

# **Saving Inheritance Tax with Discretionary Trust Wills**

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## 1. Introduction and Disclaimer

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 married couples have a combined estate worth well in excess of the Inheritance Tax (IHT) threshold (which is roughly £250,000 at present - you can find out the current level at our website [www.tenminutewill.co.uk](http://www.tenminutewill.co.uk)). This can give rise to potential demands for large (and unnecessary) IHT payments: -

*Since all transfers – no matter how large - between UK-resident spouses are tax free, IHT can easily be avoided entirely upon the **first** death.*

*Without proper planning however, **a large IHT liability can be incurred when the surviving spouse dies**. For a combined estate worth £500,000 (£250,000 above the IHT threshold), that liability would be approximately £100,000 - all of which could have been avoided simply by making and implementing a pair of correctly worded Wills known as **Discretionary Trust Wills**.*

Basically, Discretionary Trust Wills (sometimes referred to as Nil-Rate Band Discretionary Trust Wills) work by using up **both** IHT Thresholds for **both** spouses. This document explains the details of how they work, the different types offered by [www.tenminutewill.co.uk](http://www.tenminutewill.co.uk), and how to save up to £100,000 Inheritance Tax by making one.

Please note that this document deals with the (still tax-effective) method of **Nil-Rate Band** Discretionary Trust Wills and **not** with the (recently clamped-down-on) Trusts used by some married couples to avoid IHT entirely by selling their house to a Trust and then continuing to live in it.

**Please also 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' £250,000 IHT Threshold is used throughout this document to make examples given easier to understand. This is the **2002** IHT Level and it has since **increased** – please see our website [www.tenminutewill.co.uk](http://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. How do Discretionary Trust Wills work?

Discretionary Trust Wills save Inheritance Tax for married couples by making use of the Nil-Rate band of **both** spouses, rather than just that of the surviving spouse (as would normally be the case). The following example explains what happens without Discretionary Trust Wills, and then how the IHT liability changes if Discretionary Trust Wills are used.

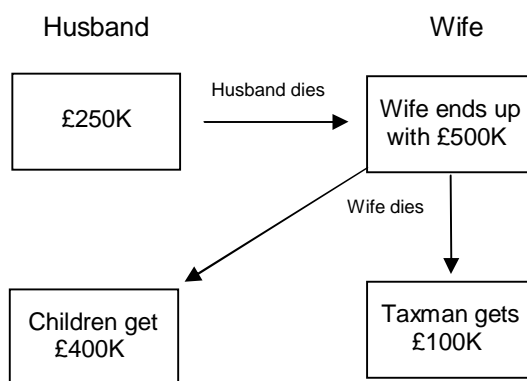
For ease of explanation, it will be assumed that the husband dies first. However, the rules are exactly the same if the husband lives the longer. We will also assume, for simplicity, that the IHT Threshold is at the 2002 level (£250,000 – it has since increased – you can find out the current level at our website [www.tenminutewill.co.uk](http://www.tenminutewill.co.uk)).

Assume that a husband and wife each have an estate of £250,000. They wish to give everything to the survivor when the first one dies, and on the second death they wish everything to go to their children.

On the husband's death he gives all his property to his wife (when addressing the issue of IHT, "property" means everything of value including money, shares, buildings, land, business interests etc). No Inheritance Tax is payable on the husband's death as there is an IHT exemption for property passing between spouses.

On the wife's death, she leaves all her property to the children. For arguments sake we shall assume that her estate now consists of her own £250,000 plus the £250,000 she inherited from her husband, a total of £500,000.

