



BY-PASS TRUST FOR USE WITH DEATH BENEFITS UNDER A LONDON & COLONIAL SIPP

CLIENT GUIDE (April 2011)

CONTENTS

- 1. INTRODUCTION – SIPP_s AND INHERITANCE TAX**
- 2. DEATH BENEFITS THAT CAN BE PAID UNDER THE LONDON & COLONIAL SIPP**
- 3. PAYMENT OF DEATH BENEFITS – THE GENERAL RULES**
- 4. THE OBJECTIVES OF THE LONDON & COLONIAL BY-PASS TRUST AND HOW IT ACHIEVES THESE**
- 5. CASE STUDY – HENRY AND JEAN**
- 6. SOME QUESTIONS ON THE LONDON & COLONIAL BY-PASS TRUST**
- 7. THE LONDON & COLONIAL BY-PASS TRUST PROVISIONS IN DETAIL**

This Guide should be read in conjunction with the London & Colonial By-Pass Trust Technical Guide which covers many of the taxation issues.

Important note:

This trust should only be used with the London & Colonial SIPP under which the Scheme Trustee has a discretion to pay lump sum death benefits to any person in the discretionary class and the discretionary class includes the trustees of a trust declared by the member of the SIPP.

1. INTRODUCTION - SIPPs AND INHERITANCE TAX

(a) The Impact of Inheritance Tax

Inheritance tax (IHT) can significantly diminish the amount of a person's estate that is inherited on death. On a person's death, IHT applies at a flat rate of 40% on the excess over the nil rate band. This is £325,000 in 2011/12 and is scheduled to stay at that level until 5 April 2015.

An important exemption for inheritance tax is the spouse exemption. This exemption prevents IHT arising on the transfer of assets between UK domiciled spouses. **It should be noted that Registered Civil Partners are treated as being married for IHT purposes and any mention of spouse in this Guide should be taken to also refer to a Registered Civil Partner.**

The Finance Act 2008 provides that any percentage of the nil rate band not used on the death of the first of a married couple or registered civil partners to die can be utilised on the survivor's death if that survivor dies after 8 October 2007. Whilst this is a welcome relief, many married couples will find that the value of their combined estates may well still fall into the inheritance tax net. For example, currently on the death of a surviving spouse with a taxable estate of £1 million, an IHT charge of £140,000 would arise even though two full nil rate bands may be available.

For married couples, the fact that an individual can leave an unlimited amount of assets to a UK domiciled surviving spouse free of inheritance tax may act as a disincentive for them to carry out any planning to minimise the liability. But, of course, this will cause both sets of assets to be aggregated in the taxable estate of the survivor and, even though two nil rate bands may be available on the survivor's death, will mean that the aggregate sum will be fully exposed to inheritance tax.

(b) Pension Schemes and Inheritance Tax

Where a person is a member of a registered pension scheme, such as the London and Colonial SIPP, a substantial lump sum can become payable on that person's death. Such payments are free of inheritance tax if made within two years of the Scheme Trustee being notified (or, if earlier, being reasonably aware) of the member's death. Whilst this is welcome for the receiving beneficiary, unless the cash is spent during that beneficiary's lifetime, on the subsequent death of the receiving beneficiary it could be potentially subject to inheritance tax. This problem is likely to be particularly acute where the beneficiary is the member's surviving spouse.

The London & Colonial By-Pass Trust seeks to overcome this problem. If a member of a SIPP establishes a By-Pass Trust during their lifetime and death benefits are paid before an annuity has been purchased (ie. before pension benefits have been vested or while in payment as a drawdown pension) then if the payment is to the Trust rather than to a beneficiary, it will be possible to mitigate any future potential IHT tax liability on the lump sum without necessarily denying the member's surviving spouse access to the trust assets.

The Trust is called a By-Pass Trust because the pension scheme death benefits are not paid to the surviving spouse and are not part of their taxable estate. Instead, they are paid to a trust under which the spouse can benefit. The Trust can therefore incorporate flexibility over who benefits under it and, in particular, means that the trustees can pay some benefits to the pension scheme member's spouse without all of the trust assets forming part of their taxable estate. In other words, only amounts actually paid to the surviving spouse from the Trust would be part of the surviving spouse's taxable estate and, of course, if those amounts are spent the surviving spouse's taxable estate will not be increasing.

