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ALL MATTERS FINANCIAL

PASSING ON WEALTH WITH A TRUST

A guide to trusts - why and how they are used

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WHAT IS A TRUST?

A trust is a legal arrangement. It allows a third-party, or trustee, to hold assets on behalf of a beneficiary or beneficiaries. Once the trust has been created, a person can use it to 'ring-fence' assets.

Protecting family wealth through trusts can offer a range of benefits, including asset protection, tax efficiency, and control over how assets are distributed.

The way in which assets held within trusts are treated for Inheritance Tax (IHT) purposes depends on whether the choice of beneficiaries is fixed (named or easily identifiable,) or discretionary (the trustees have the discretion to choose from a pool of potential beneficiaries).

Why are trusts used?

Trusts are used to protect family wealth for future generations, reducing the inter-generational flow of IHT and ensuring bloodline protection for your estate from outside claims.

The two main uses are:

Family Protection Policies

A trust allows a policy holder (the settlor) to give their life insurance policy to someone else (the beneficiary). It's a way to ensure that the proceeds of life insurance are not considered to be a part of the estate when the policyholder dies, so their beneficiaries won't face the burden of inheritance tax on their life policy.

The main reasons for putting a protection policy into a trust include:

- It makes sure that the money paid out from the plan goes to the people the settlor wants to benefit from it.
- The life insurance company can usually pay a death claim more quickly than they could if it were not put in trust.
- The money the plan pays out may be free of inheritance tax.

Estate Planning

Trusts in estate planning provide individuals with a comprehensive framework to manage their assets and distribute wealth according to their wishes.

The primary advantages of utilising trusts in estate planning include:

- Offer a robust mechanism for shielding assets from various risks, including creditor claims, lawsuits, and divorce settlements.
- Allow for the seamless transfer of assets to beneficiaries outside of the probate process.
- Can be a tax efficient way of transferring wealth and mitigating unnecessary inheritance tax.

TRUST TERMS:

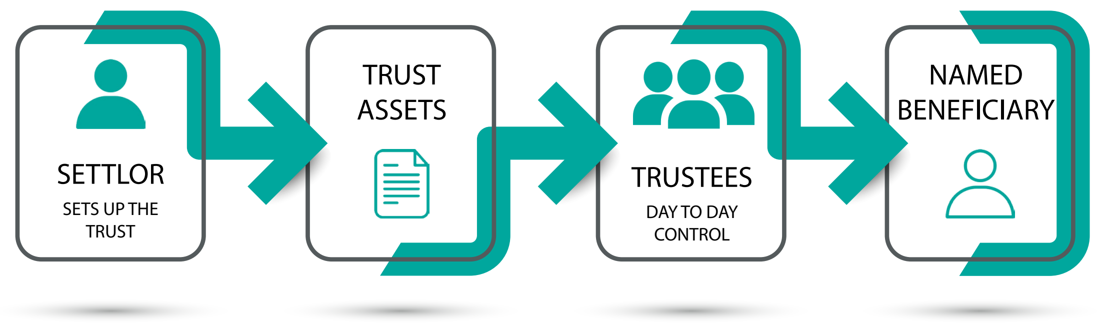
- Settlor – The person setting up the Trust.
- Trustees – The people tasked with looking after the Trust and paying out its assets.
- Beneficiaries –The people who benefit from the assets held in Trust.
- Trust Assets – The assets transferred into the trust by the settlor.
- Trust Document or Deed – The legal document that establishes the trust and outlines its terms.

ABSOLUTE TRUSTS

An Absolute Trust, also known as a Fixed Trust or Bare Trust, operates in a straightforward manner compared to other types of trusts.

They can provide a structured and transparent framework for holding and distributing assets to beneficiaries, ensuring that their entitlements are clearly defined and protected.

- **Purpose:** Absolute Trusts are straightforward arrangements where assets are held in the name of a trustee for the benefit of a specific beneficiary.
- **Key Features:** The beneficiary has an absolute right to both the trust capital and income. They are entitled to the assets at the age specified by the settlor, or age 18 if there is no age stated on the trust deed.
- **Benefits:** Useful for passing on assets to minors or individuals who are unable to manage their own affairs. They offer simplicity and transparency in asset ownership. Transfers into a bare trust may also be exempt from IHT, as long as the person making the transfer survives for 7 years after making the transfer.

