

Wills, Trusts and Probate Briefings

Family trusts

Trust basics

A trust enables a 'settlor' to give away assets, but on terms that they will be dealt with in a certain way - usually to benefit his children or other members of his family.

Legally, ownership of the assets (the trust property) passes from the settlor to the trustees of the trust - the trustees become the owner of the assets, instead of the settlor. However, the trustees must look after the assets according to the terms of the trust set up by the settlor. These will say who the trustees are, identify the beneficiaries (the people entitled to benefit from the trust assets and/or income generated from them) and how the trust is to operate.

The trust can provide that different beneficiaries may receive different benefits from the trust. For example:

- A settlor might want assets to pass to a child, but not until the child is older. They can be held on trust for him until he reaches the age specified in the trust.
- A settlor might want assets to eventually pass to the children, but to ensure that his spouse can benefit from them for the rest of his or her life.

A settlor can set up a trust during his lifetime (under a deed of trust), or can provide for a trust to be set up in his will, to take effect on his death. Some settlors also write a 'letter of wishes', which gives guidance to the trustees on how the settlor would like them to administer the trust assets. This is not legally binding, but can be helpful to the trustees if the trust is a discretionary trust, ie the deed gives the trustees wide-ranging powers to decide how the benefits are to be shared out.

Trustees can be beneficiaries, but do not normally benefit from the trust - although they can claim expenses from the trust and professional trustees can claim their professional charges.

The trustees have a legal duty to act fairly, balancing the interests of different beneficiaries.

Types of trust

There are many different types of trust, which are used in different circumstances.

A bare trust is a simple form of trust where the beneficiary is absolutely entitled to the trust property (provided the beneficiary is 18 or over and mentally capable). Bare trusts are often used to hold investments for children (and for adults who wish to hold shares anonymously - as it is the name(s) of the trustee(s) that appear in a company's register of shareholders, and not the beneficiary's name).

Under an interest in possession trust, a beneficiary is entitled to the net income of the trust - the trustees must hand over all the income after expenses and taxes. These are often used in wills, to give a spouse (or another dependent) an income for life. Once the spouse has died, the assets pass to the children.

A discretionary trust is one where the trustees have more discretion over how they distribute income. For example, several children might be the beneficiaries of a discretionary trust, and the trustees could provide money to each child as they need it (eg to pay for their education).

An accumulation and maintenance trust is a special kind of trust set up for the benefit of a group of grandchildren. These are becoming less common since changes to the tax rules in 2007 eliminated their tax advantages.

A variety of other kinds of trust can be set up for specific purposes. Flexible discretionary trusts are often the best way of achieving the desired results.

Taxation

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This document was created on 06 May 2010

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The tax treatment depends on such factors as the kind of trust, the value of the assets put into it, and who the beneficiaries are. Changes to the rules in 2007 mean that the tax treatment of many trusts is no longer as favourable as it used to be, but there are still circumstances in which they can help to reduce the overall level of tax payable. This is a complex area where you need advice on your particular circumstances.

Income and capital gains in a bare trust are normally treated as the income and gains of the beneficiary. However, if assets provided by a parent of the beneficiary produce income of £100 or more, that income is taxed as the parent's.

Tax rates for an income in possession trust depend on the source of the income: 22% for rents and trading income, 20% for savings income and 10% for dividends.

Income in a discretionary trust is taxed at 40%, or 32.5% for dividends. The first £1,000 is charged at the lower rates applicable to interest in possession trusts.

Trusts are subject to capital gains tax on any gains over their annual capital gains tax allowance.

Beneficiaries are liable to income tax on any income they receive from the trust, but can offset the tax already paid by the trust. Beneficiaries are not liable for tax on distributions of trust capital.

The inheritance tax treatment of trusts depends on the type of trust and the amounts gifted into the trust. Gifts into "relevant property trusts" (most kinds of trust) are subject to an immediate 20% IHT charge on amounts in excess of your free nil rate band (£325,000 for 2009/10). Any previous gifts made by you (either outright or into trust) maybe taken into account your free nil band, there is a further 6% charge every ten years on the value of the trust's assets, with a proportionate charge on any assets withdrawn from the trust between ten-year anniversaries.

If you die within seven years of making a gift into trust, there may be a further inheritance tax liability.

Bereaved minor's trusts and 18-25 trusts are trusts set up under your will for the benefit of a child. These have tax advantages compared to ordinary discretionary trusts.

There are also tax advantages to trusts set up under your will for your spouse, and to some trusts where the beneficiary is mentally or physically disabled.

You should take advice on whether trusts could be of benefit for your particular circumstances and requirements.