While the By-Pass Trust offers the opportunity for effective inheritance tax planning, it also gives rise to a number of tax implications. Some of these are touched on in this document but more comprehensive coverage is contained in the Technical Guide.

2. DEATH BENEFITS THAT CAN BE PAID UNDER THE LONDON & COLONIAL SIPP

Before considering the By-Pass Trust in detail, it is first appropriate to look at the rules that apply to the payment of death benefits under the London & Colonial SIPP.

(i) Overview

The death benefits payable under the London & Colonial SIPP will depend upon a number of factors, including the following:

- Whether all or part of the member's benefits have been crystallised (ie vested) and, if they have, what form those benefits have taken (e.g a lifetime annuity or a drawdown pension).
- Whether the member's benefits include any protected rights (ie. benefits that replace their entitlement to State additional pension benefits while the individual was contracted out under a suitable occupational, personal or stakeholder pension scheme).

(ii) Protected Rights

Protected rights can be transferred into a SIPP. The payment of protected rights on the death of a member is, however, subject to different rules. In particular, lump sum death benefits can only be paid if the member dies leaving no surviving spouse/civil partner. From 6 April 2012 protected rights benefits will be paid in the same way as other benefits.

Until 6 April 2012, in order for a member of a SIPP to facilitate a payment of protected rights to the By-Pass Trust they would need to make a binding nomination in favour of the Trust. The inheritance tax treatment on the payment of protected rights benefits is dealt with in more detail in the Technical Guide.

3. PAYMENT OF DEATH BENEFITS – THE GENERAL RULES

In this section we consider when death benefits may be paid and how they may be subject to inheritance tax.

(1) LUMP SUM DEATH BENEFITS PAID UNDER A SIPP

Death benefits can be paid under the London & Colonial SIPP in a number of situations. The use of the By-Pass Trust may be appropriate in the following two sets of circumstances:-

- before any retirement benefits are drawn - this is known as uncrystallised benefits; and
- where the member has opted for a drawdown pension.

(A) Member dies with uncrystallised benefits

Where a member of the London & Colonial SIPP dies before any retirement benefits have been drawn a lump sum death benefit can normally be paid out free of inheritance tax provided the trustees make the payment, in general, within 2 years of the member's death. Lump sum death benefits will also be free of income tax if the member dies before age 75. Otherwise they will be subject to a 55% recovery tax charge.

The question then arises as to who those death benefits can be paid.

Where a member of the London & Colonial SIPP dies and has some uncrystallised benefits, the Scheme Trustee has a discretion to pay a lump sum death benefit to anybody who falls within the definition of beneficiary in Rule 21.1 of the SIPP Rules. The potential beneficiaries include the member's relatives (ie. the member's widow(er), children and grandchildren. **In particular, the Scheme Trustee can make a payment to the trustees of a separate personal trust that has been established by the member during their lifetime for the benefit of those relatives.**

The SIPP member should indicate to the Scheme Trustee who he would wish to benefit on his death by completing a "nomination/expression of wish" form. The member can nominate the trustees of an existing "personal trust" as people who can receive death benefits. It is important to note that lump sum death benefits can only pass free of IHT because they are payable at the discretion of the Scheme Trustee and therefore any "nomination/expression of wish" form completed by the member is not binding on the Scheme Trustee. In considering a nomination the Scheme Trustee will need to first of all be satisfied that the person nominated is an appropriate Beneficiary to receive the death benefits.

The London & Colonial SIPP scheme offers a "nomination/expression of wish" form for the SIPP member to indicate who he would wish death benefits to be paid to.

Example - Jane

Under the rules of Jane's London & Colonial SIPP, the Scheme Trustee has a discretion to pay benefits to anybody who is in the discretionary class of beneficiaries. This includes the "trustees of any discretionary trust" nominated by the member.

Jane declares a London & Colonial By-Pass Trust with a gift of £10. She then gives the Scheme Trustee a non-binding expression of wishes form requesting that, in the event of her death, death benefits are paid to the trustees of her personal Discretionary (By-Pass) Trust. Separately, she gives those personal trustees a non-binding letter of wishes as to who she would wish them to pay benefits to and when. The trustees can then pay the cash out of the trust or keep the cash in the Trust.

