Age conditions in Wills and their effects

Age contingencies in wills are very common. Many testator's wish to make gifts or leave a share of their estate to their beneficiaries' subject to them having reached a certain age first. This is most often seen with gifts to the testator's own children but does also extend to gifts to remoter issue and sometimes even to other beneficiaries altogether. This month's CPD will examine the different effects of age contingencies in wills.

What is the issue?

Age conditions certainly have their uses. They're a great vehicle for exercising some control over when a beneficiary may inherit. It may be that a testator sees no reason that their children shouldn't inherit absolutely but they want to push back that inheritance age to a point where they feel the child will be more mature and capable of managing an inheritance.

The issue then comes down to understanding how the effect of these gifts change depending on who the beneficiary is, what age condition is set, and how the finer details of how the clause is worded can undermine that control.

Vested vs Contingent Interests

Firstly, we need to establish whether a gift is vested or contingent as the two types of legacy are treated very differently. If a beneficiary doesn't need to meet any kind of condition in order to be entitled to a legacy, then the gift is vested. If a beneficiary is not entitled to the subject matter of the gift until a specified condition is met, then the interest is contingent. This distinction is important because it effects what level of entitlement a beneficiary has to a legacy, and therefore the level of control that a testator retains over the eventual destination of it.

If a testator states in their will that a legacy should be paid to their nephew immediately on the testator's death their nephew has a vested interest. Immediately upon the testator's death the legacy belongs to the beneficiary. If the legacy can't be paid to the nephew immediately because they are a minor and they can't give a valid receipt they still have a vested interest and the legacy still belongs to them. This means that if he dies before he reaches 18 the legacy forms part of his estate and will pass on to those who are entitled under his intestacy.

Let's contrast this with a contingent legacy. If instead the testator had made the gift to his nephew conditional upon him reaching the age of 18, he would have had greater control over it. The nephew would have no immediate entitlement to the legacy, and it would only vest in him if he met the condition by reaching the age of 18. If he died before reaching 18 the gift would fail and result back to the testator's estate. This would then either pass to a substitute beneficiary named in the testator's will or to the residuary beneficiaries of his estate.

A further issue is whether or not the beneficiary is entitled to the intermediate income from the legacy. Where a legacy is vested the beneficiary is absolutely entitled to the income from the legacy. The situation with contingent legacies is more complicated. If the beneficiary has a contingent interest in the legacy then he is not entitled to receive the intermediate income unless one or more of the following conditions are met:

- The testator is the child's parent or stepparent.
- The will shows an intention that the beneficiary should be maintained out of the income.
- The legacy is expressly directed to be invested for the beneficiary.

How does this effect age conditions then? Most of the time an age condition will be a contingent interest, and I'd suggest that this is the type of interest that many drafters are intending to create when adding an age condition to a gift. It is possible to include an age condition in a vested gift, however. The following clauses show the difference in drafting required to achieve this:

Vested: "*I give to my daughter A the sum of £10,000 at the age of 25*".

Contingent: "*I give to my daughter A the sum of £10,000 subject to her attaining the age of 25*".

Notice that the difference in wording is quite minor, and in both cases the legacy will only be paid to the beneficiary when she reaches the age of 25. The difference in effect is substantial though; firstly, with regards to the beneficiary's actual entitlement as discussed above, and secondly with regards to the tax treatment of the trust that has been created should the testator die while the beneficiary is still under 25.

Differing tax treatment of vested and contingent interests

In the case of the vested interest a bare trust has been created. The beneficiary has a vested interest, is treated as beneficially entitled to the trust assets and is therefore taxed accordingly. They are treated as though the assets are in their own hands, so any income and capital gains tax are levied on them and using their own personal allowances. The beneficiary must declare any taxable income or chargeable gains on their Self-Assessment tax return.

In the case of the contingent interest the tax treatment is more complex and will differ depending on whether the beneficiary is a child of the testator and what age condition has been set, as well as what statutory trustee powers have been included or modified. These rules will be discussed below.

Gifts to a testator's own children

From this point onwards we will be discussing only contingent legacies.

