

Saving Inheritance Tax with Discretionary Trust Wills

IMPORTANT NOTE

This document has been written following the Chancellor's announcement on October 9th 2007 of a doubling of the IHT Threshold for married couples and civil partners, and is up to date with all legislation included therein.

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Please note that, whilst providing useful information on the function and tax advantages of Discretionary Trust Wills, this document by no means exhaustive.

Please also note that a 'rough' £300,000 IHT Threshold is used throughout this document to make examples given easier to understand. This is the **2007** IHT Level – please see our website www.tenminutewill.co.uk for the very latest IHT Threshold level.

As legislation changes all the time, all information in this document is given without warranty of any kind.

2. Introduction

With property prices near to an all-time high, and most mortgages carrying a life insurance which ensures that the outstanding debt is paid off at death, a large number of couples have a combined estate worth well in excess of the Inheritance Tax (IHT) threshold (which is roughly £300,000 at present - you can find out the current level at our website www.tenminutewill.co.uk). This can give rise to potential demands for large (and sometimes unnecessary) IHT payments.

Following the Chancellor's announcement on October 9th 2007 of a doubling of the IHT Threshold for married couples and civil partners, it would appear at first that the need for Discretionary Trust Wills has been almost completely removed.

However, whilst trying to remain politically impartial, if you are married or in a civil partnership then IHT is still an issue worth planning for in your Will - simply because Labour may backtrack or the Conservatives may get in with different proposals or the HMRC will interpret Darling's changes to the advantage of the Government.

Furthermore, **the IHT situation for un-married couples remains the same** and, for them, the **significant IHT savings** from making Discretionary Trust Wills are exactly as they were before.

Our recommendation is that the '2 Year Discretionary Trust' type of Will is used by both married (or civil partner) and un-married couples alike:- This type of Will basically leaves the entire estate to a Discretionary Trust managed by the appointed Executors, and allows them 100% flexibility to set up any further Trusts required to maximise any potential IHT saving.

With this type of Will, even in the worst case (i.e. if there is no IHT saving to be had) there is nothing to lose for married couples and civil partners, because the Executors can also simply pass the entire estate directly to the surviving spouse/partner on first death or the eventual heirs on second death - i.e. the '2 Year Discretionary Trust' Wills can be used as normal Mirror Wills. And, as we have said, for un-married couples, the IHT savings are significant.

In summary, then, this is far from being the end for Discretionary Trust Wills. A '2 Year Discretionary Trust' Will gives:-

- Significant IHT savings for non-married couples
- The new combined IHT threshold savings for married couples and civil partners, plus any future IHT savings from future legislation without having to write new Wills.

This document explains the 2 year Discretionary Trust Will and also, for reference, past methods for using 'Nil Rate Band' Discretionary Trusts in Wills to minimise IHT for couples – be they married, in civil partnership, or just partners.

3. How do Discretionary Trust Wills work?

Discretionary Trust Wills basically 'ring-fence' some or all of the assets of the first spouse/partner to die such that they can either:-

- Be used to use up the IHT allowance of the first spouse/partner to die (this requirement is no longer an issue for married couples or civil partners after the Chancellor's announcement of double IHT relief for them on October 9th 2007); AND/OR
- Be used to ensure that the assets of the first spouse/partner do not attract Inheritance Tax **twice** – i.e. upon first death and then upon second death (see example in the next section).

So what is a 'Discretionary Trust'?

Well basically it has 4 constituent parts:-

1. Assets
2. Beneficiaries
3. Trustees
4. Rules

The **Assets** can be cash in a bank, an 'IOU' or a 'charge' on a property (which is an 'IOU' that by law must be paid off if the property is sold), shares, etc., etc. – i.e. anything of value owned by the Testator (the person making the Will).

The **Beneficiaries** are the people who can – at the discretion (hence the name '**Discretionary Trust**') of the **Trustees** – be given or loaned any part or all of the **Assets** (or any income e.g. bank interest) in the Discretionary Trust.

The **Rules** define how the **Trustees** may or must manage the **Assets** in the Trust and, for example, under what terms and conditions they may advance or loan **Assets** from the Trust to one or more of the **Beneficiaries**.

Finally, in order to legally 'qualify' as a Discretionary Trust, the Trustees must be able to demonstrate that they are exercising their discretion in how they give or loan the Assets in the Trust. In practice this is quite easy – they just need to meet once every 12 months, take and act on decisions about what to do with the Assets in the Trust: investments, loans, payments, etc. and keep written minutes detailing what they decide to do.

In all of our Discretionary Trust Wills, the Discretionary Trust is set up in and by the Will, and its beneficiaries are the surviving spouse/partner plus all of the beneficiaries (and substitute beneficiaries if specified) of the Residuary Estate. This means that, whilst the **Assets** in the Discretionary Trust are 'ring-fenced' for the eventual benefit of the eventual heirs, they are still accessible by the surviving spouse/partner (at the discretion of the Trustees, of course).

The normal method for the surviving partner to access the **Assets** in the Discretionary Trust is via a 'loan' arrangement (e.g. a straightforward 'IOU' or by putting a charge on the first to die's share of the home to make up some of the **Assets** of the Discretionary Trust) or simply by drawing an income (e.g. Bank and/or Building Society Interest and/or Share Dividends if the **Assets** in the Discretionary Trust are so-invested).

In this way the survivor is able to 'have use of' the **Assets** without actually owning them i.e. **without** them forming a part of his/her estate and hence being subject to Inheritance Tax.

4. Why make Discretionary Trust Wills ?

4.1. Married Couples and Civil Partners

In the past, married couples have made Discretionary Trust Wills to ensure that the nil rate band of the first to die was used up. However, following the government's announcement of a revision of the IHT threshold for married couples and civil partners on October 9th 2007, this is no longer a requirement for these types of couples, as the new legislation allows the percentage of the nil-rate band 'un-used' upon first death to be added to the surviving spouse/partner's nil rate band upon his/her death.

Note that this means that if **none** of the first to die's nil rate band is used up (i.e. he/she leaves the entire estate to the surviving spouse/civil partner) then the second to die's nil rate band is **doubled** – i.e. it's the nil rate band on **second death** that counts. So if A dies in May 2007 (nil rate band £300K) leaving his entire estate to spouse B, who dies in September 2009 (nil rate band £325K), then the nil rate band for spouse B is £325K x 2 = £650K (i.e. **not** £300K + £325K = £625K).

Whilst the need for a Nil Rate Band Discretionary Trust Will has been removed for Married Couples and Civil Partners, there is still some mileage in writing (or 'converting to' – after all, it's free at our website) a pair of 2 Year Discretionary Trust Wills for the simple reason that legislation never stands still, and this form of Will basically enables your Executors to re-write the Will to maximise IHT effectiveness at the time of death

4.2. Non-married Couples

For non-married couples, nothing changes with the Chancellor's announcement of October 9th 2007. There is still a need to save the estate of the first to die being, in effect, taxed twice. Consider the following example:-

Partner A's estate is worth £500,000, Partner B's the same. They have 2 children (both by the relationship).

Partner A dies and leaves his entire estate to Partner B. The first £300,000 is free of IHT, but IHT of £80,000 is paid on the remainder (40% of £200,000).

Partner B then dies 3 months later. For simplicity, we'll assume her estate has not changed in value, nor has what she inherited from Partner A. Her estate is now therefore worth £500,000 plus the (net) £420,000 that she inherited from Partner A – i.e. £920,000.

The first £300,000 of Partner B's estate is free of IHT, but the rest (£620,000) is taxed at 40% - a whopping bill of £248,000. (Thus the total IHT paid by the couple is £80,000 + £248,000 = £328,000)

The children therefore inherit **£672,000**. But wait a minute - surely if each estate had been properly taxed the IHT bill would have been 2 x £80,000, leaving them with £840,000? Where has the other **£168,000** gone ??

The simple answer is that **Partner A's estate has been taxed twice** – once when he died, and once when Partner B died.

