GUIDE TO WILLS

Introduction

This guide sets out in a simple and straightforward manner the options available to individuals in their overall estate planning, ie: lifetime inheritance tax planning and Will planning. Having read this guide the reader will be aware both of the choices before him and also of the matters which require thought. It is not intended as a do-it-yourself manual but rather to put the reader in the best position to cover the subject with his financial adviser and solicitor and arrive at the most appropriate approach for him. It is very important when drawing up a Will that account is taken of any lifetime planning that is or has been undertaken. To help this, checklists are included to ensure that, as far as is possible, no important areas are overlooked.

In many family situations it is often wished to build in flexibility, eg: to allow for future unborn grandchildren, and/or control, etc. It may be wished, for example, to provide children with education funding but not to allow access to capital until some time later. In these cases the use of trusts can often provide the degrees of control, security and flexibility required. In most people's minds, trusts are thought to be confusing, complex and costly. However, this does not have to be the case. Modern trusts, whilst being extremely flexible, can provide significant financial and taxation benefits in a simple, straightforward and inexpensive manner. A section is therefore included on trusts and their practical benefits and uses, which can apply equally for lifetime and Will planning.

During their lifetime many people acquire different life assurance policies and pension plans. Simple planning can ensure that the benefits from such policies and plans are received in the most tax efficient manner; this area is also covered in the guide.

As with all financial planning it is necessary to be aware of the main legal and taxation rules which apply. The main rules are therefore set out, in an easy to understand manner, to enable the reader to fit their thinking into an overall framework, relying on their financial adviser and solicitor to take care of the necessary detail.

Any reference to spouse includes reference to civil partner and any reference to marriage includes civil partnership.

Part I – Making a Will

Why make a Will?

1. Without a Will, your estate will be distributed on your death under rules laid down in the Administration of Estates Act 1925. These are known as the intestacy rules. Subject to rules concerning joint property (see below), if you die leaving a surviving spouse and children then the estate will be distributed as follows:

(a) Your spouse would take the "personal chattels".

(b) Your spouse would receive up to £250,000.

(c) The rest of the estate would be divided into two. One half would be held upon trust for children on them attaining 18. The other half would be held upon trust for the spouse for life (ie: an entitlement to income only from that half) and on the spouse's death would be distributed to the children.

2. Without a Will, a surviving spouse does not necessarily inherit the whole of your estate. If there were no surviving children then a surviving spouse would receive £450,000 and then other relatives would benefit from the remainder in addition to the surviving spouse.

3. In a Will you can choose who will administer your estate (Executors).

4. In a Will you can appoint guardians to look after your minor children (ie: children under the age of 18 years).

5. In a Will you can make gifts to persons who would not benefit under the intestacy rules.

6. Administering an estate can be easier where a Will has been made.

7. Properly drawn up Wills may reduce inheritance tax charges.

8. Directions as to burial or cremation or donation of any part of your body for medical purposes can be made in a Will.

What property passes by Will?

1. All assets you own personally will pass under the terms of the Will. This includes everything from jewellery, cash, furniture and investments to your house..

2. If you own some assets jointly (such as a house owned jointly with your spouse) then whether your half share passes under the Will or not depends

upon whether you own as "joint tenants" or "tenants in common". If you own as tenants in common, then your share passes under your Will (or the intestacy rules). If you own as joint tenants, your half share automatically passes to the survivor irrespective of the terms of the Will (or intestacy rules).

3. Property held in trust does not pass by your Will but according to the terms of the trust.

4. The proceeds of a life assurance policy will pass through your Will unless the policy is held in trust.

5. Lump sums payable under death in service benefits or under pension plans pass according to the rules of the scheme. Some rules provide that the sum passes back into the estate and will therefore pass under your Will. Many schemes give the pension scheme trustees discretion as to who to pay the benefit to and in this case the lump sum does not pass through your Will.

Who can make a Will?

Any person over the age of 18 can make a Will. The only persons under the age of 18 who can make a Will are members of Her Majesty's Forces and even then only in specific circumstances.

To make a Will you have to be of a "sound and disposing mind and memory". This means you have to be capable of understanding the broad effects of the Will.

How should a Will be signed?

