c). That is no doubt for the simple reason that voluntary terminable annuities are a very risky way of making provision for someone in inflationary times.⁴³

Thus, let us ask whether the “administration” of the property the subject of the disposition is governed by provisions “equivalent in effect” to those which would apply if the property were held on trusts falling with section 43(2)(a) or (b).⁴⁴ The word “administration” is not perhaps the most apt the draughtsman could have chosen if were intending to catch foreign arrangements - I deliberately use a vague word - which had an effect equivalent to, say, an English⁴⁵ trust. In the English law of trusts, we would normally draw a sharp line between the trustees’ power of administration of the trust property and their duties (and powers) to benefit beneficiaries in accordance with the terms of the trust. “Administration” is about property management, not about distributions or other benefits made to or conferred on beneficiaries.

If “administration” is used in its normal sense in the English law of trusts, it is difficult to see how a foundation could normally be a “settlement” or its property be “settled property” for inheritance tax purposes. The Board of a foundation will normally have extensive powers relating to the administration of its property. Or it could exceptionally have only restricted powers. And no doubt the trustees of an

⁴² Even here, there is a slight complication in that a trust would not be necessary under the law of the Province of Northern Ireland.

⁴³ Section 43(2)(c) echoes the wording of the Settled Land Act 1925, an admirable piece of legislation which was one of the casualties on which an ignorant Law Commission has wreaked havoc in the form of the Trusts of Land and Appointment of Trustees Act 1996. It in turn was drafted to cater for the world of Miss Austen’s *Sense and Sensibility* (as well as for the contemporary world).

⁴⁴ In practice, most property held in trust will fall within either or both of limbs (a) or (b). Exceptions will be property held on trust for one individual absolutely or property held on trust for joint or co-owners. These exceptions will not normally be relevant to a foundation.

⁴⁵ I do not forget that we must not ignore the trust laws of Scotland and of Northern Ireland. However, while there are some important differences, these three trust laws sufficiently resemble each other as compared with the laws relating to foundations.

English trust could be given equally extensive or restrictive powers. Yet that surely cannot be enough to make a foundation a “settlement”; for the same could be said of virtually every company in the world. Someone - usually the equivalent of a board of directors - will have powers of management of its property and those powers could be similar to those which a settlor might prescribe in relation to an English trust. Yet I apprehend that not even Her Majesty’s Commissioners of Revenue and Customs would contend that every company established under the law of a jurisdiction outside of the United Kingdom would constitute a “settlement” for United Kingdom inheritance tax purposes. In short, the argument proves far too much.

The difficulty, from the taxpayer’s point of view, is in giving the italicised words any scope of application at all. A court might therefore be tempted to hold that the draughtsman was using the word “administration” in an unusual sense and not in the sense in which it is used in the English law of trusts. A court might conceivably hold that “the administration of the property is for the time being governed by provisions equivalent in effect to those which would apply if the property were [held on trusts falling with section 43(2)(a) or (b)]” if the net effect of the arrangement was to create something which, in substance, resembled an English trust. It might be more tempted to do so if it felt that the use of foundations might allow what it considered widespread tax-avoidance.

Let us suppose that a court did so hold. That would not be the end of the matter. It would have to go further and ask: “What are the salient characteristics of a trust governed by English law which an arrangement governed by some foreign law might share without being in fact a trust?”

Different answers might be given by different people to this question. On one view, the most salient feature of a trust by far is that legal title to property is vested in one person (the trustee) yet he is under an obligation to third parties to deal with it for their benefit, in accordance with the terms of the trust, even if those terms to a lesser or greater extent confer on him a discretion. On that view, a plausible, nay, a compelling, argument could be mounted that a foundation would indeed be sufficiently close to an English trust as to constitute a “settlement” for inheritance tax purposes **if and only if** the Beneficiaries had enforceable rights to ensure that benefits were conferred on them in accordance with its constitution (to use a neutral word).

The question whether any given foundation constitutes a “settlement” for inheritance tax purposes or, more pertinently, whether its property is “settled property” cannot be regarded as beyond argument. In the next sections, I shall explore what the consequence would be if the property of the foundation were indeed “settled property”.

3.4 Construction of Inheritance Tax Act 1984 Part III if a Foundation's Property is Settled Property

3.4.1 General Principle

Given that Inheritance Tax Act 1984 section 43 extends the meaning of “settlement” to various arrangements which are not trusts, but that much of the language of Part III is couched in the language of trusts,⁴⁶ one would expect there to be a provision, probably in section 43, that in the case of a “settlement” which is not in fact a trust, various references in Part III which prima facie apply only to settlements which are trusts should be construed with the necessary modifications so that, so far as possible, Part III has the same effect in relation to such a settlement (i.e. one which is not in fact a trust) as it does in relation to settlements which are trusts.

Such a provision could be important. For example, the special rules relating to settled property in which there subsists an interest in possession, in particular a qualifying interest in possession, and of reversionary interests would prima facie have no scope as these are expressions which, in England at least, are normally encountered only in the context of trusts. Nor would provisions such as Inheritance Tax Act 1984 section 80 (Initial interest in possession of settlor or spouse or civil partner).

I can find no such provision in Part III. The question then arises whether the courts would imply one. That is a difficult question.