Now consider if Partner A has left his entire estate in a 2 Year Discretionary Trust Will. Upon his death, the Executors could have decided to distribute the net estate (after IHT) of £420,000 as follows:-

- £120,000 to the children
- £300,000 into a Discretionary Trust with the Partner B and the children as the beneficiaries.

This would have allowed Partner B access to £300,000 (e.g. as a loan) which with her £500,000 should give her enough to live on. The IHT Bill would have been the same - £80,000.

Upon Partner B's death, her estate would not contain any of the above assets, and would therefore attract IHT of £80,000 just like Partner A's.

The children would then get their original £120,000, plus the £300,000 in the Discretionary Trust, plus Partner B's net estate of £420,000 – i.e. **£840,000**.

Simply by making a pair of 2 Year Discretionary Trust Wills and the Executors setting up one Trust in the first Will, **the IHT bill has been cut from £328,000 to £160,000** – i.e. it's been more than **halved**.

How would this apply to you? Well here's how to calculate the IHT saving from having a pair of 2 Year Discretionary Trust Wills:-

The **maximum saving** will be : (40% of the first £300,000) + (24% of the rest) of the estate of the first to die.

ALL UNMARRIED COUPLES WILL SAVE IHT WITH 2 YEAR DISCRETIONARY TRUST WILLS.

If you want to calculate **your exact** potential IHT saving, use the **free IHT calculator** at our website.

5. Are there any disadvantages to Discretionary Trust Wills?

5.1.1. Inconveniences

Obviously there is a difference between the surviving spouse/partner having some degree of control over a Discretionary Trust fund and inheriting 100% of the estate. However, provided that the Trustees act sensibly, the effect of this should not be of any real significance.

5.1.2. Preparatory Work

Also, you must ensure that all of your assets – especially your home and any other properties you own – are (in value terms) split evenly between you and (if jointly owned) are owned as 'Tenants in Common'. This latter point is important, as assets held as 'Joint Tenants' instead of as 'Tenants in Common' pass automatically to the survivor upon first death and this will almost certainly over-ride what you are trying to achieve.

So this means that there's the small disadvantage of a little bit of preparatory work to do.

Note that converting to 'Tenants in Common' is not a legal pre-requisite to making Discretionary Trust Wills – it need only be done **before** first death.

However, obviously this means that the sooner it is done the better:- Click 'Sever a Joint Tenancy' on the menu on the left-hand side of our web page www.tenminutewill.co.uk to convert your property(s) from 'Joint Tenants' to 'Tenants in Common'.

5.1.3. Pitfalls to be avoided

Finally, if your Estate is split very unevenly – e.g. 90% to one of you and 10% to the other – then you need to be careful not to get caught by s133 of the Finance Act 1986. We strongly advise you to read Section 14.1.4 of this document on the Phizackerley case.

6. How do I make a Discretionary Trust Will?

There are 3 steps to making a Discretionary Trust Will: -

1. Deciding which type of Will fits your situation
2. Preparing/writing the Will
3. Preparing your Estate

6.1. Deciding which type of Will fits your situation

Up until the chancellor's announcement on 9th October 2007, you would have needed to read the next section of this document and decide which type of Discretionary Trust Will is most appropriate for you in terms of the advantages/disadvantages. However, we now recommend just the '2 year Discretionary Trust' Will.

6.2. Preparing/writing the Will

All you have to do is go to our site – www.tenminutewill.co.uk - and make the Will by clicking 'WRITE YOUR WILL NOW' – it should take no more than a few minutes.

Note that you do not have to specify when making your Will how much you are setting aside in the Discretionary Trust. This is because: -

- Our two NRB Wills are worded in such a way that, whatever the IHT threshold happens to be when the Will is executed, that amount is set aside into the Discretionary Trust. (The actual wording is: - "... I give a pecuniary legacy of the maximum sum (if any) which can in the circumstances subsisting at my death be given by this clause without any liability being incurred for the payment of inheritance tax")
- Our third type of Discretionary Trust Will – the 2 Year Discretionary Trust – leaves the entire Estate to the Discretionary Trust. **After** first death, the Executors then decide what to put into further Trusts.

6.3. Preparing your Estate

It is vital that your estate is properly 'prepared'.

If your **joint** Estate is worth more than **double** the IHT threshold, the most important thing to do is to ensure that you both have an estate of at least £300,000 (or whatever the current IHT threshold is).

Or, if your **joint** Estate is less than **double** the IHT threshold, you should ensure that it is evenly divided between the 2 of you.

An extremely common mistake is for couples that jointly own a home to assume that they own half each. **This is rarely true.** In almost all cases, homes jointly owned are owned under what is called a 'Joint Tenancy'. This means that if one of you dies, their 'half' automatically passes to the other before any Will comes into effect and therefore cannot be considered to be part of their estate – i.e. it can't be used to make up any or all of the £300,000.

What you must do, therefore, is sever your Joint Tenancy. This is a service that we offer at our website – including helping you to check first of all whether you are '*Joint Tenants*' or already '*Tenants in Common*'. Provided that you know your property's Title Number and Administration Area – or if the property is not registered – then the process takes about 5 minutes. For more details, click 'Our Products and Prices' and then 'Tenants in Common' at our website. Or to simply go ahead and sever your Joint Tenancy click 'Sever a Joint Tenancy' in the menu on the left-hand side of our web page.

Just a quick note: if you do not own your property jointly – i.e. one of you is the sole owner – then we strongly advise you to read the Section on the Phizackerley Case at the end of this document before taking **any** action.

If (and only if) the above arrangement does not give you each a separate estate of at least the Nil Rate Band, it will also be advisable to consider 'severing joint tenancy' for any joint investments that carry funds of significant value. You should write a letter to each financial institution concerned telling that you want to do this, and follow up the actions they ask you to take.

7. What are the different types of Discretionary Trust Wills?

Please note that in this section, for the sake of simplicity, we shall use the 2007 IHT Threshold of £300,000.

Our website www.tenminutewill.co.uk offers 3 types of Discretionary Trust Will designed to suit 3 different sets of circumstances: -

1. Nil-Rate Band (NRB) Discretionary Trust Legacy – surviving spouse/partner gets absolute interest in Residue.

Following the Chancellor's announcement of changes to IHT on October 9th 2007, this type of Will is no longer suitable for partners/spouses making new Wills. We also advise all clients who currently have these types of Wills to convert it to a pair of 2 Year Discretionary Trust Wills.

2. Nil-Rate Band (NRB) Discretionary Trust Legacy – surviving spouse/partner gets protective life interest in Residue.

Following the Chancellor's announcement of changes to IHT on October 9th 2007, this type of Will is no longer suitable for partners/spouses making new Wills. We also advise all clients who currently have these types of Wills to convert it to a pair of 2 Year Discretionary Trust Wills.

3. 2 Year Discretionary Trust for entire estate.

This best suits the situation where you would rather wait until after the first death and then make a decision as to how to what to do with the estate to maximise IHT efficiency.

Each of the above Wills are provided as a 'mirrored pair' of Wills – the online forms need only be completed for one spouse/partner and the second 'mirrored' Will is generated automatically.

The following sections 7.1, 7.2, and 7.3 give a more detailed explanation of each type of Will. However, the following features are included in **every** type of Will: -

1. The primary beneficiary in each Will is the surviving spouse/partner. The secondary beneficiaries by default are the children, in equal shares (although you can change this). The Wills are worded such that if you both die together then it is a straightforward exercise for the entire estate to go directly to your heirs using up **both** IHT allowances and paying IHT **only once** on the entire estate.
2. As well as being able to 'replace' the children as beneficiaries with whomever you wish, you can also specify substitute beneficiaries to cater for the event of none of your preferred heirs outliving you both.
3. Should any or all of your children not be 18, standard clauses exist in the Wills to allow their inheritance to be invested on their behalf until they reach 18 years of age, and for your Executors and Trustees to pay for their education and maintenance etc. until they are old enough to receive their share of the Estate.
4. All of the necessary Trusts are set up in the Wills: - in the case of the two 'Nil Rate Band' types of Will, the nil rate band Discretionary Trust is set up in the Will. In the case of the '2 Year Discretionary Trust' type of Will, a Discretionary Trust is set up and the entire estate put in it. The Executors are then given powers to create further (Discretionary) Trusts if necessary.