The Wills Act 1837 lays down strict rules as to how a Will should be signed if it is to be valid. Merely writing out your wishes and signing them will not be sufficient – such a document is not legally valid and is not effective.

Your solicitor will explain carefully how the Will should be signed and will usually arrange for you to sign the Will in his office to ensure that all formalities are carried out.

Marriage and divorce

If you have made a Will and then marry, the Will is automatically revoked and is invalid.

It is possible for you to make a Will in contemplation of marriage so that the Will is not revoked by that marriage. The Will needs careful drafting to do this. Apart from this, you must remember to make a new Will on marriage.

A divorce does not automatically revoke a Will. However, any appointment of a spouse as an Executor and any gift to a former spouse would not take effect. A Will should therefore be reviewed following a divorce. Merely separating from a spouse does not invalidate a Will which should therefore be reviewed.

If you remarry following the death of a spouse or divorce then existing Will is automatically revoked and is invalid.

The main provisions of the Will

There are seven main provisions you should address when you make your Will:

1. ***Burial/Cremation***

If you have any special wishes as to burial or cremation, these can be included in the Will. Such wishes usually appear at the beginning of the Will so that your Executors are immediately aware of your wishes when you die.

2. ***Appointment of Executors and Trustees***

You will need to consider who is going to administer your estate and, if you are creating trusts in your Will, who will act as Trustees. It is usually convenient to appoint the same persons to act as Executors and Trustees.

You may wish to appoint relatives or friends to act as Executors. Many clients also wish to appoint their professional adviser such as a solicitor or an accountant as an Executor to ensure that the Estate is dealt with by an expert.

It is also possible to appoint one of the leading banks or trust companies as an Executor. The bank's scale of charges can be very much higher than other professionals' fees and you should compare fees before making such an appointment.

You may want to appoint one person to act as Executor, such as your spouse, but to appoint other persons as Executors (for example children) should your spouse die before you.

3. ***Guardians***

You can appoint guardians of minor children in your Will. Such an appointment would normally only take effect after the death of any surviving spouse. You should of course consult your proposed guardians before appointing them, to ensure they are willing to act.

4. ***Legacies***

You may wish to make a number of different types of legacies:

(a) You may wish to leave a pecuniary legacy (eg: £500) to a specific person (eg: a godchild or a charity). You should bear in mind that if that person dies before you, the gift will not take effect and is said to

"lapse". In this case the legacy will pass as part of the residue of your estate.

(b) You may wish to leave a specific item of property to a specific person (eg: "my china tea service"). You should bear in mind that if you no longer own the item at the time of death then the gift will not take effect and is said to "adeem", ie: the person will not receive the specific item.

(c) If you make a gift of mortgage property then the property will pass to the beneficiary subject to the mortgage (ie: the beneficiary will be liable for the mortgage and may then have to sell the property to pay off the mortgage). If this is not the intended result, any gift of a mortgaged property should be stated to be "free of mortgage" so that the mortgage is paid out of the residue of your estate.

(d) If your estate is large enough to attract inheritance tax (see below), then in relation to a legacy you need to decide whether the legatee should pay tax on the gift or whether he should receive it free of tax so that the tax is paid out of the rest of the estate.

Example

If you leave "£500 free of tax to Uncle John" then Uncle John will actually receive £500. If you leave "£500 subject to tax to Uncle John" then if your estate attracts inheritance tax, Uncle John will receive the £500 less the tax on it.

5. ***Gifts of residue***

Having made any specific legacies, you then need to decide where the rest or "residue" of your estate should go.

If you are married and wish to leave the residue of your estate to your spouse then you can either leave the residue to that spouse absolutely or in trust.

If the estate is left to your spouse absolutely, then following your death your spouse will be free to do as she or he pleases with your estate, ie: give it away (including giving it to a new spouse) or spend it. There would be no guarantee that your estate would eventually pass down to your children.

If this is of any concern then the estate can be left in trust for the surviving spouse, so that he or she receives the income from your estate for his or her lifetime, with perhaps the Trustees of your estate having discretion to advance capital to the surviving spouse. Your Will would then provide where your estate goes following the death of your surviving spouse thus retaining control over the ultimate destination of your estate. Such a trust has no advantages or disadvantages for inheritance tax. The type of trust used would normally be an "interest in possession trust" (see Part II "What is a trust?").