If a testator makes a contingent legacy to his own children this may be a Bereaved Minor's Trust, a Bereaved Young Person's Trust, or a relevant property trust depending on what age condition is set. Please also note that a reference to a parent also includes a stepparent for the purposes of these trusts (section 71H Inheritance Tax Act 1984).

Bereaved Minor's Trust (BMT)

If the age condition is no later than the beneficiary's 18th birthday the trust created as a result should the testator die while the beneficiary is a minor may be a Bereaved Minor's Trust (or section 71A settlement).

The trust must meet the conditions set out in section 71A of the Inheritance Tax Act 1984 (IHTA 1984):

- The minor becomes absolutely entitled to the trust property on or before he turns 18
- So long as the bereaved minor is living and under the age of 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
- The beneficiary is entitled to all the income arising or any income applied while the beneficiary is under 18 is applied for their benefit, or while the minor is living and under 18, either the minor is entitled to all of the income arising or no income is paid to any other person

These types of trust are useful for a parent who has no objection to their children inheriting absolutely at 18.

BMTs are IHT effective as they are not subject to the IHT charges that apply to relevant property trusts or to those that apply to IPDI trusts. No matter the value of the trust fund there will be no anniversary charges. There will also be no exit charge when capital is distributed or when the trust comes to an end. Additionally, if the trustees use their statutory powers to advance trust assets on to new trusts there will be no exit charge.

If the beneficiary dies while under 18 there will be no charge on their estate and no exit charge on the trust.

Bereaved Young Person's Trust (BYPT)

If the age condition is set at an age greater than 18 but no later than the beneficiary's 25th birthday the trust created as a result may be a Bereaved Young Person's Trust (or section 71D settlement).

In this case the trust must meet the conditions set out in section 71D IHTA 1984:

- The beneficiary becomes entitled to the trust property no later than their 25th birthday
- The beneficiary is entitled to all the income arising or any income applied while the beneficiary is under 25 is applied for their benefit
- While the beneficiary is living and under 25, either they are entitled to all of the income arising or no income is paid to any other person

These types of trust are useful for a parent who is happy for their children to inherit absolutely no later than 25. They are also attractive for their flexibility in comparison to BMTs.

Tax wise these trusts are slightly less IHT effective than BMTs but still hold some benefits over relevant property trusts and IPDIs. While the beneficiary is under 18 the trust will be taxed as a BMT. If the trustees may exercise their statutory powers or are given express powers to make an advance and choose to bring the inheritance age forward to 18, they can do so without any charge to IHT.

If the trust exceeds its nil rate band of £325,000 and it continues beyond the beneficiary reaching 18 then there is an exit charge when assets leave the trust, either through distributions of capital or because the trust comes to an end.

The exit charge that applies when a beneficiary is between 18 and 25 is calculated in a similar way to an exit charge from a relevant property trust. The charge covers a maximum period of seven years, beginning when a beneficiary reaches 18 or if later, when the trust became an 18 to 25 trust.

The maximum rate of charge is 4.2%, compared to the rate for an ordinary relevant property trust which is 6%.

BMTs and BYPTs are both qualifying settlements for the Residence nil rate band (RNRB), so it is safe for a testator to leave their qualifying residential interest (QRI) on either of these trusts.

OTHER GIFTS

In other situations where an age contingent gift is made the trust created will be a relevant property regime trust. The main situation this arises in would be:

- A gift to the testator's children or stepchildren contingent on reaching an age greater than 25.
- A gift to a beneficiary who is not the testator's child or stepchild contingent on any age condition.
- A gift-over to the issue of the testator's children or stepchildren that is subject to the same age condition.
- A gift of property to the testator's children or stepchildren at the end of an IPDI trust subject to any age condition.

Trusts that are subject to the relevant property regime and that exceed their nil rate band of £325,000 will see IHT charges on every 10-year anniversary of the trust. They will also suffer exit charges when capital leaves the trust. These charges are a maximum of 6% of the trust fund in excess of the NRB in the case of anniversary charges, or the loss to the trust in the case of exit charges. This makes a relevant property trust less favourable than a BMT or BYPT.