In order to achieve freedom from inheritance tax, the payment of the lump sum death benefit must be made within two years of the Scheme Trustee being notified (or, if earlier, being reasonably aware) of the member's death. This rule applies irrespective of whether the lump sum death benefits are paid to an individual or a trust – such as the By-Pass Trust. Therefore, even where the Scheme Trustee may have difficulty in deciding to whom the payment is to be made, the payment must be made within the two year period to avoid inheritance tax. Failure to pay the lump sum death benefits within this period may also result in the benefit being taxed as an unauthorised payment which would lead to substantial income tax liabilities. This will depend on the precise circumstances.

Example – Jason

Jason has a London & Colonial SIPP under which death benefits are paid at the discretion of the Scheme Trustee. He declares a By-Pass Trust for a nominal £10. He then completes a nomination/expression of wishes form requesting the Scheme Trustee to make the payment to the trustees of his Discretionary By-Pass Trust on his death. Jason also completes a further expression of wishes asking his trustees to keep the benefits in trust until his two grandchildren attain age 21 and then pay them.

On Jason's death, the death benefits are paid to the trustees. The grandchildren are then aged 11 and 13. In accordance with Jason's wishes, those trustees keep the death benefits in the trust until Jason's grandchildren attain age 21 and then make payment to them.

(B) Death while taking unsecured pension

Where a member of a SIPP dies whilst in receipt of a drawdown pension, lump sum death benefits will be subject to a recovery tax charge of 55%. However, no inheritance tax charge will apply provided, in general, the payment is made within 2 years of the member's death.

Under the current pension tax regime there is no requirement for a member of a money purchase scheme, which includes a SIPP, to purchase an annuity when they draw benefits. Instead, where a member wishes to draw all or part of their retirement benefits on or after age 55 under a SIPP they will be able to take a drawdown pension.

Where a member dies while taking a drawdown pension, their residual SIPP fund is available to provide death benefits. Benefits can be paid, subject to the scheme rules, in total or in part as

- (i) a dependant's scheme pension
- (ii) a dependant's annuity
- (iii) dependant's income withdrawal payments
- (iv) a lump sum death benefit paid at the discretion of the Scheme Trustee (to, for example, the trustees of a By-Pass Trust)

The Scheme Trustee would normally select the form of benefit to be paid. Should the lump sum option in (iv) be selected, the death benefits would normally be paid to the By-Pass Trust. Section (3) below sets out how protected rights can be dealt with.

Where a lump sum death benefit is to be paid this will be subject to an automatic recovery tax charge of 55%.

Clearly, where a lump sum death benefit is to be paid, payment to the By-Pass Trust will be an attractive option – especially when the surviving spouse does not require income because she has, for example, inherited other assets, including investments, on the member's death.

On the other hand if following the death of the member, the surviving spouse takes income drawdown pension, on the surviving spouse's subsequent death the pension fund will, most commonly, be paid as a lump sum. At that point it may be desired that the benefits are not paid to one particular individual – for example, a child who may already have his/her own potential IHT liability. In these circumstances it may be useful to have the facility to arrange for the payment to be made to the By-Pass Trust and used for different beneficiaries at different times depending on their needs and the exercise of the trustees' discretion.

In the case of payments under both (A) and (B) above, in general, no IHT liability will arise on the payment of lump sum death benefits by the Scheme Trustee within two years of the member's death. However, there are certain occasions when IHT considerations may arise and these are dealt with in the Technical Guide.

(2) THE BENEFITS OF USING PERSONAL TRUSTS TO RECEIVE DEATH BENEFITS

By setting in place arrangements so that death benefits could be paid to a separate personal trust (such as the London & Colonial By-Pass Trust), the member can secure several advantages.

As well as providing scope for future inheritance tax saving, if the Scheme Trustee exercises their discretion to pay lump sum death benefits to a personal trust, it will then be the trustees of that personal trust who decide who receives benefits in the future. The use of a separate personal trust in respect of the death benefits under the SIPP therefore gives the member more control over who is to ultimately benefit under the Trust, in that it will be the trustees

selected by the member, and not the Scheme Trustee, who will be making the decision as to who benefits on a distribution of capital from the Trust.

