

Trustee Powers of Maintenance

This month's CPD paper follows on from the statutory powers of advancement covered last month. This time we will examine the powers given to trustees in relation to trust income under s31 of the Trustee Act 1925 (TA 1925). This power is known as the statutory power of maintenance and like its s32 counterpart an understanding of how this power works is integral to the drafting of trusts.

OVERVIEW

The statutory power of maintenance is provided by s31 TA 1925. This gives trustees powers and duties in relation to trust income. Unamended, this covers powers to apply and accumulate income for beneficiaries under 18, as well as a duty to pay trust income to a beneficiary over 18. This paper will mainly consider the power of maintenance as it applies to trusts created after 1 October 2014, though the changes made in 2014 will be discussed.

Last month's paper covered the statutory power of advancement under s32 TA 1925. It is recommended that if you missed last month's paper you go back and read it for a rounded understanding of how these key statutory powers work.

WHEN DOES SECTION 31 APPLY?

s31 is implied into most lifetime and will trusts and so it will apply unless expressly excluded or there are contrary provisions.

It will apply where a legacy carries with it the intermediate income. We will examine these rules separately.

It does not apply to discretionary settlements where the trustees have a general power of appointment. None of the beneficiaries of this type of trust have a defined interest in the fund, only a hope of obtaining an interest if the trustees exercise their discretion in their favour. The trustees may exercise their power of appointment to create a vested or contingent interest for a beneficiary, so s31 would apply from that point.

s31 also applies to contingent interests for minors under a trust for a bereaved minor and contingent interests of beneficiaries of bereaved young person's trusts. This latter one can cause issues for the trust which will be discussed separately.

WHEN DOES A GIFT CARRY THE INTERMEDIATE INCOME?

It was previously mentioned that the statutory power of maintenance only applies if the interest carries the intermediate income. This means that the beneficiary must be entitled to the income earned by the share of the legacy that they have an interest in between the date of the gift and the date that the

legacy is actually paid to them. Do not confuse this with the entitlement to income granted by a life interest trust.

The rules for working out whether a gift carries the intermediate income are complex, but we will consider them briefly here to give you at least a cursory understanding of them.

1. Vested gifts

Vested gifts carry the intermediate income unless there is a contrary intention, for example if the income is directed elsewhere.

2. Contingent gifts of residuary personal property

These types of gift carry the intermediate income from the date of the testator's death.

3. Specific devises or bequests

Under s175 of the Law of Property Act 1925 (LPA 1925) a contingent specific gift of property, either personal or real, carries the intermediate income from the date of the testator's death unless it is otherwise disposed of.

4. Contingent pecuniary legacies

These are not covered by s175 LPA 1925 and as such do not generally carry the intermediate income. There are three exceptions to this rule. This first exception is where a father or someone standing *in loco parentis* for a minor beneficiary leaves a contingent pecuniary legacy. The legacy will then carry the intermediate income if the contingency is the minor reaching the age of majority, and there is no other fund provided for the child's maintenance.

The second exception is where the gift is made with the clear intention of providing maintenance for the minor. In these cases, it is not necessary that the contingency is the minor attaining the age of majority. In *Re Churchill* [1909] 1 Ch 642 it was held that a contingent pecuniary gift to a grandnephew carried the intermediate income as it directed the trustees to pay, at their discretion, any part of the fund 'towards the advancement in life or otherwise for the benefit' of the beneficiary.

The third exception is 'set aside' gifts, where the testator directs for a pecuniary legacy to be set aside as a separate fund for the beneficiary's benefit to be paid to them when the contingency is met.

HOW DOES IT WORK?

The power is twofold; it draws a distinction between a minor who is contingently interested in a fund and an adult who has a similar contingent interest. When s31 applies the trustees will have a discretionary power to apply the income until a beneficiary reaches 18. The trustees may apply the income for the minor's 'education, maintenance, or other benefit'. The income may be applied either to the minor directly, or by paying it to their parent or guardian.

Once the minor reaches 18, if the contingency is not yet met and the trust continues, the trustees' discretion is extinguished and is replaced by a duty to pay the income to the beneficiary until their

interest either vests or fails. This is also the case where the beneficiary is an adult when the trust commences; this grants them an interest in possession in the trust fund.

The duty to pay the income to an adult beneficiary may be excluded by contrary intention. For example, if a direction is included to direct the trustee to accumulate the income instead. This was the case in *Re Turner's Will Trusts* [1937] Ch 15 where it was held that a beneficiary who was 24 was not entitled to the income as the settlor had directed for it to be accumulated. The beneficiary had to wait until the fund vested in them at age 28.

s31 may also be excluded by deferring a contingent interest. In the case of *Re McGeorge* [1963] Ch 544 a testator made a gift of his land to his daughter which was not to take effect until his widow died. It was held that the daughter had no entitlement to income as by deferring the enjoyment of the land the testator had expressed that the gift would not carry the intermediate income.

The application of s31 may have either a vesting effect:

Example 1: Trustees hold assets in trust for James. His interest is contingent upon him reaching 25. He is currently aged 14 so he has no entitlement to income, though the trustees may apply it for his maintenance, education, or benefit. Any income that is not applied must be accumulated and paid to James when he reaches 25. When James reaches 18 he gains an entitlement to the trust income.

Or a divesting effect:

Example 2: Hannah has a life interest in a trust fund. She is aged 10. Ordinarily a life tenant would have a right to receive the trust income, but due to the application of s31 the trustees have discretion over paying the income or accumulating it. Any accumulated income will be paid to her at 18.