We've established that if a testator makes a gift to their child subject to an age condition later than 25 this will create a relevant property trust. It is also important to note that in these cases the trust is a relevant property trust from the onset; it won't qualify as a BYPT while the beneficiary is under 25 and then transition to the relevant property trust post 25.

Where the testator's QRI is left to a relevant property regime trust no RNRB will be available, so this type of interest should be avoided over property if the RNRB needs to be used.

Age conditions for the remainder beneficiaries of an IPDI over property should also be avoided. The interest created at the end of the IPDI in these circumstances would be a relevant property regime trust and not a BMT or BYPT as the trust is established as a result of the IPDI and not arising immediately on the parent's death as a result of their will. The QRI is therefore not being closely inherited at the end of the IPDI so no RNRB is available.

THE PROBLEM OF ACCIDENTAL IPDIS

An issue that should not be overlooked is how the statutory powers given to trustees by the Trustee Act 1925 affect settlements that are created by age contingencies. In past CPD papers this year we have discussed how sections 31 and 32 of the Trustee Act 1925 work in some detail, and readers are encouraged to go back and revisit these papers. In short, these sections concern a trustee's statutory powers of maintenance and advancement respectively.

Section 32 gives the trustees powers over trust capital. This allows them to advance capital for a beneficiary's maintenance, education, or other benefit. This power is relevant to any trust created by an age contingency and may be used to benefit a beneficiary before they reach the age at which the assets will vest. This is what would allow a trustee to bring an inheritance forward in a BYPT. This can also work in the opposite direction by allowing the trustees to make a 'settled advance', pushing the age of inheritance further back by settling the assets on a further trust. This gives the trustees a degree of flexibility. These powers do not prevent a trust qualifying as a BMT or BYPT.

The main issue is section 31. This section concerns the trustees' powers over trust income and can have the greatest effect on a trust. It is by ignoring this power a drafter can accidentally create an IPDI where the intention was to create a BYPT for a beneficiary.

Section 31 allows a trustee discretion over trust income while the beneficiary is under 18*. The income may be used for the beneficiary's benefit or may be accumulated. However, once the beneficiary reaches 18 this discretion is lost and the beneficiary becomes entitled to all trust income.

If the testator dies leaving a legacy to their child contingent on them reaching 25 and section 31 applies unamended, then the trust created may not be a BYPT. If the beneficiary is over 18 but under 25 then they will have an immediate entitlement to income on the testator's death. Their interest will not be that of a bereaved young person, but an IPDI. The situation becomes more complicated where there are multiple beneficiaries, as in the below example:

Example: Tim dies leaving his residuary estate to his children contingent on them reaching 25. Section 31 applies unamended. When he dies his son Jacob is 15 and his daughter Ruby is 19. The share of the estate held on trust for Jacob will be a BYPT so the trustees will have discretion over the income until he is 18. Once he turns 18 the trustees must pay income to him, but the trust still qualifies as a BYPT.

As Ruby was over 18 when Tim died, she will have an IPDI in the share of the estate held in trust for her.

This does not present a problem for BMTs as the trust has ended by time any entitlement to income can arise.

If the testator wishes to avoid the consequences of an IPDI then section 31 can be expressly excluded. In these cases, alternative powers should be included in the will instead to give the trustees the power to use or accumulate any income for the entire duration of the trust period, avoiding any actual entitlement to income.

*If the STEP Provisions (2nd edition) are incorporated into the will then this age of entitlement to income is deferred to 21 rather than 18.

CONCLUSION

Hopefully this month's paper has given readers an appreciation for what needs to be considered when drafting an age condition. While they look like relatively straightforward clauses it is important that the full implications of the proposed age condition are understood before the will is signed, including the tax consequences and the actual entitlement that is being given to a beneficiary. This is now especially important considering the incidence of the RNRB, don't be caught out by age conditions on gift overs!

Important Reminder:

These notes are produced solely for the benefit of SWW members when completing the October 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.