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Trustees and Trust Advisers

Are YOU at risk of a complaint?

How many Trusts do you act for, where this situation applies?

The details of this case study are based on an actual and recent situation; the names have been changed for confidentiality

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The Trust's situation

- In 2010, I was requested by the Trustees of the Mr Jones Will Trust to provide advice in respect of the capital now in the Trust, of approximately £1,150,000
- Mr Jones, as is very common today, had been divorced and remarried. He had 2 adult children from his first marriage, Tom and Dick. His second wife, Ann, had two adult children from her first marriage, Harriet and Gemma.
- Ann was now independently wealthy from assets passed to her from the marriage, with an estate value significantly in excess of the nil rate band.
- The Will Trust was a Life Interest Trust with Ann being the life tenant and Mr Jones' children Tom and Dick being the remaindermen.
- The Trustees, under the Trustee Act 2000, needed to balance the interests of both the life tenant and the remaindermen. They also noted that Ann did not enjoy the best of health and believe her life expectancy is not good

Initial Thoughts:

- My initial thoughts were to consider a traditional approach of investing the capital in a well balanced and diversified collectives portfolio with a below average risk profile to reflect the Trustees' Cautious attitude to risk, particularly in view of the potentially limited time horizon
- I explained that a realistic total return expectation would be 5% to 6% per annum, with a natural income yield of approximately 2.5% to 3% available to the life tenant.
- The respective interests would be balanced as follows:

Total investment approximately	£1,150,000
Life tenant income	2.5% to 3%
Remaindermen capital growth	2.5% to 3%
Life Tenant's income approx	£28,750 to £34,500 pa

This at first sight seems to meet all the Trustees' objectives and balances the interests of both beneficiaries fairly.

HOWEVER, on closer investigation, the remaindermen will suffer significantly upon Ann's death. As the value of the Trust will be aggregated with her own estate for Inheritance Tax, the Trustees will face an Inheritance Tax liability on Ann's death of approximately £395,000.

This will reduce the remaindermen's inheritance as follows:

Trust Capital	£1,150,000
Inheritance Tax payable	£395,000
Net Estate	£765,000

The question here is, is this fair to the remaindermen and have the <u>Trustees</u> considered everything possible to protect their capital?

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Alternative Approach

I therefore suggested an alternative strategy to the Trustees to consider, as follows:

- I explained that they could instead invest the capital across a range of investments qualifying for Business Property Relief (BPR).
- The benefit of this would be that once held for two years, these investments would be exempt of IHT, protecting the remaindermen's capital and saving £395,000 Inheritance Tax.
- If the life tenant did not survive two years, then the remaindermen would have been no worse off.
- This strategy could continue to pay an income to the life tenant of £30,000 pa

The Trustees were understandably nervous about a strategy they were less familiar with and concerned, as they had heard BPR investments can be very high risk and volatile.

- I explained that there are some very volatile BPR investments, which we would not recommend here, and even if we were considering these the investment could fall in value by up to 40% and the remaindermen would be no worse off at the end of year 2.
- I reassured the Trustees that we were not looking at this type of plan but at BPR investments with the lowest volatility, where the risk has been mitigated as far as possible and where the focus is on capital preservation.
- I completed a report considering both the traditional approach and the BPR strategy side by side and this was presented to the Trustees and all the beneficiaries.

The Current Position:

The Trustees implemented my recommendations for the BPR strategy in December 2010. I am pleased to say the life tenant has survived and all of the investments reached their two year qualifying period in mid January 2013.

Original Investment, December 2010	£1,150,000
Value January 2013	£1,153,041
Income paid out to date	£76,250 (£38,125 pa)
Total return approximately	3.39% pa
Inheritance Tax saved	£395,000

The Result:

- An investment which has preserved its capital value and paid out (and continues to pay out) the income to the life tenant
- An uplift in value paid to remaindermen after 2 years of £395,000
- Two very pleased remaindermen and a happy life tenant.

Would the remaindermen be happy if we had not implemented this strategy?

Who might they look to blame/seek compensation from, if this had not been properly considered?

If you are a Trustee or act for a similar Trust, please contact me to discuss whether this type of strategy would be appropriate for your Trust
on

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