



3D Financial Planning Independent Financial Advisors

Trusts

A beginner's guide to using trusts in England and Wales.

Trusts are legal arrangements that enable you to transfer the ownership of assets such as cash, property and investments to a trustee, or group of trustees. The trustees will manage the assets and pass them on to beneficiaries according to your wishes.

Placing assets into a trust has several key benefits. Most importantly, they are tax-efficient vehicles that can ensure that you pass on as much of your estate to your loved ones as possible.

Distributing your assets to your beneficiaries from a trust is also considerably easier than doing so with a will, allowing your family and friends to avoid the drawn-out probate process.

Types of trusts

You should consider a number of factors when deciding which type of trust is right for you. Simple trusts are generally cheaper to set up and administer but don't provide the flexibility of more complex trusts, which usually involve higher initial and ongoing costs.

Bare trusts

These are simple trusts that involve minimal costs and administration.

The trustees hold on to both assets and income until the beneficiaries have turned 18. The beneficiaries gain full control over their share of the trust on their 18th birthday.

Bare trusts are often used by parents and grandparents to pass on assets to children.

The main disadvantage of bare trusts is their inflexibility. Ownership of trust property is legally transferred to the beneficiaries as soon as they turn 18, irrespective of whether it will be used in a sensible manner. As a consequence, some people may want to give trustees more power over how the assets are passed on.

Interest in possession trusts

Interest in possession trusts (also known as life interest trusts) pass income earned from trust assets onto the beneficiaries. The assets are inherited by other beneficiaries when the income beneficiary dies.

For example, using the trust to provide an income for your partner and then passing the assets to your grandchildren when your partner dies.

Unlike bare trusts, the beneficiaries do not have automatic access to the assets when they reach adult age.

Interest in possession trusts are useful if you want to provide the beneficiaries with a regular income without giving them actual control over the assets.

Discretionary trusts

Trustees are given more power in a discretionary trust. They are able to distribute the income and assets of the trust to the beneficiaries at their discretion (although this depends on the nature of the trust deed). This means that the trust's beneficiaries do not assume automatic entitlement to or ownership over its contents.

Trustees also determine the frequency of payments to beneficiaries, can introduce payment conditions and exercise greater powers over how the trust is managed (again, the extent of these powers depend on the specific trust deed).

Accumulation trusts

Trustees of an accumulation trust collect the income earned from trust property. They can then either use it to make maintenance payments to the beneficiaries or add it to the trust's capital.

There are many other types of trusts, talk to us about which is best for you.





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Key terminology

Newcomers to trusts may find it helpful to familiarise themselves with the following terms.

People involved

Settlor: the owner of the assets (for example the parent or grandparent) who decides to gift assets into a trust.

Trustees: these are the people appointed by the settlor to control the trust's assets and distribute them to the beneficiaries. Trustees have a fiduciary duty to the trust, which is a very high standard of responsibility.

Beneficiaries: the individuals named by the settlor to benefit from the trust property.

Protector: if they choose, the settlor can appoint a protector to supervise the trustees. The settlor can allow the protector to appoint new trustees, dismiss existing trustees and overrule decisions taken by trustees. The legal status of protectors is unclear, as whether or not they have a fiduciary duty in the same way that trustees do has not been tested in the courts.

Common terms

Trust deed: this is the legally binding document that lays out the terms of the trust.

Trust property: this refers to the assets placed into trust by the settlor.

Letter of wishes: the settlor can write a non-legally binding document to advise the trustees on how they want the trust to be managed.

Choosing your trustees

Trusts are usually managed by 2 or 3 trustees. These may be close friends or family members, or indeed anyone you trust to manage your assets effectively.

You may decide to include a professional trustee but this is not strictly necessary as those you appoint will be legally required to seek investment advice from professionals if they encounter any problems. Professional trustees will charge a fee for their services.

It is possible for the settlor to appoint themselves and beneficiaries as trustees, though doing this may lead to a conflict of interest.

Given the amount of power and responsibility given to trustees (especially in discretionary trusts), you should think carefully about who you would like to manage your trust.

Always ask yourself this question: can you trust this person to make sensible decisions and act in the best interests of the beneficiaries?

Ensuring effective management

Clarity is the most important component of effective trust management. Before approaching a specialist to begin drafting the trust deed it's vital that you understand why you're setting up the trust, what the long-term goals are, and how much discretion you want to give the trustees.

It is equally important that you communicate this clearly to whoever is drafting the deed. This is a legally-binding document so your intentions must be well-represented and unambiguous.

You should also think about drafting a letter of wishes if the trust deed gives trustees discretionary powers. This will inform their decision-making and help ensure that they manage the trust in the way you envision.

We can give advice and technical guidance on how to use a trust for effective financial planning.

Inheritance tax

A key benefit of trusts is their ability to minimise your exposure to inheritance tax (IHT). Assets in a trust are not included in your estate for IHT purposes as you technically no longer own them.

You must live for at least 7 years after placing the assets into trust to get the full tax benefit. Should you die within 7 years of the transfer, the applied tax rate will depend on the amount of time between making the transfer and death.

If a trust is worth more than £325,000, HMRC will tax you the full 40% IHT rate on the assets should you die in the first 3 years but the rate will gradually reduce the longer you live. This is known as taper relief.

Years between transfer date and death	Effective IHT rate
0-3	40%
3-4	32%
4-5	24%
5-6	16%
6-7	8%
7+	0%

The tax treatment will depend on what type of trust you set up. Asset transfers into bare trusts are known as potentially exempt transfers (PETs).

PETs are not liable to an immediate IHT charge. Transfers into any other trust are known as chargeable lifetime transfers (CLTs). CLTs are subject to an immediate 20% IHT charge on amounts exceeding the nil-rate band.

Residence nil-rate band

Family homes placed into a trust will be eligible for the residence nil-rate band (which is being introduced from April 2017) provided that the beneficiary is a direct descendant. This will include:

- bare trusts
- interest in possession trusts
- bereaved minor trusts
- 18-25 trusts
- disabled persons' trusts.

Getting professional help

Setting up a trust is a complex process that requires the help of a professional. Contacting a financial adviser will ensure that you achieve your goals and avoid making costly mistakes.

Important information

The way in which tax charges (or tax relief, as appropriate) are applied depends upon individual circumstances and may be subject to change in the future.

FCA regulation applies to certain regulated activities, products and services, but does not necessarily apply to all tax and trust planning activities and services.

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