To give maximum flexibility over who can benefit, a discretionary trust can be used. In this respect the use of such a personal trust will give greater continuing flexibility than a disposal of death benefits direct to beneficiaries via the Scheme Trustee.

Problems may sometimes arise where it is desired to make payments to minor beneficiaries because, in such cases, it would normally be appropriate for the Scheme Trustee to declare a new trust into which to pay death benefits to be held for those beneficiaries. This is likely to complicate matters and probably result in a delay in making the lump sum payment. The use of a personal trust (such as the London & Colonial By-Pass Trust) established during the member's lifetime can help avoid this problem.

4. THE OBJECTIVES OF THE LONDON & COLONIAL BY-PASS TRUST AND HOW IT ACHIEVES THESE

The objective of the London & Colonial By-Pass Trust is to provide a flexible structure to receive death benefits from a SIPP which can provide for the payment of those benefits to a wide range of beneficiaries including the member's widow/er and dependants.

In general, the London & Colonial By-Pass Trust can continue for up to 21 years from the date of the death of the Settlor (the SIPP member). All payments made from the SIPP will be free from inheritance tax if paid, in general, within 2 years of the member's death. Further information on inheritance tax is given in the Technical Guide.

The surviving spouse (**as widow or widower**) will be one of the Discretionary Beneficiaries and the trustees (of whom the surviving spouse could be one) can make appointments of trust capital, if necessary, to the surviving spouse without the trust fund being treated as forming part of the estate of the surviving spouse.

The trustees have power to grant interest-free loans to a Beneficiary (including the surviving spouse) and this can represent a particularly attractive inheritance tax planning opportunity. This is dealt with in more detail in the Technical Guide.

5. CASE STUDY – HENRY AND JEAN

Henry is aged 58. He is married to Jean who is 56. They have two adult children, Brian aged 29 and Jenny 27. Both children are married with families of their own.

Henry has a London & Colonial SIPP to which he has transferred the benefits from his previous occupational scheme. The plan has a current value of £700,000 - which is also the amount payable on death should he die before he draws his benefits. So far, he has not drawn any benefits from the plan. When he originally set up the plan, he completed a nomination/expression of wish naming his wife Jean (one of the Discretionary Beneficiaries) as the intended recipient of death benefits. Nothing has changed.

Should Henry die now, the Scheme Trustee under the London & Colonial SIPP would need to decide to whom they should pay the death benefits. It is very likely that they would act in accordance with Henry's expression of wishes and make payment to Jean. But would that be the most tax efficient solution? Certainly Jean would then have the benefit of £700,000 in cash but that would increase the potential IHT liability by £280,000 on her subsequent death. What's more, if she wished to make a gift of the cash to the next generation, this would involve her:-

1. needing to survive the gift by 7 years for maximum IHT efficiency, and
2. assessing her likely need for income from, and access to, the funds in the future so as to take account of the gift with reservation rules.

So could matters have been arranged more tax efficiently? Indeed they could - provided Henry had established a London & Colonial By-Pass Trust that could have received the death benefits. Such planning could have:-

- (i) given Jean, via the trustees, access to the cash representing the death benefits, and
- (ii) improved the IHT position on her subsequent death.

Let's compare what the position of the Beneficiaries would be, firstly if the death benefits were paid directly to Jean and, secondly, if they were paid to the London & Colonial By-Pass Trust.

Let's assume that on his death Henry's assets amounted to £750,000 (ignoring his interest in the family home), and all of these passed to Jean under the terms of his Will. The family home is owned in joint tenancy and passes automatically to Jean.

Jean has a personal estate of £450,000 and, now, sole ownership of the family home (which has a value of £600,000) and Henry's other assets worth £750,000. She also receives the lump sum death benefit of £700,000 from Henry's pension plan. On the assumption that she lives 10 years and each year she uses £35,000 (i.e. 5% of the capital of the lump sum death benefit) to live on, then on her death in 10 years' time her total estate will be £2,150,000, on which there is a potential IHT liability of £600,000 - this assumes the nil rate band is £325,000 and takes account of Henry's full transferable nil rate band.

