Information

Trust types – a Key Features guide

Introduction

As a legal structure, the trust has proved to be remarkably adaptable over several centuries. Today, trusts are a commonplace of everyday life, from the pensions and investment world to the ownership of land. In family wealth planning the trust operates as a managed gift, protecting beneficiaries from themselves and others and ensuring that assets are used for the purposes intended during a given period, or even inter-generationally.

As professional advisers we often find that clients have only a limited appreciation of what trusts can do to address a variety of issues in their estate and tax planning. The following parts of this information sheet provide an overview of the principal types of trust which may be created by Will or lifetime settlement, and the circumstances in which they are likely to be appropriate.

Bare Trusts

Key Features

- the trust fund belongs to the beneficiary;
- a beneficiary with capacity can take personal control at 18;
- the tax treatment is transparent — inheritance tax (IHT), capital gains tax and (in the absence of a parent-settlor) income tax are all assessed on the beneficiary.

When to Use

- for small trust funds;
- for trust funds which will mostly be spent by the time the beneficiary reaches 18 (e.g. on school fees);
- to manage funds for incapacitated beneficiaries or those who are otherwise dependent and in need of support;
- to hold personal injury awards and preserve access to benefits.

Points to Watch

- income over £100 is taxed on a parent-settlor;
- there is no flexibility — if a beneficiary dies the trust fund devolves in accordance with his or her Will (if any) or intestacy.

Life Interest Trusts

Key Features

- trust income must be paid to the life tenant (if over 18);
- the life tenant's occupation of a house or flat can take the place of income;
- income is taxed at the basic rate and may be assessed directly on the life tenant;
- capital is held by the trustees for one or more 'remaindermen' who are intended to benefit after the life tenant's interest has come to an end.

When to Use

- to provide someone with an income (or a place to live) while protecting the underlying capital assets for the ultimate benefit of others;
- to balance the competing financial interests of particular family members, for example the widow(er) of a second marriage and children of the first;

Head Office
Heathervale House
2-4 Vale Avenue
Tunbridge Wells
Kent TN1 1DJ
T 01892 510000
F 01892 540170

Thames Gateway
Corinthian House
Galleon Boulevard
Crossways Business Park
Dartford
Kent DA2 6QE
T 01322 623700
F 01322 623701

- to shelter capital from third party claims against a particular individual, whether arising from creditors, a divorce or some form of means assessment.

Points to Watch

- the discretionary release of capital to a life tenant, and flexible powers of appointment over the entire trust fund, are frequently built in;
- lifetime trusts post-Finance Act 2006 (except for certain disabled person's interests) are within the 'relevant property' IHT regime with 10 yearly and exit charges where the assessable value is above the nil rate allowance;
- with pre-Finance Act 2006 trusts and those arising from Wills with 'immediate post-death interests', the life tenant is treated for IHT as if owning the trust fund.

Discretionary Trusts

Key Features

- the trustees have wide powers to distribute income and/or capital, at their discretion, to any of the members of a defined class of beneficiaries;
- membership of the beneficial class can be tailored;
- none of the beneficial class has an entitlement to income or capital unless and until conferred by the trustees;
- income does not have to be paid out, but may be accumulated and reinvested within the trust fund.

When to Use

- for a number of beneficiaries, when flexibility is required in deciding how, and to what extent, they should benefit;
- to shelter both income and capital from third party claims against beneficiaries;
- where the investment priority is long-term capital growth rather than immediate income generation;
- in the context of Wills, to preserve the benefit of certain IHT reliefs and allowances when providing for a spouse and not adding to his or her taxable estate;
- for pension and life policy trusts, where it is undesirable to fix the ultimate beneficiaries many years before funds become available.

Points to Watch

- within the 'relevant property' IHT regime with 10 yearly and exit charges where the assessable value is above the nil rate allowance;
- in Will trusts, exit charges may not apply within two years of the date of death;
- the income tax rates for trusts apply unless an appointed life interest is created;
- income may not be accumulated beyond five years without being treated as capital for IHT.

Age Contingent Trusts

Key Features

- entitlement to the trust fund, or a part of it, arises when the beneficiary reaches a specified age;
- income may be accumulated and reinvested for some or all of the period that a beneficiary is under the specified age;
- income and capital may be released to beneficiaries on a discretionary basis while under the specified age;
- income is taxed at the rates applicable to trusts unless an income entitlement arises, or is appointed, before the specified age.

When to Use

- to look after funds on behalf of a young beneficiary until he or she is better able to manage them personally;
- where equality of treatment among a number of beneficiaries is an important objective;
- within Wills, when in most cases the age of the intended beneficiaries at the testator's death cannot be predicted.

Points to Watch

- within the 'relevant property' IHT regime with 10 yearly and exit charges where the assessable value is above the nil rate allowance;
- flexible powers of appointment over the entire trust fund may apply;
- a nil or reduced rate of IHT may apply to such trusts in Wills for the benefit of the testator's children or step-children (provided that no overriding power of appointment applies);
- income and capital gains may be assessed at the equivalent of the beneficiary's own tax rates if the conditions for a 'vulnerable person' trust are met (in this context, a trust for a person under 18 who has lost at least one parent), and an election is made.

Trusts for Disabled People

Key Features

- may take the form of a life interest trust or a discretionary trust;
- outside of the 'relevant property' IHT regime even if created by lifetime settlement and/or the trustees have discretion over income.

When to Use

- to make provision for 'disabled persons' as defined in the IHT legislation (mentally incapable or in receipt of certain benefits such as attendance allowance or personal independence payment) whenever there may be drawbacks in using the main types of trust referred to above.

Points to Watch

- in general, income and capital paid or applied by the trustees in the disabled person's lifetime must be for his or her benefit;
- the trust fund will be subject to IHT at death rates when the beneficiary dies;
- income and capital gains may be assessed at the equivalent of the

Trust types – a Key Features guide

Continued

disabled person's own tax rates if an election is made.

Conclusion

The effective use of trusts requires that appropriate administrative processes are put in place. The form these take will depend on the type of trust, the needs of beneficiaries and, critically, the nature and extent of the trust assets. Common elements will, generally, be the periodic review of investments, proper accounting and record-keeping, and HM Revenue & Customs compliance. Deficiencies in these areas make it less likely that trustees are performing their fiduciary duties adequately, and managing funds in the best interests of those for whom a trust has been created.

Disclaimer

This information sheet is intended to be for general guidance only and is not a substitute for specific advice. It is based upon our understanding of the legal position as at April 2019 and may be affected by subsequent changes in the law. Should you require any specific legal advice on the issues covered, please contact Stuart Goodbody or Mark Politz on 01892 510000 or by email at:

stuart.goodbody@ts-p.co.uk

mark.politz@ts-p.co.uk

© Thomson Snell & Passmore LLP All Rights Reserved