Law Commission
Reforming the law

Intestacy and Family Provision Claims on Death: Sections 31 and 32 of the Trustee Act 1925

A Supplementary Consultation Paper

Consultation Paper No 191 (Supplementary)
26 May 2011

THE LAW COMMISSION – HOW WE CONSULT

About the Law Commission: The Law Commission for England and Wales was set up by section 1 of the Law Commissions Act 1965 for the purpose of promoting the reform of the law.

The Law Commissioners are: The Rt Hon Lord Justice Munby (*Chairman)*, Professor Elizabeth Cooke, Mr David Hertzell, Professor David Ormerod and Frances Patterson QC.

The Chief Executive is Mr Mark Ormerod CB.

Topic of this consultation: This Supplementary Consultation Paper reviews sections 31 and 32 of the Trustee Act 1925. We discuss the current law and set out a number of provisional proposals and options for reform on which we invite consultees' views.

Scope of this consultation: The purpose of this consultation is to generate responses to our discussion, provisional proposals and questions with a view to making recommendations for reform to Parliament. In particular, we focus on an area already examined in our initial consultation (Intestacy and Family Provision Claims on Death (2009) Law Commission Consultation Paper No 191) and take a broader look at the issues identified in that consultation process.

Geographical scope: This Supplementary Consultation Paper refers to the law of England and Wales.

Impact assessment: The impact of the current law and potential reforms is considered throughout this Supplementary Consultation Paper. Consultees are invited to give their views on the financial and other impacts of the current law or of reform and to suggest sources of further information.

Duration of the consultation: from 26 May 2011 to **21 July 2011**.

How to respond
Please send your responses either –

By email to: propertyandtrust@lawcommission.gsi.gov.uk or

By post to: Sarah Hansen, Law Commission, Steel House, 11 Tothill Street, London SW1H 9LJ
Tel: 020 3334 0298 / Fax: 020 3334 0201

If you send your comments by post, it would be helpful if, where possible, you could also send them electronically.

After the consultation: In the light of the responses we receive, we will decide our final recommendations and present them to Parliament. It will be for Parliament to decide whether to make any change to the law.

Code of Practice: We are a signatory to the Government's Code of Practice on Consultation and follow the Code criteria, set out on the next page.

Freedom of information: It is important that you refer to our Freedom of Information Statement on the next page.

Availability of this Consultation Paper: You can view or download the paper free of charge on the consultation pages of our website: www.justice.gov.uk/lawcommission/consultations.htm.

CODE OF PRACTICE ON CONSULTATION

THE SEVEN CONSULTATION CRITERIA

Criterion 1: When to consult

Formal consultation should take place at a stage when there is scope to influence the policy outcome.

Criterion 2: Duration of consultation exercise

Consultations should normally last for at least 12 weeks with consideration given to longer timescales where feasible and sensible.

Criterion 3: Clarity and scope of impact

Consultation documents should be clear about the consultation process, what is being proposed, the scope to influence and the expected costs and benefits of the proposals.

Criterion 4: Accessibility of consultation exercises

Consultation exercises should be designed to be accessible to, and clearly targeted at, those people the exercise is intended to reach.

Criterion 5: The burden of consultation

Keeping the burden of consultation to a minimum is essential if consultations are to be effective and if consultees' buy-in to the process is to be obtained.

Criterion 6: Responsiveness of consultation exercises

Consultation responses should be analysed carefully and clear feedback should be provided to participants following the consultation.

Criterion 7: Capacity to consult

Officials running consultations should seek guidance in how to run an effective consultation exercise and share what they have learned from the experience.

Under Criterion 2 of the Code of Practice on Consultation, the duration of a consultation will normally be at least 12 weeks. However, as this consultation is an additional, more detailed look at a specific element of policy, this consultation will last for eight weeks in accordance with paragraph 1.5 of the Code of Practice on Consultation 2008.

CONSULTATION CO-ORDINATOR

The Law Commission's Consultation Co-ordinator is Phil Hodgson.

You are invited to send comments to the Consultation Co-ordinator about the extent to which the criteria have been observed and any ways of improving the consultation process.

Contact: Phil Hodgson, Law Commission, Steel House, 11 Tothill Street, London SW1H 9LJ
Email: phil.hodgson@lawcommission.gsi.gov.uk

Full details of the Government's Code of Practice on Consultation are available on the BIS website at http://www.bis.gov.uk/policies/better-regulation/consultation-guidance.

Freedom of Information Statement

Information provided in response to this consultation, including personal information, may be subject to publication or disclosure in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004).

If you want information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence.

In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Law Commission.

The Law Commission will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

THE LAW COMMISSION

SECTIONS 31 AND 32 OF THE TRUSTEE ACT 1925

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PART 1
INTRODUCTION

INTRODUCTION

1.1 This Supplementary Consultation Paper is part of our project reviewing the law of intestacy and family provision claims on death. A number of reform options and questions were put forward in our Consultation Paper, published on 29 October 2009.[1] Among the areas of law considered in the Consultation Paper, in the context of the law of intestacy, were the powers given to trustees by sections 31 and 32 of the Trustee Act 1925. This paper examines those powers in a wider context.

1.2 If a person dies without leaving a valid will his or her assets are inherited according to the intestacy rules.[2] Adult beneficiaries identified by the intestacy rules can take their shares of the inheritance outright. But beneficiaries who are under 18, and not married or civil partnered, are not entitled to take their shares outright; their shares are therefore held on trust. Those beneficiaries might be the deceased person's children, but could also be siblings, nieces or nephews, grandchildren, and so on. In this paper we refer to these continuing trusts for under-18s as the "statutory trusts".[3]

1.3 In the Consultation Paper we examined the statutory powers which enable trustees of the statutory trusts, before the beneficiary becomes entitled to take his or her share outright, to distribute income or capital from the trust fund to or for the benefit of the beneficiary.[4] These powers are found in sections 31 and 32 of the Trustee Act 1925.[5]

1.4 However, sections 31 and 32 are not limited to the statutory trusts. They also apply to trusts created by a person in his or her lifetime, or by will. It is possible to exclude or modify their provisions;[6] trusts may be established for a variety of beneficiaries and settlors have a wide range of options as to the provisions they include to determine the beneficiaries' entitlement to capital and income.

1 Intestacy and Family Provision Claims on Death (2009) Law Commission Consultation Paper No 191.

2 Other than assets which in any event pass irrespective of a will, in particular jointly owned property owned in such a way that it automatically passes to the survivor. For more information, see Intestacy and Family Provision Claims on Death (2009) Law Commission Consultation Paper No 191, paras 2.13 to 2.40 and 2.91.

3 Administration of Estates Act 1925, s 47. Strictly speaking, the "statutory trusts" have a wider significance than this because they also determine how the intestate estate is divided between various beneficiaries; see Intestacy and Family Provision Claims on Death (2009) Law Commission Consultation Paper No 191, paras 2.29 to 2.30.

4 The courts have used the metaphor of a tree and its fruit to explain the concepts of capital and income. The "tree" is the capital – such as an office block – and the "fruit" is the income – such as the rent received from renting out the offices. Not all receipts which become due in respect of trust property are classified as income. For example, although one would naturally think of dividends on a share portfolio as income, some distributions by way of dividend are in fact capital.

5 They are applied to the trusts arising on intestacy by section 47(1)(ii) of the Administration of Estates Act 1925.

6 Trustee Act 1925, s 69(2).

OUR PREVIOUS CONSULTATION

1.5 In the Consultation Paper we examined the provisions of section 31 as to how income is treated under the trust, and we made a provisional proposal for an amendment to section 32. The amendment proposed would widen the trustees' powers, in the context of intestacy only, to use the capital of a beneficiary's share before he or she becomes entitled outright:

> We provisionally propose that trustees' power of advancement (pursuant to section 32 of the Trustee Act 1925) should be extended (for the purposes only of the statutory trusts on intestacy) to the whole, rather than one half, of the share of a beneficiary who is not yet absolutely entitled under the statutory trusts.[7]

1.6 Section 32 of the Trustee Act 1925 enables trustees to "pay or apply" capital "for the advancement or benefit" of a beneficiary who has a recognised entitlement to the capital of the trust fund but is not entitled to have it paid over outright. For example, it may be appropriate to release capital for the benefit of a young child who is a beneficiary under the statutory trusts created on a parent's intestacy. However, the scope of section 32 is limited: the trustees can use only one-half of the beneficiary's capital share in this way.

1.7 We proposed removing that one-half limit in relation to the statutory trusts arising on intestacy for three main reasons.[8] First, it would bring the provisions which apply to such trusts into line with what we understand to be standard practice in drafting wills and lifetime trusts.[9] Secondly, it would reduce administrative difficulties in calculating and keeping within the one-half limit. Thirdly, it would increase trustees' flexibility and reduce the need for court applications to be made in order to permit advances.

1.8 Statistics on the size of intestate estates suggest that they are often of relatively modest size compared to estates where the deceased left a will: analysis carried out by HM Revenue & Customs for the Consultation Paper shows that 64% of intestate estates have a net value of less than £100,000, half of these being less than £25,000.[10] We considered that in such cases there might be particularly good reasons to advance the whole fund to the beneficiaries outright to simplify the administration of the trust or to make provision for them at a time when it may be particularly needed.