On the other hand, had the pension scheme lump sum death benefit been moved into the London & Colonial By-Pass Trust then this would not have been included in Jean's taxable estate yet the trustees could have paid 5% of the capital each year to Jean to help her maintain her standard of living. Indeed, had these annual £35,000 payments been made to her by way of interest-free loans repayable on demand, they would be deductible from Jean's taxable estate on death. (This is covered in more detail in section 6(3) below).

This would mean that Jean's estate would then be £1,450,000 with a potential IHT liability of £320,000. Although the net amount available to the children would have reduced, this would be more than compensated for by the £700,000 available in the discretionary trust which could be distributed to them with only a small IHT exit charge. The increase in net assets passing to their Beneficiaries would be in the region of £280,000.

In tabular form, the figures showing the net estate for the Beneficiaries, before planning with the London & Colonial By-Pass Trust and after implementing the London & Colonial By-Pass Trust, would look like this:-

	Before	After
Henry's estate	£750,000	£ 750,000
Jean's estate	£450,000	£ 450,000
Family home	£600,000	£ 600,000
Residual lump sum death benefit	£350,000 (1)	
Total of Jean's estate after Henry's death	£2,150,000	£ 1,800,000
Less repayable loans		<u>£ 350,000 (4)</u>
Taxable estate		£ 1,450,000
Less IHT (2) (3)	£ 600,000	£ 320,000
Net estate	<u>£1,550,000</u>	<u>£1,130,000</u>
Plus value of discretionary trust	-	£ 700,000 (5)
Net amount available to Beneficiaries (6)	£1,550,000	£ 1,830,000
Improvement in net amount available for Beneficiaries		£280,000

- (1) Lump sum death benefit reduced by £35,000 per annum of expenditure for 10 years. No investment growth assumed.
- (2) Nil rate band assumed to be £325,000.
- (3) Takes account of Henry's full transferable nil-rate band which was not utilised on his death.
- (4) Assumes an interest-free loan of £35,000 granted each year by the trustees of the By-Pass Trust for 10 years which is spent when received, leaving the loans repayable on death.
- (5) Assumes trust assets are reinstated by repayment of loans and no IHT exit charge on distribution of cash from trust to Beneficiaries.
- (6) Assumes asset values and rates of IHT remain at the current level.

6. SOME QUESTIONS ON THE LONDON & COLONIAL BY-PASS TRUST

(1) What is the London & Colonial By-Pass Trust?

The London & Colonial By-Pass Trust is a discretionary trust to which death benefits can be paid in respect of a member of the London & Colonial SIPP. The trustees can then, at their discretion, pay benefits to the member's surviving spouse during the remainder of their lifetime but without that lump sum forming part of the surviving spouse's taxable estate. The idea is that lump sum benefits payable on the member's death before pension benefits have commenced (or during a period of unsecured pension/income drawdown) could be paid into this trust should the Scheme Trustee exercise their discretion to make such a payment to the trustees of the By-Pass Trust. Those death benefits will then, in effect, "by-pass" the surviving spouse's taxable estate for IHT purposes.

It is reiterated that, under a SIPP, the payment of the death benefits to the trustees of the By-Pass Trust depends on the SIPP Scheme Trustee exercising their discretion to make such a payment. Provided the member has indicated in any "nomination/expression of wish" form that he would like the Scheme Trustee to pay the death benefits to the trustees of the By-Pass Trust, it is likely that the Scheme Trustee will follow the member's wishes unless they find compelling reasons not to.

(2) How is the London & Colonial By-Pass Trust established?

The London & Colonial By-Pass Trust is established during the lifetime of the SIPP member and contemplates that the property initially made subject to the Trust will be a nominal sum, e.g. £10, and no additions will be made until after the death of the Settlor (the member) when the SIPP death benefits are paid to it. Even though the sum is nominal, it is essential that it is transferred to the trust to ensure that the trust is properly established. It is recommended that

anyone who also wishes to carry out other inheritance tax planning with lifetime gifts should use a separate trust and establish it **after** creating the By-Pass Trust.

Once the London & Colonial By-Pass Trust is established, it is then in place to receive the payment of any death benefits under the London & Colonial SIPP by the Scheme Trustee.