You will probably need to make some provision in your Will as to where your estate goes if your spouse dies before you. In this case, if you are leaving your estate to your children, you need to decide at what age your children should become entitled to the capital of your estate, if they are not to be immediately entitled on your death. If you specify an age for capital, you need to decide at what age they should become entitled to the income, if earlier. For inheritance tax reasons it is usually beneficial to provide that children become entitled to the capital of your estate *or* the income from it on or before attaining the age of 25.

6. ***Administrative powers and provisions***

Your Will should also contain a number of administrative powers and provisions to facilitate easier administration of your estate, particularly if your Will establishes trusts.

If you set up a trust for minor children (which is usual) you will need to make sure that Trustees have sufficient powers to invest funds, pay out monies for the children's maintenance or education, or even purchase or enlarge a house for them to live in with their guardians.

Part II - Inheritance Tax and Wills

If your estate exceeds the inheritance tax "nil rate band", of £325,000 (2009/2011), then you may be liable to inheritance tax. The value of an estate over this threshold is charged to inheritance tax at 40%. Even a smaller estate may incur inheritance tax liabilities if you have made substantial gifts seven years prior to your death.

Any part of your estate which passes to a surviving spouse is exempt from tax. However, if you leave all your estate to a surviving spouse then while there will be no tax to pay on your death.

Transferable nil rate bands

<u>The Basics</u>

1. ***What do you mean by a transferable nil rate band?***

A transferable nil rate band arises when one party to a marriage or civil partnership dies and the amount of their estate that is chargeable to Inheritance Tax (IHT) does not use up all of the nil rate band they are entitled to. Where this happens, the unused part can now be transferred to the surviving spouse or civil partner when they die.

2. ***How does that work then?***

Everyone is entitled to a nil rate band for IHT. Assets that pass from one spouse or civil partner to another are exempt from IHT. So if on death, someone leaves everything they own to their spouse or civil partner, it is exempt from IHT and they have not used any part of their nil rate band. That

unused nil rate band can now be transferred to their surviving spouse or civil partner and used in working out the IHT liability on their estate when they die.

3. ***Does it matter when the deaths occurred?***
Yes – this applies where the surviving spouse or civil partner died on or after 9th October 2007. But it does not matter how long before them their spouse or civil partner died. (there are limitations on the potentially transferrable amount if the first spouse died before 1971 in the Capital Transfer Tax & Estate Duty periods – please speak to us if this affects you).

4. ***How much is the nil rate band?***
For 2009/10 and 2010/11 the nil rate band is £325,00.

5. ***So you mean that if I inherited all the assets from my spouse or civil partner, my executors could add that nil rate band to the nil rate band that applies when I die?***
Essentially yes – but it works by looking at proportion of the nil rate band was unused when your spouse or civil partner died and uprating the nil rate band available when you die by that same proportion.

6. ***What do you mean by uprating the nil rate band available by the same proportion?***
The amount to be transferred is worked out by taking the proportion of the nil rate band that was unused on the first death and applying that to the nil rate band available when you die. So if your spouse or civil partner left assets worth £150,000 to your children with everything else to you and the nil rate band on the first death was £300,000; one-half of their nil rate band is unused and is available for transfer. If, when you die, the nil rate band had increased to £325,000, the amount available for transfer would be 50% of £325,000 or £162,500 giving your estate a nil rate band of £325,000 + £162,500, or £487,500 in total.

7. ***What if my spouse or civil partner's estate was only worth £100,000, so that they did not need all of their nil rate band. Is the amount that can be transferred tied to the amount that they actually left to me?***
No - it doesn't matter what the size of first estate was, whatever proportion of the nil rate band is unused may be transferred to you. If you spouse of civil partner's estate was worth only £100,000 and they left everything to you, they will not have used any part of their nil rate band. So 100% of the nil rate band is available for transfer when you die.

8. ***What about any gifts my spouse or civil partner may have made in the 7 years before they died; or any other assets that were chargeable when they died?***
Gifts and any other assets that are chargeable on the first death (say assets in trust or assets owned jointly with a son or daughter) all eat into the nil rate band in the normal way and so reduce the amount that may be available for transfer. (Note: see paragraphs at the end of this Q&A about in impact for Capital Transfer Tax & Estate Duty).

