PREFACE

Trust drafting is a professional skill. Trust drafting needs trust law, succession law, a considerable amount of tax law (and time and energy to keep up to date); some property law; and a dash of insolvency and family law. That is not all. Many laymen's wishes are unformulated beyond a general desire to put their affairs in order; conversely, some clients have firm ideas as to the disposition of their property which are far from suited to their circumstances. To deal with this calls for empathy and an ability to communicate.

The aim of this work is to aid the drafter by discussing all the issues which arise in drafting settlements and will trusts, and to provide precedents.

The precedents are accompanied with an explanation of why the text is there and the choices that have to be made. The explanation is of the essence; the adoption of a precedent without understanding it is a recipe for trouble.[1] The precedents in this book adopt a drafting style which reads simply and naturally.

We also discuss many standard forms and questions which the reader of settlements in common use will often meet. This book will also serve as a guide to the interpretation of trust documentation. Obfuscatory formulae, which spring so lightly from the pen of the experienced practitioner, will baffle the less experienced. Here is some guidance for those who wish to understand their origin, meaning and effect, if any.

Although this book contains many precedents, WE hope to persuade the reader to regard standard drafts with an independent eye; as a suggestion and not a solution. The solicitor does not serve their client well if they produce for execution any standard draft without consideration of individual circumstances.

It is unusual for a single work to discuss both settlements and will trusts. These topics are usually considered in isolation. More care is normally lavished on lifetime settlements than will trusts; this can be measured by the prolixity of a typical settlement, and the brevity of a typical will. But there are few differences of principle between them. If the will drafter took as much care as the trust drafter, then wills (if longer) would be better documents, and beneficiaries better provided for.

This is a practical book but it tries to address the hard questions which do arise in practice. Topics of trust and tax law are discussed so far as they impinge upon trust drafting. General questions of tax and tax planning are not developed here; the topic of

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1 See 32.3 (Use and misuse of precedents).

drafting requires a book to itself. Drafting suffers if it is regarded as a mere afterthought to the more serious matter of tax planning. But some of the questions which arise are so interesting that this policy is adopted with regret, with the occasional lapse, and only by the exercise of considerable restraint.

Standard trust drafts need regular review, and so do books on the subject.[2] The author owes to their readers an obligation to keep this work up to date.

We continue to apply to the text the test of practice at the chancery bar. The experience so gained enables us in each new edition to explain some matters a little more clearly, and investigate some problems a little more deeply. The task can never be accomplished to an author's total satisfaction.

The law has not stood still since the previous edition. The Privy Council has given trusts practitioners plenty to consider in *Grand View Private Trust Co v Wong* [2022] UKPC 47 (on the scope and legitimate exercise of trustees' powers) and *Equity Trust (Jersey) Ltd v Halabi* [2022] UKPC 36 (on trustees' indemnities). There has also been a spate of cases on protectors' powers of consent, a line of judgments culminating - for the moment at least - in *Re The Piedmont Trust* [2021] JRC248. The weight of judicial opinion is currently in favour of treating a protector's consent power not as a power to bless or as a power of review but rather as a (significantly more robust) power of veto; the editors entirely endorse that approach. Chapter 7 digests and incorporates the implications of those decisions. Readers considering the execution of documents will also want to bear in mind *Bioconstruct GmbH v Winspear* [2020] EWHC 7 (QB) (on the use of pre-signed signature pages in deeds) and the Wills Act 1837 (Electronic Communications) (Amendment) (Coronavirus) Order 2020 (which allows for remote attestation of wills until 31 January 2024). The text has also been updated to refer to the most recent Law Society and SRA guidance.

We remain indebted to friends and readers who have commented and continue to comment on the text. Responsibility for errors is, of course, our own. As to responsibility for errors in a document which draws on this book, see paragraph 32.3 (Use and misuse of precedents). We have enjoyed writing this book and hope our readers enjoy reading it.

This book attempts to state the law for 2023/24.