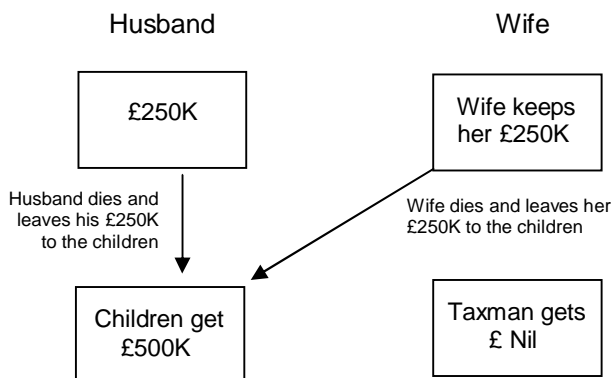
Assuming the rates haven't changed, the first £250,000 would be taxed at the "nil-rate" with the remainder being taxed at 40%. This gives an Inheritance Tax liability on her death of £100,000.



**Figure 1 - Husband leaves entire Estate to wife**

If, instead of leaving his £250,000 to his wife, the husband had left it directly to the children, then on his death there would still be no tax payable as his estate would be within the current nil-rate band. On the wife's death her estate would amount to £250,000 and would again be free of tax. The result of making use of the husband's nil-rate band by passing assets directly to the children would therefore give rise to an Inheritance Tax saving of £100,000.

Passing assets directly to the children on the first death is fine in theory, but it does mean that the wife may be left short of money following her husband's death, she may even have to sell the marital home, and she would have no control over the money held by the children. The risk of making use of the nil-rate band on the husband's death (by passing his estate to the children) may therefore be deemed to be too great.



**Figure 2 – Husband and wife each leave £250K to children**

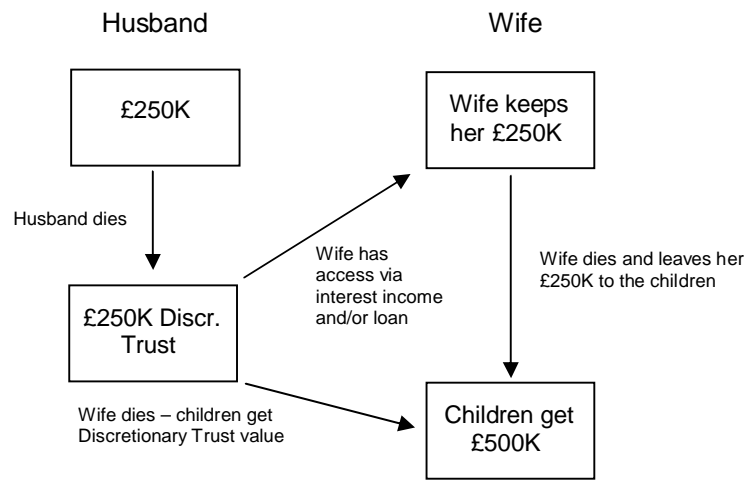
There is, however, a way to make use of the nil-rate band on the husband's death whilst still permitting the wife to continue to benefit from, and control, his estate. This is achieved by using the Nil-Rate Band Discretionary Trust Will.

Instead of leaving £250,000 directly to the children, the husband, by his Will, leaves it to the trustees of a purpose made "discretionary trust". The wording of the Trust would permit the £250,000 in the Trust to be – instead of money or property worth £250,000 – a charge on a property or a promise of payment from the wife, or alternatively for the wife to borrow or draw income from the Trust. Thus – and this is important if most of the estate is tied up in the marital home – the wife is not left short of money and the marital home does not have to be sold.

Because the capital from the husband's estate has been passed to a discretionary trust and not to the wife, it will be outside of her estate and will not be taxable on her death.

When she dies her own estate will still only amount to £250,000 and, therefore, be tax-free.

Thus, the Inheritance Tax liability is still reduced from £100,000 to nothing, but without the hardship and inconvenience suffered by the wife were she only to inherit £250,000.



**Figure 3 - Husband leaves £250K to Discretionary Trust**

### 3. Are there any disadvantages to Discretionary Trust Wills?

Obviously there is a difference between the surviving spouse having some degree of control over a Discretionary Trust fund and inheriting 100% of the estate. However, if the most suitable type of Discretionary Trust Will is chosen then the effect of this should not be of any real significance.

Additionally, a charge or debt scheme may need to be set up where appropriate (see Section 5.1.3 for details), and this may incur a small amount of additional work for the Executors and Trustees. Again, we are talking about fairly trivial inconveniences here.