1.9 This provisional proposal was addressed by 34 respondents to the Consultation Paper, of whom 28 supported the proposal. Some of those consultees also argued that the amendment should apply to trusts created in the settlor's lifetime or by will, as well as to the statutory trusts on intestacy. Similarly, some of the consultees who opposed the provisional proposal did so on the basis that it

[7] Intestacy and Family Provision Claims on Death (2009) Law Commission Consultation Paper No 191, para 5.52.

[8] Intestacy and Family Provision Claims on Death (2009) Law Commission Consultation Paper No 191, paras 5.50 to 5.51.

[9] See paras 3.20 to 3.21 below.

[10] Intestacy and Family Provision Claims on Death (2009) Law Commission Consultation Paper No 191, Appendix C, para C.13. In comparison, only 33% of testate estates have a net value of less than £100,000, approximately one-third of those falling under £25,000.

would be disadvantageous to reform section 32 only insofar as the statutory trusts on intestacy are concerned; they felt that section 32 should be amended for all trusts, or not at all. We consider the responses to the consultation in Part 3.

NEXT STEPS: THIS SUPPLEMENTARY CONSULTATION PAPER

1.10 We are grateful to all consultees for their responses on this issue. Having analysed them we decided that a further consultation would be appropriate, taking a broader view of reform in two main respects.

1.11 First, we take seriously the concerns of consultees that reform of section 32 only for the statutory trusts arising on intestacy could create confusion and anomalies between different types of trusts. We are also encouraged by comments that there are advantages in reform across all trusts.

1.12 Secondly, we felt that we should consult again as to whether it would be appropriate to reform section 31, again for all trusts. Section 31 includes restrictions on the trustees' power to use income for the benefit of trust beneficiaries. In the context of a consultation on a general relaxation of the restrictions on trustees' power to make payments of capital under section 32, we think it appropriate to examine again section 31. This is supported by the fact that, as one consultee noted, it is also common to modify the effect of section 31 when drafting wills and trust documents.

1.13 In Part 2 we set out the relevant details of the current law, before setting out and explaining our reform proposals in Part 3. Our provisional proposals and consultation questions are summarised in Part 4.

1.14 We ask consultees to send responses to this consultation to us by 21 July 2011. The Law Commission is a signatory to the Government's Code of Practice on Consultation, which establishes that consultations should normally last for at least 12 weeks. In this paper we are focusing on only one of the many areas considered in the Consultation Paper, and although it is broader in scope for the reasons set out above, many of the issues raised have already been taken into account in that consultation and were considered by consultees. We therefore take the view that it is appropriate for the consultation to run for eight weeks, from 26 May 2011 to 21 July 2011.[11]

1.15 Please send your responses either:

by email to: propertyandtrust@lawcommission.gsi.gov.uk; or

by post to: Sarah Hansen, Law Commission, Steel House, 11 Tothill Street, London SW1H 9LJ

For more detailed information on how to respond and how we will deal with responses, see pages i to ii above.

[11] HM Government, *Code of Practice on Consultation* (2008) para 1.5. Full details of the Code are available at www.bis.gov.uk/policies/better-regulation/consultation-guidance.

PART 2
CURRENT LAW

INTRODUCTION

2.1 Sections 31 and 32 of the Trustee Act 1925 relate to the powers of trustees to make certain payments from trust funds. The two sections apply to all trusts, whether created by the intestacy rules, by a will or in the settlor's lifetime, but they may be (and indeed are routinely) excluded or amended by express provision.[1]

2.2 Section 31 relates to the income of the trust fund, and one of its functions is to enable trustees to make payments from income for the maintenance, education or benefit of certain beneficiaries. Section 32 gives the trustees power to make an early release of some of the capital of a beneficiary's prospective share in the trust fund to, or for the benefit of, that beneficiary.

2.3 In this Part, we sketch the current law on both statutory provisions.

SECTION 31: POWERS AND DUTIES REGARDING INCOME

2.4 Section 31 of the Trustee Act 1925 is set out in full in the box on the next page. It concerns trustees' dealings with the income of a fund held on trust, and applies "where any property is held by trustees in trust for any person for any interest whatsoever, whether vested or contingent". An interest is vested if the person in question has a right to it which does not depend on a prior condition being fulfilled, such as reaching a specified age, marrying or forming a civil partnership, or on the trustees exercising a discretion. The right does not have to be permanent; for example, the trustees may be able to bring the vested interest to an end, or it may cease on the occurrence of a specified event.

2.5 Alternatively, the interest may be contingent; for example, in a gift "to E if she survives me and attains the age of 21", E's interest is contingent both on her surviving the person who is making the gift, and on her turning 21. Section 31 only applies to contingent interests where there is income out of which the beneficiary can be maintained. This will occur:

(1) where the trust "carries the intermediate income of the property";[2] and

(2) in certain other circumstances where the gift was given by a legacy in a will by someone who is the parent of the beneficiary, or a person standing in the place of a parent to him or her.[3]

1 Trustee Act 1925, s 69(2); *Re Turner's Will Trusts* [1937] Ch 15; see paras 3.20 to 3.21, 3.27 to 3.30 below.

2 That means, roughly, that the income "belongs with" the gift, so that it is available to be used in accordance with section 31, or accumulated, or paid out to the beneficiary depending on the circumstances. A contingent interest created in a lifetime settlement will generally carry the intermediate income, subject to contrary provision. If the gift is made by will the rules are more complex; see J Mowbray QC and others (eds) *Lewin on Trusts* (18th ed 2008) paras 31-19 to 31-23, 31-27 to 31-29.

3 Trustee Act 1925, s 31(3).

31 Power to apply income for maintenance and to accumulate surplus income during a minority

(1) Where any property is held by trustees in trust for any person for any interest whatsoever, whether vested or contingent, then, subject to any prior interests or charges affecting that property –

(i) during the infancy of any such person, if his interest so long continues, the trustees may, at their sole discretion, pay to his parent or guardian, if any, or otherwise apply for or towards his maintenance, education, or benefit, the whole or such part, if any, of the income of that property as may, in all the circumstances, be reasonable, whether or not there is –

(a) any other fund applicable to the same purpose; or

(b) any person bound by law to provide for his maintenance or education; and

(ii) if such person on attaining the age of eighteen years has not a vested interest in such income, the trustees shall thenceforth pay the income of that property and of any accretion thereto under subsection (2) of this section to him, until he either attains a vested interest therein or dies, or until failure of his interest:

Provided 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.

(2) During the infancy of any such person, if his interest so long continues, the trustees shall accumulate all the residue of that income by investing it, and any profits from so investing it from time to time in authorised investments, and shall hold those accumulations as follows –

(i) If any such person –

(a) attains the age of eighteen years, or marries under that age or forms a civil partnership under that age, and his interest in such income during his infancy, or until his marriage or his formation of a civil partnership, is a vested interest; or

(b) on attaining the age of eighteen years or on marriage, or formation of a civil partnership, under that age becomes entitled to the property from which such income arose in fee simple, absolute or determinable, or absolutely, or for an entailed interest;

the trustees shall hold the accumulations in trust for such person absolutely, but without prejudice to any provision with respect thereto contained in any settlement by him made under any statutory powers during his infancy, and so that the receipt of such person after marriage or formation of a civil partnership, and though still an infant, shall be a good discharge; and

(ii) In any other case the trustees shall, notwithstanding that such person had a vested interest in such income, hold the accumulations as an accretion to the capital of the property from which such accumulations arose, and as one fund with such capital for all purposes, and so that, if such property is settled land, such accumulations shall be held upon the same trusts as if the same were capital money arising therefrom;

but the trustees may, at any time during the infancy of such person if his interest so long continues, apply those accumulations, or any part thereof, as if they were income arising in the then current year.

(3) This section applies in the case of a contingent interest only if the limitation or trust carries the intermediate income of the property, but it applies to a future or contingent legacy by the parent of, or a person standing in loco parentis to, the legatee, if and for such period as, under the general law, the legacy carries interest for the maintenance of the legatee, and in any such case as last aforesaid the rate of interest shall (if the income available is sufficient, and subject to any rules of court to the contrary) be five pounds per centum per annum.

(4) This section applies to a vested annuity in like manner as if the annuity were the income of property held by trustees in trust to pay the income thereof to the annuitant for the same period for which the annuity is payable, save that in any case accumulations made during the infancy of the annuitant shall be held in trust for the annuitant or his personal representatives absolutely.

(5) This section does not apply where the instrument, if any, under which the interest arises came into operation before the commencement of this Act.

2.6 In order to illustrate the various provisions of the section, we will consider the example of the XYZ Trust, a fund which trustees are holding on trust for the settlor's children X, Y and Z such that they will take the fund in equal shares when they reach 25. The trust was created five years ago, and X, Y and Z are now aged 10, 15 and 19 respectively. Section 31 applies to this trust because the terms of the trust – unusually – did not exclude it or modify its effect.

Power to pay or apply income for the maintenance, education or benefit of a beneficiary who is under 18

2.7 Under section 31(1)(i), the trustees of the XYZ Trust can make payments of income for or towards the maintenance, education or benefit of X or Y. This is because X and Y are both under 18.[4] In each case they can only use the income which is properly attributable to X or Y's interest in the trust property – that is, one-third of the whole trust income respectively.