Under s31(2) any income that is not applied during a beneficiary's minority must be accumulated. Any accumulated income may be distributed for the beneficiary's maintenance and applied as though it were income arising in the current year.

A beneficiary becomes absolutely entitled to the accumulated income at 18 or on their earlier marriage or civil partnership as long as their interest in the capital was vested or becomes vested upon reaching 18. If the beneficiary's interest is contingent on a later event, then the trustees will hold the accumulated income on trust until the date that the beneficiary becomes absolutely entitled.

If a minor dies before reaching 18 any accumulated income will not form part of their estate unless the nature of their interest meant that the capital formed part of their estate on death.

CHANGES MADE BY THE INHERITANCE AND TRUSTEES' POWERS ACT 2014

s8 of the Inheritance and Trustees' Powers Act 2014 made changes to the statutory power of maintenance. These changes apply to trusts created after 1 October 2014.

Trusts created prior to 1 October 2014 required the trustees to apply only an amount of income that was reasonable, and also to consider a number of factors when deciding whether income should be applied.

As originally enacted s31(1)(i) directed the trustees to apply the income that they ‘as may, in all the circumstances, be reasonable’ for the minor’s education, maintenance and other benefit. This wording has now been removed and replaced with ‘as the trustees think fit’, thus giving the trustees wider discretion.

This change was made as a result of the Law Commission’s recommendations in their December 2001 report ‘Intestacy and family provision claims on death’, as it was felt that the general law could be relied on as this already expected trustees to act in good faith and consider all relevant circumstances when making decisions relating to the trust.

The second change made to s31 was to remove the proviso to s31(1). Originally this read:

“Providing that, in deciding whether the whole or any part of the income of the property is during a minority to be paid or applied for the purposes aforesaid, the trustees shall have regard to the age of the infant and his requirements and generally to the circumstances of the case, and in particular to what other income, if any, is applicable for the same purposes; and where trustees have notice that the income of more than one fund is applicable for those purposes, then, so far as practicable, unless the entire income of the funds is paid or applied as aforesaid or the court otherwise directs, a proportionate part only of the income of each fund shall be so paid or applied.”

As you can see, this gave trustees a lot to consider. The removal of this proviso gives trustees much wider discretion in how they manage the fund by removing any obligation to consider particular factors. They are also no longer obliged to balance the income they pay from the fund proportionately against any other trust fund that the minor has an interest in, taking some administrative burden off of them.

WHEN TO APPLY, EXCLUDE OR MODIFY

As with s32 discussed last month, it is helpful to make sure that it is clear on the face of the will or trust whether s31 applies. This can avoid any uncertainty. When making amendments to s31 or when choosing to exclude it you need to be aware of the tax consequences of this.

If the testator’s intention is to grant a minor an interest in possession s31 will need to be excluded. If it is allowed to apply this will prevent the minor having an IIP as it gives the trustees the discretion to apply the income for the minor’s maintenance, education, or other benefit, or to accumulate it. This has a divesting effect as it deprives the minor of an actual entitlement to the income and means that their estate will not be entitled to any accumulated income if they die before 18.

s31 should be excluded when the testator’s intention is to avoid granting an IIP to an adult beneficiary. If s31 applies unamended, then the trustees must pay the income of the fund to an adult beneficiary.

You should exclude s31 to avoid creating unintended IPDIs. A common mistake is failing to exclude s31 when drafting an 18-25 trust, also known as a bereaved young person’s trust. If when the testator dies a beneficiary of this kind of trust is under 25 but over 18, they will instead have an IIP and the trust will be taxed as an IPDI rather than an 18-25 trust.

Another adverse effect on 18-25 trusts can be seen if s31 is not excluded and a beneficiary turns 18 within 2 years of the testator's death. In this case the trust may become an IPDI when the beneficiary becomes entitled to income as a result of the reading back effect of s144 Inheritance Tax Act 1984.

Example 3: Charlotte left her estate on an 18-25 trust for her children Abi and Dan. S31 applies unamended. At the time of Charlotte's death Abi is 20 and Dan is 15. Abi has an IIP in her share of the fund that is taxed as an IPDI. Dan's interest is as a bereaved minor.

It is common to amend s31 to change the age at which a beneficiary becomes entitled to income to an age later than 18. In fact, provision 17 of the STEP provisions 2nd edition does this by deferring a beneficiary's entitlement to income to 21 so if you include all of the STEP standard and special provisions this amendment is already made. The effect of this is that the beneficiary does not become entitled to the income at age 18. The trustees retain the discretion to apply or accumulate the income up until the age specified.

Example 4: Billy has a contingent interest in a trust. His interest in the capital will vest at age 25. S31 was modified so that his entitlement to income is deferred until 21. He is currently 19 but has no entitlement to the trust income, the trustees can continue applying this at their discretion for his maintenance, education or other benefit.

CONCLUSION

Hopefully this month's readers have finished this paper with a good understanding of the statutory powers of maintenance available to trustees under s31 of the Trustee Act 1925. Going forward, make sure you consider the effect that s31 will have on the settlements you are drafting and whether it should be included, excluded or modified to achieve the testator's goals. This power should always be considered alongside the statutory power of advancement, so if you missed last month's paper it is recommended that you go back and read this.

Important Reminder:

These notes are produced solely for the benefit of SWW members when completing the April 2019 CPD test to gain 1 hour of structured CPD towards their annual quota. The notes do not represent legal advice and no reliance can be made on the content of the notes in any or individual specific client circumstances. Having read the notes members should cement their understanding by considering further reading around the subject – cases details can be found by searching the case references using BAILII or GOOGLE.