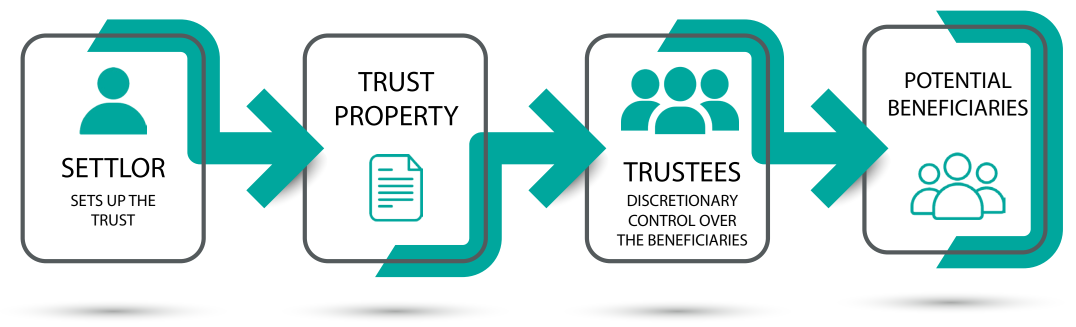


DISCRETIONARY TRUSTS

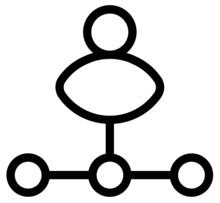
A Discretionary Trust operates differently from an Absolute Trust in estate planning.

Discretionary Trusts offer flexibility and control to trustees in managing trust assets and distributing benefits to beneficiaries. However, they also require careful consideration and discretion to ensure that the trustees act responsibly and in accordance with the settlor's intentions and the best interests of the beneficiaries.

- **Purpose:** Discretionary Trusts offer flexibility in determining how and when trust assets are distributed among a class of beneficiaries. They are often set up to put assets aside for grandchildren or beneficiaries who are not capable or responsible enough to deal with money themselves.
- **Key Features:** Trustees have discretionary powers to decide on distributions, including the timing, amount, and recipients (limited to one of the classes of beneficiary) of income and capital.
- **Benefits:** They may offer some protection from creditors, divorce settlements, and other potential threats to family wealth.



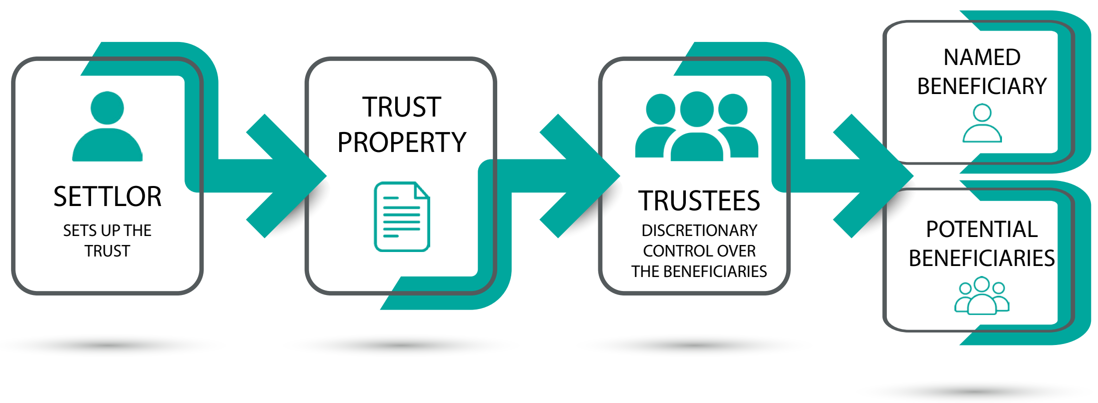
FLEXIBLE TRUSTS WITH DEFAULT BENEFICIARIES



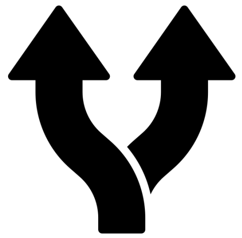
A Flexible Trust with Default Beneficiaries is a type of trust commonly used in estate planning.

They provide the settlor with the flexibility to adapt the trust to changing circumstances while also ensuring that there are provisions in place to distribute the trust assets if specific beneficiaries cannot be determined.

- **Purpose:** Flexible Trusts provide a high degree of adaptability to changing circumstances and evolving family needs.
- **Key Features:** They allow for amendments to the terms of the trust, such as adding or removing beneficiaries, changing trustees, or altering distribution provisions.
- **Benefits:** Offer long-term flexibility and the ability to respond to unforeseen events, ensuring that the trust remains aligned with the family's objectives over time.