2.8 It has been said that the words "maintenance, education or benefit":

> … are generally regarded as authorising the application of trust income for routine, recurring expenses of a beneficiary; they are words "of the widest import" and, in appropriate cases, include capital investment, for example to buy a house in which the beneficiary can live or a share in a partnership, or even placing money on deposit.[5]

The meaning of "benefit" is considered further below, in connection with section 32.[6]

2.9 The income may be applied directly for X or Y's maintenance, education or benefit – for example, the trustees might decide to pay for school trips or music lessons – or it may be paid to the beneficiary's parent or guardian.

2.10 The trustees are authorised to pay out "the whole or such part, if any, of the income ... as may, in all the circumstances, be reasonable". Section 31 expressly contemplates that there may be other sources of funds for the beneficiary's maintenance or education: another trust fund, or people – particularly parents – who are legally required to make such provision. The power may be exercisable despite such alternative sources of support.[7]

2.11 The trustees must, however, take various specified factors into account when they consider whether and to what extent to exercise the power. These include:

(1) the age of the beneficiary;

[4] Section 31 refers to a person who is under 18 as an "infant" and to the period from birth to his or her 18th birthday as the beneficiary's "infancy" or "minority".

[5] G Thomas and A Hudson, *The Law of Trusts* (2nd ed 2010), para 14.13, referring to *Re Heyworth's Contingent Reversionary Interest* [1956] Ch 364, 370, by Upjohn J, and *Allen v Coster* (1839) 1 Beav 202.

[6] See paras 2.23 to 2.25 below.

[7] The exercise of the power may incidentally benefit those who are not beneficiaries of the trust fund, and who are relieved of an expense by provision made pursuant to section 31, although the trustees must not set out to achieve this by the exercise of the power: *Fuller v Evans* [2000] 1 All ER 636.

(2) the beneficiary's requirements; and

(3) any other income applicable for the same purposes.

In addition, if the trustees of the XYZ Trust have notice that the income of another trust fund can be applied for (say) X's maintenance, education or benefit, the default rule is that only a proportionate part of the income of the XYZ Trust can be used – unless both trusts are using the whole of the relevant income.[8]

2.12 The trustees must take a conscious and considered decision to make payments of income in the beneficiary's best interests, taking into account all relevant circumstances as required by section 31 and by the general law on trustees' decision-making.[9] They must not simply pay the income over to the beneficiary's parent, without giving proper thought to the issue.[10]

Trust to accumulate the residue of the income

2.13 Suppose that the share of trust income attributable to X in a particular year is £1,000. The trustees exercise their discretion to pay £750 of the income for X's maintenance, education and benefit. Under section 31(2), the remaining £250 must be accumulated. This means that it is added to capital, although even after this has occurred the trustees can at their discretion make payments of accumulated income under section 31(1) as though it were current income.[11]

2.14 The obligation on the trustees to accumulate the £250 under section 31(2) is sometimes known as a "trust to accumulate"; in this context "trust" denotes a duty or obligation. It contrasts with the trustees' power to pay income under section 31(1), which is at their discretion; they may choose whether or not to exercise it, and the extent to which they do so, although this is subject to the constraints noted above and to the proper exercise of their discretion.

2.15 The trustees' obligation to accumulate under section 31(2) can prevent a beneficiary who would otherwise be entitled to the income from having that entitlement. It has been called an "engrafted" trust, meaning that although the beneficiary's interest may at first appear to be absolute, the provisions of section 31(2) cut down the interest.[12] The beneficiary is not entitled to the income after all; although he or she will be entitled to the accumulations of that income on attaining 18 or marrying or forming a civil partnership under that age.[13]

2.16 Section 31(2) can – like the rest of section 31 – be excluded by contrary provision in the trust instrument.[14]

8 Trustee Act 1925, s 31(1).

9 See for example J Mowbray QC and others (eds) *Lewin on Trusts* (18th ed 2008) paras 29-117 to 29-119, 29-137 to 29-164.

10 *Wilson v Turner* (1883) 22 Ch D 521; *Turner v Turner* [1984] Ch 100.

11 Trustee Act 1925, s 31(2), proviso.

12 See for example *Stanley v IRC* [1944] KB 255, 259 by Lord Greene MR; J Mowbray QC and others (eds) *Lewin on Trusts* (18th ed 2008) para 31-12.

13 Under section 31(2)(i)(a); see para 2.20 below.

14 Trustee Act 1925, s 69(2); *Re Turner's Will Trusts* [1937] Ch 15.

Destination of accumulated income

2.17 Section 31 sets out how any income which has been accumulated, and not paid out as current income, should pass. The general rule is that the accumulated income passes with the capital of the trust fund.[15] For example, in the case of the XYZ Trust, the beneficiaries do not become entitled to the capital outright until they are 25, and they have no entitlement to the income until they are 18. Therefore, if X, Y and Z all die while they are under 25, the capital and any income which was accumulated in respect of them while they were under 18 will pass to whoever is entitled under the trust in that event.[16]

2.18 The legislation also specifies two particular cases in which the beneficiary to whom the income relates will take the accumulations outright on reaching 18, or marrying or forming a civil partnership under that age.[17]

2.19 The first occurs where, under the terms of the trust, the beneficiary on reaching 18 or marrying or forming a civil partnership under that age "becomes entitled to the property from which such income arose in fee simple, absolute or determinable, or absolutely, or for an entailed interest".[18] The terms "fee simple, absolute or determinable" and "entailed interest" are relevant to land,[19] while the reference to the beneficiary becoming entitled "absolutely" is relevant to other property.

2.20 The other occurs where, under the terms of the trust, the beneficiary has a vested interest in the income of the trust fund while under 18 and not married or civil partnered. A beneficiary with a vested interest in income does not have to satisfy any contingencies or conditions in order to have a right to the income. For example, the trust document may simply state that the income is to be paid to the beneficiary for life. It has already been noted that such a provision in the trust document would be modified by the engrafted trust to accumulate in section 31(2). Section 31(2)(i)(a) provides that the accumulations made under that engrafted trust are to be held for the beneficiary if he or she attains 18 or marries or forms a civil partnership under that age. It makes the entitlement to those accumulations contingent on either of those events, rather than absolute as would be expected on the face of the trust document. That effect can be excluded by an express provision that the accumulations are to be held for the beneficiary absolutely.[20]

[15] Trustee Act 1925, s 31(2)(ii).

[16] If no one is specified under the trust as being entitled to the fund in that event, the person who created the trust (or his or her estate, if he or she has already died) will become absolutely entitled to it.

[17] There is a further exception for a vested annuity; accumulations made while the annuitant is under 18 are held in trust for the beneficiary absolutely: Trustee Act 1925, s 31(4).

[18] Trustee Act 1925, s 31(2)(i)(b).

[19] A fee simple is a freehold ownership right; an entailed interest is one that can only pass to the direct descendants of the owner.

[20] *Re Delamere's Settlement Trusts* [1984] 1 All ER 584. Note that a mere direction that the beneficiary is to be entitled to the income, by itself, will not be sufficient to exclude the trust to accumulate: [1984] 1 All ER 584, 589 to 590, by Slade LJ.

Trust to pay income to the beneficiary once he or she has reached 18

2.21 Under section 31(1)(ii), once a beneficiary has reached 18 the trustees must pay to him or her the appropriate share of the income. Therefore, in our example Z (who has reached 18) must receive one-third of the income of the XYZ Trust. This is so even though Z will not become entitled to capital until reaching 25.[21]

SECTION 32: POWER OF ADVANCEMENT

2.22 Section 32 of the Trustee Act 1925 is set out in full in the box below; it contains the trustees' power to use the capital of the trust fund to which a beneficiary is contingently entitled, for the beneficiary's advancement or benefit. This is commonly referred to in short form as a "power of advancement"; in this paper we will refer to "the section 32 power".

32 Power of advancement

(1) Trustees may at any time or times pay or apply any capital money subject to a trust, for the advancement or benefit, in such manner as they may, in their absolute discretion, think fit, of any person entitled to the capital of the trust property or of any share thereof, whether absolutely or contingently on his attaining any specified age or on the occurrence of any other event, or subject to a gift over on his death under any specified age or on the occurrence of any other event, and whether in possession or in remainder or reversion, and such payment or application may be made notwithstanding that the interest of such person is liable to be defeated by the exercise of a power of appointment or revocation, or to be diminished by the increase of the class to which he belongs:

Provided that –

(a) the money so paid or applied for the advancement or benefit of any person shall not exceed altogether in amount one-half of the presumptive or vested share or interest of that person in the trust property; and

(b) if that person is or becomes absolutely and indefeasibly entitled to a share in the trust property the money so paid or applied shall be brought into account as part of such share; and

(c) no such payment or application shall be made so as to prejudice any person entitled to any prior life or other interest, whether vested or contingent, in the money paid or applied unless such person is in existence and of full age and consents in writing to such payment or application.

(2) This section does not apply to capital money arising under the Settled Land Act 1925.

(3) This section does not apply to trusts constituted or created before the commencement of this Act.

"Advancement or benefit"

2.23 "Advancement" is difficult to define precisely. It has been said that in this context it means "establishment in life of the beneficiary ... or at any rate some step that would contribute to the furtherance of his establishment".[22] In other words, the central idea is of setting the beneficiary up in life, giving him or her a permanent benefit or advantage: for example, buying a business to be owned and run by the beneficiary.

