Advancements out of Engrafted Trusts

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Powers of advancement; Trustees' powers and duties

One of the glories of English trust law, largely worked out by judges without benefit of statutes, is that rules are often known by the names of reported decisions. The rule in Shelley's case *may have been overturned by statute, and the rule in* Sibley v Perry *may not be much of a rule anyway, but it is to be hoped that pupils in Lincoln's Inn still quail at the rule in* Andrews v Partington*, not to mention* Lassence v Tierney. Beddoe *summonses are still known by that name, at home and abroad, as is the jurisdiction described in* Public Trustee v Cooper. *None of those cases is relevant to the article below, and therefore none has been graced with a case reference in this paragraph, and they are all too long in the tooth to have had neutral citations. But* Hancock v Watson[1] *is another case which still commands respect amongst twenty-first-century trust draftsmen and women, and it even provides us now with a new point of law after almost 120 years.*

The case of *Womble Bond Dickinson (Trust Corp) v Glenn*[2] has answered an important outstanding question on when the trustees of *Hancock v Watson* trusts can use the statutory power of advancement. The result gives trustees more flexibility to advance capital to beneficiaries who appear to only have a life interest in the trust.

Hancock v Watson trusts

Many trusts are drafted as life interest trusts—that is, with a beneficiary (the "life tenant") entitled to the income of the trust, and other beneficiaries (the "remaindermen") entitled to the capital of the trust fund after the death of the life tenant. The remaindermen are often the children of the life tenant, although this is not a requirement.

It is particularly common to see life interests in trusts drafted prior to 2006 and in will trusts, as in either case the trust capital will be treated as belonging to the life tenant for inheritance tax purposes.

When drafting a life interest trust, there are broadly two approaches. The "standard" approach expressly gives the life tenant a right to the income, and the remaindermen a right to the capital after the life tenant's right to the income has ceased.

The *Hancock v Watson* approach gives the intended life tenant what is apparently an absolute gift of the capital of the trust fund, but then provides that the capital does not vest in the beneficiary absolutely and "engrafts" trusts onto the gift. The engrafted trusts stipulate that the intended life tenant is only entitled to the income of the trust during his lifetime, with the capital passing to the remaindermen.

The approach is named after the case of that name, which confirmed that if the engrafted trusts fail (e.g. because no remaindermen are born) then the absolute gift to the intended life tenant takes effect. This

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1 *Hancock v Watson* [1902] A.C. 14.

2 *Womble Bond Dickinson (Trust Corp) Ltd v Glenn* [2021] EWHC 624 (Ch).

ensures that if the engrafted trusts fail, the capital does not pass according to the default provisions in the trust or pass back to the settlor on resulting trust.

Trustee Act 1925 s.32

There has never been certainty as to how the statutory power of advancement at s.32 of the Trustee Act 1925 (the "s.32 power") applies to *Hancock v Watson* trusts.

The s.32 power gives trustees the power to advance capital to beneficiaries with a right to the capital of the trust fund. Prior to the Inheritance and Trustees' Powers Act 2014, this was limited to one-half of the beneficiary's capital interest, although in practice most trust deeds expressly extended the power to cover the whole of the beneficiary's capital interest.

The beneficiaries do not need to have an absolute interest in the capital of the trust fund—it can be contingent or defeasible. However, if there is a "prior or other life interest" in the trust fund, then the person with the prior interest must consent to the exercise of the s.32 power, as it will reduce their rights in the trust fund.

The s.32 power is not relevant for "standard" life interest trusts, where the beneficiary is only given a right to the income. However, there has been uncertainty as to whether the s.32 power applies to *Hancock v Watson* trusts, and (if it does) whether the consent of the remaindermen is required for the exercise of the s.32 power.

The facts of the *Glenn* case

These questions came before Master Clark in the High Court in the case of *Womble Bond Dickinson v Glenn*, concerning a trust settled by the 7th Earl of Lonsdale.

The 7th Earl of Lonsdale created a trust which gave his 10 grandchildren a *Hancock v Watson*-style life interest in the trust fund, with the remainder passing to the grandchildren's own children. At the time of the application, the grandchildren were aged between 15 and 38 and did not have any children of their own.

The trusts were in this form:

> "The Trustees shall hold the Remaining Fund and the income thereof in trust for all or any one or more of the Beneficiaries who shall attain the age of twenty five years or shall be living and under that age at the end of the Trust Period in such shares as the Trustees shall at any time or times during the Trust Period … by any deed or deeds revocable or irrevocable appoint …"

The Beneficiaries were defined to include the settlor's present and future grandchildren.