7.1. NRB Discretionary Trust Will – spouse/partner gets absolute interest in Residue

Following the Chancellor's announcement of changes to IHT on October 9th 2007, this type of Will is no longer suitable for partners/spouses making new Wills. We also advise all clients who currently have these types of Wills to convert them to a pair of 2 Year Discretionary Trust Wills.

7.1.1. Advantages and Disadvantages

The **advantages** of using this type of Discretionary Trust Will are

- The surviving spouse/partner has immediate access to – and ownership of - the 'Residuary Estate' – i.e. the total estate minus the £300,000 Discretionary Trust Legacy (which may itself be made up by a 'share' in the marital home). This means that, if the Estate were made up of a £300,000 home plus £200,000 in investments & money, the surviving spouse/partner would have immediate access to the £200,000. So if any quick cash were required, there would be plenty.
- There can (obviously) be an Inheritance Tax saving of up to £120,000 when the surviving spouse/partner dies and the estate passes on to the children (or whoever) as both nil-rate IHT bands will have been used.

The **disadvantages** of using this type of Discretionary Trust Will are

- If the surviving spouse/partner wishes to sell the marital home, for example to live nearer to the children, then any charge placed on it (to make up some or all of the Discretionary Trust) must be **settled in full** or the IHT advantage (i.e. the £120,000 tax saving) of the Discretionary Trust could be lost. See Appendix 4 for more details.
- If the estate is split very unevenly then there is a chance that the Wills may get caught by s.133 of the Finance Act 1986. You are strongly advised to read Section 14.1.4 of this document.

7.1.2. How to create the Will

For this type of Will to work, you **should** appoint at **least two Executors** (none of whom can be the spouse/partner) and you **must** appoint **at least two Trustees to the Discretionary Trust Legacy**. The Executors and the Trustees to the Discretionary Trust Legacy must **not** be **exactly** the same group of people (although one or more could appear in both groups). These appointments are straightforward on our online forms and are done by simply entering names and addresses.

You should also minimise the value of any legacies which you give in your Will which are non-exempt from IHT i.e. which are not given to the spouse/partner or to a charity. This is because the amount that can be put into the Discretionary Trust without incurring IHT is reduced by the total value of such non-exempt gifts.

You will only need to specify your eventual heirs when creating the Will – the spouse/partner's details are automatically inserted as the primary beneficiary.

7.1.3. How the Will works

There are **three** ways that this type of Will can be worked (and this can be decided **after** the first death): -

- (i) The Discretionary Trust legacy of £300,000 is paid out of cash from the estate and invested, with the surviving spouse/partner allowed to draw an income from it. The rest of the estate – including the marital home - goes directly to the spouse/partner. Upon the death of the surviving spouse, the sum in the Discretionary Trust 'investment' goes to the children (or whoever else was specified). Along with, of course, the rest of the estate. This option would be used, for example, if the £300,000 could be raised without selling the marital home and if the surviving spouse/partner would still be left enough to live on.
- (ii) The Discretionary Trust legacy is 'paid' by accepting a promise of payment ('debt scheme') from the surviving spouse/partner or putting a charge on the **first to die's share** of the marital home to the value of £300,000 ('charge scheme'). The rest of the estate goes directly to the spouse/partner. Upon the death of the surviving spouse, the debt or charge is removed and the entire estate passes to the children (or whoever else was specified).

These options would be used if there were not enough cash in the estate to raise £300,000 whilst still leaving the surviving spouse/partner with a home and enough money to live on. See Appendix 4 for more details. Examples of the documents that are used after the first death to execute the 'debt scheme' and 'charge scheme' are given in Appendixes 1 and 2. Your Trustees may copy their wording, inserting the correct values and names, and sign/witness them in exactly the same way as you sign and witness your Will.

- (iii) A combination of any of the above methods.

7.2. NRB Discretionary Trust Will – spouse/partner gets protective life interest in Residue

Following the Chancellor's announcement of changes to IHT on October 9th 2007, this type of Will is no longer suitable for partners/spouses making new Wills. We also advise all clients who currently have these types of Wills to convert them to a pair of 2 Year Discretionary Trust Wills.

7.2.1. Advantages and Disadvantages

The **advantages** of using this type of Discretionary Trust Will are

- The surviving spouse/partner can move home without the danger of losing the IHT advantage (i.e. the £120,000 tax saving) of the Discretionary Trust. See Appendix 4 for details.
- The surviving spouse/partner's creditors cannot access the Residuary Estate if he/she runs into financial difficulties because he/she does not own it absolutely – it is owned by a Trust.
- There can (obviously) be an Inheritance Tax saving of up to £120,000 when the surviving spouse/partner dies and the estate passes on to the children (or whoever) as both nil-rate IHT bands will have been used.

The **disadvantages** of using this type of Discretionary Trust Will are

- The surviving spouse/partner receives only an income from (and/or 'use for life' of) – and not any of the cash value of – the Residuary Estate. However, this can be mitigated by leaving a cash legacy to the surviving spouse/partner in the Will which he/she will receive before the Residuary Estate is determined.

7.2.2. How to create the Will

For this type of Will to work, you **should** appoint at **least two Executors** (none of whom can be the spouse/partner) and you **must** appoint **at least two Trustees to the Discretionary Trust Legacy**. The Executors and the Trustees to the Discretionary Trust Legacy must **not** be **exactly** the same group of people (although one or more could appear in both groups). These appointments are straightforward on our online forms and are done by simply entering names and addresses.

You should also minimise the value of any legacies which you give in your Will which are non-exempt from IHT i.e. which are not given to the spouse/partner or to a charity. This is because the amount that can be put into the Discretionary Trust without incurring IHT is reduced by the total value of such non-exempt gifts.

You will only need to specify your eventual heirs when creating the Will – the spouse/partner's details are automatically inserted as the primary beneficiary.

7.2.3. How the Will works

There are again **three** ways that this type of Will can be worked (and this can be decided **after** the first death): -

- (i) The Discretionary Trust legacy of £300,000 is paid out of cash from the estate and invested, with the surviving spouse/partner allowed to draw an income from it. The rest of the cash in the estate is invested and the income from the investment is paid to the spouse, and he/she has 'use for life' of all assets which cannot easily be invested – e.g. the marital home. Upon the death of the surviving spouse, the sum in the Discretionary Trust 'investment' goes to the children (or whoever else was specified). Along with, of course, the rest of the estate.
- (ii) The Discretionary Trust legacy is 'paid' by accepting a promise of payment ('debt scheme') from the surviving spouse/partner or putting a charge on the **first to die's share** of the marital home to the value of £300,000 ('charge scheme'). The rest of the cash in the estate is invested and the income from the investment is paid to the spouse, and he/she has 'use for life' of all assets which cannot easily be invested – e.g. the marital home. If the spouse/partner wishes to sell the marital home, and the 'charge scheme' is used, the 'charge' can be transferred to the new home. Upon the death of the surviving spouse, the debt or charge is effectively cancelled and the entire estate passes to the children (or whoever else was specified).

Examples of the documents that are used after the first death to execute the 'debt scheme' and 'charge scheme' are given in Appendixes 1 and 2. Your Trustees may copy their wording, inserting the correct values and names, and sign/witness them in exactly the same way as you sign and witness your Wills.

- (iii) A combination of any of the above methods.

7.3. 2 Year Discretionary Trust

This type of Will is most appropriate where the maximum amount of flexibility is required. Basically, the Will is worded in such a way that the (Discretionary) Trust(s) providing the maximum IHT efficiency can be set up **after** the first death, when the first Will is executed – i.e. when it is known exactly what will be the most convenient option for the surviving spouse/partner.

7.3.1. Advantages and Disadvantages

The **advantages** of using this type of Discretionary Trust Will are

- Total flexibility. If circumstances change between the making of the Will(s) and the first death, then they can be catered for.
- Un-married couples can maximise not only the use of both IHT thresholds, but also the proportion of the joint estate on which 'double-IHT' is not paid.