[21] Some doubt has been expressed as to whether, on a literal reading of section 31, this trust to pay the income applies to a beneficiary who was already 18 (though not yet absolutely entitled to capital) at the time when the trust was created. We agree with commentators' arguments that the trust to pay the income does apply to such beneficiaries: see J Mowbray QC and others (eds) *Lewin on Trusts* (18th ed 2008) para 31-16.

[22] *Pilkington v IRC* [1964] AC 612, 634, by Viscount Radcliffe.

2.24 The term "benefit", however, has a much wider meaning: it has been described as "the widest possible word one could have".[23] Applications of capital for the "benefit" of a beneficiary have included paying a beneficiary's debts,[24] providing a house for young beneficiaries to live in with their parents,[25] and making provision to ameliorate the beneficiary's tax liability.[26] It may even include making charitable donations on behalf of a beneficiary who feels morally obliged to make them,[27] although there are limits on the extent to which such a moral obligation can validly be satisfied from trust assets.[28]

2.25 It is also possible to exercise the section 32 power to create a new (or add to an existing) separate trust; this is sometimes termed a "settled advancement". In the usual case, the beneficiary in question would also be a beneficiary – and probably a principal beneficiary – of that separate trust.[29]

For whom may the power be used?

2.26 The section 32 power can be used in respect of a beneficiary who has some recognised entitlement to the capital of the trust fund but, for a particular reason, cannot require that it should be paid over to him or her now. Suppose that S created a trust to which section 32 applies unamended, and consider the following alternative scenarios:

(1) The trust fund is held for S's son B absolutely, but as he is under 18 he cannot require the trustees to pay the capital over to him. Once he reaches 18 the section 32 power will cease to be exercisable.

(2) S created the trust in her will; the fund is held for all S's children so that they will take it outright in equal shares on attaining 25. If any of them die under 25, but leave children, then those children will take their parent's share at 18. The trustees can exercise the section 32 power in B's favour, even though he is under 25 and therefore not yet absolutely entitled to the capital. B may have children of his own who would benefit from B's share if he were to die under 25. The trustees can exercise the section 32 power in favour of B, even though that reduces the potential entitlement of B's children.

[23] *Re Moxon's Will Trusts* [1958] 1 WLR 165, 168, by Danckwerts J (as he then was).

[24] *Lowther v Bentinck* (1874) LR 19 Eq 166.

[25] *Re Lesser* [1947] VLR 366.

[26] *Re Ropner's Settlement Trusts* [1956] 1 WLR 902.

[27] *Re Clore's Settlement Trusts* [1966] 1 WLR 955.

[28] *X v A* [2005] EWHC 2706 (Ch), [2006] 1 WLR 741, in which the beneficiary requested a very large payment which went beyond her own free assets, but had no intention to satisfy it from those assets if the trustees refused to do so. It was considered that a moral obligation to the extent of that advance could not be supported on the decided cases.

[29] *Pilkington v IRC* [1964] AC 612. There will usually also be other beneficiaries, such as the beneficiary's children or other family members. Alternatively it appears that the beneficiary in question could be excluded from benefit under the new trusts if they were for the benefit of his or her dependants: see, for example, G Thomas and A Hudson, *The Law of Trusts* (2nd ed 2010), para 14.41; J Kessler QC and L Sartin, *Drafting Trusts and Will Trusts: A Modern Approach* (10th ed 2010) para 11.11.

(3) S declared the trust in her lifetime in favour of all her children in equal shares at 25, and is still alive. The trustees can exercise the section 32 power in B's favour even though he is under 25 and even though S may have more children (which would reduce B's share).

(4) The trust is for all of S's children in equal shares at 25, but the trustees have a power of appointment which if exercised can change the shares of the children or redirect one or more shares to S's nieces and nephews. Until they do so, the trustees can use the section 32 power in favour of B.

(5) S's will created a trust by which her husband H is entitled to take the income of the fund for his lifetime, and subject to that the capital is to pass to B outright. The section 32 power can be exercised in favour of B even while H's life interest is still continuing, provided that H agrees to this. That would be the case even if the trust stated that B must reach a specified age (or survive H, or both) before he could take the capital.[30]

2.27 On the other hand, the section 32 power will not be exercisable if the beneficiary has no entitlement to capital. For example, if S left the fund on trust:

(1) so that B would have the right to the income for his lifetime, and the capital would pass to his children at 25 (a life interest trust); or

(2) as to both capital and income for such of her children and grandchildren and in such shares as the trustees in their discretion determine (a discretionary trust)

then the trustees would not be able to exercise the section 32 power in B's favour. In the first example he has an entitlement to income but no entitlement to capital; in the second he has only a hope or expectation of benefiting from the trust fund if the trustees exercise their discretion in his favour. If they were to do so in such a way as to give him a requisite capital entitlement, the section 32 power might then become exercisable.[31]

Consent of beneficiaries with prior interests

2.28 Before the section 32 power can be exercised in favour of a beneficiary, it is necessary to obtain the written consent of "any person entitled to any prior life or other interest, whether vested or contingent, in the money paid or applied" who would be prejudiced by the exercise of the section 32 power.[32]

2.29 For example, funds might be left on trust by will to the deceased's spouse for life, and subject to that the deceased's children take the capital. In such a case the section 32 power could not be exercised in favour of any of the children without

[30] *Re Garrett* [1934] Ch 477.

[31] *Re Hodgson* [1913] 1 Ch 34. There is some debate associated with more complex scenarios; see for example J Mowbray QC and others (eds) *Lewin on Trusts* (18th ed 2008) para 32-24, citing *Attorney-General v Lloyds Bank* [1935] AC 382 at 394, by Lord Tomlin.

[32] Trustee Act 1925, s 32(1)(c).

the spouse's consent; a payment from capital will, of course, diminish the fund which is producing income for the spouse.[33]

2.30 It is not possible to dispense with the consent of a beneficiary with a prior interest, even if that beneficiary cannot be contacted.[34]

How much capital may be paid out?

2.31 The section 32 power can only be used to pay out capital from the share of the beneficiary in question; and the maximum payment is one-half of that share.

2.32 Suppose that S's will settles funds on trust for her children A, B and C in equal shares at 25. One year after her death the value of the trust fund is £300,000. The trustees wish to advance capital to B; the maximum is £50,000, one-half of B's notional one-third share of the trust fund.

2.33 If the value of the trust fund later increases, it appears that the trustees nevertheless cannot make any further use of the section 32 power.[35]

Bringing into account

2.34 If a beneficiary has received a payment under the section 32 power, that payment must be brought into account when the time comes to distribute his or her share. If B is entitled to a one-fifth share of a £500,000 trust fund on attaining 25, and has already received a payment of £25,000 as a house deposit at 21, then that payment must be brought into account (and so B would receive only £75,000, assuming no increase in the value of the fund). This is sometimes termed "bringing into hotchpot" – the idea is that the beneficiary notionally returns the payment to the common pot so that the whole amount can be divided in the appropriate shares.[36]

2.35 It may be that the beneficiary never becomes entitled outright to his or her share. For example, a beneficiary whose entitlement is contingent on attaining 25 may die under that age. In that case any payments already made under the section 32 power do not need to be repaid from the beneficiary's estate.

[33] If a person with a prior interest is bankrupt, his or her trustee in bankruptcy must also agree: *Re Cooper* (1884) 27 Ch D 565. In some respects the exact boundaries of "prior interest" remain to be delineated; see for example *Re Beckett's Settlement* [1940] Ch 279, *IRC v Bernstein* [1961] Ch 399.

[34] *Re Forster's Settlement* [1942] 1 All ER 180.

[35] This follows from *Re Marquess of Abergavenny's Estate Act Trusts* [1981] 2 All ER 643. The relevant power was set out in a private Act of Parliament, but given the similar wording in section 32(1)(a) of the Trustee Act 1925, it is generally considered that the same reasoning is applicable to the section 32 power. See, for example, D Hayton, P Matthews and C Mitchell, *Underhill and Hayton: Law of Trusts and Trustees* (18th ed 2010) para 63.4.

[36] No actual payment is required – even if the advancements made to the beneficiary turn out, on the calculation being made, to exceed his or her share of the entire fund. The amount remaining in the trust fund is valued at the date of actual distribution (rather than the date on which the distribution is due). See further J Mowbray QC and others (eds) *Lewin on Trusts* (18th ed 2008) para 32-28.

PART 3
REFORM

INTRODUCTION

3.1 In this Part we ask consultees to comment on reforms to sections 31 and 32 of the Trustee Act 1925 and on transitional provisions for those reforms.

3.2 We begin by considering reform of section 32, having already made a provisional proposal on that topic in the Consultation Paper.

SECTION 32: THE RESTRICTION TO ONE-HALF OF A BENEFICIARY'S SHARE

The proposal in the Consultation Paper

3.3 We remain of the view we expressed in the Consultation Paper that it would be appropriate to amend the section 32 power so that it is exercisable over the whole of a beneficiary's prospective share under the statutory trusts.[1] We expressed that view only in the context of a discussion of the trusts arising on intestacy, but the arguments in favour of reform are relevant to other trusts.