(3) The nature of the London & Colonial By-Pass Trust

The Trust is a discretionary trust which gives the trustees wide powers to appoint benefits to Discretionary Beneficiaries. The Trust requires the Settlor to insert the names of the Default Beneficiaries when establishing the Trust. These are the people who will benefit in the very unlikely event that the trustees do not appoint the trust fund to other Beneficiaries within the trust period. It would be usual to include the member's children as Default Beneficiaries. Alternatively, a charity could be named.

The member's widow(er), as well as the member's children, grandchildren and other specified individuals, are amongst the Discretionary Beneficiaries.

To avoid adverse income tax and capital gains tax consequences during the Settlor's lifetime, neither the Settlor nor the Settlor's spouse may benefit from the trust in any way. However, the Settlor's widow/widower can. Further information on this point is given in the Technical Guide.

The trustees also have power to lend funds, interest free, to a Beneficiary. The power to lend may give the opportunity to reduce IHT by creating debts for IHT purposes on the estate of, say, a surviving spouse of the Settlor to whom an interest-free loan has been made. Because of this, if a surviving spouse did need to have access to funds from the By-Pass Trust, payment by the trustees to the Beneficiary by way of loan rather than by way of capital appointments would probably be preferable from an IHT standpoint.

Again, further information on this planning is given in the Technical Guide.

(4) Nomination/Expression of wishes to the Scheme Trustees

Where the member sets up a London & Colonial By-Pass Trust, it is envisaged that they will then make a non-binding nomination/expression of wishes to the SIPP Scheme Trustee requesting that death benefits will be paid to the trustees of the London & Colonial By-Pass Trust. This, of course, assumes that a SIPP member would not wish death benefits to be paid directly to the surviving spouse, dependants or other beneficiary(ies) under the SIPP's Trust or Rules.

It is important to note that the Scheme Trustee will not be bound in any way by any such expression of wishes that may be made but would usually take it into account in making their decision.

(5) Expression of wish to trustees of the London & Colonial By-Pass Trust

The scheme member will be the Settlor of the By-Pass Trust. Having established it, they would normally complete an “expression of wish” form to indicate to the trustees of the London & Colonial By-Pass Trust the person they would wish them to consider as the prime Beneficiary under the Trust. This would usually be the Settlor's spouse in their capacity as widow/widower under the Trust. For this reason, it would be best to specifically name them rather than just refer to them as “spouse”. Whilst the expression of wish would not bind the trustees, it is thought that they would normally act in accordance with it.

(6) Why is the By-Pass Trust a Discretionary Trust?

Following changes made in the Finance Act 2006, all new lifetime trusts, other than bare trusts and certain trusts for the disabled, are treated for IHT purposes in the same way as discretionary trusts. As a discretionary trust gives the maximum possible flexibility to trustees to appoint benefits, it makes sense to use this type of trust to hold pension scheme death benefits. This is especially so given that it is not intended to hold substantial assets in this trust (other than the original nominal gift) until the death of the Settlor, which means that until that time the usual charging regime and the reporting requirements will not have any practical application.

However, it is important to remember that once the SIPP death benefits are paid to the trustees of the By-Pass Trust, this Trust will then hold substantial assets on which there may be an inheritance tax charge. Further information on this is given in the Technical Guide.

7. THE LONDON & COLONIAL BY-PASS TRUST PROVISIONS IN DETAIL

For tax purposes, the London & Colonial By-Pass Trust is a discretionary trust. The Trust gives the trustees power to appoint benefits under the Trust among a wide class of Beneficiaries. No Beneficiary is entitled to any benefit until the trustees so decide – the ultimate Default Beneficiaries named in the Trust will benefit only if no other appointment has been made by the end of the trust period which is 21 years from the date of death of the Settlor (SIPP member).

The following is a summary of the key provisions as they appear in the draft SIPP By-Pass Trust deed.

Part 1 - The trust declaration

The deed is executed by the Settlor and the named additional trustees. It is assumed that the Settlor will establish the Trust with a nominal amount, say, £10.

It is recommended that the Settlor should appoint at least two additional trustees to ensure that there are two trustees able to act upon the death of the Settlor.

Part 2 - Definitions

In this part of the Trust the terms used throughout the Trust are defined to avoid repetition. The most important definitions are those of the Discretionary Beneficiaries and the Default Beneficiaries.