This book is one of a series covering Wills and Trusts in different jurisdictions, which include: Australia, BVI, Canada, Cayman Islands, Channel Islands, Hong Kong, New Zealand, Northern Ireland, Singapore and Scotland. Any reader who is a trust practitioner in Bahrain, Cyprus, Dubai, India, Ireland, Mauritius, South Africa or any

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2 "It is very strange that a clause should have been inserted in 1936 in this form. No doubt it was taken from some older and obsolescent precedent in a book of conveyancing precedents." (*Re Brassey* [1955] 1 All ER 577; the drafter had overlooked the Statute of Westminster 1931 in a trustee investment clause.)

other trust jurisdiction, who is sympathetic to the approach of this book, and interested in such a project, should please contact James Kessler.

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Trusts Discussion Forum

Readers are invited to join the Trusts Discussion Forum, an internet discussion group dedicated to discussion of trust and will drafting and related private client topics, founded by James Kessler and now run by STEP.

To subscribe visit *www.trustsdiscussionforum.co.uk*
There is no charge.

A note to the lay reader

Our advice is not to draft your own trust or will, but find a competent solicitor to advise you. Self-help guides extol “the benefit of bypassing expensive lawyers”; but the bypass may prove the more expensive route in the long run.

This book is not intended as a self-help guide, and is addressed to professional practitioners, but it is readable for a lay person. If you wish to research this subject in depth, and so take more control of your own legal affairs, read on.

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Chapter 1

THE RAID ON TRUSTS

1.1 Policy of Finance Act 2006

The FA 2006 made revolutionary changes to the IHT treatment of trusts. Until 2006, the basic principle of tax policy had been that the tax system should not discriminate against trusts:

> The government recognises the important role trusts play in society and has said that as far as possible it wants a tax system for trusts that does not provide artificial incentives to set up a trust, but equally avoids artificial obstacles to the use of trusts where their use would bring significant non-tax benefits.[1]

In 2006 this policy was reversed. The policy now is to impose additional charges on trusts, other than very limited, privileged trusts, with the result that:

(1) In most cases trusts will not be created. In particular a lifetime gift to another individual is a PET: a gift to a trust is generally chargeable.

(2) In most cases, where privileged trusts have been created, they will be wound up relatively quickly:

   (a) IPDI trusts will generally be wound up on the death of the life tenant. In particular, a gift to another individual may qualify for the IHT spouse exemption: the termination of an IPDI will not usually do so unless the trust then comes to an end.

   (b) Bereaved Minors trusts and Age 18-to-25 trusts will be wound up when the beneficiaries reach 18 or 25.

1.2 Misconceptions

More striking than the revolutionary nature of these changes was the dishonesty used in their presentation. Fundamental misconceptions (or, as a less charitable commentator might say, lies) were propounded by those pushing through the new law, including the following:

(1) The changes "aligned" the formerly "privileged" tax treatment of IP and accumulation and maintenance ("A&M") trusts with the "normal" "mainstream" tax regime for discretionary trusts.[2] In fact, as any practitioner

1 HMRC, "Modernising the Tax System for Trusts" (2004).
2 HC Official Report, Standing Committee Debates, F(No.2) Bill 2006, 13 June 2006, cols 569, 570

knew, substantial discretionary trusts, i.e. those paying any substantial IHT, were highly exceptional.[3]

(2) The changes would only raise £15 million per year.

(3) Only a very small number of very rich people, quantified as 20,000, would be affected.

(4) The new rules had been supported by professional bodies in prior consultation.

(5) The new rules offer a “modicum of simplification”.[4]

To anyone knowledgeable in practice in this area, these statements were absurd and scarcely deserve refutation. But the formal evidence of refutation was in due course assembled, with sufficient success to lead the Select Committee on Treasury to conclude:

> With respect to the new rules on the tax treatment of accumulation and maintenance and interest in possession trusts, we are concerned that estimates of the expected numbers of affected trusts vary so widely between Government and practitioners. If the Government’s estimate, that the new rules will affect “only a very small number of very wealthy people” is correct, then the Government needs to provide much more detailed information about its estimates, in order to allay taxpayer and industry concerns. We are concerned that a legitimate measure designed to reduce tax avoidance may penalise trusts established to protect family members and consider that the issue merits further consideration. We recommend that the Government provide detailed information about how it has arrived at its estimate that the new rules on the tax treatment of certain trusts will affect only “a minority of a minority” of 100,000 discretionary trusts. This information should be provided prior to consideration in Committee of the House of Commons of Clause 57 of, and Schedule 20 to, the Finance Bill.[5]

No such evidence was ever produced (for the good reason that it did not exist).