First, let me dispose of a factor which is probably of very little weight. The side note to section 43 is “Settlements and related expressions”. Yet the section itself lays down no general rule as to related expressions. The traditional rule is that a side note is not an aid to construction of a statute: see *R v Schildcamp* [1971] AC 2, although that rule may be applied with more flexibility nowadays. Even if one could rely on the side note as an aid to construction of section 43, it does contain ample specific provisions as to which the side note could refer, in particular in regard to the law of Scotland and Northern Ireland.

On the one hand, one needs some warrant for implying in a statute words which are not there. One type of warrant is that the deeming provision in section 43(a) so operates by necessary implication. See *Marshall v Kerr* [1993] STC 360 in the Court of Appeal, approved on this point by the House of Lords at ([1994] STC 638). Yet that is clearly not the case here.

⁴⁶ There are, of course, terms used which could apply equally to trusts or to non-trusts, such as the definition of “Settlement power” contained in section 47A, namely “any power over, or exercisable (whether directly or indirectly) in relation to, settled property or a settlement”.

Another type of warrant would be that the statute would otherwise be unworkable. Yet that is not the case here either. What one can say is that if one did not make the implication, Part III could often apply differently in relation to settlements which were trusts than in relation to settlements which were not. That would be very surprising. In my view, a modern court would probably therefore make the implication. Or it might achieve the same result by a different means. It might hold that given that Part III was to apply to settlements which were not trusts, terms and expressions of trust law which were found in Part III were to be given a less technical meaning than would be the case if Part III applied only to settlements which were trusts.

3.4.2 “Trustee”

A foundation does not have any “trustee” in the normal sense of the word. However, whatever the correctness of the view I have expressed in the preceding section, Inheritance Tax Act 1984 section 45 (Trustee) makes it quite clear that the term “trustee” covers certain persons who are not trustees at all. It provides:

“In this Act “trustee”, in relation to a settlement in relation to which there would be no trustees apart from this section, means any person in whom the settled property or its management is for the time being vested.”

Thus, if the property owned by a foundation is settled property, the foundation will be a “trustee”. What is less clear is whether the members of its Board will be “trustees”. If the management of the property of the foundation is vested in them, then, if section 45 is read literally, they would be. Yet if the foundation had been an actual trustee of trust property which was settled property, they clearly would not be. The point is very important in that trustees of a settlement are personally liable for inheritance tax charged on the settled property. I would like to think that the courts would construe section 45 as follows:

“In this Act “trustee”, in relation to a settlement in relation to which there would be no trustees apart from this section, means any person in whom the settled property is for the time being vested or, *if there is no such person*, any person in whom the management of the settled property is for the time being vested.”

It should be noted that section 45 applies for the purposes of the whole of the Act (and of the inheritance tax legislation) and not just for the purposes of Part 3. Thus, it would apply, for example, for the interpretation of Inheritance Tax Act 1984 section 218 (Non-resident trustees), which imposes a reporting requirement on certain persons who, in the course of a trade or profession carried on by them, have been concerned with the making of a settlement and who know or have reason to believe-

- (a) that the settlor was domiciled in the United Kingdom, and
- (b) that the trustees of the settlement are not or will not be resident in the United Kingdom.

3.4.3 Property Leaving Temporary Charitable Trusts

Inheritance Tax Act 1984 section 70 (Property Leaving Temporary Charitable Trusts) imposes a special exit charge on property which ceases to be “held for charitable purposes only until the end of a period (whether defined by date or in some other way)”. While the side note refers to charitable *trusts*, nothing in the section refers to trusts. Hence, there is in my view no reason why this section could not apply to a foundation the property of which was “settled property”

3.4.4 Trusts for Bereaved Minors

Inheritance Tax Act 1984 section 71A (Trusts for bereaved minors) would in my view be very difficult to apply to a settlement which was not a trust, on account, not of the side note, but of the very specific wording of the section.

3.4.5 Section 71D Age 18-to-25 trusts

Inheritance Tax Act 1984 section 71D (Age 18-25 Trusts) would in my view be very difficult to apply to a settlement which was not a trust, on account, not of the side note, but of the very specific wording of the section.

3.4.6 Property Becoming Held for Charitable Purposes, Etc

Inheritance Tax Act 1984 section 76 (Property becoming held for charitable purposes, etc) can easily apply to a settlement which is not a trust.

3.4.7 Employee Trusts and Newspaper Trusts

Inheritance Tax Act 1984 section 86 (Trusts for benefit of employees) is important in its own right and because several other provisions of the Inheritance Tax Act 1984 refer to it. The side note is not important. The section does refer to settled property which is “held on trusts”. However, the section would be perfectly workable in the case of other types of settlement. Whether or not section 86 could apply to a settlement which is not a trust would therefore depend on the general principle, discussed at 3.4.1 above.

Inheritance Tax Act 1984 section 87 (newspaper trusts) is in effect an extension of section 86. Very similar considerations are in point.

3.4.8 Protective Trusts

Inheritance Tax Act 1984 section 88 (Protective trusts) applies to “settled property ... which is held on trusts to the like effect as those specified in section 33(1) of the Trustee Act 1925”. The side note is not important. The section does refer to settled property which is “held on trusts”. However, the section would be perfectly workable in the case of other types of settlement. Whether or not section 88 could apply to a settlement which is not a trust would therefore depend on the general principle, discussed at 3.4.1 above.

