

# User Guide



# A Guide to Trusts



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Trusts are a way of looking after assets (money, investments, land or buildings) for people. This User Guide provides a brief view of why people set up trusts and who is involved in setting them up and running them. This User Guide should not be regarded as legal advice in and of itself. For free, confidential advice from our expert team of solicitors, contact Pearson Solicitors today and help us plan and secure your future for your family.

## What is a trust?

In simple terms a trust is where property is held by “trustees” on behalf of other people. The person who creates the trust is called “the settlor” and he or she specifies the people for whom the property is to be held. They are called “beneficiaries”.

The ‘trustees’ are given legal responsibility for holding on to certain assets such as land, money, property, shares and other valuable items

Trusts can be arranged in many ways and can specify exactly how and when the assets pass to the beneficiaries.

## Why create a trust?

Trusts are created for many reasons:

- For disabled beneficiaries or minors who are not able to deal with their own property.
- For beneficiaries whom the Settlor believes would otherwise dissipate the money or property.
- To provide for a widow or widower for his or her lifetime but specifying the property then passes to the Settlor’s children.
- The Settlor wants to give property away but wants to remain in control. However, unless the Settlor and his or her spouse are excluded from benefiting from the trust he will be treated for tax

purposes as still owning the assets. For example if the Settlor gives away a house but continues to live in it, or receives income from cash or property which has been given away.

- To avoid unacceptable laws or restrictions.
- To avoid loss of benefits
- To avoid tax.



## What taxes might be payable?

Subject to various exemptions and reliefs Inheritance Tax (IHT) is payable on death or on a lifetime gift exceeding a value set in the budget each year. From 6th April 2010 this is £325,000 per person. This is called the “Nil Rate Band”. Any gifts between spouses or to charity are completely exempt. Any absolute gifts made more than 7 years before death are exempt, provided no benefit has been reserved as mentioned above. These are called “Potentially Exempt Transfers or PET’s”

Capital Gains Tax (CGT) is payable on a disposal of an asset, whether by sale or gift if the value of the asset has increased during the ownership of the person selling or giving it. Again there are exemptions and allowances set by the budget each year.

CGT is never payable on a disposal which would be subject to IHT.

Income Tax is payable on income earned on monies held in a trust. With some types of trust a higher trust income tax rate is payable. It is therefore necessary to consider whether or not the trust assets will produce income when deciding which type of trust to use.

## What types of trust are there?

Different kinds of trust are used to suit each situation, as explained below. This will depend on the wishes of the Settlor and the relevant tax considerations.

## Interest In Possession Trusts

### What is an Interest in Possession Trust?

Where a Beneficiary is entitled to immediate enjoyment of a right to trust property.

The basic structure is the payment of income as it arises to a Beneficiary (called “the Life Tenant”) during his or her lifetime, followed by a gift to other Beneficiaries on the death of the Life Tenant eg “the income from my property to my wife for her life and then the capital to my children”.

It is usual to include other powers for the Trustees, for example:-  
To revoke the right of the Life Tenant to any income and pay it instead to another Beneficiary.  
To transfer capital to the Life Tenant.

### What are the tax implications?

Income Tax is charged in the trust’s hands at basic rate.

There is a reduced allowance from CGT.

There is a 10 yearly periodic charge for IHT and potentially an exit charge when property leaves the trust.

The gift to the trust is not a PET and IHT will be payable if the value of the gift exceeds the Nil Rate Band. Hold over relief from CGT is available.

## Bare Trusts

### What is a Bare Trust?

Where the Trustee merely holds all income and capital for a Beneficiary absolutely. It belongs to the Beneficiary for tax purposes.

## Discretionary Trusts

### What is a Discretionary Trust?

The Trustees have a discretion over the distribution or accumulation of income and appointment of capital out of the trust. No Beneficiary has any right to require the Trustees to exercise their discretion in his or her favour.

### When is this used?

Nil Rate Band Discretionary trusts in Wills as mentioned below.

Lifetime gifts with an initial value within the Nil Rate Band where hold over relief is required for CGT purposes ie gifts of non business assets. This can be useful for gifts of second homes.

Trusts to hold benefits of insurance policies or pension plans.

Trusts to avoid assessment for loss of benefits.

