

Bitesize Guide to Trusts



Trusts can be a very useful tool to provide not only for Financial and Wealth Planning, but also for Succession Planning too.

All Trusts (regardless of any fancy names that they may have) fall under one of three categories:-

Bare Trusts

Life Interest Trusts

Discretionary Trusts

Bare Trusts:

- A simple Trust where the Beneficiaries have an immediate right to all of the Capital and Income.
- The Trustees act as nominees holding the Trust assets absolutely on behalf of the Beneficiaries.
- Often used to hold property for minor Beneficiaries or as Personal Injury Trust.

Beneficiaries are usually taxed as if they own the assets outright.

Life Interest Trusts:

- Where one Beneficiary (the Life Tenant) is entitled to receive the Income from the Trust for life or until some other specified events after which the Trust is wound up and further named Beneficiaries receive the funds outright.
- It is possible to build in powers to appoint Capital out to Beneficiaries while the Trust is still running giving greater flexibility.
- Often used in Wills to cater for second marriages or to preserve assets for children whilst giving a spouse an Income for his or her lifetime.
- Often used during lifetime for Care Fee Planning being used as part of a Protective Trust.

Taxation of Life Interest Trusts:

Income Tax – Income is generally taxed on the Life Tenant.

Inheritance Tax – Since March 2006 most Life Interest Trusts are taxed under the relevant property regime so that Inheritance Tax is charged at 20% on any lifetime transfer into a Trust if the value of the transfer exceeds the Settlor's available nil rate band and there will be a ten anniversary charges and exist charges when there is a Capital distribution.

The main exception to the relevant property regime is for a Immediate Post Death Interest Trusts (IPDI's) which is when a Life Interest Trust is created by Will and takes effect immediately on the Testator's death. The value of the Trust is treated as part of the Life Tenant's Estate for Inheritance Tax on their death, there are no anniversary or exist charges.

Capital Gains Tax – Holdover Relief is usually available on a lifetime transfer into a Trust.

- There is usually a free uplift in value on the death of the life tenant.
- Trustees have half the annual exemption of an individual currently £6,000.00 (2019/2020 tax year).
- The rate of tax is 20% generally, and 28% for disposals of residential property.

Discretionary Trusts:

Usually created to give Trustees maximum flexibility of distribution of the Trust Fund.

- The Trust instrument lists a number of potential Beneficiaries and the Trustees have absolutely discretion over Capital and Income distribution payments to those Beneficiaries.
- There is usually a Letter of Wishes prepared alongside the Trust, the Trustees will usually be guided by this, but they are not duty bound to follow it.
- It is vital to choose Trustees carefully because of the amount of the discretion they have.
- These Trusts are often used for Beneficiaries who you would not want to give an outright gift to perhaps those with mental health problems, bankruptcy, spend thrifts, vulnerable or disabled people. They allow Trustees to make decisions at a later date allowing for change in circumstances.



Taxation of Discretionary Trusts:

Inheritance Tax – These Trusts are taxed under the relevant property regime (as mentioned above).

Income Tax – Trustees currently have a £1,000.00 allowance which is taxed at lower rates, these rates are 20% for Income except Dividend Income which is currently 7.5% and after the first £1,000.00 other Income is then taxed at 45% and Dividend Income at 38.1%.

Capital Gains Tax - Holdover Relief is usually available on a lifetime transfer into the Trust.

- Trustees have half the annual exemption of an individual currently as referred to above.
- The rate of taxes is 20% generally or 28% for disposal of residential property.
- There are other certain types of Trusts that attract special tax treatment although all will still fall under one of the three categories above.

Bereaved Minors Trusts:

Must be created by a parent for a minor child, they are not subject to the relevant property regime, the child needs to become absolutely entitled on or before reaching the age of eighteen and has favourable Inheritance Tax treatment.

18-25 Trusts:

Must be created by a parent for a child aged between eighteen and twenty five. The taxation rules are same as for the Bereaved Minors Trusts if the child is under eighteen and a relevant property Trust if the child is between eighteen and twenty five.

Disabled Persons Trusts:

Can be created either by a disabled person or by someone else. The assets with the Trust are treated for Inheritance Tax purposes as if they were the assets of the disabled person.

Our specialists can advise on the creation, administration or termination of Trusts.

Using a solicitor as Trustee

Partners are also often asked to act as Trustees. There are some real benefits to doing this, which we would be happy to discuss.