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and 633 (Dawn Primarolo).

3 There was a good reason for this. The discretionary trust regime was designed in 1982 to impose on discretionary trusts a burden roughly equal to the burden of *capital transfer tax* on non-settled property. It achieved that. In 1986, CTT was then replaced by the much lighter IHT regime, under which tax was no longer charged on lifetime gifts. There is no obvious solution as to how to deal with discretionary trusts under an IHT regime. The solution adopted was to retain the old CTT rules, which then imposed a burden on discretionary trusts rather greater than that which applied to non-settled property, but allowing the alternative route of IP trusts (and A&M trusts) which were, broadly, treated in the same way as non-settled property. Thus the charges on discretionary trusts had something of the nature of anti-avoidance provisions. Although the tax charge could be unduly high, that did not matter at all because nobody needed to pay it, and very few actually did.

4 HC Official Report, Standing Committee Debate, F(No.2) Bill 2006, 13 June 2006, col.605 (Dawn Primarolo). Further consequential amendments in ss.52 and 53 F(No.1)A 2010 have in fact rendered the IHT treatment of trusts incomprehensible even to trust lawyers.

5 Select Committee on Treasury, Fourth Report of Session 2005–6, HC Paper 994, para.109 *http://www.publications.parliament.uk/pa/cm200506/cmselect/cmtreasy/994/99407.htm*.

1.3 Policy issues

Trusts offer important protection for beneficiaries as the courts have often accepted:

> Speaking in general terms, it is most important that young children should be reasonably advanced in a career and settled in life before they are in receipt of an income sufficient to make them independent of the need to work.[6]

Research by the Financial Services Authority shows (if proof was needed) that 18-year-olds are much less financially capable than 25-year-olds.[7]

Of course it is not just young persons who may be at risk:

> People with mania sometimes believe they are rich and go on spending sprees and people with depression commonly spend money in an effort to make themselves feel better. Conversely, people with depressive symptoms may withdraw and ignore official letters, appointments and bills often leading to mounting debt.[8]

Until 2006 the financial protection which trusts can confer had been available to everyone; it was one of the benefits of living in a common law jurisdiction.[9] The attack on trusts is a reform which in the long term (if it remains) has profound social implications. But the dishonest manner in which the changes were introduced effectively prevented any serious debate on the policy issues from taking place.

Does it now matter? Readers may think it pointless to cry "foul" in a game which has no referee, and whose result has now long been declared. But the story needs to be recorded, for several reasons.

The UK tax system is notorious for its instability[10] and tax law which is not founded on honest debate and a modicum of consensus is not likely to prove stable.

The relationship between the individual and HMRC has in the past depended mainly on willing compliance. A system based substantially or entirely on forced compliance could be created, and indeed we are presently moving in that direction, but no-one has ever openly advocated that. HMRC rightly protest when they are cheated:

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6 *Re Holt* [1969] 100 at 122. Another example: *Re Gates* [2003] 3 ITELR 113, *www.jerseylaw.je*: "It is not in our judgment generally in the interests of young persons to come into possession of large sums of money which might discourage them from achieving qualifications and from leading settled and industrious lives to the benefit of themselves and to the community."

7 The report, "Levels of Financial Capability in the UK" concluded that 18-year-olds have a factor score of just 27 out of 100, while those aged 20 to 29 have a higher factor score of 40. See *https://www.fca.org.uk/publication/research/fsa-crpr47.pdf.* Dawn Primarolo's response was "I, for one, have more faith in our young people". During this *soi disant* debate, members of the Standing Committee passed the time reading "Private Eye": HC Official Report, Standing Committee Debate, F(No.2) Bill 2006, 13 June 2006, col.710.

