



The Law Society

Vulnerable Beneficiaries

Response of the Law Society of England and Wales

February 2013



Vulnerable Beneficiaries

Comments of Tax Law Committee of the Law Society of England & Wales

Introduction

1. The Law Society is the representative body for over 166,000 solicitors in England and Wales. It negotiates on behalf of the profession, and lobbies regulators, Government and others.
2. This response has been prepared on behalf of the Society by members of the Tax Law Committee, which is made up of senior and specialist tax lawyers practising in this field.
3. The Law Society welcomes this opportunity to comment on the draft clauses relating to vulnerable beneficiaries.

Comments

4. We are greatly concerned about the proposal to delete the “section 32 disregard” provisions (as defined below) contained in the draft Finance Bill. This proposal will have a wide ranging and adverse effect on many Wills, past and future and we would urge HMRC to reconsider the proposal.
5. Paragraph 2(4) of the new Schedule proposes the omission of section 71A(4) IHTA 1984, the provision which disregards:
 - The trustees' statutory power of advancement conferred by section 32 Trustee Act 1925;
 - That statutory power of advancement but as modified so it is less restrictive than the statutory power; and
 - Powers to the like effect (together 'the section 32 disregard')in the context of trusts for bereaved minors ('BMT'). Paragraph 3(4) does likewise in the context of trusts for 18-to-25 year olds ('18-25 trusts'), by proposing the omission of the section 32 disregard from section 71D(7) IHTA.
6. Section 71A requires that the bereaved minor becomes absolutely entitled to the settled property at 18, and, while he is under 18, if any of the settled property is applied for the benefit of a beneficiary, it is applied for the benefit of the bereaved minor (section 71A(3)(a)(i) and (b)). Similar provisions (with the necessary references to 25) are in section 71D in the context of 18-to-25 trusts. The draft provisions for Finance Bill 2013 do not propose any change to these capital conditions.
7. These proposals did not receive great attention at the consultation stage as the Consultation Document was concerned mainly with the appropriate targeting of tax benefits following the introduction of the Welfare Reform Act 2012 and dealing with inconsistencies across the different taxes in this context (see paragraphs 2.1 and 2.2 of the Consultation Document issued in August 2012).

8. It was specifically stated in paragraph 2.8 of the Consultation Document that “there are no plans currently to adjust the arrangements regarding orphaned minors”.
9. While orphaned minors are mentioned in a footnote in section 5 concerning the application of capital, that section is mainly concerned with ensuring that the vulnerable beneficiary benefits from every application of the capital and that the capital is not used, for example, to make gifts to others.
10. In the Summary of Responses document, the comments on the application of capital were directed to enabling the trust to benefit others e.g. by making gifts to close family members. Neither the Consultation nor the Summary of Responses were focused on bereaved minors trusts and age 18-25 trusts and the importance of section 32 and similar powers in this context.
11. We assume that the section 32 disregard was included to address concerns that the ability under section 32 to advance capital to someone other than the bereaved minor (in the case of BMTs) or ‘B’ (in the case of 18-to-25 trusts) might jeopardise the beneficial tax treatment under the relevant regime. However guidance published by STEP on 29 June 2007 (with which HMRC are said to have agreed) suggests that HMRC did not see section 32 as incompatible with the BMT/18-to-25 regimes. Many testators will have drawn up wills in reliance on this guidance.
12. This must be right. Both section 71A and section 71D provide that any application of capital during the lifetime of the beneficiary must be for the benefit of the beneficiary. By definition, section 32 and equivalent powers can be exercised only for the “benefit” of the beneficiary in question. The cases have shown that “benefit” is to be interpreted widely which means that an exercise of the power can result in some incidental benefit to other people, but only where this incidental benefit to others is provided in order to benefit the primary beneficiary. Section 32 and similar powers would not permit the trustees to use capital for the benefit of anyone other than the beneficiary unless the application was for the beneficiary’s own benefit. Further, trustees have a responsibility to see that any advance is used for the purpose stated, for example a payment to the parents to pay the child’s school fees is used to pay those fees rather than pay off the parents’ debts. If the trustees do not do this and the money is used for other purposes then the trustees may have to replace it themselves (Re Pauling’s Settlement Trusts [1964] CH 303).
13. It appears that the proposed omission of the section 32 disregard will not itself exclude section 32 (section 32 Trustee Act 1925 applies to trusts except where otherwise expressly provided) but it appears that HMRC now consider that the existence of a section 32 power (even unamended) will be incompatible with a BMT or 18-to-25 trust and consider that the trust deed will need to exclude the section 32 power, or limit it to circumstances where the bereaved minor or B receives a benefit. Paragraph 5.8 of the Consultation Document says:

‘However, in order to secure that the vulnerable beneficiary benefits from every application of the capital, it will be necessary for the trust deed to deny the trustees’ the general power under section 32, or limit it to circumstances where the vulnerable beneficiary receives a benefit during their lifetime (or other relevant period). Consequently, the current disregard of the statutory powers of advancement is thought to have no lasting purpose and can be safely removed.’

But as pointed out, section 32 **can** only be exercised so as to benefit the vulnerable beneficiary.

14. If HMRC now take the view that a section 32 or similar power is incompatible with a bereaved minor's trust or 18-25 trust and that section 32 must be excluded, the trustees would appear to have no power at all to apply capital for the beneficiary: section 32 is the provision which gives the trustees that ability.
15. In the context of Wills, it is extremely important that the trustees have the flexibility to use capital to benefit the beneficiary in whatever might be the most appropriate way. For example, the Trustees might need to acquire a home for the beneficiary or meet education or maintenance costs for which the income is inadequate. Or there may be other, less tangible benefits. For example, it was accepted in the recent case of *Wright v Gator* [2011] EWHC 2881 (Ch) that it was for the benefit of an orphaned child, who would otherwise have become entitled to a large sum of money at the age of 18, that the statutory trusts arising on intestacy were varied so as to defer the child's entitlement to most of the capital until he attained the age of 25. It was for his benefit that the capital was to be looked after by trustees until he was mature enough to manage the money himself. Trustees will often rely on section 32 powers to confer similar benefits.
16. The section 32 disregard enables trustees of a Will to make similar provision without an expensive and time consuming application to the Court and to deal with capital in other ways which benefit the beneficiary without the need for a court application. If section 32 powers are excluded, it is unclear how trustees could ever use capital for the beneficiary without a court application.
17. We consider, for the reasons set out above, that the section 32 disregard **is** compatible with the requirements for both bereaved minors' trusts and 18-25 trusts, that capital which is used during the beneficiary's lifetime must be used for the benefit of the beneficiary. We would therefore urge HMRC to reconsider the proposed amendments deleting the disregard.
18. HMRC's apparent view that the existence of section 32 powers is incompatible with BMTs and 18-to-25 trusts gives rise to problems in connection with the statutory trusts established on an intestacy which would currently be BMTs (i.e. where funds are held on statutory trusts for the benefit of a bereaved minor under sections 46 and 47(1) AEA 1925). Section 47(1)(ii) AEA 1925 provides that the statutory power of advancement shall apply to the statutory trusts. If it is the case that the statutory power of advancement can exist and be exercised in the context of a trust for a minor established on intestacy, but not in the context of a similar trust arising under a will, this is unfair to those who have had the foresight to make a will. The alternative view, which follows from the current proposals, is that the statutory trusts arising on intestacy can never qualify for the inheritance benefits conferred on BMTs.
19. We also have the following comment on the draft legislation. The proposed amendments are intended to have effect in relation to property transferred into settlement on or after 8 April 2013, but wills which contain BMT and 18-to-25 trusts but which have not taken effect (as the testator has not yet died) will be affected as property will be transferred into the BMT or 18-to-25 trust only after the testator dies which could be after 8 April 2013. The effect will be that the many testators who wish their funds to enter the tax advantaged BMT and 18-to-25 regimes will have to go to rewrite their wills. We consider that the proposed changes should not in any event apply to wills written before 8 April 2013, irrespective of when they take effect.