Part III – Subsequent Claims against the Estate

Under the Inheritance (Provision for Family and Dependants) Act 1975 it is possible for certain persons subsequently to make a claim against your estate if you have failed to make reasonable financial provision for them. The persons who can make such a claim include a spouse and also a former spouse. A former spouse cannot however make a claim if she or he has remarried or if the Court barred such a claim on the grant of the divorce. A child can also make a claim as can any person who immediately before your death was being maintained wholly or partly by you. Such a claim would normally have to be made within six months of Grant of Probate of your Will. If there is a possibility of a claim then your Executors will probably defer distributing the bulk of your estate until after this time period has expired.

Altering or changing a Will

Just as there are special formalities to be followed to make a Will, there are similar formalities for changing a Will.

If you wish to make a few changes to your Will, then your solicitor will normally draw up a "Codicil" to your Will which needs to be signed in the same way as a Will. If there are substantial changes it may be easier to make a new Will.
Merely writing over existing provisions in your Will will not be effective and in certain circumstances could have the effect of revoking provisions in your Will.

Part IV – Probate

Following death, the Executors will need to apply for a Grant of Probate of the Will. This is the formal authority from the Court which enables the Executors to have access to the Deceased's assets and deal with them in accordance with the terms of the Will.

The Executors will be required to sign an "Oath" before an independent solicitor under which they confirm they will deal with the estate as the law requires. Depending upon the size of the estate the executors will also be required to complete an Inheritance Tax Return for submission to the Capital Taxes Office.

Any inheritance tax payable on the estate has to be paid at the same time as the application for the Grant of Probate. This can in some cases cause a problem since the executors will be unable to have access to the assets of the estate until after they have obtained the Grant of Probate. In these cases the executors will need to borrow money from a bank to pay the tax which they repay out of assets of the estate once a Grant of Probate has been granted. Alternatively, if there are sufficient funds in the Deceased's bank account, it may be paid directly to HM Revenue & Customs.

Part V – Lasting Powers of Attorney

The use of a Lasting Power of Attorney offers a very easy and inexpensive means of looking after the affairs of persons who have become mentally incapable of managing them themselves. Without a Lasting Power of Attorney in place, then when a person becomes mentally incapable of managing his or her affairs, a Deputy would have to be appointed by the Court of Protection. The powers of a Deputy are limited and authority of the Court is often required before certain actions can be taken; accounts also need to be filed with the Court each year. The Court makes an annual charge.

Under a Lasting Power of Attorney, you can appoint persons who will look after your affairs in the event that you become mentally incapable of managing them yourself. The Lasting Power of Attorney needs to be drawn up in a form prescribed.

Part VI – Deeds of Variation

It is possible, following a person's death, for the beneficiaries of the estate to vary their entitlement. To do this they need to be over the age of 18 and have satisfied all conditions (if any) imposed on the gift to them. It can be quite difficult to carry out a Deed of Variation where assets are left in trust.

The most common use of Deeds of Variation is vary the terms of the Deceased's Will to carry out inheritance tax planning. For inheritance tax purposes, any variation carried out within two years of death is treated as if it were made by the Deceased, eg: to bypass a generation.

Example

Mr Dodds dies leaving £100,000 to his daughter. She has no need of the money and wishes it to pass to her children. Within two years of his death his daughter decides to carry out a Deed of Variation under which she redirects the £100,000 to the children. This is not treated as a lifetime gift by the daughter to the children but as a gift made by Mr Dodds in his Will.

Notification has to be made to the Capital Taxes Office of HM Revenue & Customs within six months of a Deed of Variation being signed.

Of course, you cannot always rely on beneficiaries agreeing to carry out a variation following death. In addition, if there is any concern that beneficiaries could carry out a variation and you wish to prevent them doing so, this could be done by careful Will drafting.

Part VII – Inheritance Tax

Rules and exemptions

Inheritance tax is chargeable on a person's estate at death and also takes into account gifts made within seven years of death. Additionally, transfers above a certain amount into discretionary trusts may attract lifetime inheritance tax at the rate of 20%. Certain transfers are however exempt, ie: free of inheritance tax, most importantly those between spouses.

