Information

Bare Trusts

What is a Bare Trust?

A bare trust is, in a sense, a halfway house between a full trust and outright ownership. The legal control rests with the trustees and they have the usual trustee responsibilities but ownership for tax and all other purposes belongs to the beneficiary. A bare trust can arise in different ways:

- it may come about informally where, say, a parent simply holds an investment or an account with the designation indicating ownership for someone else
- a formal bare trust involves a trust deed conferring suitable investment and other powers on the trustees. The core of the document would still be simple: "The trustee holds the trust fund on trust for the beneficiary absolutely." When the beneficiary is a minor, there is a trust because the beneficiary has no capacity to call for the assets to be passed to him or he.
- where there is a bare trust in place, once the beneficiary reaches the age of 18 he or she can demand the transfer of the assets. If that does not happen for any reason, the bare trust will carry on. At that point, the trust would continue as a simple nominee arrangement. The trustees would still have the management powers conferred on them by the trust deed and the general law
- in a similar way, a bare trust can come into effect as a result of changing circumstances. Take a trust which provides for a life interest to an individual beneficiary, with the remainder to other beneficiaries, such as children. If the life tenant dies, at that point the trustees will automatically be holding on bare trusts for those children
- if executors of an estate or trustees of a discretionary trust wish to sell an asset, they might declare that they hold the asset for beneficiaries prior to sale in order to make use of the beneficiaries' annual exemptions and lower rates of tax for Capital Gains Tax (CGT). They would then sell as bare trustees for the beneficiaries.

Tax implications

Inheritance Tax

For Inheritance Tax (IHT) purposes the assets belong to the beneficiary. Most significantly, this means that a gift to a bare trust will be a potentially exempt transfer, and not immediately chargeable as would be the case with a transfer into a full trust. On the beneficiary's death, the assets in the bare trust will form part of his or her estate.

Capital Gains Tax

The trust has the benefit of the beneficiary's full personal annual exemption for CGT (currently £11,700 – and not the reduced exemption that applies to other trusts). Capital gains above that are taxed at the beneficiary's rate, which, in the case of most minors, will almost certainly be 10% (18% if residential property is held as an investment), rather than the trust rate of 20% (28% on residential investment property).

Income Tax

The income is the beneficiary's, whose individual personal allowance, savings allowances and, lower personal rates of tax can be used. This compares very favourably to the 45% rate applying to full trusts. It should be noted, however, that the Income

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Tax treatment is different if the funds have originated from a parent of a minor child, where the income will be taxed on the parent until the beneficiary reaches the age of 18.

Common uses

One of the most common uses for bare trusts is where grandparents want to set aside funds for their grandchildren's education. If the funds are given early on and if the grandparents survive for seven years, the gift will be outside the IHT charge on their deaths.

Because of the tax treatment referred to above, the monies in most bare trusts for minors will effectively be free of Income Tax and CGT. The trustees have the power to apply capital for the children's benefit which they can do by paying school fees on their behalf.

If the funds are intended only for school costs, then if the calculation of fees, investment returns and inflation has been accurate, the monies will be exhausted ideally when the final term's fees are being paid. Should that not be the case, then when the child reaches 18, as indicated before, the funds would normally be transferred to them, although the trustees may be able to retain the bare trust structure or otherwise exert influence to ensure the monies are sensibly used; for example, for university expenses.

Trustee duties

While the beneficial interests in bare trusts are less complicated than fully drafted trusts, the trustees have most of the usual duties and responsibilities. Among many, they must:

- act prudently, and in the best interests of the beneficiary
- exercise what is referred to as the duty of care
- have regard to what are referred to as standard investment criteria when exercising their powers of investment
- protect and appropriately manage trust assets.

Disclaimer

This information sheet is written as a general guide. As any course of action must depend on your individual circumstances, you are strongly recommended to obtain specific professional advice before you proceed. We do not accept any responsibility for action which may be taken as a result of having read this information sheet.

NOTE: The law is stated as at 30 July 2018.

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