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Financial planning and trusts

Managing your assets for the benefit of others.

If you've been thinking about ways to plan your finances with beneficiaries in mind, it's likely placing your assets into trusts would've been on your radar at some point.

They can provide your loved ones with financial security in the form of guaranteed income, while protecting your assets from estate-dwindling care home fees further down the line.

A trust is a way of managing cash, property, land or investments for the benefit of others. All trusts have three things in common:

- the settlor
- the trustee
- the beneficiary.

The **settlor** is the person seeking to place assets into a trust; the **trustee** is the settlor's appointed person to manage assets within the trust; and the **beneficiary**, or beneficiaries, refers to those who will eventually benefit from the trust.

Getting started

If you're considering placing money or assets into a trust, the first thing to know is you can no longer benefit from it because you have made an absolute gift and the money or assets belong to the trust.

Furthermore, if you establish a trust in which you maintain some sort of benefit from the trust assets this can have significant negative tax consequences.

Your next consideration should be appointing your trustee.

You transfer ownership of assets to trustees, who will manage and pass them onto your beneficiaries.

This person should be someone you know implicitly, such as a family member or close friend.

Trustees can be a group of friends, family or professionals.

Types of trust

Once you've selected your trustee or group of trustees, there are several different trusts for you to consider.

Bare

Bare trusts are usually used for young people. Assets placed in bare trusts are held in the name of a trustee, who looks after them until the beneficiary reaches adult age.

The beneficiary will be entitled to all of the capital or income from the age of 16 (in Scotland) or 18 (in the rest of the UK).

Interest in possession

These are trusts where the trustee must pass on all income from the trust assets to one beneficiary as it arises (minus any expenses), while another beneficiary is entitled to the capital value of the trust assets when the income entitlement for the other beneficiary ends.

Discretionary

Trustees decide how to use the income and sometimes the capital in discretionary trusts. The terms of their obligation are agreed with the settlor and defined in the deed.

Depending on the deed, trustees can decide:

- what gets paid out (income or capital)
- how often payments are made
- any conditions to impose on the beneficiaries
- which beneficiaries to make payments to.

Discretionary trusts can help beneficiaries who are unable or incapable of dealing with finance themselves, while beneficiaries' only legal right is to be considered for distributions.

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Accumulation

Trustees can accumulate income within this type of trust to add towards its overall capital. Like discretionary trusts, trustees decide how to distribute income.

The beneficiaries gain from any income and any capital after the death of the settlor.

This sort of trust can be used to pay towards a beneficiary's education, while trustees can keep a rein on funds until they see fit to distribute.

Mixed

These are a combination of trusts and are usually set up for more than one beneficiary, such as siblings. Different parts of the trust are subjected to different tax rules.

They accumulate income and evolve after beneficiaries reach adult age, at which point the assets can be used however the trustee sees fit.

For example, a mixed trust may begin as an accumulation trust until the eldest child reaches adult age before converting to an interest in possession trust.

The other part of the trust remains in accumulation until the younger sibling reaches adult age.

Settlor-interested

These could be one of three trusts: **interest in possession**, **accumulation** or **discretionary**.

The settlor, their spouse or civil partner benefits from this sort of trust.

For instance, the settlor knows they will be incapacitated by illness and sets aside assets in a trust for future use, either by the settlor, their spouse/civil partner or child.

Non-resident

Non-resident trusts are usually where:

- none of the trustees live in the UK for tax purposes
- some of the trustees live in the UK and the settlor was not a UK resident, ordinarily resident or domiciled in the UK when the trust was set up or funds added.

Trustees of non-resident trusts don't usually pay UK tax on foreign income they may receive.

Tax rules for non-residents of the UK are complicated. Each trust is treated differently depending on:

- the residence of the settlors/beneficiaries
- whether it's a discretionary trust or interest in possession trust.

Tax benefits and implications

The key tax benefit of placing assets into a trust is the ability to minimise the inheritance tax (IHT) bill for your beneficiaries.

Each type of trust is taxed differently and assets placed within a trust may be excluded from your estate for IHT purposes.

If a trust is worth more than £325,000, the excess is subject to IHT charges of:

- 20% when assets are put in the trust
- a charge every 10 years based on the current and historic value and transfers in and out of the trust
- an exit charge when assets are taken out or the trust ends
- when someone dies.

However, there are various exemptions to these rules and older trusts in particular may have a different tax treatment. For example, assets placed into bare trusts are known as potentially exempt transfers, which are not liable to an immediate IHT charge.

Seven-year rule

In order for your beneficiary to obtain the full tax benefits, you must place assets into a trust at least seven years before you die.

If you die within seven years of the transfer and the trust is worth more than £325,000, the IHT rate will be tapered at the following rates:

Years between gift and death	Tapered relief
Less than 3	40%
3 to 4	32%
4 to 5	24%
5 to 6	16%
6 to 7	8%
More than 7	Nil

Family home allowance

Until earlier this year, families were able to use discretionary trusts to pass on property to their children.

But from April 2017, the family home allowance (or residence nil-rate band as it's also known) came into force and trusts were explicitly excluded.

The allowance is only granted where a property, such as the family home, is inherited by direct descendants.

These exclusively include children, grandchildren, stepchildren, foster children, adopted children and their lineal descendants.

Discretionary trusts are excluded because the assets are owned by the trust, and managed by trustees, not the beneficiaries.

If you have placed property into a discretionary trust, you may not qualify for this tax break. However, we're happy to talk you through your options.

Capital gains

Trustees only have to pay capital gains tax (CGT) if the total taxable gain exceeds the trust's annual tax-free allowance.

Assets, such as property, transferred into trusts may be liable for CGT if their value has increased at the time the asset is taken out of the trust.

The tax-free allowance is currently £5,650. This rises to £11,300 where vulnerable beneficiaries, such as disabled people or a child whose parent has died, are involved.

Speak to us about planning your finances.

Important information

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

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