What is the rate of tax? In 2009/2011 the first £325,000 of a person's chargeable estate (including the gifts made within seven years of death) is free of tax; this is known as the nil rate band, and assets in excess of this are taxable at a rate of 40%.

Example (a)

Husband dies and leaves his house plus £350,000 to his wife; to his children he leaves a further £350,000.

Inheritance tax payable = (£350,000 - £325,000) x 40% = £10,000
ie: only the assets which pass to the children are taxable.

Example (b)

Miss Baker, a spinster, dies and leaves to her nieces and nephews £400,000.

Inheritance tax payable = (£400,000 - £325,000) x 40% = £30,000.

What transfers are exempt? The main exemptions which will be of general interest and use are as follows:

1. ***Spouse exemption***
As already mentioned, transfer between husband and wife are exempt. This applies for transfers made during lifetime or on death. (NB: for transfers to a non-UK domicile spouse the exemption is limited to £55,000).

This exemption applies not only for outright gifts but also where the spouse is given a right to income in a trust; this type of trust is most commonly used in Will planning.

2. ***Annual exemption***
Each year an individual can gift up to £3,000 completely free of inheritance tax: thus a married couple can gift £6,000 in one year. If this exemption is unused in any one fiscal year it can be carried forward but only for one year.

It is worth noting that this is a lifetime exemption and therefore not available on death if unused in that year.

3. ***Normal expenditure out of income***

Gifts made out of income, which are regular and habitual, are exempt so long as they leave the donor with sufficient income to maintain his normal standard of living. There is no monetary limit on this exemption and thus the Inland Revenue are very keen to ensure that it is not abused.

For those with an investment portfolio which is providing a low level of income there may be the opportunity to re-arrange the portfolio to provide higher income, part of which could be gifted under this exemption.

NB: This exemption will not be available where income is being gifted and the individual lives off part of his capital.

4. ***Small gifts exemption***

Gifts up to £250 to any one person in any one year are free of inheritance tax. This exemption cannot be used as part of a larger gift to the donee (ie: the person who receives the gift). This exemption is mainly of use for a grandparent who wishes to make smallish gifts to a number of grandchildren.

For example, gifts of £250 to each of eight grandchildren will enable £2,000 to be transferred free of inheritance tax; this can be repeated every year.

5. ***Gifts in consideration of marriage***

Gifts to the parties of a marriage, which are made before or at the date of a marriage, are exempt up to various limits. These depend upon the relationship of the donor (ie: the person who makes the gift) to the parties of the marriage as follows:

(a)	Parents	£5,000
(b)	Grandparents	£2,500
(c)	Others	£1,000

6. ***Gifts for maintenance of family***

Lifetime gifts for the maintenance, education or training of a child up to the age of 18, or where he ceases to undergo full time education or training, are exempt. Thus, all costs of education of a child are exempt.

Other "family" gifts can be exempt, in particular those for the care or maintenance of a "dependent relative". A dependent relative is any relative of the donor or his spouse who is incapacitated by old age or infirmity for maintaining him/herself and also includes a mother or mother-in-law, whether or not incapacitated.

7. ***Gifts to charities***

Unconditional gifts to charities either during lifetime or on death are exempt.

The exemptions mentioned above are the ones which are most likely to be of use in the common family situation.

Part VIII – Potentially Exempt Transfers, Gifts with a Reservation and Capital Gains Tax

There are two other inheritance tax rules which are very important for lifetime estate planning; these are Potentially Exempt Transfers (known as PETs) and Gifts with Reservation.

Before inheritance tax was introduced in 1986, gifts made in lifetime, above the nil rate band, were subject to Capital Transfer Tax (CTT) at the time they were made. Although the lifetime CTT rates were lower than the death rates, the fact that lifetime tax would become payable on any substantial gifts limited the scope for significant estate planning.

On the other side of the coin it was possible, under CTT, to gift assets outside of one's estate for CTT purposes but still be able to benefit from those assets in the future. This was usually achieved by the use of trusts.

Under inheritance tax two main changes were introduced. The first was Potentially Exempt Transfers which enable certain gifts to be made of unlimited amount (with no lifetime inheritance tax payable) which will be complete free of inheritance tax if the donor lives for seven years. The other was the introduction of the Gift with Reservation rules, which mean that for a transfer to be effective for inheritance tax purposes, the donor cannot be in a position to benefit from the assets he has gifted.