3.4 While beneficiaries are under 18 there are many reasons why this increased flexibility would help to support them in the most appropriate way, particularly if the trust fund is small. Indeed it may be appropriate for the whole fund to be used for those purposes, in which case it can be wound up, thus saving administration expenses.

3.5 This reform will not affect trustees' duties to exercise the power properly. Their use of the power must be for the benefit of the particular beneficiary.[2] It has been said that:

> This ... follows from a consideration of the fact that the parties to a settlement intend the normal trusts to take effect, and that a power of advancement be exercised only if there is some good reason for it. That good reason must be beneficial to the person to be advanced; it cannot be exercised capriciously or with some other benefit in view. The trustees, before exercising the power, have to weigh on the one side the benefit to the proposed advancee, and on the other hand the rights of those who are or may hereafter become interested under the trusts of the settlement.[3]

3.6 The trustees must also take reasonable steps to safeguard the application of the money for the beneficiary's benefit. They do not have to apply it to the purpose they have decided on themselves; but they cannot simply pay it over to, say, the beneficiary's parent and leave it at that. In such cases they should at least specify

1 Intestacy and Family Provision Claims on Death (2009) Law Commission Consultation Paper No 191, paras 5.50 to 5.52; for the provisional proposal see para 1.5 above.

2 See paras 2.23 to 2.25 above.

3 *Re Pauling's Settlement* [1964] Ch 303, 333, by Willmer LJ.

the purpose and it may well be appropriate for them to make reasonable enquiries as to how the funds have been used.[4]

3.7 It is already, therefore, the case that the trustees must properly consider the relevant circumstances and that the payment must be for the benefit of the beneficiary in question.[5] All that will change is that the trustees will have the option to make payments which exceed one-half of the beneficiary's share and may extend to the whole of it.

3.8 The current statutory limit does define the amount of the trust fund which may properly be applied, and may therefore serve as a restraint upon careless or dishonest trustees. It is more straightforward for a wronged beneficiary to demonstrate simply that more than one-half of the fund has been paid out, than that the trustees have behaved wrongly in making the decision to do so. However, trustees' existing equitable duties should be sufficient to guard against, or allow compensation for, improper applications – of whatever share of the fund. We consider that the advantages of increased flexibility therefore outweigh the risks of increasing abuse or fraud.

3.9 We also acknowledge that the ability to pay out the whole of a beneficiary's presumptive share would mean that if such a beneficiary were to die before being entitled to the capital outright, the beneficiaries who would then be entitled will find that there is nothing left for them to take. We do not think, however, that this justifies a strict rule of preserving one-half of the capital for such beneficiaries. They are, by definition, not primarily in line for benefit under the trust. The primary beneficiary should be first in line for benefit and if the trustees properly consider that the primary beneficiary's interests require it they should be free to use the whole of the trust fund for that purpose. In making that decision they are already required to take into account the interests of those entitled in default.

Responses to the Consultation Paper

Support for the provisional proposal

3.10 The proposal that we made in the Consultation Paper was well-supported by consultees. The reasons given are outlined below, although not all consultees explained why they supported the proposal.

3.11 First, several consultees – both barristers and solicitors – confirmed our perception that it is standard practice to extend section 32 in wills and trust instruments to give the trustees power to advance the whole of the fund to a qualifying beneficiary. They described it as routine, so that it would be unusual not to make the amendment.

3.12 Other consultees referred to the benefit which would be felt by young beneficiaries, in particular because funds would be available when they might be most needed – during a period while the child is dependent on others, and before he or she has the opportunity to become self-supporting. Potential savings in the cost of administering trusts were also mentioned, as well as the advantage of giving trustees the flexibility to wind up small trusts where that was appropriate.

[4] *Re Pauling's Settlement Trusts* [1964] Ch 303, 334, by Willmer LJ.

[5] See para 2.24 above.

The current law was considered to cause problems in these respects due to its inflexibility.

3.13 It was also suggested that trustees probably already make such advancements, in breach of trust. We can see two reasons why that might happen. First, the trustees may consider that the beneficiary's present need is so compelling that it justifies a breach of trust. Secondly, the trustees may overlook the restriction in section 32; by its nature it does not appear in the trust document unless it is being amended, and by virtue of the common practice in drafting wills and trusts referred to above the one-half restriction looks increasingly counter-intuitive. A failure to observe the restriction, however, puts the trustees at the risk of a claim against them personally for breach of trust.

Opposition to the provisional proposal

3.14 Other than the disadvantages of reform limited to the statutory trusts on intestacy (which is examined further below), the main issue raised by consultees who opposed the provisional proposal was that it would reduce protection for young beneficiaries. Two consultees felt that the reform might lead to more trustees abusing their position and dissipating the trust fund which should be held for the young beneficiary.[6] It was noted that in the majority of cases, the trustees of trusts created on intestacy are not expressly selected by the deceased as trustworthy, but are (at least in the first instance) the administrators of the estate.[7] At least two administrators are required where a beneficiary of the estate is under 18,[8] and in the usual case they will be family members.[9]

3.15 The risk of abuse was addressed by two consultees who supported the provisional proposal. One suggested that the involvement of an independent third party should be required in order for the power to be exercisable. The other argued that the risks of abuse were acceptable when set against the advantages of increased flexibility making the power much more useful, particularly in the context of the typically small size of statutory trusts on intestacy.

Reforming section 32 for all trusts

3.16 Six consultees expressly engaged with the issue of reform to section 32 for all trusts. Three supported both the provisional proposal in the Consultation Paper and a wider reform; the other three found themselves unable to support the proposal unless it formed part of such wider reform.

6 Similar considerations may have led to one consultee, while agreeing with the provisional proposal, to mention the possibility of imposing a capital limit on advancements.

7 Exceptionally, the deceased may have left a valid will which appoints executors, but which does not dispose of the whole of the estate. This means that the executors will act but that the way in which the estate (or the part not governed by the will) is inherited will be governed by the intestacy rules. In such a case the executors would be the trustees.

8 Senior Courts Act 1981, s 114(2).

9 In general, entitlement to a grant of letters of administration follows the order of entitlement on intestacy: Non-Contentious Probate Rules 1987, SI 1987 No 2024, r 22. Where a beneficiary who would otherwise be entitled to a grant is under 18, the grant will usually be taken for his or her benefit by a parent, guardian or other responsible person. In some situations this may result in the surviving spouse of the deceased, who is also the parent of the deceased's children, nominating a co-administrator. See further R D'Costa and others (eds) *Tristram and Coote's Probate Practice* (30th ed 2006) ch 7.

3.17 Consultees gave various reasons for favouring an extension of reform of section 32 to all trusts. It was argued that many of the reasons for supporting the reform in the context of the statutory trusts arising on intestacy also applied to other trusts. The Society of Trust and Estate Practitioners and the Institute of Professional Willwriters referred in particular to the prevalence of the amendment in wills and trust documents in support of their argument that the reform should only be made if it applied to all trusts. Consultees also noted that the settlor or testator would have the opportunity to express a contrary intention and thus disapply the default position established by the amendment.[10]

3.18 Consultees also drew attention to the advantages of consistent treatment for all trusts. In particular it was felt that to draw a dividing line between the statutory trusts arising on intestacy on the one hand, and trusts established by will or in the settlor's lifetime on the other, could create a trap for trustees and professional advisers.[11] As well as this risk of confusion, it was pointed out that anomalous results could follow in practice. There would be a difference in treatment between A, a beneficiary taking on intestacy, and B, a beneficiary under a will which was not professionally drafted and did not include provision to extend the scope of the power under section 32. The trustees of the statutory trusts would have more flexible powers to benefit A than the will trustees would have to benefit B.

Our revised provisional proposal

3.19 We think that there is merit in the arguments of consultees that this reform to section 32 should apply generally, and not only to the statutory trusts on intestacy. There are two main reasons for this.

3.20 First, we note the comments of consultees that it is very common to make this amendment to section 32 in any case. This is confirmed by our own research into standard precedents for will and trust drafting, which have for some years recommended such an amendment. For example, the standard provisions for inclusion in wills published by the Society for Trust and Estate Practitioners includes a provision that section 32 shall apply, but with the deletion of the words "one-half of" in section 32(1)(a).[12] Similar provisions are included in other precedent works regarding wills,[13] and are recommended for other trusts.[14]

[10] Trustee Act 1925, s 69(2).

[11] It is important not to overstate this risk in view of the fact that in so many express trusts the limit on the section 32 power is removed.

[12] Society for Trust and Estate Practitioners, *Standard Provisions* (1st ed 1992), clause 4. The same provision is included in the currently available draft of the second edition, on which the Society has consulted.

[13] See, for example, C Sherrin and others (eds) *Williams on Wills* (9th ed 2008) vol 2, para 218.105, Form B18.20; G Ashton and others (eds) *Butterworths Wills, Probate and Administration Service Precedents* (Issue 73, 2011) para 5.196, Form 1A.30.2; Withers LLP, *Practical Will Precedents* (Release 23, 2010) eg Precedent B1a, para B1-013; M Waterworth, *Parker's Modern Wills Precedents* (6th ed 2009), para 12.23, Form 12.3.

