Will trusts, types, investments and advantages

Synopsis: Everything you need to know about Will Trusts.

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What is a Will Trust?

This is a trust that is created through a Will which commences on your death.

The wording contained within the Will constitutes the trust and therefore there is no need for another trust deed. It is normal for the executors to also be appointed the trustees of the Will however these can also be different individuals.

There are no transfers of value or gifts made whilst you are alive as the trust only comes into effect on death which means that you can control and enjoy those assets whilst you are still alive.

Inheritance tax will be calculated and paid first on the estate before any assets are made subject to the trust, so, normally the value being transferred is within the available nil rate band.

Creating a trust within your Will allows you to decide how your assets should be dealt with, who should benefit and in what circumstances.

Types of Will Trusts

There are two main variants of the Will Trust on the market...

- The "fully" discretionary trust - without an interest in possession.
- The "flexible" interest in possession trust with power of appointment.

Discretionary trust

Under a discretionary trust the classes of beneficiary would normally include the spouse (civil partner), children, grandchildren and remoter issue of the deceased. The trustees would have the power to accumulate income within the normal accumulation period (usually 21 years) and to retain discretion over income and capital for the duration of the trust (normally 125 years under English law).

It is arguable that provided there could be some certainty that the trust asset will always remain at a value less than the nil rate band and the transfer to the trust on the death of the testator is within the available nil rate band of the settlor then there is no inheritance tax detriment to having a fully discretionary trust.

It is, however, important to bear in mind that should the value of the trust property exceed the nil rate band then there is the risk (whilst the trust remains in discretionary format) of incurring inheritance tax charges. These would be in the shape of the ten-year periodic charge and the exit charge. It is important therefore to closely monitor the value of the Will Trust.

Nil rate band discretionary Will Trusts...

Before the ability to transfer unused nil rate band to your spouse/civil partner, nil rate band Will Trusts were used by individuals to enable both of a married couple's/civil partnership's nil rate bands to be used up efficiently. If, on first death, all assets passed to the surviving spouse/civil partner the nil rate band was lost and there was no facility in place to transfer this to your widow/widower/surviving civil partner.

A more tax efficient way of using the first nil rate band was to create a discretionary trust in your Will up to the value of the free nil rate band available on first death. The discretionary trust normally had a class of beneficiaries including the surviving spouse/civil partner, children and descendants.

Of course, the need to ensure that the nil rate band is fully utilised on the first death has now largely been negated by the introduction of the transferable nil rate band on death. However, there may still be circumstances where planning of this type remains useful.

Two-year discretionary trust...

Sometimes individuals may find it difficult to make a decision over the ultimate destination of their estate. In such a case it is possible to postpone the choice of beneficiaries until the very last moment or, indeed, leave the decision up to the trustees by including in a Will a discretionary trust over all of the estate.

Under section 144 Inheritance Tax Act 1984 any distributions made from the trust within two years of the death will be treated as if they took place under the Will for all tax purposes. For example, the trustees may make an appointment that uses the nil rate band but leaves the rest of the estate to the surviving spouse/civil partner. Therefore, no inheritance tax would arise regardless of the fact that at the time of the death of the testator the entire estate passed to a discretionary trust.

It used to be that the executors had to wait until after three months of death before exercising S144. However, for deaths on or after 10 December 2014, it no longer matters if the event was within three months of the testator's death because of amendments made in the summer Finance Bill 2015.

A very important point to remember is that where a Will includes a discretionary trust in excess of the nil rate band any inheritance tax will have to be paid on the discretionary trust fund on the application for a grant of probate, even if it is intended that an appointment should be made in favour of a surviving spouse/civil partner at a later date by the trustees.

Flexible (interest in possession) trust

Under this type of trust, there will be one or more named beneficiaries with an interest in possession in the trust property and the trustees of the trust will have a wide power to appoint benefits amongst a wide class of discretionary beneficiaries.

The named beneficiaries are entitled to all of the income generated by the trust assets.

It would be important to ensure that any trust created on death satisfies the conditions required to be an immediate post-death life interest trust under the changes made in the Finance Act 2006. This will ensure that the trust is not taxed as a discretionary trust.

The wordings provided by most life offices to create a Will Trust will either be in the form of a codicil to an individual's own Will or merely a form of words for an individual to incorporate into their own Will.

Either way, it is essential that the testator consults their solicitor in order to ensure that no conflicts with other Will planning occur and that an integrated approach to inheritance tax and estate planning is implemented.

