



ESTATE **PLANNING**

WHY MIGHT A TRUST BE OF BENEFIT?

There are many reasons and many circumstances where a trust might be of benefit. It is a relationship in which one or more people (the trustees) holds and manages assets for the benefit of one or more other people (the beneficiaries).

THE DIFFERENT BASIC TYPES OF TRUST:

1

BARE TRUST

A bare trust is essentially a nominee arrangement whereby the legal title is held by the trustees for the beneficiary who is the absolute beneficial owner of the assets. The beneficiary is entitled to demand that the legal title is transferred to them, provided that they are over 18.

Bare trusts are most commonly seen when a parent or grandparent wants to make a gift to a young child, and where there are several owners of a particular asset but not all of them are the legal owners.

2

DISCRETIONARY TRUST

In a discretionary trust, the trustees have complete discretion to decide when to distribute income or capital, and to which of the named beneficiaries. This is the most flexible type of trust, and the trustees' powers are very wide. For that reason it is essential to choose the trustees carefully.

3

LIFE INTEREST TRUST

The life tenant of a life interest trust (also known as an interest in possession trust) is entitled to all income arising and/or is entitled to live in and enjoy any property owned by the trust. Often, the trustees will also have overriding powers to benefit a wider class of beneficiaries. On the death of the life tenant, or if their interest is terminated earlier, there will either be ongoing trusts or outright gifts for other beneficiaries.

ESTATE PLANNING

KEY ADVANTAGES AND CONSIDERATIONS OF ESTABLISHING A TRUST:

TAX

While tax comes first in this list, it is rarely the main driver for establishing a trust. In making major changes to the taxation of trusts in 2008, the government seemed to be under the impression that trusts were primarily a vehicle for avoiding tax. While there can undoubtedly be tax efficiencies of trusts in certain situations (some of which are described in more detail below), usually the starting point for creating the trust is rather different.

Tax is, however, a major consideration whenever an individual (the settlor) establishes a trust, not least because there are a number of pitfalls to avoid. For example, the vast majority of trusts created during the settlor's lifetime will suffer inheritance tax (IHT) at 20 per cent to the extent that the assets being transferred into the trust exceed £325,000. Often, the perceived tax "benefits" of a trust are simply mechanisms to avoid the settlor or beneficiaries ending up in a worse position in comparison to direct personal ownership.

CONTROL AND ASSET PROTECTION

Protecting assets and ensuring that control rests with appropriate people are usually the main drivers behind creating a trust. Often a parent or grandparent wants to transfer assets down a generation or two but does not feel that the young recipient is ready to handle what could be a substantial amount. There may be a fear that they would fritter the money away, that the wealth would act as a disincentive to work hard and make a living themselves, or that the responsibility of managing the assets would be overwhelming.

A trust is an excellent way of maintaining control with responsible people (the trustees), while making the assets available to benefit the chosen beneficiaries. The beneficiaries may be unsuited to managing the assets, particularly if they are complex (for example, a business) and/or substantial. Trustees with appropriate expertise can instead be chosen.

Assets within a trust are also far better protected than they would be if held directly by a beneficiary. A beneficiary's own assets are vulnerable in the event of, for example, bankruptcy or divorce. While assets held in a trust are not completely impervious to attack if a beneficiary falls into these troubles, they are far better protected in comparison to personal ownership.

FLEXIBILITY

You may be ready and able to pass assets on, but unsure of exactly how much each beneficiary should receive and when. What may seem like a sensible division of assets now may seem wildly inappropriate in 10 or 20 years, when circumstances may have changed significantly. If assets are held in trust, the trustees usually have wide powers to be able to react to changing circumstances; changing the nature of the trust if necessary, and making distributions to beneficiaries only when appropriate.

Given the broad discretion trustees have, it is clearly important that the right people are chosen to take on the role, and that the settlor leaves them detailed guidelines in a letter of wishes.

This can be hugely valuable for an international family with some UK presence.