3.4.9 Disabled Trusts

Inheritance Tax Act 1984 section 89 (Trusts for disabled persons) applies where settled property is “held on trusts”. The side note is not important. The section does refer to settled property which is “held on trusts”. However, the section would be perfectly workable in the case of other types of settlement. Whether or not section 89 could apply to a settlement which is not a trust would therefore depend on the general principle, discussed at 3.4.1 above. However, even if the rest of the section so applied, it would be more difficult to apply subsection (3) which refers in terms to the English Trustee Act 1925 section 32 and its Northern Ireland counterpart.

3.4 Consequences if the Foundation’s Property is Settled Property

3.4.1 The General Rule

If the property of the foundation is settled property, it will be potentially liable to inheritance tax in just the same way as any other settled property.

3.4.2 Foundation Property as “Relevant Property”

In practice, the property of a foundation which is settled property is likely to be “relevant property”, in which case it will be subject to periodic and exit charges to inheritance tax, levied under Inheritance Tax Act 1984 sections 64 and 65. A full definition of “relevant property”, contained in Inheritance Tax Act 1984 section 58, is beyond the scope of this article.⁴⁷

3.4.3 Foundation Property as Excluded Property

There are exceptions, of which perhaps the most common will be where it constitutes excluded property, the test being that laid down in Inheritance Tax Act

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See my *The Taxation of Trusts Post Finance Act 2009* currently in preparation and to be published by Key Haven Publications PLC.

1984 section 48 (excluded property), which provides:

“...

- (3) Where property comprised in a settlement is situated outside the United Kingdom-
 - (a) the property ... is excluded property unless the settlor⁴⁸ was domiciled in the United Kingdom at the time the settlement was made ... “

See also section 48(3A) for a holding in an authorised unit trust or a share in an open-ended investment company. See also the anti-avoidance provisions in section 48(3B) to (3C), as well as section 48(4) (exempt gilts).

3.4.4 Qualifying Interests in Possession

If a qualifying interest in possession subsists in settled property, then that settled property will not, in general, be “relevant property”: see Inheritance Tax Act 1984 section 58(1) to (1C). The term “interest in possession” is not defined. In the context of a trust, it has a fixed meaning, even if that meaning has been fixed by a waiver-thin majority of the House of Lords in which the Chancery judges dissented: see *Pearson v Inland Revenue Commissioners*.⁴⁹ A “qualifying” interest in possession is defined only in terms of certain types of “interest in possession” (which, as stated, is not defined).

The owner of the qualifying interest in possession will normally be deemed for inheritance tax purposes to own the underlying settled property: see Inheritance Tax Act 1984 section 49.

⁴⁸ Inheritance Tax Act 1984 section 44 (Settlor) provides:

- “(1) In this Act “settlor”, in relation to a settlement, includes any person by whom the settlement was made directly or indirectly, and in particular (but without prejudice to the generality of the preceding words) includes any person who has provided funds directly or indirectly for the purpose of or in connection with the settlement or has made with any other person a reciprocal arrangement for that other person to make the settlement.
- (2) Where more than one person is a settlor in relation to a settlement and the circumstances so require, this Part of this Act (except section 48(4) to (6)) shall have effect in relation to it as if the settled property were comprised in separate settlements.”

The obiter dicta in *Hatton v IRC* [1992] STC 140 on section 43(2) were in my view misconceived and been impliedly overruled by the House of Lords in *Fitzwilliam v Commissioners of Inland Revenue* [1993] STC 502.

⁴⁹ [1980] STC 318. I consider the majority got this right and that, quite surprisingly, it was the Chancery judges who erred on this occasion. Moreover, if one has regard not simply to the terminology used by trust lawyers but to the construction of the words in the context of what is now the Inheritance Tax Act 1984, any other construction would have been bizarre.

If the view I have expressed at the end of 3.4.1 is correct, there can be an “interest in possession”, and thus a “qualifying interest in possession”, in the assets of a foundation. It will be necessary that the owner of the interest in possession has the **legally enforceable** right to receive the net income (if any) of the foundation as it arises or, in the alternative, to enjoy the assets of the foundation in specie, e.g. by occupying real property owned by the foundation.

4 A Foundation as a Close Company

4.1 Foundations as Companies

A foundations of the type with which I am dealing will invariably be a body corporate in that it will be an artificial person having legal personality, usually under some foreign proper law. As such it will inevitably be a “company” for inheritance tax purposes.

Much more important questions are:

- (a) whether a foundation will be a “close company”,
- (b) if so, who will be the “participants” in it and
- (c) what will be the respective value of the rights and interests of the participants in or over the foundation?

As the first two of these questions arise in relation to more than one tax, they are dealt with in Part X Close Companies.

4.2 Adaptation of Close Company Definitions to Inheritance Tax

Inheritance Tax Act 1984 section 102 contains a definition of “close company” and “participant” which in terms applies only for the purposes of Part IV of that Act but is in fact adopted on every occasion on which the phrase is used in the inheritance tax acts.

Section 102 (Interpretation), so far as material, provides:

“(1) In this Part of this Act-

“close company” means a company within the meaning of the Corporation Tax Acts which is (or would be if resident in the United Kingdom) a close company for the purposes of those Acts;

“participator”, in relation to any company, means any person who is (or would be if the company were resident in the United Kingdom) a participator in relation to that company for the purposes of Chapter I of Part XI of the Taxes Act 1988, other than a person who would be such a participator by reason only of being a loan creditor;

...”