More specific disadvantages may apply in particular situations and with particular types of Discretionary Trust Wills. You are advised to read the later section in this document entitled 'What are the different types of Discretionary Trust Wills?' and to select the type of Trust whose advantages and disadvantages are most suited to you.

Care must also be taken to ensure that the estate is shared between the two spouses in such a way that **either**: -

1. If the joint Estate is worth more than double the IHT threshold, it is divided such that either spouse would own enough to fund the £250,000+ required in the Discretionary Trust fund. (How to do this is covered in the very next section).

**or**

2. If the joint Estate is worth less than double the IHT threshold, it is evenly divided such that neither spouse owns more than the IHT threshold. (If this is not done, and the 'richer' spouse is second to die, unnecessary IHT is then payable upon the second death).

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.

## 4. 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

### 4.1. Deciding which type of Will fits your situation

First of all, you need 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. In particular, you should decide who you are going to appoint to be your Executors and (if required) your Discretionary Trust Legacy Trustees according to the 'rules' that we give you.

### 4.2. Preparing/writing the Will

All you have to do is logon to our site – [www.tenminutewill.co.uk](http://www.tenminutewill.co.uk) - and make the Will – 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 both of our 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 ....").

Note also that if you leave non-exempt legacies (i.e. not to your spouse or to a charity) then the value of such legacies will be deducted from the amount available to your Discretionary Trust so as to keep it within the IHT threshold. So, for example, if the IHT threshold is £250,000 and you leave £10,000 to your son, then only £240,000 would be available to the Discretionary Trust.

Finally, if your joint Estate is worth a lot less than double the IHT threshold, there is no need to worry:- the above wording used in our Wills also ensures that if, say, you each only had £150,000 then only that £150,000 would go into the Discretionary Trust.

### 4.3. Preparing your Estate

Next, it is vital that your estate is properly 'prepared'. The most important thing to do is to ensure that you both have an estate of at least £250,000 (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 £250,000.

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.

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. The best way to do this is to write a 'severance memorandum' (there is a sample document in Appendix 3), have both of you sign it, send a copy to the relevant financial institution, and keep it (and any acknowledgement you get back from the financial institution) with your Wills.

## 5. What are the different types of Discretionary Trust Wills?

Please note that in this section, for the sake of simplicity, we shall continue to use the 2002 sum of £250,000 as the Inheritance Tax threshold, even though it has since increased.

[www.tenminutewill.co.uk](http://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 gets absolute interest in Residue.**  
This best suits the situation where the £250,000 Discretionary Trust Legacy ('the DT Legacy') is to be made up of cash or other investments apart from the marital home, or where the main asset is the marital home and the surviving spouse will not want to sell it at any time prior to his/her death other than to move to a much smaller property.
- 2. Nil-Rate Band (NRB) Discretionary Trust Legacy – surviving spouse gets protective life interest in Residue.**  
This best suits the situation where the main asset is the marital home and the surviving spouse may want to sell it at some time prior to his/her death in order to move to another property of similar value.
- 3. 2 Year Discretionary Trust for entire estate.**  
This best suits the situation where neither of the previous 2 options can be decided upon, and you would rather wait until after the first death and then make a decision as to how to make up the £250,000 Discretionary Trust Legacy.

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

The following sub-sections 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. The secondary beneficiaries by default are the children, in equal shares (although you can change this). This means that if the husband dies first, the Estate (minus the Discretionary Trust legacy) goes to his wife, and then when she dies everything goes to the children. If the wife dies first, the Estate (minus the Discretionary Trust legacy) goes to the husband, and then when he dies everything goes to the children.
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 children 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. The wording of the Will is such that as and when Inheritance Tax thresholds change, the revised threshold is automatically accommodated - i.e. you do not have to revise your Will every 12 months after the Chancellor's budget.
5. 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 Trusts if necessary.