The Trust Deed continued, so far as relevant, and it was this wording which qualified the trusts as importing the *Hancock v Watson* rule:

> "Provided always that the share (hereinafter called "the Allotted Share") taken by any of the Beneficiaries (in this clause referred to individually as 'the Beneficiary') under the trusts declared by Clause 9 … shall not vest in him or her absolutely but shall be retained by the Trustees and held on the following trusts:
>
> (1) The Trustees shall hold the Allotted Share and the income thereof in trust for the Beneficiary during his or her life …"

There was then no explicit power for the trustees to pay or apply capital to or for the benefit of the identified Beneficiary.

The trust fund was relatively modest, and the trustees were concerned that it would be eroded by professional fees and 10-yearly inheritance tax charges during the grandchildren's lifetime. They wanted to use the s.32 power to advance each grandchild's share of the capital to them to purchase a property, although they intended to delay the advancement to the youngest beneficiaries until they were slightly older.

Issues

The Court accepted that the trust was a *Hancock v Watson*-style trust, and therefore that the grandchildren each had an absolute interest in their share of the capital, subject to the engrafted trusts in favour of their children.

The Court then had to determine whether the s.32 power applied; and whether the remaindermen had a "prior or other interest" in the trust fund and so had to consent to the use of the s.32 power.

Does the s.32 power apply?

Counsel acting for the (unborn) remaindermen argued that the life interest for the grandchildren did not convert into an absolute gift to the grandchildren until the engrafted trusts failed. This would have meant that the grandchildren had no right to the capital of the trust fund until the engrafted trusts failed, and so the s.32 power could not be used.

The Court rejected this view and held that the absolute gift to the grandchildren took effect immediately but was defeasible—it would be cut down to a life interest if any of the grandchildren had their own children (who would be the remaindermen).

This meant that the grandchildren did have a defeasible interest in the capital of the trust fund, and so the s.32 power could be used for their benefit.

Do the remaindermen need to consent?

Counsel acting for the (unborn) remaindermen also argued that the remaindermen had a prior interest in the trust fund, as the grandchildren were only intended to benefit from the capital of the trust fund if the interest of the remaindermen failed.

This would have meant that the s.32 power of advancement could not in practice be used for the benefit of the grandchildren, because this would have required the consent of the unborn remaindermen.

The Court also rejected this view, on the basis that the grandchildren had an interest in the capital of the trust fund, which could be defeated by the *subsequent* interest of the unborn remaindermen. There was therefore no need for the consent of the remaindermen, as they had a subsequent (not a prior) interest.

Points to note for trustees

This decision potentially offers more flexibility for trustees. It allows trustees to exercise the s.32 power for the benefit of intended life tenants under *Hancock v Watson*-style trusts, provided there are no remaindermen currently in existence.

However, there are limits on this flexibility of which trustees should be aware:

Remaindermen in existence?

The s.32 power does not apply where there are any remaindermen in existence, because the intended life tenant's capital interest has then been cut down to an interest in the income.

The trustees should therefore be careful to investigate whether there are any living remaindermen who they do not know about (most likely, illegitimate children).

If there is even a slight risk of existing remaindermen, then the trustees should check whether there are protections in the trust deed for trustees distributing the trust fund without knowledge of existing beneficiaries. If not, the trustees should consider seeking an indemnity from the beneficiaries receiving capital or an application to Court to distribute on the assumption that there are no living remaindermen.

Fiduciary duties

While the trustees have a power to advance capital, they should take into account all relevant factors before exercising that power, including the prejudice that would be caused to unborn remaindermen.

The Court confirmed that:

> "The trustees are not of course entitled to disregard the interests of [the unborn remaindermen]. They must exercise their powers as fiduciaries and are bound to consider those interests."

In this case the Court was content to approve the advance because the trust fund was small and would otherwise have been eroded by fees and taxes, and because the grandchildren were planning to invest in property.

However, there may be different considerations in other circumstances. For example, it may be more difficult to justify an advancement if the trust fund is large enough to bear fees and taxes, if there is a risk that the intended life tenant would dissipate the assets, or if the remaindermen are not the intended life tenant's children (so they cannot expect to receive funds from the life tenant directly).

Conclusion

This case gives trustees more flexibility, but the trustees should nonetheless approach any decision to advance capital to an intended life tenant with caution, taking into account their fiduciary responsibilities to the unborn remaindermen.