The first of these adaptations, namely the extension of the concept of “close company” to a company resident outside the United Kingdom, is straightforward.

The limiting of the definition of “participator” so as not to include loan creditors is not quite so straightforward. It is a moot point whether, in determining whether a person is a “participator”, one ignores

- (a) that fact that a person is deemed by Income and Corporation Tax Act 1988 Part XI Chapter 1 to be a loan creditor and / or
- (b) the fact that a person has a beneficial interest in a debt or a loan capital to which a loan creditor is entitled

See the discussion at E.3.4 and E.3.6.

4.3 Will A Foundation be a Close Company for Inheritance Tax Purposes?

A foundation may or may not be a close company for inheritance tax purposes. That depends partly on questions of fact, such as its constitution and who has what interest (using the word in a non-technical sense) as respects it, and partly on some unresolved questions of law. See Part X and in particular Chapter E.2. While it will often be the case that much can be done by skillful planning to reduce the chances of a foundation being a close company, it will not infrequently remain the case that one will not be able to have a sufficient degree of confidence that it is not.

The fact that a foundation is a close company will not necessarily entail any adverse consequences in inheritance tax terms, especially if care is taken. It will often be prudent to plan on the basis that a foundation is, or may be, a close company for such purposes. In the rest of this section 4 I shall assume that the foundation under consideration is.

4.4 Charges to Inheritance Tax Resulting From Inheritance Tax Act 1984 Part IV Close Companies

4.4.1 Introduction

Inheritance Tax Act 1984 Part IV Close Companies contains sections 94 - 102. They do not themselves impose charges to tax but in effect apportion transfers of value made by a close company to its participators. They work in sometimes unexpected ways, especially, where, as will normally be the case with a foundation, the close company is formed under the law of a jurisdiction outside the United Kingdom and rights in or over it are property situate outside the United Kingdom for inheritance tax purposes.

4.4.2 Apportionment: the Basic Statutory Rules

Inheritance Tax Act section 94 (Charge on participators) provides:

- “(1) Subject to the following provisions of this Part of this Act, where a close company makes a transfer of value, tax shall be charged as if each individual to whom an amount is apportioned under this section had made a transfer of value of such amount as after deduction of tax (if any) would be equal to the amount so apportioned, less the amount (if any) by which the value of his estate is more than it would be but for the company’s transfer; but for this purpose his estate shall be treated as not including any rights or interests in the company.
- (2) For the purposes of subsection (1) above the value transferred by the company’s transfer of value shall be apportioned among the participators according to their respective rights and interests in the company immediately before the transfer, and any amount so apportioned to a close company shall be further apportioned among its participators, and so on but-
 - (a) so much of that value as is attributable to any payment or transfer of assets to any person which falls to be taken into account in computing that person’s profits or gains or losses for the purposes of income tax or corporation tax (or would fall to be so taken into account but for section 208 of the Taxes Act 1988 shall not be apportioned ...”⁵⁰

Although only individuals⁵¹ can be liable to pay inheritance tax in respect of a transfer of value, a company can still make a transfer of value, namely “a disposition made by a person (the transferor) as a result of which the value of his estate immediately after the disposition is less than it would be but for the disposition”: Inheritance Tax Act section 3(1). A foundation will *prima facie* make a transfer of value every time it confers a benefit on a person by a transfer of assets to him, whether that benefit is of a capital or an income nature. Hence, there will potentially be considerable scope for the application of section 94.

4.4.3 Chargeable, Exempt and Potentially Exempt Transfers of Value

A transfer of value can be chargeable, exempt or potentially exempt. Only transfers which are or become chargeable give rise to a charge to tax. See Inheritance Tax Act section 1 (Charge on transfers) “Capital transfer tax⁵² shall be charged on the value transferred by a chargeable transfer” and section 2 (Chargeable transfers and exempt transfers) “(1) A chargeable transfer is a transfer of value which is made by an individual but is not (by virtue of Part II of this Act or any other enactment) an exempt transfer.” It might be asked whether section 94 has any scope at all in that what is capable of being apportioned to an individual is merely a transfer of value and not a chargeable transfer of value. Realistically, the Courts would be reluctant to hold that section 94 had no practical effect. They might well reason that the transfer of value made by a close company imputed to an individual is *prima facie* chargeable unless it can be shown to be exempt.

The application of exemptions in relation to a transfer of value made by a close company could be problematic. For example, suppose B owns all the shares in a close company which makes a transfer of value of £10,000 by means of a transfer of cash of that amount to C, her civil partner. The transfer of value made by the close company is not itself exempt (under Inheritance Tax Act section 18, Transfers between spouses or civil partners) as C is not its civil partner. Given that the entire transfer of value is apportioned to A, will it be exempt (under section 18) on the grounds that “the value transferred is attributable to property which becomes comprised in the estate of the transferor’s ... civil partner ...” I do not myself see why not.

Suppose, however that the close company distributes all its income every year. Could the transfer of value it thereby makes qualify as an exempt transfer of value by virtue of Inheritance Tax Act section 21 (Normal expenditure out of income). Section 21(1) provides:

⁵¹ and, in some cases, the trustees of settlements.

⁵² i.e. inheritance tax.

- “(1) A transfer of value is an exempt transfer if, or to the extent that, it is shown-
- (a) that it was made as part of the normal expenditure of the transferor, and
 - (b) that (taking one year with another) it was made out of his income, and
 - (c) that, after allowing for all transfers of value forming part of his normal expenditure, the transferor was left with sufficient income to maintain his usual standard of living.”

