FINANCIAL GUIDE

A GUIDE TO TRUSTS

LAYING THE FOUNDATIONS FOR TAX PLANNING OR ASSET PRESERVATION

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As your life changes over time it's important to ensure that your financial objectives continue to meet your needs. The structures into which you transfer your assets will have lasting consequences for you and your family. Succession planning enables a smooth transition to the next generation. It also enables you to minimise potential tax liabilities.

We can help you choose appropriate trusts designed to protect your assets and give your family lasting benefits in an uncertain world.

INEVITABLY COMPLICATED RULES

Generally trusts are set up for tax planning or asset preservation purposes. Trusts give Capital Gains Tax and Inheritance Tax advantages but the rules are inevitably complicated. Trustees are also taxed in their own right and therefore they will need to complete annual Tax Returns and ensure that the rules are fully complied with.

A trust is a legal arrangement. It allows the owner of property to transfer legal ownership of that property to another person or company. The person or company receiving the property holds onto it for the benefit of a third party, called the 'beneficiary'. The person transferring the property is called the 'settlor'. Under the laws of England and Wales anyone over the age of 18 who is mentally able can be a settlor. The person or company holding onto the property is called the 'trustee'. Under the laws of England and Wales a trustee must be over the age of 18. They should also be mentally able and have a sound financial history.

INTEREST IN POSSESSION TRUSTS

This trust is one where the beneficiary is entitled to trust income as it arises. The beneficiary has an immediate and automatic right to the income from the trust after expenses. The trustee must pass all of the income received, less any trustees' expenses, to the beneficiary.

The beneficiary who receives income (the 'income beneficiary') often doesn't have any rights over the capital held in such a trust. The capital will normally pass to a different beneficiary or beneficiaries in the future. The trustees might have the power to pay capital to a beneficiary even though that beneficiary only has a right to receive income. However, this will depend on the terms of the trust.

Trustees are responsible for declaring and paying Income Tax on income received by the trust. They do this on a Trust and Estate Tax Return each year. There are different rates depending on the type of income.

A trust may have to pay Capital Gains Tax if assets are sold, given away or exchanged (disposed of) and they've gone up in value since being put into trust. The trust will only have to pay the tax if the assets have increased in value above a certain allowance. This allowance is known as the 'annual exempt amount'. Trustees are responsible for paying any Capital Gains Tax due.

Beneficiaries aren't taxed on any trust gains and don't get credit for any tax paid by the trustees.

This trust may also include the right to enjoy a non-income producing asset, for example, the right to live in a house. Inheritance Tax may be due when: assets are put into an interest in possession trust; an interest in possession trust reaches a ten-year anniversary, or; assets are taken out of an interest in possession trust or the trust ceases.

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DISCRETIONARY OR ACCUMULATION TRUSTS

A discretionary trust is one where trustees have 'discretion' about how to use the income of the trust, and sometimes the capital. An accumulation trust is one where the trustees have the power to 'accumulate' income (add it to capital). A trust may give trustees the power to do both.

In a discretionary trust, the trustees are the legal owners of any assets - such as money, land or buildings - held in the trust. These assets are known as 'trust property'. The trustees are responsible for running the trust for the benefit of the beneficiaries.

The trustees have 'discretion' about how to use the trust's income. They may also have discretion about how to distribute the trust's capital. The trustees may also be able to 'accumulate' income. Trustees may be able to decide: how much income and or capital is paid out, if any; which beneficiary to make

payments to; how often the payments are made; and what, if any, conditions to impose on the recipients.

Discretionary trusts are sometimes set up to put capital aside for: a future need that may not be known yet, for example, a grandchild that may require more financial assistance than other beneficiaries at some point in their life; or beneficiaries who are perhaps not capable or responsible enough to deal with money by themselves.

Under the terms of the deed that creates the trust, there may be situations when the trustees have to use income for the benefit of particular beneficiaries. However, they may still retain discretion about how and when to pay. The extent of the trustees' discretion depends on the terms of the trust deed.

In an accumulation trust, the trustees can accumulate income within the trust; that is, add it to the trust capital. They will often do so until the beneficiary becomes legally entitled to the trust assets (such as money, land or buildings) or the income produced from the assets. Income that has been 'accumulated' becomes part of the capital of the trust. The trustees may also pay income at their discretion.

Accumulation trusts should not be confused with 'accumulation and maintenance trusts'. Accumulation and maintenance trusts are a type of trust that qualified for favourable Inheritance Tax treatment. The Finance Act 2006 ended this treatment and made provisions so that accumulation and maintenance trusts became either '18 to 25 trusts' or were moved into the new 'relevant property' trusts.

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BARE TRUSTS

This trust is where assets are held by trustees but they actually belong entirely to the beneficiary. A bare trust is one where the beneficiary has an immediate and absolute right to both the capital and income held in the trust. Bare trusts are sometimes known as 'simple trusts.'

Someone who sets up a bare trust can be certain that the assets (such as money, land or buildings) they set aside will go directly to the beneficiaries they intend. These assets are known as 'trust property'. Once the trust has been set up, the beneficiaries can't be changed.

The assets are held in the name of a trustee - the person managing and making decisions about the trust. However, the trustee has no discretion over what income or capital to pass on to the beneficiary or beneficiaries.

Bare trusts are commonly used to transfer assets to minors. Trustees hold the assets on trust until the beneficiary is 18 in England and Wales. At this point, beneficiaries can demand that the trustees transfer the trust fund to them. ■

HAVE YOU PUT YOUR LIFE ASSURANCE POLICIES INTO AN APPROPRIATE TRUST?

Putting your life assurance policies into an appropriate trust makes sure that the money paid out goes to the people you want to benefit from it. When an appropriate trust is set up, you list all the people you want to share the money from the trust. You can even indicate what proportion of the money you would like each individual to receive.

The life insurance company can usually pay a death claim more quickly than they could if it were not put into an appropriate trust. If a life assurance plan is in an appropriate trust, it is no longer part of your estate. So if you die, the trustees claim on the life assurance and the death benefit money is paid directly to the trustees. If a life assurance plan is not put into an appropriate trust, the amount of money you have as life assurance is added to the rest of your estate if you were to die during the policy term. This means that the people that are to distribute the estate would need to obtain a grant of probate before the insurance company could pay out any money. This could take several months.

The money the plan pays out is free of Inheritance Tax. By putting the life assurance policy into an appropriate trust, it isn't included in your estate in the event of your premature death, so there is no immediate Inheritance Tax to pay. However, if the money is kept in the trust until the next 10th anniversary of the trust, some Inheritance Tax could become payable.

ENSURE THAT YOUR WEALTH PASSES TO THE RIGHT PEOPLE

Protecting the estate you have worked hard to build is essential, but often put off until too late. With the correct planning in place you can ensure that your wealth passes to the right people at the right time, and in a manner that provides protection and is efficient for tax purposes. We can help you to identify planning opportunities that could benefit you. If you would like more information please contact us to discuss your requirements.

This guide only explains how trusts work in England and Wales; it does not cover trust law in Scotland or Northern Ireland. We recommend you take professional advice before setting up a trust. The content of this guide is for your general information and use only, and is not intended to address your particular requirements. The content should not be relied upon in its entirety and shall not be deemed to be, or constitute, advice. Although endeavours have been made to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No individual or company should act upon such information without receiving appropriate professional advice after a thorough examination of their particular situation. We cannot accept responsibility for any loss as a result of acts or omissions taken in respect of the content. Thresholds, percentage rates and tax legislation may change in subsequent Finance Acts. Levels and bases of reliefs from taxation are subject to change, and their value depends on an individual's personal circumstances.

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