The **disadvantages** of using this type of Discretionary Trust Will are

- The workload for the Executors and Trustees is slightly greater than the previous two options, because there is more 'work' to be done in setting up trusts etc. after the first death. See Section 10 for details.
- It isn't really a 'disadvantage', but in this type of Will you give your Executors wide-ranging powers and what is done with the entire estate is in their hands - so you therefore need to be sure you can trust them.

7.3.2. How to create the Will

For this type of Will to work, you **should** appoint at **least three Executors**. Our software automatically appoints the spouse/partner, so you need only appoint 2 more yourselves. Your Executors will have wide-ranging powers so you should choose people you are 100% sure that you can trust – we therefore recommend that you appoint your children (if they are over 18) as the additional Executors.

These appointments are straightforward on our online forms and are done by simply entering names and addresses.

7.3.3. How the Will works

Upon the first death, the situation is assessed by the (3 or more) Executors, and Trusts are set up so as to maximise the advantage of the Discretionary Trust arrangement for Inheritance Tax purposes. It may be that arrangements similar to those in Section 7.1 are used, or maybe Section 7.2, or some other – it is entirely at the Executors' discretion. Appendix 3 gives a sample Trust Deed which can be used for this purpose.

The above process **must** be carried out between 3 months and 2 years after the first death (hence the name '2 Year Discretionary Trust'). At the expiry of the 2 year period, whatever has not been 'set aside' into Discretionary Trust or other Legacies passes to the surviving spouse/partner – if he/she is still alive, otherwise it goes to the children (or whoever) – along the same lines as in Section 7.1.3.

Note that if there is any Inheritance Tax due it must be paid within 6 months of the death, so it is advisable to start the process as soon as possible after the 3 month period since death has elapsed.

8. The (Nil or Minimal) Taxation Of Discretionary Trusts

In certain circumstances, **small** amounts of tax **may be** payable over and above the normal IHT payable. However, such sums are almost always the same as would have been paid by the beneficiaries anyway on income gained from investing their inheritance (e.g. tax on Bank Interest) and they are certainly several orders of magnitude lower than the IHT saving made.

The purpose of this section is to aid your Executors and Trustees to minimise or avoid altogether any tax by explaining all of the issues involved and the tax payable at each of 3 stages :- **Creation** of the Discretionary Trust (i.e. upon the first death), the **Duration** between the first and second deaths, and the **Termination** of the Trust – i.e. upon the second death.

8.1.1. INHERITANCE TAX

1. Creation

A gift into a Discretionary Trust **in a Will**, if it does not exceed the nil rate band threshold, is not a chargeable event.

Any amount over the nil rate band threshold is obviously going to attract Inheritance Tax at 40%.

However, if the **entire** estate is left upon Discretionary Trust to the Executors (i.e. *2 Year Discretionary Trust Will*), the HMRC does **not** tax everything over the nil rate band. Instead it waits until the Executors have distributed all of the estate (be it directly to beneficiaries, or be it setting up one or more Discretionary Trusts) and then applies the rules as if the original Will had been written to distribute the estate in the manner that it has actually been distributed. Note that the distributions must occur between 3 months and 2 years from the Testator's death for the above to be valid and applied. See HMRC document 'IHTM35182 - Distribution from a relevant property trust set up by Will' – available at <http://www.hmrc.gov.uk/manuals/ihtmanual/ihtm35182.htm>.

2. Duration

Every 10 years, under current legislation, there is a charge to Inheritance Tax. On the 10th anniversary the Trust Fund is valued. If any payments have been made out of the Trust Fund, these are added to the valuation. Any sum **in excess of** the nil rate band of tax then applying is taxed at 6%.

In practice, as the IHT Threshold normally increases in line with inflation, there is only going to be a tax liability here if the Trust Fund's value increases at above the level of inflation. For example, if the 'gain' in value of the fund exceeded inflation by the order of a few thousand pounds, the tax liability would only be of the order of a few hundred pounds.

3. Termination

On the termination of a Discretionary Trust the above rules ('Duration') apply – i.e. there is only a tax liability here if the Trust Fund's value increases at more than the rate of increase of the IHT Threshold and even then it is minimal – 6% of the increase above the IHT Threshold.

Putting all of the above into plain English, there may be a small amount of tax to pay but it is going to be an awful lot less than (a small fraction of) the IHT that has been saved.

8.1.2. CAPITAL GAINS TAX

1. Creation

A gift into a Discretionary Trust is a disposal for Capital Gains Tax (CGT) purposes and the usual rules apply to calculate any gain arising, which is payable by the settlor. Note that this means that if the marital home is part of the Discretionary Trust, there is no CGT to pay as disposal of a person's main home is exempt from CGT. Nor is Capital Gains Tax payable in respect of a gift of cash - cash not being a chargeable asset.

Any capital gains arising on a gift into a Discretionary Trust can generally be held over into the hands of the trustees, provided both the settlor and the Trust are UK-resident. The trustees are not required to join in the holdover claim.

The effect is that any Capital Gains Tax charge will only become crystallised when the trustees dispose of the assets received.

Putting this into plain English, just about the only way any Capital Gains tax would be payable would be if you used some shares or stocks or a property which was not your main home to make up the Discretionary Trust and they increased in value. Even then, it would not be payable until the shares or property were sold.

2. Duration

The Trustees are liable to pay Capital Gains Tax on any realised gain arising on trust property each year at the rate applicable to trusts which is currently 40%. The trustees have an annual Capital Gains Tax allowance which is one-half of that applicable to an individual. The amount is currently approximately £4,000. So again, tax is only payable in a 'good news' situation and is likely to be minimal unless the 'good news' is 'very good news'. Note also the key word: 'realised' – this means that CGT is payable only if a part of the Trust Fund is disposed of, and at a profit.

3. Termination

When a beneficiary becomes entitled to any portion of the Discretionary Trust assets, as against the trustees, there is a deemed disposal by the trustees for Capital Gains Tax purposes of this portion so transferred to the beneficiary. Again, the payment of tax may be deferred by way of a hold-over election into the hands of a UK-resident beneficiary so that any tax charge will only become crystallised when he disposes of the asset received.

Again, putting this entire sub-section into plain English, it is relatively easy for your Legacy Trustees to avoid CGT on the Discretionary Trust altogether.

8.1.3. INCOME TAX

1. Creation

There is no Income Tax liability upon creation of a Discretionary Trust Will.

2. Duration

The trustees' liability to Income Tax depends on the type of income-producing assets held. The trustees are liable to pay tax on all untaxed income received at the following rates:- 32.5% (Dividends) or 40% (Interest) depending on the actual source of income.

Beneficiaries who are basic-rate tax payers may be able to reclaim some of the Income Tax suffered by the Trust. Again, in plain English, some tax may be payable but it would be no more than the beneficiaries would pay if you'd given the Assets directly to them.

3. Termination

On the termination of a Discretionary Trust, the Trustees cease to be liable for any further Income Tax, because the assets and the income produced by them now belong to the ultimate beneficiaries.

8.1.4. STAMP DUTY LAND TAX (SDLT)

To cut a rather long story short, here is some confusion on this issue. The HMRC website argues that SDLT is payable if the charge or debt schemes are used. However, the logic behind their argument is seriously flawed and – according to James Kessler QC (a nationally recognised authority on the Taxation of Discretionary Trusts) – if the charge or debt schemes are correctly set up when the Will is processed through Probate then SDLT should **not** be payable. Like all things with the government, however, no guarantee can be made that they will not find a way of circumventing the logic in James Kessler QC's argument and – what's more making their legislation retrospective. It wouldn't be the first time.

We can therefore provide no guarantees on this issue but we do **strongly recommend** that you take advantage of our Document Storage Service if you are making Discretionary Trust Wills because the **Free Probate Helpline** offered with this service could prove invaluable if SDLT becomes an issue.

8.1.5. INFORMING HMRC

When the Discretionary Trust is set up (i.e. after the first death), the Trustees must inform HMRC of the existence of the Trust so that they can file an Annual Tax return for it **if** any tax is payable. This is a straightforward task and is done by completing form 41G. Form 41G is available from the HMRC Website.