## 5.1. NRB Discretionary Trust Will – spouse gets absolute interest in Residue

This type of Will is most appropriate where the main asset of the estate is the marital home, and surviving spouse intends to continue to live in it, **or** where there are sufficient other assets to make up the DT Legacy.

### 5.1.1. Advantages and Disadvantages

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

- The surviving spouse has immediate access to – and ownership of - the 'Residuary Estate' – i.e. the total estate minus the £250,000 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 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 £100,000 when the surviving spouse 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 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 £100,000 tax saving) of the Discretionary Trust could be lost. See Appendix 5 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.

### 5.1.2. 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) and you **must** appoint **at least two Trustees to the Discretionary Trust Legacy**. Also important is that 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). It is normal to appoint the 2 eldest children as the Executors (they must be over 18) and then the spouse plus one of the Executors as the Trustees to the Discretionary Trust Legacy. 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 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 must leave the Residuary Estate to the spouse, and then (if he/she does not survive you) to your children or whoever you wish the eventual beneficiaries of your combined estate to be.

### 5.1.3. 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 £250,000 is paid out of cash from the estate and invested, with the surviving spouse allowed to draw an income from it. The rest of the estate – including the marital home - goes directly to the spouse. 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 £250,000 could be raised without selling the marital home and if the surviving spouse 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 or putting a charge on the **first to die's share** of the marital home to the value of £250,000 ('charge scheme'). The rest of the estate goes directly to the spouse. 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 £250,000 whilst still leaving the surviving spouse with a home and enough money to live on. See Appendix 5 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.

## 5.2. NRB Discretionary Trust Will – spouse gets protective life interest in Residue

This type of Will is most appropriate where the main asset of the estate is the marital home, and surviving spouse intends to – or may at some date in the future want to - sell it and move to a different home, for example to live nearer to the children.

### 5.2.1. Advantages and Disadvantages

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

- The surviving spouse can move home without the danger of losing the IHT advantage (i.e. the £100,000 tax saving) of the Discretionary Trust. See Appendix 5 for details.
- The surviving spouse'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 £100,000 when the surviving spouse 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 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 in the Will which he/she will receive before the Residuary Estate is determined.

### 5.2.2. 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) and you **must** appoint **at least two Trustees to the Discretionary Trust Legacy**. Also important is that 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). It is normal to appoint the 2 eldest children as the Executors (they must be over 18) and then the spouse plus one of the Executors as the Trustees to the Discretionary Trust Legacy. 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 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 must leave the Residuary Estate to the spouse, and then (if he/she does not survive you) to your children or whoever you wish the eventual beneficiaries of your combined estate to be.

### 5.2.3. 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 £250,000 is paid out of cash from the estate and invested, with the surviving spouse 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.

This option would be used, for example, if the £250,000 could be raised without selling the marital home and if the surviving spouse 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 or putting a charge on the **first to die's share** of the marital home to the value of £250,000 ('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 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).

These options would be used if there were not enough cash in the estate to raise £250,000 whilst still leaving the surviving spouse with a home and enough money to live on. See Appendix 5 for 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.

### 5.3. 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 NRB Discretionary Trust(s) 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.

#### 5.3.1. 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.
- There can (obviously) be an Inheritance Tax saving of up to £100,000 when the surviving spouse 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 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.
- There is a possibility of more of the total IHT bill having to be paid 'up front'. i.e. after the first death instead of after the second death (but only if the necessary Trusts are not set up within 6 months).
- It isn't really a 'disadvantage', but in this type of Will you give your Executors wide-ranging powers so you therefore need to be sure you can trust them.

#### 5.3.2. How to create the Will

For this type of Will to work, you **should** appoint at **least three Executors** one of whom should be the spouse. Your Executors will have wide-ranging powers so you should choose people you are 100% sure that you can trust – we therefore recommend that as well as the spouse you appoint your children (if they are over 18) as the additional Executors.

You **do not** have to appoint any Trustees for the Discretionary Trust Legacy, because at this stage there isn't one. It is normal to appoint the spouse and 2 eldest children as the Executors (they must be over 18). 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 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.