[14] See, for example, Withers LLP, *Practical Trust Precedents* (Release 29, 2010) eg Precedent A2a, para A2-023; M Waterworth, *A Practitioner's Guide to Drafting Trusts* (2nd ed 2003) eg Precedent A1.1, clause 4(2).

3.21 Section 32 was originally included in the Trustee Act 1925 to reflect existing practice in drafting wills and trusts.[15] Now that this practice has moved on, we consider that section 32 should be updated accordingly so that it is not necessary for drafters continually to make these amendments.

3.22 We are aware that many precedent books also recommend wider powers to pay or apply capital for beneficiaries' advancement or benefit.[16] For example, a drafter may choose to include a clause which disapplies the requirement to seek the consent of a beneficiary with a prior interest, or which enables trustees to pay capital to a beneficiary who would not qualify as an object of the power in section 32, in particular a beneficiary whose entitlement to the trust fund is restricted to income.

3.23 We acknowledge that it is often sensible to advise that such clauses should be included, for greater flexibility in an appropriate type of trust. However, we do not think that such provisions should be the default for all trusts, so that it would be necessary to opt out of them where they were not appropriate. We think that most settlors would assume that if they have prioritised the interests of beneficiary A over those of beneficiary B, the trustees would not be able to reverse this without A's consent. Similarly, a settlor who has provided for an income interest for one beneficiary would, we think, expect that this would not extend to capital. The purpose of providing, for example, that X is to be entitled to the income of the trust fund for life, and subject to that the capital is to pass to Y, is usually to preserve the capital for Y.

3.24 Secondly, we take the point made by consultees that piecemeal reform could risk confusion and that, unless there are good reasons, these provisions should apply equally to all trusts. It is difficult to know how much of a problem the distinction would create in practice, particularly given the common practice of making the same amendment expressly. But we consider that it would be more straightforward to undertake the same reform for all trusts.

3.25 We are not persuaded that reform will increase the risk of abuse. Dishonest trustees will not be deterred by the current limit and are unlikely to be influenced by its removal; but the removal of the limit may remove a trap for the unwary.

3.26 **We provisionally propose that the power contained in section 32 of the Trustee Act 1925 to pay or apply capital to or for the benefit of a trust beneficiary should be extended, for the purposes of all trusts however established, to the whole, rather than one-half, of the beneficiary's share in the trust fund.**

[15] *Pilkington v IRC* [1964] AC 612, 634, by Viscount Radcliffe.

[16] See, for example, J Kessler QC and L Sartin, *Drafting Trusts and Will Trusts: A Modern Approach* (10th ed 2010) para 11.8.

SECTION 31: THE SECTION 31(1) POWER

3.27 The above provisional proposal will leave the statutory power to pay capital from the trust fund unrestricted in scope and at the trustees' "absolute discretion". This could be seen as creating a mismatch between the statutory power to pay capital under section 32 and the statutory power to make payments of income under section 31(1). The power in section 31(1) is expressed in terms of the payment of income being at the trustees' "sole discretion", but is subject to various requirements, to which precedent books often suggest amendments.

3.28 One recommended amendment is to delete the whole of the proviso to section 31(1), thus removing:

(1) the requirement on the trustees specifically to "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

(2) the requirement that "so far as practicable" the trustees can only use a proportionate part of the income for the maintenance, education or benefit of the beneficiary, if they have notice that the income of another fund or funds is applicable for those purposes.

This is the approach taken by the standard provisions for inclusion in wills published by the Society for Trust and Estate Practitioners.[17]

3.29 Other precedents not only delete the proviso to section 31(1) but also amend section 31(1)(i). Section 31(1)(i) sets up the power to pay or apply income for the beneficiary's maintenance, education or benefit as extending to "the whole or such part, if any, of the income ... as *may, in all the circumstances, be reasonable*". These precedents substitute, for the words here italicised, a phrase such as "the trustees shall in their absolute discretion think fit",[18] or "the trustees may think fit".[19]

3.30 Other precedents customise section 31 to a greater degree, for example by extending the power so that the trustees can use the income of the trust fund at their discretion for the maintenance of any beneficiary in the class of

[17] Society for Trust and Estate Practitioners, *Standard Provisions* (1st ed 1992), clause 4. The same provision is included in the currently available draft of the second edition, on which the Society has consulted.

[18] *Encyclopaedia of Forms and Precedents* (2010 reissue) vol 40(1) Trusts and Settlements, para 4815, Form 180 (sub-clauses 0.1 and 0.2), (2007 reissue) vol 42(1) Wills and Administration, para 4161, Form 306. See also, for example, Withers LLP, *Practical Will Precedents* (Release 23, 2010) eg Precedent B1a, para B1-012, amending section 31 "so that those powers shall be exercisable at the absolute discretion of the Trustees"; also found in Withers LLP, *Practical Trust Precedents* (Release 29, 2010) eg Precedent A2a, para A2-022.

[19] C Sherrin and others (eds) *Williams on Wills* (9th ed 2008) vol 2, para 218.79, Form B18.11; G Ashton and others (eds) *Butterworths Wills, Probate and Administration Service Precedents* (Issue 73, 2011) para 5.196, Form 1A.30.2. See also, for example, M Waterworth, *Parker's Modern Wills Precedents* (6th ed 2009) para 12.23, Form 12.1 ("as the trustees think fit").

beneficiaries.[20] These more sophisticated amendments may be introduced by the drafter for good reasons in a particular trust, but they are not appropriate for all trusts.

3.31 Here we examine whether the default rules for all trusts – those that apply unless active steps are taken to modify or exclude them – should be changed, so as to remove either or both parts of the proviso to section 31(1), or to substitute an unfettered discretion for the requirement of reasonableness.

Using a proportionate part of the income where the trustees have notice of other trusts

3.32 The second part of the proviso to section 31(1) requires the trustees, where they have notice of another fund applicable for a beneficiary's maintenance, to pay only a proportionate part of the income, unless they obtain a court order to the contrary. We take the view that this is unnecessarily restrictive. It may be justified on the basis that, if the remainder beneficiaries of each trust are different, an unequal use of income would be unfair to one or the other.[21] Yet there may be reasons why it is better to use the funds of one trust rather than the other; and there is no parallel requirement in relation to the advancement of capital, which usually makes a more significant inroad on a remainder beneficiary's entitlement. The requirement is an additional administrative burden which has the potential to increase costs, particularly where it is difficult to contact the trustees of the other fund or where it is appropriate to obtain a court order overriding it.

3.33 The omission of this requirement is often recommended in precedents, as noted above; and it is probably unusual to include it in express powers of maintenance. We are not aware that this practice creates injustice or difficulty in trustees' exercise of their discretion.[22] It also seems unlikely that settlors would generally expect such a requirement to be imposed on their trustees, without special provision in the trust document.[23]

3.34 **We provisionally propose that the second part of the proviso to section 31(1) (the requirement that trustees should only pay a proportionate part of the income where they have notice that the income of another fund is applicable for the same purposes) should be removed.**

Matters to which the trustees must have regard

3.35 The rest of the proviso to section 31(1) requires the trustees to have regard to the beneficiary's age and requirements, "and generally to the circumstances of the

[20] *Encyclopaedia of Forms and Precedents* (2010 reissue) vol 40(1) Trusts and Settlements, para 4813, Form 179.

[21] C Sherrin and others (eds) *Williams on Wills* (9th ed 2008) vol 2, para 218.50, going on to acknowledge that the provision "may lead to difficulty and delay" and that, although it only applies "so far as practicable", it is "commonly excluded".

[22] For consideration of the exercise of trustees' discretions in such circumstances, see for example *Smith v Cock* [1911] AC 317.

[23] See *Smith v Cock* [1911] AC 317, rejecting such a requirement and suggesting that it would defeat the intentions of settlors since it "would cause the sum payable by each estate to depend upon the joint discretion of two sets of trustees, a state of things never intended [by either settlor]" [1911] AC 317, 326, by Lord Mersey, delivering the opinion of the Privy Council.

case, and in particular to what other income, if any, is applicable for the same purposes". It could be argued that these circumstances would in any case be in the mind of a trustee who was considering the exercise of the power. The words may therefore be superfluous; but it may be helpful to have some of the most important considerations made express in the statute, as guidance for the trustees.

The requirement of reasonableness

3.36 As regards the "reasonableness" criterion, it has been said that:

> Section 31(1)(i) (standing alone at any rate) gives the impression that the amount of income to be applied depends upon a standard of reasonableness, and that it cramps the discretion of the trustees ... .[24]

3.37 That impression, by itself, would not be a good reason to change the statute unless by so doing we were making a substantive change for the better in the law as applied in practice. The question is whether the reasonableness standard introduces an undesirable element of objectivity into the trustees' exercise of their discretion. In other words, is there a serious concern that even if trustees have acted honestly and in good faith, they may be open to a legal challenge to the exercise of their discretion on the basis that they have paid out more – or less – of the income than is objectively reasonable?

3.38 We note that the Society for Trust and Estate Practitioners' standard provisions for inclusion in wills, while removing the whole of the proviso to section 31(1), make no amendment to section 31(1)(i). However, a review of these provisions when they were first published in 1992 criticised them on this point, noting that:

> This objective test is frequently modified to give the trustees an uncontrolled discretion which some (including this reviewer) would regard as an improvement.[25]

As noted above, several standard precedents do advocate making such a change.