8.1.6. SUMMARY

The tax payable on a Discretionary Trust is likely to be nil (if it is less than the IHT Threshold) or minimal – and even then not much different to that which would have been payable by the beneficiaries had the gift been directly made in the Will and they had invested it themselves.

When compared to the alternative – losing out on one 'nil rate band', paying double IHT, and unnecessarily handing over tens of thousands of pounds in IHT – Discretionary Trust Wills are very tax-efficient.

9. Summary of Discretionary Trust Wills

Recent announcements may have appeared to have made Discretionary Trust Wills redundant but, for unmarried couples in particular, nothing could be further from the truth.

There are costs associated with Discretionary Trust Wills – however such costs and inconveniences are minimal when compared to the saving.

We hope that this document has given you enough information to decide whether a Discretionary Trust Will is right for you and, if so, which one. If there's anything else you need to know, all you need to do is contact us via the 'Contact Us' link on our site at www.tenminutewill.co.uk.

The following table summarises the 3 types of Discretionary Trust Will that we offer, how they work, and their main advantages and disadvantages.

	NRB – Absolute Interest	NRB – Life Interest	2 Year DT
How it works	Nil-Rate amount left as a DT Legacy, 'paid' in whole or part by debt from surviving spouse/partner or charge on marital home. Surviving spouse/partner gets rest of Estate as a 'lump sum'.	Nil-Rate amount left as a DT Legacy, 'paid' in whole or part by debt from surviving spouse/partner or charge on marital home. Surviving spouse/partner gets income from rest of Estate.	Whole Estate in DT. Further Trusts set up between 3 months & 2 years after 1 st death to maximise IHT-effectiveness.
Appointment of Executors and DT Trustees	At least 2 Executors (spouse/partner should not be one of them) Spouse/partner plus at least 1 DT Legacy Trustee(s)	At least 2 Executors (spouse/partner should not be one of them) Spouse/partner plus at least 1 DT Legacy Trustee(s)	Spouse/partner plus at least 2 other Executors. No DT Legacy Trustees required.
Main Advantages	Surviving spouse/partner has immediate access to Residuary Estate. IHT saving of up to £120,000 when the surviving spouse/partner dies.	Surviving spouse/partner can move home. Surviving spouse/partner's creditors cannot access the Estate. IHT saving of up to £120,000 when the surviving spouse/partner dies.	Total flexibility. Non-Married couples use up both IHT allowances & save on double-IHT. Married/civil partners have Wills that are future legislation-proof.
Main Disadvantages	If marital home is main asset, and 'charge' scheme is used, the 'charge' must be settled (or IHT advantages may be lost) if surviving spouse/partner wishes to move. Relatively small amount of work associated with management. Watch for s133 of Finance Act 1986. Read Section 14.1.4 of this document.	Surviving spouse/partner receives only an income – i.e. as opposed to a lump sum. Relatively small amount of work associated with management.	Higher, although still minimal, workload associated with management. Possibility of some IHT having to be paid 'up front' after 1 st death if take > 6 months to set Trusts up.
Other comments	Any Joint Tenancy must be severed.	Any Joint Tenancy must be severed.	Any Joint Tenancy must be severed. Make sure you appoint 100% trustworthy Executors.

Note: DT stands for Discretionary Trust.

10. Managing the Discretionary Trust

This section explains what you need to do once you have written the Will(s), and then what the Executors of your Will(s) and/or the Trustees of the Discretionary Trust will have to do after first death.

The tasks that they have to perform are not overly onerous, and certainly are worth it for the IHT saving, but should be borne in mind if the value of your estate is 'borderline' and you are implementing Discretionary Trust Wills to save just a few thousand pounds in Inheritance Tax.

10.1.1. Once you have written the Will(s)

You are advised to (but do **not** have to) each write a 'Letter of Wishes'.

This letter is not a legal document (so you can word it however you want), and does not even have to be signed by you. Basically, it is a letter to the Trustees of the Discretionary Trust saying how you want them to manage the Discretionary Trust: e.g. you might want them to make up the assets of a Discretionary Trust by placing a charge on your home, or you may want them to make up the Trust by investing cash assets and you may then want them to pay any returns directly to the surviving spouse/partner as an income.

Such a letter is not obligatory, and your Trustees have no legal obligation to follow its instructions – they can use their '**discretion**' - although they **must** run the Trust for the benefit of its beneficiaries (who are the surviving spouse/partner plus the beneficiaries of your Estate).

In practice, however, assuming that you have appointed Trustees that you can trust, such a letter would be used by your Trustees as guidance for what to do.

Time required: about half an hour.

10.1.2. Upon first death

Upon first death, the Executors of the Will and Trustees of the Discretionary Trust need to do the following:-

1. The Trustees of any Discretionary Trusts created (**except** the 'entire estate' DT in the 2 year DT Will) must register the Trust with HMRC. This is a simple exercise: the form is available from HMRC and is only 2 pages long. HMRC will then tell them how to make any annual tax payments (which will only be required if the Trust makes a 'profit' e.g. if money is invested in a bank at, say 4% per annum, tax must be paid on the interest in the same way as everybody has to pay tax on interest earned on investments).
Time required: about one hour, plus about 15 minutes per year.
2. The Executors of the Will and Trustees of the Discretionary Trust should take advice (or do research) as to the best scheme – 'Debt' scheme or 'Charge' scheme – to implement **at the time**, should such schemes be necessary, and/or what (Discretionary) Trust(s) need to be set up to maximise IHT-efficiency. *Time required: anything from 0-8 hours.*
3. 2 Year Discretionary Trust: Additional (Discretionary) Trusts may be needed to be set up to maximise IHT-efficiency. *Time required: 2-4 hours per Trust.*
4. If the 'Charge' scheme is to be used, the charge should be placed on the property as soon as possible – certainly if the 'Absolute Interest' type of Will has been used this should be done **before** the surviving spouse/partner is given 100% ownership of the marital home. *Time required: about 1 hour.*
5. Trustees should meet at least every 12 months and keep minutes of the meeting which show that they have **exercised discretion** (e.g. decided to let wife stay in house another year) and keep copies of any letters etc. (e.g. copy of letter to wife saying she can stay another year, copy of 'debt' or 'charge' letters, etc.). Note that such meetings can be held via telephone conference if it is more convenient. *Time required: less than 1 hour per year.*

10.1.3. Upon second death

Upon second death, the Trustees of the Discretionary Trust(s) should 'wind up' the Trust by paying out/distributing its contents to its beneficiaries – who will automatically be the same beneficiaries as those you have nominated to benefit from your Residuary Estate. *Time required: No longer than it would have taken to distribute this part of your estate if you'd made normal Mirror Wills.*

10.1.4. Summary

The total time required should be of the order of:-

- About half an hour from each of you straight away (if you decide to write *Letters of Wishes*).
- Plus about 4-15 hours from your Executors/Trustees upon first death
- Plus about 1 hour per year from your Trustees.

11. APPENDIX 1 – Deed of promise to give: - debt scheme

(Note: - It is important that all of Appendix 4 is read by your Executors before deciding whether or not to use this scheme)

THIS DEED is made the [date] BETWEEN (1) [name of surviving spouse] of [address] ('the Promisor') (2) [name of executor] of [address] and [name of executor] of [address] ('the Executors') and (3) [name of Legacy Trustee] of [address] and [name of Legacy Trustee] of [address] ('the Legacy Trustees')

SUPPLEMENTAL to the will ('the Will') dated [date] of [name of testator] ('the Testator') who died on [date] and which was proved by the Executors on [date] in the [name] Registry

WHEREAS—

- (A) By clause + of the Will the Testator gave to the Legacy Trustees a pecuniary legacy determined according to a formula ('the Trust Legacy') to hold the same upon the trusts there set out.
- (B) In the events which have happened the amount of the Trust Legacy is [£300,000].
- (C) By clause + of the Will the Executors were given power instead of satisfying the Trust Legacy by the payment of cash or the appropriation of property to require the Legacy Trustees to accept a binding promise of payment made personally by the Promisor which shall be repayable on demand.
- (D) The Executors have decided to satisfy the Trust Legacy by exercising such power to require the Legacy Trustees to accept a binding promise of payment made personally by the Promisor and the Promisor has agreed to make such promise.