#### 5.3.3. 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 5.1 are used, or maybe Section 5.2, or some other – it is entirely at the Executors' discretion. Appendix 4 gives a sample Trust Deed which can be used for this purpose.

The above process is 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 – if he/she is still alive, otherwise it goes to the children (or whoever) – along the same lines as in Section 5.1.3.

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

## 6. The (Nil or Minimal) Taxation Of Discretionary Trusts

In certain circumstances, **small** amounts of tax **may be** payable on the Nil-rate Band Discretionary Trust Legacy.

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 legacy in the Will (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.

### 6.1.1. 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.

#### 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.

### 6.1.2. 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 Legacy, 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 Nil-Rate Band Discretionary Trust Legacy 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 Legacy altogether.

### 6.1.3. 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 Nil-Rate Band legacy 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.

### 6.1.4. 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 Brown/Blair 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.

### 6.1.5. 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 [www.hmrc.gov.uk](http://www.hmrc.gov.uk).

### 6.1.6. SUMMARY

The tax payable on a Nil-Rate Band Discretionary Trust Legacy is likely to be nil 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' and unnecessarily handing over in excess of £100,000 in additional Inheritance Tax – Discretionary Trust Wills are very tax-efficient.

## 7. Summary of Discretionary Trust Wills

Every year, thousands of married couples – having already paid tax all of their lives - needlessly let the taxman take up to £100,000 more than necessary from their heirs.

The current Inheritance Tax (IHT) laws allow for **each** of us to leave a sum in excess of £250,000 without incurring any IHT. Discretionary Trust Wills are an effective way for married couples to **both** use up their entire allowance – saving their children or other heirs up to £100,000 in IHT.

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](http://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.

	<b>NRB – Absolute Interest</b>	<b>NRB – Life Interest</b>	<b>2 Year Discretionary Trust</b>
<b>How it works</b>	Nil-Rate amount left as a DT Legacy, 'paid' in whole or part by debt from surviving spouse or charge on marital home. Surviving spouse 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 or charge on marital home. Surviving spouse gets income from rest of Estate.	Trusts set up between 3 months & 2 years after 1 <sup>st</sup> death.
<b>Appointment of Executors and DT Trustees</b>	At least 2 Executors (spouse should not be one of them) Spouse plus at least 1 DT Legacy Trustee(s)	At least 2 Executors (spouse should not be one of them) Spouse plus at least 1 DT Legacy Trustee(s)	Spouse plus at least 2 other Executors. No DT Legacy Trustees required.
<b>Main Advantages</b>	Surviving spouse has immediate access to Residuary Estate. IHT saving of up to £100,000 when the surviving spouse dies.	Surviving spouse can move home. Surviving spouse's creditors cannot access the Estate. IHT saving of up to £100,000 when the surviving spouse dies.	Total flexibility. Tax advantages if the married couple live abroad. IHT saving of up to £100,000 when the surviving spouse dies.
<b>Main Disadvantages</b>	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 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 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 <sup>st</sup> death if take > 6 months to set Trusts up.
<b>Other comments</b>	Any Joint Tenancy <b>must</b> be severed.	Any Joint Tenancy <b>must</b> be severed.	Any Joint Tenancy <b>must</b> be severed. Make sure you appoint 100% trustworthy Executors.

Note: DT stands for Discretionary Trust.

## 8. 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 an IHT saving of the order of £100,000 or more, 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.

### 8.1.1. 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 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 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**' (hence the name of the type of Trust: '**Discretionary** Trust') - although they **must** run the Trust for the benefit of its beneficiaries (who are the surviving spouse 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.*

### 8.1.2. 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 the Discretionary Trust 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 to make up some or all of the Discretionary Trust. *Time required: anything from 0-8 hours.*
3. 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 is given 100% ownership of the marital home. *Time required: about 1 hour.*
4. 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.). *Time required: less than 1 hour per year.*

### 8.1.3. Upon second death

Upon second death, the Trustees of the Discretionary Trust 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.*

### 8.1.4. 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 2-10 hours from your Executors/Trustees upon first death
- Plus about 1 hour per year from your Trustees.