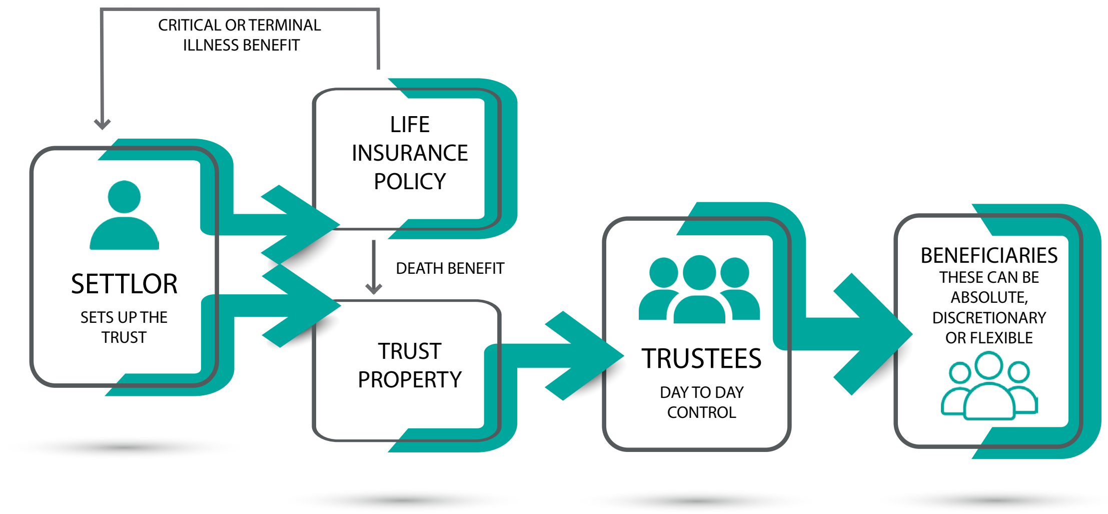
SPLIT TRUSTS



A Split Trust is a type of trust arrangement commonly used in conjunction with life insurance or critical illness insurance policies. It combines elements of both an Absolute Trust and a Discretionary Trust to provide flexibility and benefits for the policyholder and beneficiaries.

This arrangement allows the settlor to split the benefits of a life insurance policy into two separate trusts: one trust for the benefit of certain beneficiaries (usually family members) with fixed entitlements (absolute trust), and another trust for the benefit of other beneficiaries with discretionary distributions (discretionary trust).

- **Purpose:** Split trusts allow for the separation of beneficial interests in assets between different beneficiaries.
- **Key Features:** They typically involve the division of trust assets into two parts: one providing for immediate access to income, and the other for deferred access to capital.
- **Benefits:** Provide flexibility in managing distributions to beneficiaries, catering to differing financial needs and circumstances. Benefits payable from the Absolute Trust component of a Split Trust are usually paid quickly and are exempt from IHT, provided the policyholder has survived for at least seven years after making the gift. The trust may be subject to periodic and exit charges.



TRUSTEE RESPONSIBILITIES

Communication

You must communicate regularly and transparently with the beneficiaries, providing them with relevant information about the trust's assets, performance, and any significant decisions or changes.

Tax responsibilities

Trustees are responsible for reporting and paying tax on behalf of the trust. This can be done by a Self Assessment tax return after the end of each tax year. HM Revenue and Customs (HMRC) will then inform you how much you owe.

You must give the beneficiary a statement with the amount of income and tax paid by the trust, if they ask. You can use form R185 (trust) to do this. There's a different form if you need to provide a statement to a settlor who retains an interest. If there's more than one beneficiary, you must give each of them this information relative to the amount they receive.

Registering a trust

You must usually register your trust with HMRC if it becomes liable for any of the following:

- Capital Gains Tax
- Income Tax
- Inheritance Tax
- Stamp Duty Reserve Tax
- Stamp Duty Land Tax or Land and Buildings Transaction Tax (in Scotland)
- Land Transaction Tax (in Wales)

You must also register a trust to claim tax relief.

Further information on Trusts can be found at gov.uk.

OTHER TRUST STRATEGIES

Loan Trusts and Discounted Gift Trusts

Loan Trusts and Discounted Gift Trusts are both strategies used in IHT planning to mitigate the impact of tax on an individual's estate.

Loan Trusts:

- A Loan Trust is a type of trust where an individual (the settlor) lends money to the trust, which is then invested. The trust assets, including any growth or income generated, are held separately from the settlor's estate.
- The settlor retains the right to reclaim the initial loan amount, but any growth on the investment remains outside their estate for IHT purposes.
- By using a Loan Trust, the settlor can cap the value of their estate subject to IHT while retaining access to the original capital if needed.
- When the settlor dies, the outstanding loan amount is typically repaid to their estate, but any growth in the trust assets remains outside their estate and may pass to beneficiaries free of IHT. If the trust is discretionary, consideration is given to IHT periodic and exit charges.

It's important to note that the suitability of a loan trust depends on individual circumstances, including the size of the estate, the goals of the settlor, and the tax implications involved.

Discounted Gift Trusts:

- A Discounted Gift Trust involves making a gift into a trust while retaining the right to regular withdrawals, usually for life.
- The value of the gift is discounted to reflect the retained right to income or withdrawals, reducing the potential IHT liability on the gift.
- Any growth on the gifted assets is held outside the individual's estate for IHT purposes.
- When the individual dies, the assets in the trust are not subject to IHT, provided they survive the seven-year period from the date of the gift. If the trust is flexible, it is subject to IHT periodic and exit charges.

Both of these trust arrangements can be effective tools for IHT planning, but they require careful consideration and professional advice to ensure they are set up correctly and aligned with the individual's overall financial objectives.

More details can be found in our Understanding IHT Guide, please ask you adviser for more details.

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