NOW THIS DEED WITNESSETH:

- 1. The Promisor promises to pay on demand to the Legacy Trustees the sum of [£300,000].
- 2. The Legacy Trustees declare that they hold the foregoing debt and all moneys payable thereunder upon the trusts declared by the Will in respect of the Trust Legacy.

IN WITNESS whereof the parties hereto have executed these presents as their deed the day and year first above written.

SIGNED and delivered as a deed by the said [name] in the presence of—

} [Signature]

[Signature, address and description of witness]

[The foregoing from 'SIGNED' to be repeated for each party]

12. APPENDIX 2 – Deed of charge to give: - charge scheme

(Note: - It is important that all of Appendix 4 is read by your Executors before deciding whether or not to use this scheme)

THIS DEED is made the [date] BETWEEN (1) [name of executor] of [address] and [name of executor] of [address] ('the Executors') and (2) [name of Legacy Trustee] of [address] and [name of Legacy Trustee] of [address] ('the Legacy Trustees')

SUPPLEMENTAL to the will ('the Will') dated [date] of [name] ('the Testator') who died on [date] and which was proved by the Executors on [date] in the [name] Registry

WHEREAS—

- (A) By clause + of the Will the Testator gave to the Legacy Trustees a pecuniary legacy determined according to a formula ('the Trust Legacy') to hold the same upon the trusts there set out.
- (B) In the events which have happened the amount of the Trust Legacy is [£300,000].
- (C) By clause + of the Will the Executors were given power instead of satisfying the Trust Legacy by the payment of cash or the appropriation of property to charge property comprised in the Testator's residuary estate (or but for clause + would be comprised) with payment of a sum of money equal to or less than the amount of the Trust Legacy.
- (D) There is comprised in the Testator's residuary estate (or but for clause + would be comprised) [a one-half beneficial share in the property known as [description] ('the Beneficial Share')].
- (E) The Executors have decided to satisfy the Trust Legacy by exercising such power to charge [the Beneficial Share] with payment of the sum of [£300,000] enforceable on demand.

NOW THIS DEED WITNESSETH:

1. The Executors HEREBY CHARGE [the Beneficial Share] with payment to the Legacy Trustees of the sum of [£300,000] enforceable on demand.
2. The Legacy Trustees declare that they hold the foregoing charge and all moneys received thereunder upon the trusts declared by the Will in respect of the Trust Legacy.

IN WITNESS whereof the parties hereto have executed these presents as their deed the day and year first above written.

SIGNED and delivered as a deed by the said [name] in the presence of—

} [Signature]

[Signature, address and description of witness]

[The foregoing from 'SIGNED' to be repeated for each party]

13. APPENDIX 3 – A Sample Trust Deed

This document is intended to be a sample only and its purpose is to give an indication of the type of wording required, and should be read in conjunction with the Notes at the end.

Note that such a Deed will **only** need to be drawn up **after** first death (specifically, between 3 and 24 months after first death).

[Sample Trust Deed]

THIS DECLARATION OF TRUST is made the day of [insert date and year] by [insert names and addresses of the first Trustees] (*Note 1*)

(hereinafter called 'the Trustees' which expression shall include the Trustees or Trustee for the time being hereof).

WHEREAS:

1. It has been resolved to constitute a Trust for the objects hereinafter declared
2. The Trustees have raised the sum of [insert amount] and intend to raise other funds and accept gifts for the said objects. (*Note 2*)

NOW THIS DEED WITNESSETH AND IT IS HEREBY AGREED AND DECLARED as follows:

1. NAME

The Trust hereby constituted shall be known as [insert name of trust] (hereinafter called 'the Trust'). (*Note 3*)

2. THE TRUST FUND

The Trustees shall stand possessed of the said sum of [insert amount] and of all other money and property which may be paid or transferred to them for the said objects and the investments and property from time to time representing the same (hereinafter called 'the Trust Fund') upon trust either to retain or sell the same and invest the proceeds in or upon any investments hereinafter authorised with power from time to time to change such investments for others of a like nature UPON TRUST that both the income and the capital thereof shall be applied at the discretion of the Trustees in pursuance of the said objects as hereinafter declared.

3. BENEFICIARIES AND OBJECTS

The beneficiaries and objects of the Trust are [insert beneficiaries & objects here]. (*Note 4*)

4. POWERS

In furtherance of the said objects but not otherwise the Trustees shall have the following power:

- i. To employ and pay any person or persons not being a Trustee to supervise organise and carry on the work of the Trust and make all reasonable and necessary provision for the payment of pensions and superannuation to or on behalf of employees and their widows, widowers and other dependants.
- ii. To raise funds and invite and receive contributions from any person or persons whatsoever by way of loan subscription donation and otherwise.
- iii. To carry on trade insofar as either the trade is exercised in the course of the actual carrying out of a primary object of the Trust or the trade is ancillary to the carrying out of the objects.
- iv. To establish and operate both current accounts and deposit accounts in the name of the Trust PROVIDED THAT cheques drawn on such accounts shall not be signed by less than two authorised signatories.
- v. To purchase take on lease or in exchange hire or otherwise acquire any property and any rights and privileges necessary for the attainment of the said objects and to construct maintain and alter any buildings or erections so necessary as aforesaid.
- vi. To make regulations for the management of any property which may be acquired.
- vii. Subject to such consents as may be required by law to sell lease or otherwise dispose of all or any of the property or assets of the Trust.
- viii. To invest Trust moneys not immediately required for the said objects in or upon such investments or securities or property as are authorised by the terms of this Deed.

- ix. To permit any investments comprised in the Trust Fund to be held in the name of any clearing bank any trust corporation or any stock broking company which is a member of the Stock Exchange (or any subsidiary of such company) as nominee for the Trustees and to pay any such nominee reasonable and proper remuneration for acting as such.
- x. To arrange and provide for or join in arranging and providing for the holding of exhibitions meetings lectures workshops seminars and training courses.
- xi. To borrow or raise money (subject to such consents as may be required by law) for the said objects and accept gifts on such terms and on such security as shall be deemed to be necessary.
- xii. To promote and carry out or assist in the promotion and carrying out of research surveys and investigations and publish the useful results thereof for the benefit of the public.
- xiii. To do all such other lawful things as are necessary for the attainment of the said objects.

5. POWER TO MAKE REGULATIONS

Within the limits imposed by this Deed the Trustees shall have power to make vary and revoke Regulations for:

- a. the conduct of business including the time place and method of calling meetings of the Trustees
- b. the custody of moneys deeds securities and documents belonging to the Trust (including regulations enabling any property forming part of the Trust Fund to be vested in the names of any two or more of the Trustees)
- c. the invitation to and appointment of such persons as they may select to be Patrons, Presidents or Vice Presidents of the Trust

6. AMENDMENT

The Trustees may by deed or deeds stated to be supplemental hereto vary any of the provisions of this Deed.

7. POWER TO DELEGATE

- a. The Trustees in addition to the powers conferred by Section 23 of the Trustee Act 1925 may employ any duly qualified or competent agent or person to transact any or all business within the scope of his expertise of whatever nature required to be done in furthering the said objects and shall be entitled to be allowed and paid all reasonable and proper out-of-pocket expenses incurred by them PROVIDED THAT all acts and proceedings of such agent or person to whom powers are so delegated shall be fully and promptly reported back to the Trustees as soon as possible AND PROVIDED FURTHER THAT the Trustees shall exercise reasonable supervision over such agent or employee.
- b. Any one or more of the Trustees may delegate the transaction of any business or the performance of any act required to be transacted or performed in the execution of the Trusts hereof and which is within the professional or business competence of such Trustee or Trustee PROVIDED THAT the Trustees shall exercise reasonable supervision over any Trustee or Trustees acting on their behalf under this provision and shall ensure that all their acts and proceedings are fully and promptly reported to them.