This is clearly somewhat problematic. It is (c) which creates the problem. A foundation does not really have a “usual standard of living”. It might be argued that, therefore, the amount of income it needs to “maintain [its] usual standard of living” is zero, so that this condition is always satisfied. There are contrary arguments.

If the foundation itself does not make an exempt transfer of value, can it be said that the transfer of value apportioned to the participators can be exempt under section 21? At first blush, this looks difficult. For they have not, in any normal sense of the words, expended anything, certainly not out of *their* income.

Given that it would be harsh if section 21 could apply neither to the close company nor to its participators, so that section 94 was more than anti-avoidance and imposed a greater charge to tax than if the close company had not existed and given that section 94 is a deeming section which requires one to proceed on a counter-factual basis, it is possible that the Courts would allow some leeway in the adaptation of section 21 to it.

What of potentially exempt transfers? The transfer of value made by the close company cannot itself qualify, for Inheritance Tax Act section 3A (Potentially exempt transfers) provides:

- “(1) Any reference in this Act to a potentially exempt transfer is a reference to a transfer of value-
- (a) which is made by an individual on or after 18th March 1986 but before 22nd March 2006; and ...
- (1A) Any reference in this Act to a potentially exempt transfer is also a reference to a transfer of value-
- (a) which is made by an individual on or after 22nd March 2006”

A close company is not an “individual”.

Could the transfer of value apportioned to a participator under section 94 constitute a potentially exempt transfer, the other conditions being satisfied? The problem is section 3A(6), which provides:

“(6) Where, under any provision of this Act ... tax is in any circumstances to be charged as if a transfer of value had been made, that transfer shall be taken to be a transfer which is not a potentially exempt transfer.”

4.4.4 Beneficiaries with Legally Enforceable Rights

If a beneficiary has a legally enforceable right to receive a payment or transfer of assets from a foundation, then, it might be thought that in general, the foundation would make no transfer of value in making the payment or transfer, as the value of its estate would not be thereby reduced. However, one must take into account Inheritance Tax Act section 5 (Meaning of estate), which provides:

“(5) Except in the case of a liability imposed by law, a liability incurred by a transferor shall be taken into account only to the extent that it was incurred for a consideration in money or money’s worth.”

This *prima facie* presents an obstacle. However, it is one which one ought to be able to avoid by carefully structuring of the foundation and its funding.

4.4.5 Discretionary Beneficiaries

Suppose the Board of a foundation is permitted or even obliged to distribute its capital among such of a class of Beneficiaries as the Board in its discretion think fit and that the Board in fact distributes capital amongst X, Y and Z in equal shares. In such a case, it is not easy to argue that the foundation has not made a transfer of value, although the argument is by no means impossible if the constitution is properly drafted.

It may well be possible, however, depending on the proper law under which the foundation is created, to arrange that even discretionary payments made by the Board of a foundation are made in pursuance of an undoubted legal obligation, owed to the recipients, so that the foundation, and its participators, will have a decent argument that it has not made a transfer of value.

Even if the foundation makes payments or transfers of assets in satisfaction of a legal obligation owed not to the recipient Beneficiaries but to a third party, it may be possible to argue that the foundation thereby makes no transfer of value

4.4.6 Method of Apportionment

Section 94(2) tells us that the basic rule is that the value transferred by the close company's transfer of value is to be apportioned among the "participants" according to their respective rights and interests in the company immediately before the transfer.

Section 102 (Interpretation) provides:

- "(2) References in this Part of this Act to a person's rights and interests in a company include references to rights and interests in the assets of the company available for distribution among the participants in the event of a winding-up or in any other circumstances."

The definition of a "participant" is considered in Chapter E.3 and the reader is referred to that Chapter for more detailed consideration of the definition and its application to a foundation. There will, broadly speaking, be three groups of people who might be "participants" in relation to a foundation:

- (a) the members of the Board on the basis that they had "voting rights in the company",⁵³
- (b) the person entitled to Founder's Rights, if they were extensive enough to confer on him
 - (i) "voting rights in the company"⁵⁴ or
 - (ii) a right to receive or participate in "distributions" of the company or, possibly, any amounts payable by the company to loan creditors by way of premium on redemption or
 - (iii) an entitlement to secure that income or assets of the company would be applied directly or indirectly for his benefit.
- (c) a Beneficiary if he had
 - (ii) a (legally enforceable) right to receive or participate in "distributions" of the company or, possibly, any amounts payable by the company to loan creditors by way of premium on redemption or

⁵³ See Income and Corporation Tax Act 1988 section 417(1)(i).

⁵⁴ See Income and Corporation Tax Act 1988 section 417(1)(i).

- (iii) an entitlement to secure that income or assets of the company would be applied directly or indirectly for his benefit.⁵⁵

A person can be a “participator” in a foundation without having any right in the company itself, as opposed to its assets. It is for this reason that Inheritance Tax Act 1984 section 102(2) was enacted, as otherwise apportionment of a transfer of value made by a close company to a person who had no right or interests in the foundation itself would not have been possible.

Section 94(4) is far from clear as to the manner in which the apportionment is to be made. The words “according to their respective rights and interests in the company” may be clear enough in the case of a solvent company with one class of shares in issue, but becomes much more difficult where the rights and interests of the participators are generically different from each other.