## 9. Some Worked Examples of Discretionary Trust Wills

### 9.1.1. A 'Nil Rate Band with Life Interest' Will – surviving spouse moves home

Alan and Lena own a house valued at £600,000 and have £200,000 in cash and investments - a total joint estate of £800,000. They make a 'Nil Rate Band – Life Interest in Residue' Discretionary Trust Will.

When they draft the Will, they answer 'Yes' to the question asking them: "Do you want to leave an inter-spouse gift in your Wills?" and they specify a gift of £50,000.

They leave no other legacies, and specify that their children are to inherit the eventual estate (and, specifying *more detail*, that their children's children are to inherit the share of any child that dies before them).

Finally, after making the Will (but before first death) they ensure that their house is owned as Tenants in Common and that their £200,000 of other investments are split equally between them (they have a joint savings account holding £20,000 and they write to the bank stating that it is to be held as Tenants in Common and have kept the letter and the confirmation of acceptance from the bank with their Wills; they hold all other investments in their own single names).

Alan dies first, and the Will is quickly given a Grant of Probate, and Lena receives £50,000 immediately (the 'inter-spouse legacy') to go with the £100,000 in cash and investments that she already had. So Lena now has £150,000 in cash and investments.

A 'charge' to the value of £285,000 (for that is the IHT threshold at the time) is placed on Alan's Estate's share of the marital home, and Lena continues to live in it (she owns 50% of it and has a 'life interest' in the other 50%). The £285,000 'charge' now constitutes the entire value of the Discretionary Trust.

The other £50,000 of Alan's estate is invested by the Executors in a Building Society giving 5% interest, and so Lena receives £2500 a year from this investment (because she has a 'life interest' in Alan's Estate).

Lena decides that she wants to move nearer to the children – who live in a more expensive area than her and so it costs £500,000 for her to buy a home of appropriate size.

Here's what now happens:-

- Because half of the marital home is still owned by Alan's Estate, and carries a 'charge' of £285,000, half of the sale proceeds of the house are also owned by Alan's Estate and so can be transferred (with a new 'charge') to the new home.
- The new home is still owned 50-50 (as Tenants in Common) by Alan's Estate and Lena. Lena can live in the house as she owns 50% of it and has a 'Life Interest' in the other 50%.
- A 'charge' is placed on Alan's Estate's 50% of the new home – i.e. £250,000.
- The additional £35,000 required to make up the Discretionary Trust is funded by the 'balance' of Alan's Estate's share of the sale proceeds (£300,000 minus the £250,000 to buy 50% of the new home), leaving an additional £15,000 cash to be invested in the Building Society.
- The 'Building Society' investment is now £65,000, so Lena receives £3250 a year from this (as she still has a 'life interest').
- Lena's share of the sale was £300,000, and she has invested £250,000 in the new home, so she now has an additional £50,000 – making her total assets in cash and investments £150,000 + £50,000 = £200,000.

The Trustees of the Discretionary Trust meet every 12 months after Alan's death, and each time decide to let Lena continue to live in the house and to keep other investments in the Trust as before, and to not pay any money to any of the other beneficiaries. They write to Lena telling her of this decision, and keep written minutes of each (short) meeting.

To keep things simple, all aspects of the estate have exactly the same value when Lena dies 2 years later. Even the IHT threshold is the same (again, to keep things simple).

The Trustees of the Discretionary Trust now distribute the proceeds of the Trust to the children in equal shares. This is entirely IHT-Free and is (after the sale of the house and settlement of the charge) £285,000.

They also distribute the balance of Alan's Estate – the £65,000 in the Building Society – to the children, but this carries IHT at 40% - i.e. £26,000.

The Executors of Lena's estate distribute it to the children in equal shares. Her Estate is worth £450,000:- The house at £250,000 plus her other assets of £200,000. The first £285,000 is free of IHT, but the rest (£165,000) is subject to IHT at 40% - i.e. £66,000.