3.39 We should appreciate consultees' comments on this point and on their reasons for preferring one course of action or another.

3.40 **We ask consultees whether further changes should be made to the power to pay or apply income for a beneficiary's maintenance, education or benefit contained in section 31(1) of the Trustee Act 1925, and in particular whether it would be beneficial to make one or both of the following amendments:**

(1) **delete the first part of the proviso to section 31(1);**

[24] C Sherrin and others (eds) *Williams on Wills* (9th ed 2008) vol 2, para 218.63.

[25] W Norris, "The Society of Trust and Estate Practitioners standard trust provisions" [1993] *Private Client Business* 232, 236. See also, for example, M Waterworth, *Parker's Modern Wills Precedents* (6th ed 2009) para 12.3, referring to the amendment as made "to widen the trustees' discretion".

(2) **redraft section 31(1)(i) so as to remove the words "as may, in all the circumstances, be reasonable" and substitute an unfettered discretion.**

Other amendments to section 31

3.41 The other provisions of section 31 are also subject to amendment in express trusts. For example, a settlor may choose to delay the beneficiary's entitlement to income under section 31(1)(ii), prolonging the trust to accumulate under section 31(2) (and the power under section 31(1)) as appropriate.[26] The provisions in section 31(2) as to the destination of the accumulations can also be changed; in particular, a settlor might choose to provide that the accumulations should be held on trust for the beneficiary in question outright.[27]

3.42 It has been suggested that there is generally an oddity about the provisions of section 31(2)(i) in that it converts a beneficiary's vested interest in income into a contingent interest. Such a beneficiary is not entitled outright to the accumulations of income, and they will not pass with the beneficiary's estate if he or she dies before satisfying the contingency in section 31(2)(i)(a).[28] This is despite the provisions of the trust purporting to give the beneficiary the right to the income throughout. One leading textbook describes this as a "peculiar effect".[29]

3.43 There is, however, little evidence of a demand for a change to the default position, which is well-established. And we do not think that the amendments which are made expressly to some trusts are likely to be appropriate, or expected, for all trusts. It seems reasonable that settlors who require such amendments should incorporate them expressly into the trust deed or will. We therefore do not propose amendments to the remaining provisions of section 31.

TRANSITIONAL ISSUES

3.44 If any of the above reforms are taken forward, it will be necessary to consider the transitional provisions which should be applied, and determine the application of the legislation implementing reform to new and existing trusts.

Existing trusts

3.45 We consider that it is not appropriate for this reform to apply to trust interests which were already in place before its commencement date. This would change the basis of existing trust arrangements. In particular, trustees would be able to use all of the capital held for a beneficiary who has a pre-existing contingent entitlement, and therefore change the entitlement of the default beneficiaries who are entitled to the capital subject to the primary beneficiary's interest.

[26] See, for example, G Ashton and others (eds) *Butterworths Wills, Probate and Administration Service Precedents* (Issue 73, 2011) para 5.208, Form 1A.30.11; Withers LLP, *Practical Will Precedents* (Release 23, 2010) Precedent F17k, para F17-351.

[27] C Sherrin and others (eds) *Williams on Wills* (9th ed 2008) vol 2, para 218.83, Form B18.15.

[28] See paras 2.13 to 2.20 above.

[29] G Thomas and A Hudson, *The Law of Trusts* (2nd ed 2010), para 14.17.

3.46 One consultee argued that the provisional proposal in the Consultation Paper should be made retrospective for the statutory trusts. He pointed out that this deprivation of the secondary beneficiaries would only be felt in the (usually unlikely) event that the primary beneficiary fails to satisfy the contingency; and only as to the one-half of the trust fund to which the section 32 power does not currently extend. He considered that this risk would be worthwhile given the advantages which could accrue from increased flexibility being given to existing statutory trusts. We appreciate this point but consider that, particularly in view of the human rights considerations relevant to deprivation of existing property rights,[30] it is not open to us to adopt this course.

New trusts

3.47 The reforms would apply to new trusts – by which we mean those created on or after the commencement date, other than trusts which are created by trustees using their powers under an existing trust, which we discuss separately below. This can be applied simply to trusts created in the settlor's lifetime and to the statutory trusts which arise on intestacy (where the reforms would apply if the person whose estate is governed by the intestacy rules died on or after the commencement date).

3.48 Will trusts, however, are more difficult. A person may determine the terms of the will trust by executing his or her will – perhaps several years prior to death. However, a will does not become effective until the death of the person who made the will; the trust would not actually be constituted until the death. Should the reforms apply to new will trusts only where the will was executed following commencement, or for all deaths after commencement?

3.49 The approach of applying the reforms only to wills executed after the commencement date is appropriate where it is particularly important for testators to be aware of the change. On 1 January 1970, section 31 was amended to specify the age of 18 as the age at which beneficiaries would be entitled to income as of right, whereas before the age had been 21.[31] That change does not apply to wills executed before that date.[32] This upheld the expectations of testators who had executed their wills on the basis that a beneficiary would not have an absolute right to income from the trust until the age of 21. On the other hand, the reforms we have provisionally proposed in this Supplementary Consultation Paper leave the decisions to be made as to payments of income and capital under sections 31 and 32 in the hands of the trustees. They do not

[30] In particular, Article 1 (protection of property) of the First Protocol to the European Convention on Human Rights and Fundamental Freedoms, incorporated into English law by the Human Rights Act 1998, s 1 and sch 1.

[31] Family Law Reform Act 1969, s 1.

[32] Family Law Reform Act 1969, s 1(2)(b). This is the case even if the pre-1970 will has been confirmed by a post-1969 codicil: s 1(7). The Perpetuities and Accumulations Act 2009 takes a similar approach in relation to many of its provisions: s 15(1).

affect beneficiaries' rights under the trust in the same way as the change to the age specified in section 31.[33]

3.50 We note that when sections 31 and 32 were included in the Trustee Act 1925, they became effective for all will trusts where the death occurred post-commencement.[34] Section 31 replaced, with amendments, an older statutory provision;[35] section 32 had no statutory precedent, and was based on established drafting practice. We consider that it would be appropriate to take the same approach for the reforms outlined above. This has the advantage of being the clearest and simplest rule and avoids treating trusts differently depending on whether they were established on intestacy or by the making of a will, which could cause unnecessary confusion, particularly in a case of partial intestacy.

3.51 There may be some cases in which testators have chosen to leave either section 31 or section 32 unamended because they are aware of the current state of the law and are satisfied with it. We do not think that there will be many such cases. This is partly because amendments to sections 31 and 32 in lifetime trusts and wills are common; and because even where the provisions are not amended this will not always be as the result of a conscious decision to leave them as they stand. A testator who makes a homemade will, for example, is unlikely to have these provisions in mind.

3.52 In some cases where testators have deliberately left sections 31 and 32 unamended it will be possible for them to change their wills to reverse the effect of the reforms. We are, however, mindful of the fact that a testator's ability to take advantage of that opportunity depends on whether he or she is aware of the change and has the mental capacity to make a new will or a codicil as required.

3.53 We anticipate that it will be possible to make the statutory amendments to the provisions without adversely affecting testators who have already made modifications to sections 31 and 32. The statutory powers are excluded where they are inconsistent with express powers.[36] Where a settlor has made amendments to the statutory powers which do not coincide with these reforms, using the existing text of the provisions to specify particular amendments, these should be treated as express powers and not affected by the reforms.

Trusts created after commencement by the exercise of a power of appointment or advancement under a pre-existing trust

3.54 New trust provisions may be created after commencement by trustees exercising a power of advancement or appointment which pre-dates commencement. How should the reforms apply when this occurs?

[33] The situation is also distinguishable from the provision made in the Perpetuities and Accumulations Act 2009. The imposition of a single mandatory perpetuity period (under section 5), in particular, would have had the potential to disrupt existing incompatible trust provisions. See The Rules Against Perpetuities and Excessive Accumulations (1998) Law Com No 251, para 8.18.

[34] Trustee Act 1925, s 31(5) (a will comes into operation on the death of the person who made it), s 32(3) (a will trust is "constituted or created" on death: *Re Darby* (1943) 59 TLR 418).

[35] Conveyancing Act 1881, s 43.

[36] *Re Evans' Settlement* [1967] 1 WLR 1294.

3.55 For example, suppose that A creates a trust under which his trustees have discretion to make provision, by exercising a power of appointment, as to how the fund is distributed between his children and grandchildren – the shares in which they take and the conditions on their entitlements. Subject to any exercise of their discretion, the trust fund will be shared equally between the children and grandchildren living 50 years after the trust was established. The trustees exercise that power of appointment to provide that part of the fund is to be held on trust so that each of A's grandchildren B, C and D will take an equal share outright if they reach the age of 25.

3.56 A power of appointment of this type is termed a "special power of appointment" because the class of possible beneficiaries is limited: in this instance, it is limited to the settlor's children and grandchildren. A "general power of appointment", on the other hand, is a power which enables the person exercising it to appoint to anyone in the world, including himself or herself. This means that a person who holds a general power of appointment is in a position equivalent to owning outright the property which is subject to the power.