8. SECRETARY AND TREASURER

The Trustees may from time to time appoint some person to act as honorary secretary and some person to act as honorary treasurer of the Trust. Such persons may be (but need not be) Trustees.

9. PROCEEDINGS

- a. [Insert number] Trustees shall form a quorum and subject to Clause 11(c) hereof a meeting of Trustees at which a quorum is present shall be competent to exercise all or any of the powers and discretions vested in the Trustees. (*Note 5*)
- b. The Trustees shall elect one of their number as Chair and shall determine the period for which s/he is to hold office.
- c. The Chair may at any time and two Trustees jointly may at any time call a meeting of the Trustees.
- d. The Chair shall preside at all meetings of the Trustees save that if at any meeting the Chair is not present within ten minutes after the time appointed for the same the Trustees may choose one of their number present to be Chair of that meeting.

- e. Questions arising at any meeting shall be decided by a majority of votes (each Trustee present having one vote) and in case of an equality of votes the Chair shall have a second or casting vote.
- f. The majority shall be a simple majority save in the circumstances contemplated by Clause 11(c)(iv) hereof.
- g. Notice of every meeting shall be sent by the honorary secretary to each Trustee (other than a Trustee for the time being not in the United Kingdom). Any notice posted ten clear days before the date of the meeting shall be deemed to have been duly served.
- h. Every notice of a meeting shall state the place day and hour of the meeting and the business to be transacted thereat.

10. RECORDS AND ACCOUNTS

- a. The Trustees shall cause proper minutes to be kept and entered in a book provided for the purpose of all their resolutions and proceedings and any such minutes of any meeting of the Trustees purporting to be signed by the Chair of such meeting or by the Chair of the next succeeding meeting shall be conclusive evidence of the matters stated in such minutes.
- b. The Trustees shall comply with their obligations under the Law with regard to:
 - i. the keeping of accounting records for the Trust;
 - ii. the preparation of annual statements of account for the Trust;
 - iii. the auditing or independent examination of statements of account of the Trust; and
 - iv. the transmission of the statements of account of the Trust to the Commissioners.

11. APPOINTMENT AND RETIREMENT OF TRUSTEES

- a. A new Trustee may be appointed for [insert number of years] by a resolution of the Trustees recorded in the minutes and signed by the new Trustee and such record shall be conclusive evidence of his/her appointment.
[Optional] On the expiration of the term the Trustee may stand for a further [insert number] term(s). (*Note 6*)
- b. A Trustee may retire by writing under his hand and such retirement shall be recorded in the minutes and shall be conclusive evidence of his/her retirement.
- c. The office of a Trustee shall be vacated if a Trustee:
 - i. becomes incapable by reason of mental disorder illness or injury of managing and administering his/her affairs;
 - ii. resigns his/her office by notice in writing; or
 - iii. is absent from [insert number] consecutive meetings of the Trustees and/or for good and sufficient reason three quarters of the other Trustees pass a resolution that such Trustee shall be removed from office PROVIDED THAT a Trustee faced with removal shall have the right to be heard by the other Trustees before a vote is taken.
- d. The number of Trustees shall not be less than three or more than [insert maximum number of trustees] and in the event of their number falling below three such additional Trustees or Trustee shall forthwith be appointed as shall be necessary to make their number up to three but so that the Trustees may while their number is below three only act for the purpose of appointing additional Trustees or Trustee and for no other purpose. (*Note 7*)

12. PAYMENTS

No Trustee shall acquire any interest or receive any remuneration or be interested in the supply of goods or services at the cost of the Trust (*Note 8*) except in the following circumstances:

- i. any Trustee for the time being a solicitor or other person engaged in any profession shall be entitled to charge and be paid all usual professional or other charges for work done by him/her or his/her firm when instructed by his co-Trustees so to act in that capacity in connection with the trusts hereof; or
- ii. from obtaining the repayment of reasonable and proper out-of-pocket expenses incurred in connection with the trusts hereof; or
- iii. the Trustees shall be entitled to effect policies of indemnity insurance to cover the liability of the Trustees which by virtue of any rule of law would otherwise attach to them in respect of any negligence, default, breach of duty or breach of trust of which they may be guilty in relation to

the Trust: PROVIDED THAT any such insurance shall not extend to any claim arising from any act or omission which the Trustees knew to be a breach of trust or a breach of duty and provided also that any such insurance shall not extend to the costs of an unsuccessful defence to a criminal prosecution brought against the Trustees in their capacity as Trustees.

13. INDEMNITY

In the execution of the trusts hereof no Trustee shall be liable for any loss to the property of the Trust arising by reason of any improper investment made in good faith (so long as s/he shall have sought professional advice before making such investment) or for the negligence or fraud of any agent employed by him/her or by any other Trustee hereof or by reason of any other matter or thing other than wilful and individual fraud or wrongdoing or wrongful omission on the part of the Trustee who is sought to be made liable.

14. PROTECTION

Any statement in writing signed by the Trustees or any two of them to the effect that any contract deed or act signed executed or done by the Trustees is signed executed or done in accordance with and is authorised by the Trust's powers and provisions herein declared and contained shall in favour of any purchaser or other person dealing with the Trustees be conclusive evidence of the fact. (*Note 9*)

15. WINDING-UP

If the Trustees at any time unanimously decide that it is expedient to discontinue the Trust any assets remaining after the satisfaction of all its debts and liabilities shall not be paid to or distributed among the Trustees but shall be given [Insert names].

IN WITNESS whereof the parties hereto have executed this Declaration of Trust as a Deed the day and year first before written. (*Note 9*)

SIGNED AS A DEED

by the said __[Insert signature]__ in the presence of __[Insert witness signature]__

SIGNED AS A DEED

by the said __[Insert signature]__ in the presence of __[Insert witness signature]__

SIGNED AS A DEED

by the said __[Insert signature]__ in the presence of __[Insert witness signature]__

(*Note 10*)

NOTES

Note 1

The full names and full addresses of all the people who will be the first trustees should always be given. A minimum of three trustees is recommended in order to reduce problems arising from death, resignation, retirement or removal.

Note 2

It is always necessary to give a brief description of the property which is held by the Trust. A nominal sum of, say, £100 will normally be sufficient.

Note 3

You will need to insert the name by which the Trust will be known.

Note 4

Clause 3(a) declares the beneficiaries and objects of the Trust and great care must be taken over the drafting of this clause for the following reasons:

- The declared objects must describe the promoters' true primary intentions in a language which is acceptable to HMRC.

Clause 4 sets out the principal ways in which the objects are to be achieved. These are technically known as 'powers' and like the objects, they must be carefully worded. Particular attention should be given to sub-clause (i) as it prevents trustees from being paid for either services rendered to the Trust or for acting as a trustee. In certain circumstances it may be possible for trustees to be paid, in which case the Deed will need to be amended. See also Note 8 below. It is strongly recommended that legal advice be sought at an early stage in connection with the drafting of this Clause.

Note 5

At Clause 9(a) you will need to insert a number for a quorum so that the trustees can conduct legal meetings. The number should be at least two.

Note 6

Trustees can be appointed for either a fixed or unlimited period in office.

Note 7

You will need to fill in the blanks at Clauses 11(c)(iii) and 11(d).

Note 8

If trustees wish to be paid as trustees or be employed by the Trust then an express clause permitting this needs to be inserted here. Legal advice should be sought.

Note 9

The Deed should not be signed nor dated whilst it is still in draft form.

Note 10

Once the Trust Deed has been agreed the trustees should sign it where indicated in the presence of an independent witness.

Once signed the original Deed should be sent to HMRC Stamp Office for stamping which costs £5.00.

One copy of the Deed is for HMRC. The Form APP1 should state how the trust will carry out the declared objects. The actual activities of the Trust, that is the work undertaken by, or on the direction of, the trustees, must necessarily reflect the Trust's declared objects and powers.