Will Trusts and children

New provisions were introduced in Finance Act 2006 to allow testators who have minor children to create trusts for those children which benefit from favourable tax treatment.

Two types of trust are available...

- The "bereaved minor´s" trust (BMT).
- The “18 - 25” trust.

The basic conditions for both are the same (the deceased is the parent and the beneficiary a child under age 18, with the trust income either being paid to the beneficiary or accumulated for their benefit), the only difference being the age at which the child becomes entitled to capital.

Under the BMT the child must become entitled to the capital at age 18; under the “18-25” trust, not later than age 25.

Will Trust investments

It is important to state that the inheritance tax effectiveness of the Will Trust is not dependent in any way on the asset that is made subject to the Will Trust. The Will Trust wording may not even refer to a specific asset.

In this case the trustees will usually be given discretion to decide which assets from the deceased's estate will be subject to the Will Trust.

Of course, if the asset that is made subject to the Will Trust (and assuming the Will Trust is for the benefit of other than the surviving spouse/civil partner) is exempt or not subject to inheritance tax for some other reason, e.g. an inheritance tax free death benefit from an occupational or personal pension arrangement or because the asset is subject to 100% business relief, then ensuring that the value of the asset remains within the available nil rate band on death will not be an issue.

Often individuals will buy investment products that are efficient with simple administration which they wish to be held within their Will Trust on their death.

It is essential that anybody contemplating such a plan should be satisfied regarding the appropriateness of a Will Trust arrangement on two grounds...

- That the investment part of the package (e.g. an insurance investment bond) is an appropriate investment for the investor during his or her lifetime and, if it is to remain subject to the trust after the testator's death, that it is appropriate for the beneficiaries.

- That they are happy with the tax consequences of the Will Trust. These are that during the testator's lifetime the testator will have complete ownership of and control over the investment and that, on death, the investment will be held subject to the trust.

The most common financial product used in Will Trust packages is a life assurance bond written on a joint lives/multi-lives last survivor basis, although other investments, such as collectives, can also be used.

The Will Trust/life assurance bond package can be an attractive one for an investor who is clear that an investment bond is an appropriate investment for him or her during lifetime and wishes to carry out some inheritance tax planning by using the nil band on death (notwithstanding the availability of the transferable nil rate band at that time) but does not wish to give up any control or access over the investment during his or her lifetime.

Advantages of Will Trusts

- The partners may each be in a second marriage/civil partnership and each of the couple may wish to benefit their children from a former marriage/civil partnership on the first death or it may just be that each of the couple does not want the survivor to have complete legal and beneficial control of the assets following first death.

  Whilst this could technically be achieved using a life interest trust in the Will – known as an immediate post-death interest trust, (with income payable to the surviving spouse/civil partner and capital held for the children from the first marriage/civil partnership), that route lacks flexibility especially if there is an intention to make capital payments to the widow/widower/surviving civil partner by way of interest-free loans.

- There may be a desire to avoid assets being available to the local authority in the event of the survivor going into care.

  By leaving assets to a trust on the first death those assets will not count as part of the surviving spouse´s/civil partner's resources for the purposes of the local authority charge. Indeed, the split ownership of certain assets between the trust and surviving spouse/civil partner may reduce the value

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of the assets in the hands of the surviving spouse/civil partner - for example in the case of a private residence.

- It may be desired to avoid children inheriting assets outright. By passing assets to them via a trust it will mean that they are protected from the claims of creditors and ex-spouses/ex-civil partners.

- Further inheritance tax savings could be secured by the trustees of the Will Trust making loans to the surviving spouse/civil partner if and when funds are needed which create debts and so reduce the taxable estate of the survivor on their subsequent death.

  Here, it would be necessary to identify whether the surviving spouse/civil partner had previously made lifetime gifts to the deceased because in those circumstances there could be a restriction on the ability to deduct the loans from the survivor´s taxable estate. (Please see section 103(1) Finance Act 1986).

- Where a person has remarried or formed a new civil partnership after their former spouse/civil partner has died without using their nil rate band, the surviving spouse/civil partner may have a nil rate band of, currently, up to £650,000 available on their death first.

  Clearly, it would be important to utilise this because otherwise up to £325,000 of the nil rate band could be lost on the survivor´s death. This is because the maximum transferable nil rate band that can be claimed is one nil rate band, even if an individual was widowed more than once and in each case the former spouse/civil partner did not use their nil rate band (the other unused nil rate bands will then be wasted).

- It may be felt that investments made subject to the Will Trust on the first death will increase in value at a greater rate than the increase in the nil rate band.

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