While section 94(4) does not in terms refer to the values of the respective rights and interests in the company, I would suggest that this should always be the starting point and will often be the finishing point.

If the members of a Board are participators by virtue of having “voting rights in the company”, it is arguable that their voting rights have no value, at least to them, if they are held in a fiduciary capacity, as may well be the case. This, of course, could work in favour of or against Her Majesty’s Commissioners of Revenue and Customs, depending on the circumstances. The members of the Board of a foundation will normally not be resident or ordinarily resident in the United Kingdom and I apprehend that they will not normally be domiciled in any part of the United Kingdom in reality or be deemed to be so domiciled for inheritance tax purposes. In that case, it should be possible to avoid any charge to inheritance tax on them by relying on Inheritance Tax Act 1984 section 94(2)(b), as to which see 4.4.9.

If the members of the Board are the only participators, then the transfer of value must necessarily be apportioned entirely to them.

If Beneficiaries have legally enforceable rights to receive the whole or part of the capital or income of the foundation and are on that account participators, it will be possible to value their rights as between themselves.

If there are no participators, then an apportionment clearly cannot be made.

⁵⁵ The reader is referred to E.3 for the extended meanings of some of these terms. A person who had the same rights as a member of the Board or as a Founder might also be a participator on that account. There are in addition other, more remote, possibilities whereby a person might be a “participator”, as discussed in that Chapter.

4.4.7 Automatic Apportionment?

The close company apportionment of income provisions which until 1989 operated for income tax purposes⁵⁶ allowed the Inspector of Taxes to make an apportionment of the income of a company amongst its participators. Unless and until he did, no fiscal liability arose under the provisions. In that scenario, the manner of apportionment did not need to be specified precisely in the statute and guiding principles were sufficient. The Inspector of Taxes might have a certain discretion as to how the apportionment was to be made. Provided he kept within the statutory guidelines, any such apportionment would be valid.

The inheritance tax legislation, however, poses a problem. The very vagueness of the words in section 94(2) “shall be apportioned among the participators according to their respective rights and interests in the company” would be appropriate for the laying down of a guiding principle. For there could, especially in the context of a foundation, be two or more methods of making such an apportionment, all fairly falling within these words. One would therefore expect apportionment under Part IV not to take effect unless and until effected by some Revenue official duly authorised thereto. The difficulty is that there are no provisions providing the mechanism for the making of such an apportionment, let alone for an appeal against it. And inheritance tax is a self-assessed tax with no annual tax return to be completed.

If, however, apportionment is to be automatic, how is the potential taxpayer to know the basis on which apportionment is to be made, especially if there is more than one set of apportionments which could be made consistently with the statutory language?

4.4.8 Exception for Income Receipts

Inheritance Tax Act 1984 section 94(2) provides:

“...

- (a) so much of that value as is attributable to any payment or transfer of assets to any person which falls to be taken into account in computing that person's profits or gains or losses for the purposes of income tax or corporation tax (or would fall to be so taken into account but for section 1285 of the Corporation Tax Act 2009 (exemption for UK company distributions)⁵⁷ shall not be apportioned ...”

⁵⁶ See E.1.1.

⁵⁷ This is the exemption from corporation tax in respect of United Kingdom company distributions which was formerly contained in section 208 of the Taxes Act 1988. It is unlikely to be in point in the case of a foundation.

The payment or transfer of assets does not need to constitute income: it is sufficient that it is “taken into account in computing ... profits or gains”. Nor does there need to be any actual charge to income tax or corporation tax.

Section 94(2) is very odd. On the one hand, it appears too narrow. One would expect it to apply in respect of income which was not “profits or gains or losses for the purposes of income tax or corporation tax”, for example, a payment received as income by a person not resident or ordinarily resident in the United Kingdom from a non-UK source.

On the other hand, it is so phrased as to offer a relatively simple method of avoiding an apportionment under Part IV without any corresponding charge to income tax or corporation tax.

4.4.9 Foreign Domiciliaries

The operation of Inheritance Tax Act 1984 Part IV in relation to persons who are not domiciled or deemed for inheritance tax purposes to be domiciled within the United Kingdom is often misunderstood.

Section 94(2)(b) provides:

- “(b) if any amount which would otherwise be apportioned to an individual who is domiciled outside the United Kingdom is attributable to the value of any property outside the United Kingdom, that amount shall not be apportioned.”

The domicile of the person in whose favour the transfer of value is made is irrelevant. Equally irrelevant is the situs of the rights or interests in the foundation by virtue of which an individual is a participator and which gives rise to an apportionment to him.

What does count is the situs of the property of the foundation which gives rise to the transfer of value. That must be situate outside the United Kingdom.

4.4.10 Excluded Property

It might be asked whether, if a foundation is domiciled abroad, a disposition made by it of property situate outside the United Kingdom would not give rise to a transfer of value on the grounds that it was excluded property. Inheritance Tax Act 1984 section 3 (Transfers of value) provides:

- “(1) Subject to the following provisions of this Part of this Act, a transfer of value is a disposition made by a person (the transferor) as a result of which the value of his estate immediately after the disposition is

less than it would be but for the disposition; and the amount by which it is less is the value transferred by the transfer.

- (2) For the purposes of subsection (1) above no account shall be taken of the value of excluded property which ceases to form part of a person's estate as a result of a disposition."