14. APPENDIX 4 - An explanation of the Debt and Charge Schemes

14.1.1. The Debt Scheme

The wording in the NRB Discretionary Trust Wills – which can be inserted in similar form into the ‘POWERS’ section of any Trust Deed drawn up after first death when using the 2 Year Discretionary Trust Will - which permits the so-called ‘Debt Scheme’ is as follows: -

“... my Trustees may require my Legacy Trustees to accept in satisfaction of all or part of the Trust Legacy a binding promise of payment (secured or unsecured) made personally by my [wife/husband] or by my Trustees as trustees of my Residuary Estate which debt shall be payable on demand and my Legacy Trustees shall accept such as the whole or a part (as the case may be) of the Trust Legacy”

What this means is that (all or part of) the Discretionary Trust is made up by an ‘IOU’ from the surviving spouse/partner. This is the simpler of the two schemes but your Executors are strongly advised to take advice before using it, as in certain circumstances it may fall foul of the Finance Act 1986, s103 (liabilities based on ‘an incumbrance created by a disposition made’). If there is a risk, the ‘charge scheme’ is recommended instead.

14.1.2. The Charge Scheme

The wording in the NRB Discretionary Trust Wills – which can be inserted in similar form into the ‘POWERS’ section of any Trust Deed drawn up after first death when using the 2 Year Discretionary Trust Will - which permits the ‘Charge Scheme’ is as follows :-

“... my Trustees may charge (with or without there being any personal liability of any person or persons) any property which is (or but for this clause would be) comprised in my Residuary Estate with payment of a sum of money equal to or less than the amount of the Trust Legacy to my Legacy Trustees and my Legacy Trustees shall accept such charge for such sum as the whole or a part (as the case may be) of the Trust Legacy”

What this means is that before the first to die’s Residuary Estate is distributed, a ‘charge’ is placed on his/her (normally 50%) share of the marital home to make up (all or part of) the Discretionary Trust.

A ‘charge’ is basically a note made against the property’s details at the Land Registry which states that a person (in this case the Legacy Trustees) has a ‘monetary interest’ in the property and that the property cannot be sold unless this ‘monetary interest’ is paid off. So if, for example, a property were worth £500,000 and a £300,000 charge were placed on it, then it could not be sold without the £300,000 being paid off first.

When the surviving spouse/partner dies, the value of his/her estate is calculated by subtracting the amount of the ‘charge’. Thus the NRB (Discretionary) Trust Legacy can be satisfied without having to use actual funds such as bank accounts or other monetary assets.

14.1.3. Issues with the Surviving spouse/partner moving Home

The reason that the ‘charge scheme’ works without falling foul of the Finance Act 1986, s103 is that the ‘charge’ is placed on property within the first to die’s Residuary Estate **by the Executors** of the first to die’s Residuary Estate – i.e. **not the surviving spouse/partner**. Without going into too much detail, this is the key point which means that the scheme avoids falling foul of the Finance Act 1986, s103. (Note that this is the reason we strongly recommend that the surviving spouse/partner should not be an Executor for the NRB type of Will).

A problem may therefore occur if the surviving spouse/partner then wishes to move home. If a ‘NRB with **Absolute Interest**’ Will has been used, then the ‘charge’ on the first to die’s share of the original property is made **by the Executors** before distributing it to the surviving spouse/partner. However, if he/she then moves home, **the surviving spouse/partner** and not the Executors would have to impose the replacement charge because a charge may only be placed on a property by somebody who has an interest in it – i.e. as 100% owner, the surviving spouse/partner. Hence the scheme now may fall foul of the Finance Act 1986, s103. Therefore the charge must be settled **in full** upon sale of the marital home – leaving the surviving spouse/partner much less money for the replacement property.

A way round this problem – the surviving spouse/partner moving home and wanting sufficient funds for the new property – is to ensure that the property **remains** within the Residuary Estate of the first to die. This is done by using the ‘NRB with **Life Interest**’ Will. The 50% share in the property **remains** within the Residuary Estate of the first to die even after the first to die’s Residuary Estate has been distributed, with the surviving spouse/partner being permitted to occupy the home (as he/she has a ‘life interest’). Upon the sale of the original property, 50% of it **remains** within the Residuary Estate of the first to die, and so **the Executors** are able to transfer this share to the new property along with the ‘charge’. Hence the arrangement cannot fall foul of the Finance Act 1986, s103.

In summary: -

1. The key difference (so far as the 'charge' scheme is concerned) between the 'NRB with **Absolute Interest**' Will and the 'NRB with **Life Interest**' Will is the **ownership** of the marital home after the first to die's Residuary Estate has been distributed.
2. If the marital home is the main asset of the estate and the surviving spouse/partner may wish to move home, the 'NRB with **Life Interest**' Will should be used.

14.1.4. The Phizackerley Case

In February 2007 the above-mentioned case hit the news. To cut a long story short, the Nil Rate Band Discretionary Trust Wills of a retired Oxford Don and his wife failed to work, and the IHT saving was lost.

The reason for this was that an arrangement in the Will fell foul of Section 103 of the Finance Act 1986 ('s103'). The national press have claimed that this is a 'landmark case' that suggests that HMRC are clamping down on Discretionary Trust Wills. In our view it is nothing of the sort: - it is merely a classic case of getting 'caught' by legislation that has been around for over 20 years. And it could easily have been avoided.

What s103 effectively says is that you can't borrow back something that you've previously given away. If you do, then it is 'disallowed' for Inheritance Tax purposes.

In the Phizackerley case, the following occurred:-

1. Mr Phizackerley purchased the marital home and registered it in joint names with his wife.
2. Just before making the Wills, they changed the ownership to Tenants in Common.
3. The Will was an '**Absolute Interest**' type of Will.
4. Mrs Phizackerley, **who had never worked**, died first.
5. Her share of the marital home was used (using the '**Debt Scheme**') to make up some of the Nil Rate Band Trust, with Mr Phizackerley acting as a party (either Executor of the Will, or Nil Rate Band Trustee) in the execution of the deed.

The Special Commissioners ruled that in Step 1 above, as he had contributed 100% of the purchase of the marital home, he'd had to 'give' 50% of it to his wife. Thus in Step 5 Mr Phizackerley was 'borrowing back something he'd previously given away' (something, in fact, that he'd 'given away' purely as a vehicle for avoiding IHT) and disallowed the use of the marital home being used to make up some of the nil rate band.

Note that this ruling would not have been made if **Mr** Phizackerley had died first, because Mrs Phizackerley could never 'borrow back something she'd previously given away' because **she** had 'received' and not 'given' the 50% share in the marital home.

This is a classic case of getting caught by s103 which could have **easily** been avoided. Mr Phizackerley could probably even have avoided being 'caught' after first death - if he had taken professional advice and acted accordingly.

Here is our advice regarding this case, and how to avoid being caught in a similar manner:-

1. If your joint estate is split roughly 50-50 between you and you already own your home as Joint Tenants or as Tenants in Common, and have both contributed financially to its purchase/upkeep, then you have nothing to worry about regarding this case. You need read no further down this list. If, however, your home was originally owned or was funded by one of you only, then read on ...
2. If the previous paragraph has given you cause for worry, use the '**Life Interest**' type of NRB DT Will or the 2 Year Discretionary Trust type of Will. This allows the 'Charge Scheme' to be used without the surviving spouse/partner having any involvement at all in the transaction.
3. Ensure that, if you own your home as Joint Tenants, you sever the Joint Tenancy so that your ownership is as Tenants in Common as soon as possible.
4. Subscribe to our Document Storage Service: this includes a **Free Probate Helpline**.
5. If the 'non-bread winner' dies first, then the surviving spouse/partner should take professional advice before doing anything (even before applying for Probate) to ensure that the best course of action is taken to avoid being caught by s103. (Normally using the '**Charge Scheme**' would avoid s103 but it is important to be sure that, at the time in question, this is still the case). Note that Step 4 immediately above will now prove invaluable. Note also that in reality the survivor should take professional advice **whoever** has died first.

If Mr & Mrs Phizackerley had done even just steps 2 and 5 above, they would **not** have been caught by s103 and they would have avoided the extra IHT they had to pay.