The **Discretionary Beneficiaries** are those in favour of whom the trustees may make appointments of benefits. They include the widow or widower of the Settlor, the children and the remoter issue of the Settlor, their spouses, the brothers and sisters of the Settlor, and their issue, anybody who would benefit from the estate of the Settlor on the Settlor's death, any person nominated in writing to the trustees by the Settlor, as well as any charity. The Settlor can add any other individual not covered by the standard wording. The Settlor's spouse is not a Beneficiary whilst the Settlor is alive but the Settlor's widow/widower is.

The class of Discretionary Beneficiaries is very wide and can be added to by the Settlor - all that is necessary is a written notification to the trustees. However, the Settlor and the Settlor's spouse cannot be added as a class at any time.

The **Default Beneficiaries** are the individuals who will benefit if the power of appointment is not exercised by the trustees by the end of the trust period, i.e. 21 years from the date of death of the Settlor (the SIPP member). They are named by the Settlor in the Trust deed. At least one person must always be named and, if more than one is named, the shares in which they are to benefit must be stated. This is necessary to ensure that the Trust is valid. It is essential that, where more than one Default Beneficiary is appointed, the cumulative shares add up to exactly 100%, as otherwise adverse tax consequences may arise to the Trust.

Part 3 - Principal trust terms

In this part the **power of appointment** is defined as well as **the default entitlement** if the power of appointment is not exercised.

As previously indicated, the power to appoint capital and income under the Trust is vested in the trustees. The power is exercisable at the trustees' discretion and includes the power to appoint further trusts in favour of Beneficiaries.

The trustees have power to accumulate any trust income (ie. add it to capital rather than pay it out).

In default of appointment by the end of the trust period, the Default Beneficiaries will benefit.

There is also a special provision dealing with any potential conflict of interest. In many cases, the trustees of the Trust would be family members who would also be Beneficiaries under the Trust. If an appointment of benefits were to be exercised in favour of a Beneficiary who is also a Trustee then a suspicion of conflict of interest could arise. For this reason, there is a provision in this Trust which states that if a Beneficiary is also one of the trustees, the trustees can only make an appointment in favour of that Beneficiary if there is at least one other Trustee who does not benefit, directly or indirectly, from the appointment being made.

The trustees have wide powers included in the Trust to advance capital from the trust fund to Beneficiaries and to make loans to Beneficiaries. The power to lend may be more appropriate than the power to advance in many circumstances.

Part 4 - Administrative provisions

The trustees have wide administrative powers to deal with the trust fund and to reinvest the proceeds of any investment in any way they wish. They also have the power to borrow funds, to make payments to parents or guardians of minor Beneficiaries and to delegate certain powers.

Part 5- Appointment, dismissal, retirement and remuneration of Trustees

The Trust contains comprehensive provisions applying to the trustees.

The power to appoint new or additional trustees is vested in the Settlor during his lifetime and after his death in the trustees. The Settlor also has power to dismiss any Trustee, provided at least one Trustee, other than the Settlor, remains after such a dismissal.

There is no power to dismiss a Trustee after the death of the Settlor, and it must be remembered that trustees under an English trust must act unanimously. There are also powers dealing with the retirement of trustees and corporate trustees. trustees who act in their professional capacity are entitled to charge fees.

Part 6 - Further trust provisions

These mainly deal with the trustees' liability.

The liability of individual trustees is limited so that they will not be held liable for any loss to the trust fund, provided they act in good faith. Trustees who are paid for their services are also liable for negligence.

Part 7 – Proper law

The Trust is governed by the law of England and Wales.

Part 8 – Signatures

Here the Settlor and the trustees sign the Trust and have their signatures witnessed.

Further information

The information contained in this brochure is based on London & Colonial's understanding of taxation, legislation and HM Revenue and Customs' practice as at 6 April 2011, all of which may change with or without notice.

Tax rates and allowances quoted are those for the tax year to 5th April 2012.

The London & Colonial By-Pass Trust Deed is provided on the strict understanding that it is presented as a draft to be considered by the Settlor and his or her legal advisers. Ultimately, its legal and tax effects will depend on the circumstances of each particular case. Accordingly, neither London & Colonial nor any associated or affiliated company nor any of their representatives, officials, employees or professional advisers can accept any responsibility for any loss occasioned as a result of its use in any circumstances whatsoever.