This gives a total IHT Bill of £92,000. If Alan and Lena had not made a NRB Discretionary Trust Will, it would have been £206,000 – a saving of £114,000 (40% x the nil-rate band of £285,000).

### 9.1.2. A 'Nil Rate Band with Absolute Interest' Will – Discretionary Trust funded by cash

Tim and Lynette own a house valued at £700,000 and have £600,000 in cash and investments - a total joint estate of £1,300,000. They make a '*Nil Rate Band – Absolute Interest in Residue*' Discretionary Trust Will.

They leave no legacies, and specify that their children are to inherit the eventual estate (and, specifying *more detail*, that their children's children are to inherit the share of any child that dies before them).

Finally, after making the Will (but before first death) they ensure that their house is owned as Tenants in Common and that their £600,000 of other investments is split equally between them.

Tim dies first, and the Will is quickly given a Grant of Probate.

The Executors decide that Lynette has enough money (£300,000) to live on, so they fund the £285,000 (for that is the IHT threshold at the time) Discretionary Trust entirely from the cash and investments from Tim's Estate.

Lynette receives Tim's 50% share of the house, and the balance of his cash/investments (£300,000 - £285,000 = £15,000).

She decides to move home because the house is far too big for her to live in on her own.

As she owns 100% of the home, and there is no charge on it, she receives the entire £700,000 sale proceeds, giving her an extra £300,000 in cash when she buys a new home for just £400,000.

She now has £615,000 to live on, plus her own home valued at £400,000.

When she dies (unfortunately) shortly after, her estate is therefore valued at £1,015,000.

The Trustees of the Discretionary Trust now distribute the proceeds of the Trust (£285,000) to the children in equal shares. This is entirely IHT-Free.

The Executors of Lynette's estate pay it to the children, and again the first £285,000 is IHT-free. The balance (£730,000) attracts IHT at 40% - i.e. a bill of £292,000.

If they had not made NRB Discretionary Trust Wills, this bill would have been £114,000 higher – i.e. £406,000

### 9.1.3. A 'Nil Rate Band with Absolute Interest' Will – Spouse moves to smaller home

David and Julie own a home valued at £400,000 (which they own as Tenants in Common) and have £300,000 in other assets shared equally between them.

They make a '*Nil Rate Band – Absolute Interest in Residue*' Discretionary Trust Will.

They leave no legacies, and specify that their children are to inherit the eventual estate (and, specifying *more detail*, that their children's children are to inherit the share of any child that dies before them).

Julie dies first.

Upon obtaining the Grant of Probate, but before distributing Julie's share of the house to David, the Executors put a 'charge' on Julie's share of the home for £200,000 and make up the rest of the £285,000 (for that is the IHT threshold at the time) Discretionary Trust fund from some of Julie's £150,000 in other assets.

David then receives 100% ownership of the home, plus the balance of Julie's other assets (£65,000) – leaving him with total 'other' assets of £215,000.

David then decides that he wants to move to a smaller home.

When he sells the marital home, he must first settle the £200,000 'charge' placed on it – leaving him with £200,000 from the sale proceeds – i.e. he now has total assets of £415,000.

As Julie's Estate now has no interest in the home or its sale proceeds whatsoever, it can purchase no new share in – and no new 'charge' can be placed on - any new home: David must fund the new home himself.

He decides to buy himself a flat for £230,000, leaving him with £185,000 in 'other' assets (cash, investments, etc.). He decides this is OK for him, as he is still working.

**So, the surviving spouse has been able to move home** but he has not been able to use any of the 'other 50%' of the marital home's value to fund the new property. He has only been able to use 'his 50%'.

Assuming that all valuations (and the IHT threshold) are unchanged when David dies, the children will receive the Discretionary Trust (£285,000) IHT-free plus David's estate of £415,000 – of which the first £285,000 is IHT-free, leaving them with a total IHT Bill of just £52,000 (compared with the £166,000 IHT Bill they'd have had to pay if NRB Discretionary Trust Wills had not been made).