ESTATE PLANNING

TYPICAL SITUATIONS WHERE TRUSTS CAN BE ADVANTAGEOUS:

WILL TRUSTS

Many wills involve a trust of one kind or another. If you want to provide for a surviving spouse but make sure that the assets ultimately pass to your children, you can leave a life interest trust for your spouse (which also benefits from the inheritance tax spouse exemption) with your children being the ultimate beneficiaries. This is particularly useful when there are children from a previous relationship, when there is a likelihood of the surviving spouse remarrying and/or there is a significant discrepancy in wealth between the spouses.

Discretionary trusts of the nil rate band (for example, the inheritance tax allowance) used to be commonplace before it became possible in 2007 to transfer the unused portion of the first spouse's nil rate band to the surviving spouse on death and effectively accrue up to a double inheritance tax allowance. These trusts are now less common, but they can still be helpful in second marriage scenarios, either to make sure that the right beneficiaries get the benefit of your nil rate band, or to avoid the nil rate band of a deceased first spouse being wasted.

At its most extreme, some people leave their whole estate on discretionary trust. This does not necessarily mean that the trust is intended to continue in this form for long after death. Any changes made to the trust within two years of death are read back into the will for inheritance tax and capital gains tax purposes.

The reason for this type of will trust, is to create maximum flexibility for the trustees to make the best decisions, based on circumstances and the legal and tax landscape at the time.

DISABLED PERSON'S TRUST

Where an individual or a family member has a disability and is incapable of adequately managing their financial affairs, it is possible to hold funds

under a disabled person's trust. While these trusts are often discretionary in nature, the trust assets will be held and managed by the trustees for the disabled individual as the principal beneficiary.

In addition to protecting assets for the vulnerable individual from themselves and others, a disabled person's trust is not subject to the usual tax rules for trusts, but instead special rules apply. These ensure that they are taxed no more punitively than if the assets were owned by the beneficiary. Also, funds held in this way should not be included in an assessment for means tested benefits.

LIFE INSURANCE TRUST

One of the main reasons people take life insurance is to provide for inheritance tax on their death. It would therefore be counterproductive for the life insurance proceeds themselves to be included in the taxable estate. This can be avoided by holding the life insurance policy in trust. The policy (provided it is a "pure protection" policy, rather than an investment vehicle) should have little or no value at the time it is transferred into trust, and premium payments are usually exempt from inheritance tax as regular payments made out of surplus income.

There has been a recent proposal that life insurance proceeds should fall automatically outside the taxable estate, but as things stand a life insurance trust is a must.

TRUST OF BUSINESS ASSETS

Planning the succession of a privately owned business presents unique issues. Entrepreneurs and business owners will often want to plan early for passing the business on, either to family members or others.

The government recognises these challenges, therefore shares in unlisted (including AIM listed) trading companies, as well as certain other categories of business asset, benefit from 100 per cent business

ESTATE PLANNING

property relief from inheritance tax. This means that such assets can be transferred into trust without the usual 20 per cent inheritance tax over £325,000.

Transferring an interest in a business into trust may be sensible as a business owner gets older, or if an exit is likely. Capital gains tax should also be taken into account, though. Entrepreneurs' relief, which can reduce the tax on the first £10m of gains realised in your lifetime, from 20 per cent to 10 per cent, is not usually available to trustees.

Alternatively, a will trust of business property can help to carve out the management of those assets from the rest of the estate, and to crystallise the inheritance tax relief.

EXCLUDED PROPERTY TRUST

People who are not domiciled or deemed-domiciled in the UK are only subject to UK inheritance tax on assets located here. They can therefore transfer potentially substantial non-UK assets into trust without suffering the same inheritance tax penalty as a UK domiciled person. The trust assets will then remain outside the scope of inheritance tax as long as the trust holds no UK assets directly (and no UK residential property at all).



PETER DANIEL

Partner

+44 20 7468 7351

+44 7879 842645

peter.daniel@collyerbristow.com

For more information on establishing a trust please visit collyerbristow.com or telephone +44 20 7242 7363.