### What are the tax implications?

Income Tax is charged in the trust’s hands at 45%.

There is a reduced allowance from CGT.

There is a 10 yearly periodic charge for IHT and potentially an exit charge when property leaves the trust.

The gift to the trust is not a PET and IHT will be payable if the value of the

and IHT will be payable if the value of the gift exceeds the Nil Rate Band.

Hold over relief from CGT is available.

## Disabled Person's Trusts

### When is this used?

The Beneficiary must be incapable by reason of mental disorder of administering his property or managing his affairs or in receipt of attendance allowance or disability living allowance at the highest or middle rate or qualified to receive those benefits but for accommodation provided or residence outside the UK.

It has tax advantages, provided certain rules are met, in that it is as flexible as a Discretionary trust but does not have some of the tax disadvantages of a Discretionary trust.

## Nil Rate Band Discretionary Trusts

For deaths on or after 9th October 2007 on the death of a surviving spouse or civil partner any proportion of the unused nil rate band (NRB) will be applied to the NRB available at the death of the surviving spouse or civil partner.

e.g. Mr A dies in August 2007 (when the NRB was £300,000) leaving £150,000 to his son and the rest of his estate to Mrs A. 50% of the NRB is added to the NRB of Mrs A on her death in August 2008 when the NRB is £312,000 i.e. £312,000 plus £156,000 = £468,000.

Before this change it was customary to leave the value of the NRB into a discretionary trust for the potential benefit of the surviving spouse and any children in order to preserve the NRB on the death of the survivor which otherwise would have been lost.

Discretionary trusts can still however be effective when for example:

- A parent wishes to ensure children from a first marriage benefit from the estate.
- Capital appreciation in the trust is anticipated to outstrip increases in the NRB.
- There are vulnerable beneficiaries.
- Protection may be required from possible claims against beneficiaries in divorce or bankruptcy proceedings.
- Agricultural property or business property relief from IHT may be available.
- Protection from Care fees may be an issue.

Also remember that funds in the trust are still available to the surviving spouse who is also a beneficiary of the trust. The money will also be immediately available to pay any IHT due upon the death of the surviving spouse.

## Trustees' Duties and Powers

### Who should act as Trustees?

This is a very personal decision for the Settlor.

The Trustees must honour various duties but have wide powers. The Settlor must be satisfied that the Trustees chosen will be able to fulfil those responsibilities and will act on the Settlor's wishes. This is particularly important where, for example, the beneficiary may be the widow or widower of the Settlor and there may be a conflict of interest between the surviving spouse and the children of the Settlor.

It is normal to consider a solicitor or accountant to act as a trustee, sometimes jointly with a family member. It is advisable for the Settlor to write a letter to the Trustees setting out his or her wishes as to how the trust is to be administered in any given situation.

### What are the duties of Trustees?

The Trustee must:

- Exercise reasonable and proper care in relation to the management of trust assets.
- Acquire knowledge about the trust property and the nature of the trust provisions.
- Obey the directions of the Trust Deed.
- Act impartially.
- Invest in accordance with the Trust deed
- Act jointly. All trustees must act in unison. It is not permissible for a majority view to prevail unless so specified in the Trust Deed.
- Not receive reward for acting as trustee unless authorised by the Trust Deed.

## What are the powers of Trustees?

Subject to compliance with the statutory duty of care, Trustees may make any kind of investment, as if they are absolutely entitled to the assets of the trust. This can be restricted by the Settlor, for example if the Trust Deed prohibits certain investments.

Trustees will need to be given additional powers if the trust property will consist of private company shares or if the Trustees are to carry on a business or borrow money on the security of trust property.

## How do I set up a Trust?

Contact Hannah Pearson or Sarah Finnigan at Pearson Solicitors and Financial Advisers LLP Albion House, 31 Queen Street, Oldham, OL1 1RD on 0161 785 3500.

Please note that this is a brief guide to trusts. It is important to seek the

advice of your solicitor as each person's circumstances are different. The information in this guide is based upon the 2010 Budget and may be subject to amendment.

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*To speak to a solicitor about any of the issues raised in this User Guide, please call 0161 785 3500 or email: [enquiries@pearsonlegal.co.uk](mailto:enquiries@pearsonlegal.co.uk)*