8 Quotation from website of "Rethink Mental Illness" (the Schizophrenia charity). Persons with mania or depression will often not qualify as "disabled persons" in the IHT sense.

9 Or a mixed-law system, such as Scotland, which includes a law of trusts.

10 Kessler, *Taxation of Non-Residents and Foreign Domiciliaries*, 21st ed., (2022-23), para.1.11 (The promise of stability) online version *www.foreigndomiciliaries.co.uk*.

> HMRC expects professionals such as accountants who act on behalf of taxpayers to be entirely professional and honest. [The convicted defendant] has abused the trust of his clients and has failed in his legal and professional responsibilities to HMRC. He has cheated family, his friends, clients and all honest taxpayers.[11]

But honesty is a two-way street. Taxpayers should also expect HMRC to be "entirely professional and honest". In this matter HMRC abused the trust of the public (which generally assumed that HMRC press releases are reliable). Settlors and beneficiaries of A&M trusts have been cheated. They entered into arrangements which have never been regarded as tax avoidance and found themselves being penalised for having done so. The unfairness of some of the 2006 rules, combined with its dishonest presentation, corrodes goodwill upon which HMRC also needs to rely.

Most importantly of all, the needs of beneficiaries of trusts, especially those most vulnerable, require "a tax system for trusts that avoids artificial obstacles to the use of trusts where their use would bring significant non-tax benefits".[12]

1.4 Trusts after the FA 2006

Will trusts will still be used: see Chapter 17 (Types of Will Trusts). The usual situations in which lifetime trusts will be used by UK domiciliaries under the current law are as follows:

(1) If the value of the trust property falls within the nil rate band.[13]

(2) If the trust property qualifies for 100% business or agricultural property relief.

These are of course significant categories.

In all other cases, the 20% IHT charge will rule out lifetime gifts to trusts. Individuals who wish to benefit their family should:

(1) Make absolute gifts, or gifts to bare trusts,[14] which will be PETs.

(2) Make interest-free (or if desired, index-linked) loans.[15]

(3) In the case of companies not qualifying for 100% BPR, deferred share arrangements should be considered (this topic is not discussed in this book).

A sensible course is to do nothing for now and wait for the fiscal climate to improve.

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11 See Tax Bulletin 83 (2006).

12 See fn.1.

13 Spouses may each make gifts to the same trust, as that trust will be treated as two separate trusts for IHT purposes: s.44(2) IHTA 1984.

14 See Chapter 23 (Bare trusts).

15 If desired:
(1) The loan (say, to a child) could be repayable only on the death of the borrower.
(2) The individual could give away the benefit of the loan to grandchildren.

Experience suggests that the pendulum swings to and fro, just as old Labour's capital transfer tax only lasted from 1974 to 1986. The 2006 IHT regime, founded on misconceptions and lies, is unlikely to endure. Sensible advice for a client not in old age would be to wait and see.[16]

1.5 The position today

The above was written in 2006. Looking back after almost two decades, practitioners' frustration, irritation or fury (depending on expectations and temperaments) at the dishonest presentation of the 2006 reforms may have faded over time to weary cynicism, and to the new generation this story is of no more than historical interest. But one might see it in the context of a broader loss of respect for truth in political discourse, foreshadowing more egregious examples relating to Brexit, Donald Trump, and Boris Johnson's premiership.

Subsequent changes to the inheritance taxation of trusts in the period 2006– 2023 have been minor: tinkering with the rules for disabled beneficiaries and discretionary trusts, and a freezing of the Nil Rate Bands, amounting to a substantial reduction in their real value.

The fundamental problem with the current inheritance taxation of trusts is that:

(1) it *is* an effective method of taxing wealth transfers to trusts or via trusts, but

(2) it is *not* an effective method of taxing wealth transfers otherwise.[17]

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16 The life expectancy of an individual aged 60 is 22 years (male) and 25 years (female). See *http://www.ons.gov.uk*.

17 See Kessler, "The Quest for Fair Inheritance Taxation of Trusts" (2012) *https://www.kessler.co.uk/wp-content/uploads/2014/08/Kessler-The-Quest-for-Fair-Inheritance-Taxation-of-Trusts.pdf.*