The problem is that section 6 (Excluded property) provides:

- "(1) Property situated outside the United Kingdom is excluded property if the person beneficially entitled to it is an individual domiciled outside the United Kingdom."

A body corporate is not an individual. Hence, property to which a foundation is beneficially entitled cannot on account of section 6(1) be excluded property.

For the position where the property of the foundation constitutes settled property, however, see 5.2.

4.4.11 Apportionments of 5% or Less of Value Transferred

Section 94(4) provides:

"Where the amount apportioned to a person under this section is 5 per cent or less of the value transferred by the company's transfer of value then, notwithstanding section 3(4) above, tax chargeable under subsection (1) above shall be left out of account in determining, with respect to any time after the company's transfer, what previous transfers of value he has made."

This is in some ways more extensive and in some ways less extensive than the corresponding relief under Taxation of Chargeable Gains Act 1992 section 13, as to which see Chapter C.2.5.

First, one looks at an individual in isolation and not at amounts apportioned to persons connected with him.⁵⁸

However, if less than 5 per cent or less of the value transferred would be apportioned to an individual, he is not thereby spared apportionment.⁵⁹ The only relief he has is that the value transferred is not taken into account in computing the rate of tax on subsequent transfers of value made by him. In popular parlance, his inheritance tax "clock" is unaffected.

⁵⁸ Contrast Taxation of Chargeable Gains Act 1992 section 13(4), discussed at C.2.5.6.

⁵⁹ Contrast Taxation of Chargeable Gains Act 1992 section 13(4), discussed at C.2.5.6, where the fraction is 10 per cent.

No doubt some person more intelligent than I am will be able to explain the rationale behind this very odd provision. As a *de minimis* provision, it would have made perfect sense.⁶⁰ However, it does nothing to prevent an apportionment of even an insignificant amount. Once, that amount has been apportioned and any tax charged, however, it operates so as to ensure the apportioned transfer of value is for future inheritance tax purposes forgotten.

This provision allows considerable scope for tax planning. Let us suppose that a transfer of value made by a close company could otherwise be apportioned to twenty individuals in equal shares. None of them has any cumulative history of chargeable transfers of value (i.e. ones made in the last seven years). It is proposed to make a discretionary capital payment of £1,000,000 out of the assets of the foundation to a beneficiary. If instead of one payment of £1,000,000, there are made four separate payments of £250,000, no inheritance tax will become eligible and the future inheritance tax position of the individuals will not be adversely affected.

4.4.12 Annual Exemption

Inheritance Tax Act 1984 section 19 confers an annual exemption on the first £3,000 of chargeable transfers of value made by individual in any year (ending April 5th), with a carry-forward for one year only of any part of the unused annual exemption.

Section 94(4) makes it clear that the annual exemption can be used as respects a transfer of value apportioned to an individual under section 94. It provides:

“(5) References in section 19 above to transfers of value made by a transferor and to the values transferred by them (calculated as there mentioned) shall be treated as including references to apportionments made to a person under this section and to the amounts for the tax on which (if charged) he would be liable.”

4.4.13 Special Cases

There are rules dealing with special situations which are beyond the scope of this article. I shall simply list them:

Participators in two companies (Inheritance Tax Act 1984 section 95 (Participator in two companies), subsection (1) of which can provide relief where:

- (a) the value of the estate of a company (“the transferee company”) is increased as the result of a transfer of value

⁶⁰ Section 96 contains a *de minimis* provision which applies only to preference shares and which will therefore not be in point in the case of a foundation.

made by a close company (“the transferor company”), and

- (b) an individual to whom part of the value transferred is apportioned under section 94 above has an interest in the transferee company (or in a company which is a participator of the transferee company or any of its participators, and so on))

Transfers within a group etc (Inheritance Tax Act 1984 section 97)

Alterations of capital, etc (Inheritance Tax Act 1984 section 98), which can apply at a time when there is:

- (a) an alteration in so much of a close company’s ... loan capital as does not consist of quoted shares or quoted securities [or]
- (b) an alteration in any rights attaching to ... unquoted debentures of a close company

Transfers where participators are trustees (Inheritance Tax Act 1984 section 99. The application of this section would be highly problematic if the members of the Board of a Foundation were participators in it and the property of the foundation were settled property.

Alterations of capital, etc where participators are trustees (Inheritance Tax Act 1984 section 100)

4.4.14 Planning

Planning to avoid the application of Inheritance Tax Act 1984 Part IV should be along the following lines.

First, steps should be taken, if at all possible, to ensure that the foundation is not a close company at all.

Second, one should seek to ensure that the foundation has no participators. However, given that the very steps which one will have taken in an attempt to ensure that the company is not a close company will often be those one will take to ensure that the company has no participators, I apprehend that there will not be many foundations both (a) constitute a close company and (b) have no participators.

Third, one should attempt to ensure, as far as possible, that any participators to whom an apportionment (or sub-apportionment) might be made are either not individuals or, if they are individuals, they are neither domiciled nor deemed for

inheritance tax purposes to be domiciled in the United Kingdom **and** that they can take the benefit of section 94(2)(b).⁶¹ If there were Beneficiaries who were so domiciled (or deemed to be so domiciled), then steps should be taken to ensure that they were not participators.

Fourth, one should aim to ensure so far as possible to ensure that the only participator to whom a transfer of value made by the foundation could be apportioned would be the one who benefitted by the transfer of value and who could take advantage of section 94(2)(a).

