Tried and Trusted

How to Financially Protect Your Family and

Defend Them From The Tax Man

What is a Trust?

A Trust is a legal arrangement where assets are managed by one person for the benefit of another. Different Trusts have different rules according to the way they are set up. With inheritance issues the one that is used most often is a Discretionary Trust.

What is a Discretionary Trust?

The Trustees (ie managers of the Trust) have 'discretion' about how to use the income received by the Trust. This gives them the power to act quickly in changing circumstances. They may also have discretion about how to distribute the Trust's capital. The extent of the Trustees' discretion depends on the terms of the Trust deed.

What Is the Trust Deed?

A deed is a legal document used to grant a right. In a discretionary Trust this gives the Trustees the right to administer the Trust for the benefit of the people you have named in it. In order for it to be properly recognised in law the Trust deed needs your signature and the signatures of witnesses. When setting up a Trust you should leave a 'letter of wishes' attached to your will. This document should give guidance to your Trustees regarding the way in which your assets should be used to benefit the people named in the deed. A solicitor is the best person to advise you how to set up a Discretionary Trust and will explain more about the Trust deed.

Who should I appoint as Trustees?

As a result of the power given to Trustees in a Discretionary Trust, it is important to think hard about who should be appointed as they will have control and make important decisions. Trustees are often family members or friends who you would expect to act as you would wish. The Trust will normally have between one and four Trustees. Solicitors can help you appoint Trustees, or may act as a Trustee themselves, particularly if your affairs are complex. Appointing a firm of solicitor or bank as one of the Trustees does sometimes help should your family member or friend Trustee die, or become incapable of performing their duties.

Why set up a Discretionary Trust?

Many family and partnership situations are not straightforward and in these cases setting up a Discretionary Trust can be a good option.

Children under 18
One of the most common uses of Trusts is to hold assets (ie money and/or property) on behalf of a child until they reach 18 or older. A Trust can be structured to allow a child to receive an income from the Trust until they inherit the assets outright.

Example:

Margaret wants to leave money for her grandchildren aged 6 and 8, who given the chance might want to spend it all on toys, sweets and going to Disneyland! So Margaret asks her solicitor to set up a Discretionary Trust to be held for twenty years with her two sisters as Trustees. The Trustees can decide how to invest or use the money to benefit the grandchildren. So, when the children are young, the Trustees might decide to pay for piano lessons for them. As they get older, the Trustees might pay towards a wedding.

Children from a previous marriage

The flexibility of Discretionary Trusts can be a useful protective element. A Trust can ensure children of a previous marriage are financially secure upon a second marriage. With divorce and step-families becoming common, a Trust can help determine the line of inheritance for future generations.

Example:

Fred is married to Joyce but has two children by a previous marriage. He wants Joyce to inherit everything when he dies, but he also wants to make sure that his children inherit when Joyce dies. He can set up a Trust so Joyce has a life interest in his assets and then they pass to his children after her death. Without a Trust, the assets would have been divided according to Joyce's wishes in her will and he would have no control over who inherits.

Long-term care costs

Under the English system, anyone with savings or capital of more than £23,000 is required to pay for his or her own care fees. If your house is worth more than this and you live with a partner, former partner or relative, your house will be disregarded when calculating your assets. But if you are the only person living there, it will be included.

Example:

Joe dies and leaves everything to Jane so his half of the property goes to Jane. A few years later she needs to go into a Nursing Home so the local authority may force Jane to sell it to pay for care. Alternatively they may ask for the fees to be paid after she dies and the property is sold.

However, if the house is jointly owned by a Trust for your children's benefit, the council cannot make a claim against it. They may place a charge against the property so they get some of the proceeds when it is eventually sold. Even then the local authority can only claim on half of the property. If your family doesn't want to sell and the local authority is still pursuing a claim, their own guidelines state that the value of a half-share of a property is in effect nil.

Tax-saving for your family

The sums passed on in Trust can be free of Inheritance Tax for up to 80 years. If your children do well and face an Inheritance Tax bill as a result, the money you left them in Trust can be exempt. Income Tax on the interest generated by the Trust may be claimed back by the beneficiaries. If you do leave the first £325,000 in Trust for your family they can enjoy tax free income if they are non tax payers. For example, while they are at school, students or on a gap year.

Tax-saving for unmarried couples

Most unmarried couples nowadays opt to own a house as beneficial joint tenants. This means when the first partner dies, the surviving partner will automatically inherit the other partner's share of the property. However a Discretionary Trust can also be used to reduce Inheritance Tax where an un-married couple has a house together should one partner die. Putting assets into Trusts can maximise the nil rate band (the Inheritance Tax threshold currently at £325,000). If the house is the main asset and is owned on a 'joint tenancy' basis, the structure is changed to be owned as 'tenants in common'. On the death of the first spouse, their 50% share of the house goes into a Discretionary Trust. The surviving spouse continues to own and live in the property, but it falls outside their estate. This means it's not counted for long-term care costs and will pass directly to the first spouse's beneficiaries (such as children from a previous marriage) on the death of the second spouse.

> **Example:**
> Sue and Nathan, both 56, marry later in life. Jim has children from a previous marriage and wants to ensure they'd get their share of his estate if he dies first. Sue and Nathan set up a Discretionary Trust to contain his share of the house. This means his children would automatically receive their share.

If your partner has died and you owned your house as beneficial joint tenants it is possible to use a Deed of Variation to create a tenancy in common to reduce Inheritance Tax.
(see information leaflet Good Deed of the Day)

Any information we give is for general guidance only and does not represent actual legal or financial advice. We strongly recommend all our patients, families and supporters to seek professional assistance from a qualified practitioner.

You should bear in mind that the tax laws are continually changing. What may be valid today may not be so tomorrow. It is important therefore to always keep any financial arrangements that you may make under regular review.