1. ***Potentially Exempt Transfers***

The main transfers which rank as PETs are gifts to:

(a) another individual

(b) certain types of trust:

(i) 18 - 25 trusts
(ii) interest in possession trusts (where one or more beneficiary is entitled to the income of the trust)
(iii) trusts for the disabled.

When a gift ranks as a PET then no inheritance tax is payable when the gift is made and it is completely free of tax if the donor then survives seven years.

If death occurs within seven years then tax may become payable at the death rate but reduced by the following scale (this is known as tapering relief).

Year between gift and death	% of tax payable
3-4	80
4-5	60
5-6	40
6-7	20

A number of important points need to be made:

(a) Tax payable (if any) on the PET is based on the value of the gift at the time it was made; thus any subsequent growth is free of inheritance tax.

(b) The reduction (shown above) is of the tax payable on the gift not of its value. If death occurs within seven years the full value of the gift is still taken into account when calculating the tax on the estate.

(c) In working out the tax on the PET and on the estate, any PETs made within seven years of death are deemed to form the bottom of the estate and will therefore be set against the nil rate band.

This last point can be very important when trying to benefit equally recipients of gifts and beneficiaries under a Will.

Example

Mrs Peters, a widow, has two children, Sandra and Hazel.
Her estate totals £650,000.
There is no available transferable nil rate band.
She makes a gift (a PET) of £325,000 to Sandra.
Two years later she dies, leaving the balance of her estate to Hazel.

The inheritance tax position is as follows:
The PET to Sandra becomes chargeable (because of death within seven years) but no tax is payable since it is equal to the nil rate band.

The £325,000 legacy to Hazel will all be taxable at a rate of 40% (the nil rate band having been used by the PET). Inheritance tax of £130,000 will be payable and Hazel's net inheritance will be £195,000.

This example clearly illustrates the importance of taking a whole view of estate planning and integrating lifetime planning with Will planning.

2. ***Gifts with Reservation***

As already mentioned rules were introduced, when Capital Transfer Tax was changed to inheritance tax, which mean that if a gift is to be effective for inheritance tax purposes then the donor cannot benefit from any of the property gifted. Whilst the Gift with Reservation rules are complicated, their main effect is to put an emphasis on the individual ensuring his own financial security and that of his spouse, both now and in the future, before making gifts.

In the introduction to this section, mention was made that whilst the donor cannot be in a position to benefit in any way from property that is gifted.

3. ***Capital Gains Tax (CGT)***

With the exemption of certain assets, eg: business and agricultural, gifts to individuals and most types of trust can incur a CGT charge at the time of the gift. CGT can be deferred if a gift is made to a discretionary trust. Care should therefore be taken when making gifts either to transfer assets which are not subject to CGT, eg: cash, insurance policies, etc, or alternatively to transfer assets which are carrying little or no gain.

Another relevant point is that any potential CGT liability is wiped out on the death of the owner of the asset; this has to be borne in mind when assessing the advisability of making lifetime gifts.

Part IX – Life Assurance and Pension Policies

1. ***Life Assurance***

There are two main uses for life assurance policies: firstly to provide a sum payable on death, either during a certain number of years (known as a term assurance) or at any time (known as a whole life policy). Secondly, as a savings/investment vehicle to provide a sum of money payable at a date (the maturity date) in the future, in return for regular investment (the premiums) in the meanwhile (these policies are known as endowment or investment plans).

There are many different types of policy often providing a mixture of benefits, including critical illness and disability benefits. It is beyond the scope of this booklet to look at all the different types of policy but there are some very important points concerning inheritance tax planning.

The first, and most important point where the main purpose of the policy is to provide a sum on death, is that when death occurs the sum assured is payable to the owner of the policy or to his estate if he was the life assured. If the sum assured is payable to the estate of the deceased then it will be added to his other assets and will be subject to inheritance tax like any other asset. If all the estate is passing to the surviving spouse then no inheritance tax will be payable at that time (because of the spouse exemption, see above); but obviously this will not be the case for a single person, widow/widower or if significant assets are being left to the children.