5 A Foundation as a Settlement and a Close Company

5.1 Potential Double Charge

If a foundation is a settlement for inheritance tax purposes, or rather, if its property constitutes settled property (of which it is the (or a) trustee) and if the foundation is a close company, a disposition by the Foundation as a result of which its estate was diminished in value could *prima facie* give rise to an exit charge on the settled property under Inheritance Tax Act 1984 section 65 as well as an apportionment under section 94. There is no express relieving provision from this potential double charge.

Reliance might be placed on a line of authorities, which I cited to the House of Lords in *R v Dimsey* [2001] UKHL 46 [2001] STC 1520, which hold that there is a strong presumption against double taxation. Her Majesty's Commissioners of Revenue and Customs might, however, have arguments that they were not in point in the circumstances envisaged.

Another argument is that if the property of a foundation is settled property, it must be deemed not to be beneficially entitled to it so that if it disposes of it, any charge must be under section 65 and not as a result of the operation of section 94.

5.2 The Property of the Foundation as Settled Property which is Excluded Property

Whatever the correctness of the above arguments, there is one situation where a double charge could in my view undoubtedly be avoided.

If the property of the Foundation is settled property and it is also excluded property, then to the extent that the foundation disposes of it, it will not make a transfer of

⁶¹ See 4.4.9.

value. That is the effect of Inheritance Tax Act 1984 section 3(2). Hence, there will, to that extent, be nothing which falls to be apportioned under section 94.

6 Taxation of Rights over the Foundation

6.1 The General Principle

Various persons may have rights over or respecting a foundation or its assets. Such rights will *prima facie* constitute part of the estate of their owner, at least if they are not of a fiduciary nature, which in general they will not be.

Thus, a dealing with such rights could in principle give rise to a charge to inheritance tax, subject to the usual conditions being satisfied. And such rights would *prima facie* form part of the estate of an individual on his death so that they could again in principle give rise to a charge to inheritance tax on that occasion.

In the remaining part of this section, I discuss various exceptions to the *prima facie* rule.

6.2 Beneficiaries Without Rights

If a Beneficiary of a foundation has no enforceable rights of any value, including a right to require the members of the Board properly to exercise their discretion, then the previous section will be of no relevance.

6.3 Excluded Property

Rights over a foundation incorporated under some foreign law will normally be situated outside the United Kingdom. Thus, if owned by a person who is neither domiciled nor deemed for inheritance tax purposes to be domiciled in the United Kingdom, they would normally constitute excluded property.

6.4 The Foundation's Property as Settled Property

If the property of foundation is settled property, certain special rules apply.

An interest in possession in settled property which is not a qualifying interest in possession is normally not regarded as part of a person's estate for inheritance tax purposes: Inheritance Tax Act 1984 section 5.

A reversionary interest in settled property will often constitute excluded property: Inheritance Tax Act 1984 sections 47 and 48(1) and (2).

6.5 Settlement Powers

A right over or respecting a foundation could well constitute a “settlement power” if the property of the foundation is settled property, even if the foundation is not itself a “settlement”. Where a person acquires a “settlement power” for consideration in money or money’s worth, Inheritance Tax Act 1984 section 55A (Purchased settlement powers) could be brought into play, usually with dire effects. The section provides:

- “(1) Where a person makes a disposition by which he acquires a settlement power for consideration in money or money’s worth-
 - (a) section 10(1) above shall not apply to the disposition;
 - (b) the person shall be taken for the purposes of this Act to make a transfer of value;
 - (c) the value transferred shall be determined without bringing into account the value of anything which the person acquires by the disposition; and
 - (d) sections 18 and 23 to 27 above shall not apply in relation to that transfer of value.
- (2) For the purposes of this section, a person acquires a settlement power if he becomes entitled-
 - (a) to a settlement power;
 - (b) to exercise, or to secure or prevent the exercise of, a settlement power (whether directly or indirectly); or
 - (c) to restrict, or secure a restriction on, the exercise of a settlement power (whether directly or indirectly),as a result of transactions which include a disposition (whether to him or another) of a settlement power or of any power of a kind described in paragraph (b) or (c) above which is exercisable in relation to a settlement power.”

“Settlement power” is defined, by Inheritance Tax Act 1984 section 47A, to mean “any power over, or exercisable (whether directly or indirectly) in relation to, settled property or a settlement.”

Inheritance Tax Act 1984 section 5 (Meaning of estate) provides:

- “(1) For the purposes of this Act a person’s estate is the aggregate of all the property to which he is beneficially entitled, except that ...”

Section 272 (General interpretation) provides:

“In this Act, except where the context otherwise requires,-

...

“property” includes rights and interests of any description but does not include a settlement power;

...”

Hence, a settlement power does not form part of a person’s estate.

Inheritance Tax Act 1984 section 5(2) also needs to be borne in mind. It provides:

- “(2) A person who has a general power which enables him, or would if he were *sui juris* enable him, to dispose of any property *other than settled property*, or to charge money on any property *other than settled property*, shall be treated as beneficially entitled to the property or money; and for this purpose “general power” means a power or authority enabling the person by whom it is exercisable to appoint or dispose of property as he thinks fit.”

If the property of a foundation is settled property, then a general power to dispose of, or charge money on, that property, does not fall within section 5(2). If it does not, it could do.