

Estate Planning and Trusts

A brief introduction to the use of Trusts - as a helpful aid in Estate Planning

What is a Trust?

A trust¹ is an obligation binding a person (which can be an individual or a company) called a “Trustee” to deal with “Property” in a particular way, for the benefit of one or more “Beneficiaries”.

Put simply a person (“the Settlor”) gives Property (buildings, land, money, securities, works of art etc.) to a trust to be looked after by the Trustee(s) for the ultimate benefit of the Beneficiaries who may be a person or group or class of person or, for example, Children or a Charity. Once given (“Settled”) the trust owns the Property and the Trustee is legally responsible for it.

The objects of the trust and the powers given to the Trustees are normally set out in a written “Trust Deed”. However a written Trust Deed is not mandatory.

Trusts may be established in the Settlor’s lifetime or by provision in a Will after the Settlor’s death.

Tax treatment of Trusts

Depending on the type of trust the taxation regime² ranges from simple to complex and the Trustees generally needs to seek expert advice.

Estate planning and Trusts

The use of Trusts can be helpful in estate planning. In general when considering the use of trusts it is important to take account of the value not only of the client’s estate but also their parents’ estates and to plan accordingly. This applies especially where an inheritance received from their parents would create or increase an inheritance tax liability for the clients. In this instance it may be beneficial to consider making a gift to a trust in the parents’ Wills.

Common uses of Will Trusts

To provide for a surviving spouse or partner, for children and future generations, for disabled or vulnerable people.

To protect property against the cost of long-term care for a surviving spouse in later life and to protect property for children should a surviving spouse remarry.

¹ Under the laws of England and Wales

² This note was written taking account of UK taxation in October 2008

To protect the assets of a family business and an inheritance for future generations.

To mitigate against Inheritance Tax. Will Trusts can be utilised to ensure that Inheritance Tax on assets is only paid once for several generations of a family.

Children's Will Trusts

Children cannot inherit before reaching the age of 18 years. Parents are generally cautious about their children inheriting a potentially large sum at 18 often thinking how able they were to manage money at this age. An 18 to 25 Trust can hold the capital for the children until they reach the age chosen by their parents for them to inherit. In the meantime the Trustees can use the trust assets to pay for the children's upkeep, maintenance and education.

Property Protection Will Trusts

Property usually a half of the principal private residence of a couple is placed in an Interest in Possession trust through the Will of the first to die. The survivor becomes the life tenant and can continue to live in the trust property for the remainder of his or her life rent free. On second death the trust property passes to the Beneficiaries, usually the children.

The principal advantage of this type of trust is that firstly it can ensure that the property does not have to be sold to pay for the cost of long term care for the survivor in later life and to protect at least half the value of the property for the Beneficiaries. And secondly the value of the property in the trust is protected for the Beneficiaries should the survivor remarry.

However this trust should not be used if the estate has, or is likely to have, a liability for Inheritance Tax.

General Discretionary Will Trusts

The management of a Discretionary Trust is, by definition, at the absolute discretion of the Trustees subject to their powers as set out in the Trust Deed. As such a Discretionary Trusts can be tax efficient.

A trust can hold property of all types for the Beneficiaries who might be -

- A surviving spouse or named individuals
- Disabled dependents, where their means tested benefits could be protected
- Vulnerable people, those incapable of managing money, bankrupt or likely to become bankrupt or married and likely to divorce
- A class of people, for example 'my children and remoter issue'
- A charity.

A discretionary trust can be used to hold property, a family business for example, for the benefit of future generations. The property placed in trust does not count in the calculation of any Inheritance Tax liability of individual beneficiaries. Inheritance Tax, if any, is only paid once on the Settled property. If the property was given directly to the beneficiaries rather than to the trust Inheritance Tax may in addition have to be paid by future generations.

Nil Rate Band Discretionary Will Trusts

Property usually, but not necessarily, half of the principal private residence of a couple up to the value of the Nil Rate Band³ (“NRB”) is given in the Will of the first to die to the trust. The Beneficiaries of the trust are normally the surviving spouse and the children. The survivor can borrow trust assets generally without the payment of interest through an IOU or charge scheme.

On the second death the survivor’s estate pays any debts to the trust. The trust is wound up and its assets passed to the surviving Beneficiaries, there is normally no Inheritance Tax liability on the trust’s assets.

The survivor’s net estate is subject to Inheritance Tax at the prevailing rate⁴ over the NRB, the balance passes to the Beneficiaries.

NRB Discretionary Will Trusts preserves two NRB allowances for married couples and those in a Civil Partnership. With effect from 9th October 2007 for these two types of couples NRB Trust Wills are not strictly necessary but do provide flexibility and the potential to maximise the value of the estate for the Beneficiaries in certain cases.

For co-habiting couples and for widows and widowers who have remarried it is essential in order to benefit from all of their Inheritance Tax NRB allowances they make Wills that include NRB Discretionary Trusts.

If the gift to the NRB Discretionary Trust on first death comprises or includes a share of the principal private residence then this property will be protected from forced sale to cover the long term care of the survivor in later life.

Lifetime and other Trusts

Some of the trusts discussed so far can be established in one form or another during the Settlor’s lifetime. For example a couple may set up and make a gift to a discretionary trust during their lifetime for the benefit and/or to pay for the education of their grandchildren.

³ The Nil Rate Band is the amount of a person’s estate that can be given, other than to his or her spouse or Civil Partner, on which Inheritance Tax is chargeable at 0%. The NRB in the tax year 2008/09 is £312,000.

⁴ 40% in the 2008/09 tax year

Lifetime Discretionary Trusts are a tax efficient vehicle for making absolute gifts⁵ above the annual lifetime IHT allowances that subject to NRB allowances will not be counted for Inheritance Tax if the donor survives for seven or more years.

Charities and qualifying Charitable Trusts are subject to special tax treatment and gifts to these trusts are free of IHT liability. Gifts of assets including, for example, an interest in a business to a Charitable Trusts can be made at anytime during life or through a Will.

A Flexible Life Interest Trust is a useful Will Trust that can be utilised to give a life interest in the residue of the testator's estate to a surviving spouse. The trust includes an overriding power for the Trustees to revoke all or a part of the life interest trust and to establish new trusts holding trust property in favour of individuals or a class of beneficiaries listed in the Will. The class of beneficiaries may include a surviving spouse, children and grandchildren. Property transferred to a trust in which the surviving spouse is not a beneficiary is not subject to the 'gift with reservation of benefit' provisions. On the surviving spouse's death any remaining life interest comes to an end and the trust property either passes directly to the beneficiaries or can be held in a discretionary trust.

⁵ There are annual gift allowances that don't count for Inheritance Tax