In order to avoid the sum assured itself becoming liable to inheritance tax, the policy should be written in a trust or assigned. In this way the sum assured will be payable to the trustees for the benefit of the beneficiaries and will be outside of the estate of the deceased and thus free from inheritance tax. If it is appropriate, the spouse can be included as a beneficiary in the trust and this will provide flexibility on the destination of the sum assured. By the use of a trust or assignment, the need for probate is avoided and thus money can become quickly available at a time when it might be most needed; it is essential that there are additional trustees other than the lives assured.

If a policy is written in trust or assigned the premiums will count as gifts but will probably be covered by either the annual exemption or gifts out of normal expenditure exemption.

Normally, where appropriate, policies should be written in trust at the outset, but policies already in force can be put into trust. In the latter case there will be a gift equal to the open market value of the policy at the time, subject to a minimum of the premiums paid (special rules apply for term assurance policies).

2. ***Pension Policies/Schemes***

Many pension schemes and pension policies provide death benefits if death occurs before retirement. If these benefits are held on discretionary trusts then they will fall outside of the client's estate and be free of inheritance tax. With group pension schemes and many personal pension policies, the benefits will automatically be held on trust, but this is not the case for retirement annuity policies (old style personal pension policies) and some personal pension policies. The client needs to take two steps with regard to this.

Firstly, he should ensure that all his pension death benefits are held on trust. If they are not, then this can be set up now.

Secondly, and very importantly, he should lodge a nomination form with the trustees to tell them how he wishes the benefit to be payable, eg: "50% to my wife, and 25% each to my two children". Whilst this nomination, or expression of wish, is not binding on the trustees, they will in normal circumstances follow it. In the absence of such a nomination, they will typically pay all the benefit to the widow/widower.

For wealthier clients, significant inheritance tax benefits can be achieved by thoughtful use of pension death benefits. For example, if a widow/widower does not have immediate need for the funds they could be paid into a trust thus keeping them outside of the estate, but providing access to the capital if needed.

Part X – What is a Trust?

A trust is a mechanism whereby one or more persons, called trustees, are obliged to look after and deal with assets (the trust property) for the benefit of the beneficiaries. The trust deed, which might be incorporated in a Will, will establish the obligations of the trustees and how they are to benefit the beneficiaries, eg: "pay the income of the trust to my wife during her lifetime and thereafter divide the capital equally between my children".

It is essential to have trusts properly drawn up since they may establish the control of assets for a long time, possibly decades. Also it is important to build in flexibility to allow for changing circumstances in the future.

Why should you use a Trust?

1. ***Family Provision***
   A trust is useful for passing assets out of one person's estate without passing them directly into another person's. They are particularly useful where children are involved or perhaps where there are others who cannot manage their own affairs.

2. ***Uncertainty***
   Often a person will want to make gifts to his family but is not in a position to decide how much each of them should get or it may be that he wants to control what happens to the gift if the donee should die.

3. ***Family Companies***
   Shares in a family company may be of significant value and this value could increase considerably in the future. For example, future plans for a full listing on the Stock Exchange or a flotation on the Alternative Investment Market could result in very substantial capital tax liabilities. At the same time, typically someone who has built up a company over the years will not be keen to pass over voting control, so here again trusts have a useful role.

Who should be Trustees?

As the name implies trustees should be people who the person creating the trust can rely on to carry out his wishes. Usually it is best to have at least two trustees and often a trustee who is independent of the family, such as the solicitor, who will be familiar not only with the family circumstances but also the laws governing trusts.

What are the main types of trust?

1. ***Discretionary Trust***
   A discretionary trust is one where the payment or distribution of income to the beneficiaries is at the discretion of the trustees. No beneficiary has a right to receive the income and so there is no "interest in possession" (see below). In some discretionary trusts, the trustees are permitted to accumulate income and add it to the capital of the trust, whilst in others they have to distribute all income within a reasonable time. The great advantage of discretionary trusts is their flexibility and they are most appropriate where the settlor wishes to benefit a group of individuals – for instance his wife, children and grandchildren – but has not yet decided what shares each should take.

2. ***18 – 25 Trusts***
   This is a special type of discretionary trust in which at the outset all the beneficiaries must be under 25. By the age of 25, one or more of the beneficiaries must at least become entitled to income from the trust. This type of trust is particularly useful for school fees planning and for providing for children (born and unborn) in general.

