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IN PRAISE OF THE FLEXIBLE LIFE INTEREST TRUST: ARRANGEMENTS UNDER WILLS

Ralph Ray¹

In the accompanying article in this issue the author praised the virtues of life interest trusts used by way of lifetime arrangements. In this article the relevant advantages of using such trusts in wills are summarised.

What is envisaged is an estate of a husband and wife with issue which is substantial - say three quarters of a million pounds and upwards - where the spouse testator, say husband, leaves part of his estate (say a third or a half of residuary estate) to the widow, not absolutely but by way of a flexible life interest. This will trust will have the same type of flexibility as the lifetime version, namely the relevant life interest, e.g., to widow, will be revocable with powers of appointment to a wide-ranging class of alternative beneficiaries and with power to advance capital to the life tenant if necessary.

The type of advantages that can be gained from this sort of arrangement include the following:

- IHT - gifts with reservation provisions FA 1986 s.102. If a surviving spouse inherits assets absolutely which she then settles so as to reserve a benefit to herself, e.g., as a discretionary beneficiary, the assets remain in her estate for IHT - FA 1986 s.102 and Schedule 20. She will also be a "settlor" for CGT purposes: TCGA ss.77 and 78 (see also below); and for income tax purposes: TA 1988 s.674.
- A life interest gift in a will can overcome this. Thus a testator could leave a life interest to his widow coupled with wide powers in the trustees to terminate that interest whereupon the surviving spouse could benefit in a different capacity. Thus if the trustees did terminate the life interest, the

¹ Ralph Ray FTII, TEP, BSc(Econ), Consultant Solicitor, Shoosmiths & Harrison, C/o 52-54 The Green, Banbury, Oxon OX16 9AB.
Tel: (01295) 267971 Fax: (01295) 265620

assets in question could thereupon fall into a discretionary trust in which the surviving spouse could be one of the discretionary beneficiaries; although this would not be a PET, it may be appropriate to route via the children utilising their respective nil bands. In those circumstances the surviving spouse would not have reserved a benefit as above because she had made no gift, only the testator would have made such gift (via the trustees' power of appointment). Moreover, that arrangement would be specifically excluded from the gift with reservation provisions by virtue of FA 1986 s.102(5)(a) (inter-spouse).

- IHT - flexibility in lieu of variations Budget and Finance Bill 1989 cl 167: instruments of variation under s.142 were to be severely curtailed but in a statement by the then Financial Secretary to the Treasury, Norman Lamont, on 20th June 1989, these proposals were abandoned, although he warned that he would be keeping the matter under review and could introduce a more targeted specific measure to counter abuse "next year". Thus, for example, disclaimers, particularly partial and staggered variants, may also be attacked. Although no anti-avoidance arrangements have been announced since, time is likely to run out soon, particularly on a change of government.
- The inclusion of a flexible life interest as referred to above will largely overcome these restrictions. As wide powers of appointment are written into the will itself, it will not be necessary to rely on the s.142 powers of variation.
- CGT: TCGA ss.4, 77 & 78. When the trustees make chargeable disposals of the estate's assets, the rate of CGT will normally be the lowest rate, i.e., 24% as compared with 34% for a discretionary or accumulation and maintenance trust, or a maximum of 40% for an individual (e.g., where a spouse is left an absolute interest and she disposes of assets). As the spouse's interest is as widow(er), the anti-avoidance provisions in TCGA ss.77 & 78 do not apply.
- On the settlor's/testator's death, the assets will be uplifted to their market value under TCGA s.62; therefore there should be no CGT charge on the settlement becoming non-resident under s.80.
- Reversionary interest - consider the same advantages mentioned in the earlier article.
- Practical use of life interest

There is an important practical use of life interests in retaining the capital assets in the estate for the eventual benefit of the testator's children in circumstances which cannot be guaranteed where the surviving spouse is

given the asset absolutely; for example, in circumstances where he/she remarries, when there is a danger that the assets will be diverted to the new husband or wife or their side of the family.