#### 9.1.4. A 'Nil Rate Band with Absolute Interest' Will – Spouse wants new home of same size

Eric and Lisa own a home valued at £400,000 (which they own as Tenants in Common) and have £300,000 in other assets shared equally between them.

They make a '*Nil Rate Band – Absolute Interest in Residue*' Discretionary Trust Will.

They leave no legacies, and specify that their children are to inherit the eventual estate (and, specifying *more detail*, that their children's children are to inherit the share of any child that dies before them).

Eric dies first.

Upon obtaining the Grant of Probate, but before distributing Eric's share of the house to Lisa, the Executors put a 'charge' on Eric's share of the home for £200,000 and make up the rest of the £285,000 (for that is the IHT threshold at the time) Discretionary Trust fund from some of Eric's £150,000 in other assets.

Lisa then receives 100% ownership of the home, plus the balance of Eric's other assets (£65,000) – leaving her with total 'other' assets of £215,000.

Lisa then decides that she wants to move to a home of similar size but nearer the children.

When she sells the marital home, she must first settle the £200,000 'charge' placed on it – leaving her with £200,000 from the sale proceeds – i.e. she now has total assets of £415,000.

Lisa doesn't work, so if she buys another home for £400,000 she'll only have £15,000 left to live on.

She decides that £15,000 – or any similar amount of money – simply isn't enough. **She will therefore have to stay where she is or 'trade down' to a much smaller home.**

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

(Note: - It is important that all of Appendix 5 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 [£250,000].
- (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 [£250,000].
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]

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

(Note: - It is important that all of Appendix 5 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 [£250,000].
- (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 [£250,000] 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 [£250,000] 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]

## 12. APPENDIX 3 – Sample Severance Letter

Below is a sample Severance Letter that can be used to ensure that you own assets such as bank accounts as 'tenants in common'.

If you want to own your home (or some other property) as tenants in common, you will need to use the 'Tenants in Common' (also known as 'Sever a Joint Tenancy') product available at our website.

From: [Name 1]

of [Address]

To [Name 2]

of [Address of recipient]

The Asset: [e.g. BarWest Bank Account Number 12345678]

### Notice

I, [Name 1], now give you notice terminating with immediate effect our joint tenancy in equity of the above Asset so that the it will be held by us in equity as tenants in common in:-

(Examples) [the following shares, namely 30% held for you and 70% held for me] [Equal shares] [shares yet to be decided]

I REQUEST you to acknowledge receipt of this notice by signing and returning the Receipt of Notice below.

DATED this dd day of Mmm YYYY

Signed ..... [Name 1]

-----

### Receipt of Notice

I, [Name 2] now acknowledge receipt of the notice of which this is a copy.

I [do accept] [do not accept] [make no comment on] the apportionment of the shares in the Asset described above. I understand that the joint tenancy has been severed.

DATED this dd day of Mmm YYYY

Signed ..... [Name 2]

## 13. APPENDIX 4 – A Sample Trust Deed

Note that a document such as this is **only** required when setting up any Discretionary Trusts resulting from the execution of the **2 Year Discretionary Trust Will** - after the first death. The Trusts required by the NRB Discretionary Trust Wills are automatically set up in the Wills themselves.

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.

### **[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. OBJECTS**

The objects of the Trust are [insert 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 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)(iv) 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 5 - An explanation of the Debt and Charge Schemes

### 14.1.1. The Debt Scheme

The wording in the NRB Discretionary Trust Wills 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 Legacy is made up by an 'IOU' from the surviving spouse. 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 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 Legacy.

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 £250,000 charge were placed on it, then it could not be sold without the £250,000 being paid off first.

When the surviving spouse 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 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**. 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 should not be an Executor for the NRB type of Will).

A problem may therefore occur if the surviving spouse 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. However, if he/she then moves home, **the surviving spouse** 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. 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 much less money for the replacement property.

A way round this problem – the surviving spouse 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 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 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 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 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.