3. ***Interest in Possession Trust***
One or more of the beneficiaries must have a right to receive the trust income, or would do if there were any. These are most typically used where the settlor wishes the beneficiaries to enjoy the trust income or to have use of the trust property, but would like to defer the age at which they can use or dispose of the trust assets. These are also useful if the settlor wants one person to enjoy the income of the trust fund, perhaps during that person's lifetime, and for the trust assets then to pass outright to someone else, eg: "the income to my widow during her lifetime and thereafter the capital for my children".

4. ***Absolute Trust***
The main feature of an absolute trust is that the beneficiary is absolutely entitled and any income arising is treated as though it were his own for all tax purposes, with the exception of parental settlements. If 18 or over, the beneficiary of an absolute trust can call for the assets in the trust to be transferred to him at any time.

5. ***Taxation of Trusts***
This is a specialist area outside of the scope of this leaflet and you should seek specialist advice.

Part XI – Lifetime Planning

The basic rule of estate planning is to ensure financial security for oneself and one's spouse and thereafter planning can be undertaken.

In the previous sections mention has already been made of making sure that pension death benefits and life assurance policies are held in trust where appropriate; this is straightforward planning not to be ignored.

Basic planning methods

There are essentially four approaches to inheritance tax planning:

(a) reducing the taxable estate

(b) freezing the estate

(c) providing sums payable to beneficiaries free of inheritance tax
(d) investing in assets which attract relief.

A combination of these approaches is usually the most effective:

1. ***Reducing the taxable estate***
This can be achieved by making gifts of capital using the exemptions or as Potentially Exempt Transfers.

It is important to make sure that enough assets/income are retained to provide security. By using trusts such security can be provided for the potential widow/widower.

2. ***Freezing the estate***

This means giving away the future growth on the estate; the most common way of achieving this is by using interest free loans. Such loans are repayable on demand and thus the lender retains access to the original capital loaned. Growth on the capital loaned is not in the lender's estate and is therefore not subject to inheritance tax on his estate.

Many insurance companies market loan plans which also enable the lender to obtain an "income" (in the form of partial repayments of the loan).

3. ***Providing sums payable to beneficiaries free of inheritance tax***

A very straightforward piece of planning, which can often help with particular family situations, is to effect a whole life policy written in trust. The trust can be flexible and therefore allow for changing circumstances in the future.

Whilst not reducing the taxable estate, except by the premiums paid, this approach increases the total receipts of the beneficiaries.

An example where this can be very useful is one where there is a family business with some children involved in it and some not. If it is wished to leave the business to the "business" children then an equal inheritance can be achieved by effecting a whole life policy for the "non-business" children.

4. ***Investing in assets which attract relief***

For example, investing in farmland or certain business assets and certain private company shares can attract 100% relief.

Conclusion

Making a Will can be one of the most important decisions you make in your lifetime. A Will directs who will inherit your estate when you die. Bearing in mind your estate will include your house and furniture besides cash and all investments, the cost of making a Will is modest. The purpose of this guide is to help you understand what is involved in making a Will and to make the task of your solicitor much easier, thus keeping the cost to a minimum.

Wills also are an important part of inheritance tax planning. This guide will also help you understand how inheritance tax works, not only in relation to your Will, but also in relation to lifetime planning, pension schemes, life assurance and the use of trusts.

Glossary of Terms

Testator	The person who makes the Will
Intestate	Dying without making a Will
Executor	A person who is appointed by Will to administer an estate
Administrator	A person who administers an estate either where there is no Will of where the Will fails to appoint an executor
Personal Representative	Either an executor or an administrator
Trustee	A person who is appointed to act as a trustee of any trusts established under the Will and usually the same person as the executor
Guardian	The persons who you nominate to have physical custody of your minor children
Legacy	A gift in your Will
Pecuniary Legacy	A gift of money in your Will
Specific Legacy	A gift of a particular item in your Will (eg: "my china tea service")
Legatee	A person who receives a gift under a Will
Residue	The remainder of your estate after all debts, liabilities, legacies and testamentary expenses (eg: inheritance tax) have been paid
Residuary Legatee	A person who receives the residue of your estate
Codicil	A document which varies the provisions of a Will
Personal Chattels	The most common examples are jewellery, books, furniture, clothes and household goods