3.57 Since a general power of appointment is equivalent to having the property under one's own control, the same rules should apply to trusts created under such appointments as to entirely new trusts which are settled. So we think that the reformed provisions should apply where the power is exercised after commencement.[37]

3.58 We believe that a similar rule should apply where the new trusts are established by a power of advancement. For example, trustees hold property on trust for A for life and subject to that for A's three children in equal shares on reaching 30. Section 32 applies to the trust without amendment. The trustees decide, with A's consent, to use the section 32 power to take one-half of each child's share and settle it on trusts by which that child will have an immediate right to the income and become entitled to the capital at 30.

3.59 In such cases it is considered that the trustees may include in the settled advancement new powers exercisable by the trustees of the trusts thereby created, including powers of advancement. An express power in the same terms as the section 32 power was included in the settled advancement proposed in *Pilkington v IRC.*[38] It was held that this did not involve an impermissible "delegation" of the trustees' original powers: since section 32 enabled them to settle the funds advanced, the trustees had the authority to do so on the trusts envisaged.[39]

3.60 In the usual case the power of advancement under which the settled advancement is made will either be the section 32 power itself, or will be in similar terms. Therefore, it seems that it would be unusual for any delegation

[37] *Re Bransbury's Will Trusts* [1954] 1 WLR 496 (application of section 32 of the Trustee Act 1925 where a general power of appointment conferred by a pre-1926 instrument had been exercised after 1925).

[38] [1964] AC 612.

[39] *Pilkington v IRC* [1964] AC 612, 639, by Viscount Radcliffe; see also J Mowbray QC and others (eds) *Lewin on Trusts* (18th ed 2008) para 32-20.

involved in incorporating the statutory powers in sections 31 and 32 to be unauthorised.

3.61 Trustees do need to exercise caution so as to avoid including powers in advancements which are so wide that the advancement is no longer for the benefit of the beneficiary in question, and therefore is an impermissible use of the power. It is difficult to imagine cases in which the reforms set out above would cause significantly more problems in this respect than the provisions as they currently stand. Therefore we think that in such specialised cases it would be reasonable for the burden of excluding the provision to be on the trustees who are making the advancement.

3.62 Should the same rule apply to special powers of appointment? When a special power of appointment is exercised, as in the example of the appointed trust for B, C and D, the provisions created can be considered as filling in the blanks left by the settlor of the original trust. The new provisions are not free-standing; they are, in a sense, read back into the original trust.[40]

3.63 It has been established that the exercise of a power of appointment to create new trusts can – if the terms of the power of appointment are sufficiently wide – include a power of advancement applicable to those trusts. In the decided cases, the advancement was limited to one-half of the trust fund; that is, it was not more extensive than that in section 32.[41] In *Re Morris' Settlement Trusts* Jenkins LJ commented that:

> A power of advancement is a purely ancillary power, enabling the trustees to anticipate by means of an advance under it the date of actual enjoyment by a beneficiary ... and it can only affect the destination of the fund indirectly in the event of the person advanced failing to attain a vested interest.

He referred to such powers of advancement as being part of "normal conveyancing practice which made such powers no more than 'common form' incidents of interests conferred ...".[42]

3.64 We agree with the view taken by commentators that in such cases the trustees would similarly be able to include in the appointed trusts a power of advancement which applies to the whole of the capital of the trust fund, in accordance with the now common drafting practice of removing the one-half restriction in section 32.[43] Equally, assuming a sufficiently wide enabling power, they should be able to make provision as to the income of the appointed trust fund covering the same ground as section 31 – giving the trustees power to pay or apply it for

[40] Thus the perpetuity period of the original trust applies to them: *Muir v Muir* [1943] AC 468.

[41] *Re Mewburn's Settlements* [1934] Ch 112; *Re Morris' Settlement Trusts* [1951] 2 All ER 528.

[42] [1951] 2 All ER 528, 532.

[43] See for example J Kessler QC and L Sartin, *Drafting Trusts and Will Trusts: A Modern Approach* (10th ed 2010) para 11.5, arguing (at n 24) that *Re Joicey* [1915] 2 Ch 115 does not represent the current law; J Mowbray QC and others (eds) *Lewin on Trusts* (18th ed 2008) para 29-93.

beneficiaries' maintenance, education and advancement, requiring it to be accumulated, paid out to or held for a beneficiary, and so on.

3.65 It therefore seems to us that a similar approach should be taken to trusts created by a special power of appointment as is used for those created by a power of advancement. The two are not the same, but we think that they are sufficiently similar in practice to justify the same rule being applied to both. This would also have the advantage of simplicity.

3.66 We are aware that when the Trustee Act 1925 itself came into force on 1 January 1926, the approach taken where a special power of appointment is exercised differed between section 31 and section 32. Section 31 applies to trust provisions created following commencement by the exercise of a pre-existing power of appointment, but section 32 does not. This reflects the divergent wording of the two provisions.[44]

3.67 We do not think that it is necessary to continue that divergence in relation to these reforms. It appears to us that in the majority of cases, trusts currently in existence which include powers of appointment wide enough to enable the creation of new trusts are unlikely to include limits which prevent the trustees from including powers to use income and capital which reflect the reforms to the statutory powers which we have outlined above. While we acknowledge that there is an important technical difference between powers of appointment and powers of advancement, we do not think that it requires us to adopt a different approach in relation to the transitional provisions for these reforms.

3.68 **We provisionally propose that the reforms to sections 31 and 32 of the Trustee Act 1925 should apply (subject to section 69(2) of the Trustee Act 1925) in relation to interests arising under instruments which take effect after the commencement of the implementing legislation. This includes:**

(1) **interests arising under wills that take effect on the death of the testator after commencement; and**

(2) **interests arising by the exercise, after commencement, of general powers of appointment, special powers of appointment and powers of advancement contained in instruments which had already taken effect before commencement.**

[44] For section 31 the relevant interests arise by virtue of the appointment, and so it is the date of the exercise of the power which is relevant: *Re Dickinson's Settlements* [1939] Ch 27 (and see *Begg-McBrearty v Stilwell* [1996] 4 All ER 205). Section 32(3) however focuses on the date at which the trust was "constituted or created", and since the exercise of a power of appointment is read back into the existing settlement, the date of the appointment is irrelevant: *Re Batty* [1952] Ch 280.

PART 4
LIST OF PROVISIONAL PROPOSALS AND CONSULTATION QUESTIONS

INTRODUCTION

4.1 In this Part, we set out the provisional proposals and consultation questions on which we are inviting the views of consultees. We should be grateful for comments not only on the issues specifically listed below, but also on any other points raised in this Supplementary Consultation Paper.

4.2 It would be helpful if, when responding, consultees could indicate either the paragraph of this list to which their response relates, or the paragraph of this paper in which the issue was raised.

SECTION 32: THE RESTRICTION TO ONE-HALF OF A BENEFICIARY'S SHARE

4.3 We provisionally propose that the power contained in section 32 of the Trustee Act 1925 to pay or apply capital to or for the benefit of a trust beneficiary should be extended, for the purposes of all trusts however established, to the whole, rather than one-half, of the beneficiary's share in the trust fund.

[paragraph 3.26]

SECTION 31: THE SECTION 31(1) POWER

4.4 We provisionally propose that the second part of the proviso to section 31(1) (the requirement that trustees should only pay a proportionate part of the income where they have notice that the income of another fund is applicable for the same purposes) should be removed.

[paragraph 3.34]

4.5 We ask consultees whether further changes should be made to the power to pay or apply income for a beneficiary's maintenance, education or benefit contained in section 31(1) of the Trustee Act 1925, and in particular whether it would be beneficial to make one or both of the following amendments:

(1) delete the first part of the proviso to section 31(1);

(2) redraft section 31(1)(i) so as to remove the words "as may, in all the circumstances, be reasonable" and substitute an unfettered discretion.

[paragraph 3.40]

TRANSITIONAL ISSUES

4.6 We provisionally propose that the reforms to sections 31 and 32 of the Trustee Act 1925 should apply (subject to section 69(2) of the Trustee Act 1925) in relation to interests arising under instruments which take effect after the commencement of the implementing legislation. This includes:

(1) interests arising under wills that take effect on the death of the testator after commencement; and

(2) interests arising by the exercise, after commencement, of general powers of appointment, special powers of appointment and powers of advancement contained in instruments which had already taken effect before commencement.

[paragraph 3.68]

APPENDIX A
RESPONDENTS TO PROVISIONAL PROPOSAL IN CONSULTATION PAPER NO 191

Association of Contentious Trust and Probate Specialists

Boodle Hatfield

Sheila Campbell

Chancery Bar Association

City of Westminster and Holborn Law Society

Convenient Wills

Cripps Harries Hall LLP

Davenport Lyons

Richard Dew

Andrew East

Family Justice Council, Money and Property Committee

Family Law Bar Association

Farrer & Co LLP

Giles Harrap

Gregory Hill

Institute of Professional Willwriters

Chris Jarman

Donald Jolly

Judges of the Chancery and Family Division of the High Court

Law Reform Committee of the Bar Council

Law Society

Official Solicitor

Francesca Quint

Sidney Ross

Royal Bank of Scotland Trust & Estate Group

Paul Saunders

Society of Trust and Estate Practitioners

Anne Thom

Trust Law Committee

Richard Wallington

Mary Welstead

Withy King LLP

The Woodland Trust

The Yorkshire Law Society