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Trusts

Trusts are mainly used by individuals as a way of holding, preserving and generating wealth. In this guide, we consider issues around trusts, trustees and taxation.

- A trust places assets under the control of a trustee for specified beneficiaries.
- There are four main types of trust; uses for trusts include enabling property to be held for people who cannot hold it directly themselves and protecting property from claims brought against the beneficiaries.
- All trustees have a duty to manage and protect the trust assets diligently and prudently.
- Inheritance tax, capital gains tax and income tax all need to be considered in the context of any trust.

A trust is a legal relationship created by someone (a settlor), during their lifetime or when they die, that places certain assets under the control of a trustee for the benefit of one or more beneficiaries.

Types of trust

Express trusts are intentionally created by a settlor, and usually set out in a trust document or will.

There are four broad categories of express trust:

- **Bare trusts** – essentially, the assets of the trust are treated as belonging to the beneficiaries and, when they reach 18, they are entitled to have the assets transferred to them. While a beneficiary is under 18, the trustees have control of the administration of the trust assets and, through their choice of investments, they can exert some control over the flow of income.
- **Interest in possession (IIP) or life interest trusts** – where one or more beneficiaries is entitled to the income generated by the assets held in trust, or is entitled to occupy property held as an asset of the trust.
- **Discretionary trusts** – these are very flexible trusts, where the beneficiaries have no fixed right to income and/or capital, and the distribution of funds is at the trustees' total discretion. They are ideal when you have a group of people you would like to help, but you are unsure exactly how, when and in what proportions.
- **Contingent trusts** – typically these are trusts for children, where each child has an interest that is dependant on them reaching a certain age. The trustees usually have powers to use the income and capital to benefit the children before they reach the specified age.
- A will may contain one or more of the above types of trust.

When are trusts used?

Trusts have a wide variety of uses, including:

- Enabling property to be held for people who cannot (or should not) hold it directly themselves (for example, children under 18).
- Allowing someone to make provision for others privately (because while they are in trust, the assets are held in the name of the trustees, rather than the beneficiaries).
- Preserving property for future generations.
- Protecting property from claims brought against any of the beneficiaries, eg on divorce or bankruptcy.

Trustees

The choice of trustees is important as they control the trust assets. The settlor or person making the will (testator) appoints the first trustees.

In general, the trustees may consist of:

- One or more individuals
- A company or corporation

Trustees' duties

The Trustee Act 2000 imposes a statutory duty of skill and care on trustees carrying out certain functions, including:

- Investing trust property
- Acquiring land
- Appointing agents, nominees and custodians
- Insuring trust property

The duty of care can be excluded or modified by express provisions in the trust document.
The duty requires trustees to act with reasonable care and skill in all circumstances. When considering what is required of a particular trustee, the following must be taken into account:

- Any special knowledge or experience that they have or claim to have.
- For professional trustees, any special knowledge or experience that it is reasonable to expect of them.

In addition to the statutory duty of skill and care, a trustee's principal duty is to act in accordance with the directions of the trust and in the best interests of its beneficiaries.

Trustees must not:

- Put themselves in a position where their fiduciary duties and their personal interests may conflict.
- Make a personal profit from their trustee-ship, unless they are authorised to do so.
- Limit their discretion to act in the future.
- Delegate their powers, unless they are authorised to do so.

Trustees' powers

There are two sources from which a trustee derives their powers:

- General law, ie statute and case law.
- The trust document or will. The trust document or will sets up the express trust and governs how it works. It usually takes precedence over general law and extends trustee powers, rather than restricts them.

Trust documents and wills

Trust documents vary in form, but they usually cover a number of common elements:

- **The parties (the settlor and the trustees)** – in the case of a trust set up under a will, the testator is the settlor.
- **The initial trust fund** – if established during someone's lifetime, the initial fund is normally stated to be a nominal sum of cash, eg £10, with the addition of further assets noted by memorandum, so that the trust document does not actually show the fund size. If coming into effect on death, either specific assets, a cash sum or the balance of the testator's estate after the payment of debts, inheritance tax and legacies will form the initial trust fund.
- **How long the trust can last** – the length of time a non-charitable trust can run is 125 years for trusts created on or after 6 April 2010. For trusts created before that date, the maximum period was normally restricted to 80 years.
- **The trustees' beneficial powers and duties** – the beneficial powers set out how the beneficiaries will (or may) benefit from the income and capital of the trust.
- **The trustees' powers and duties regarding management and administration** – the administrative powers enable the trustees to manage and invest the trust property before it is distributed to the beneficiaries. If the trust document does not contain adequate administrative powers, general trust law often fills the gap.

How trusts are taxed

Inheritance tax

A gift into a bare trust during your lifetime is not subject to an immediate inheritance tax charge, and there is no charge at all if you survive the date of the gift by seven years.

Subject to some exceptions, in the case of other trusts, there may be an inheritance tax liability on:

- Assets being transferred into a trust
- Assets being held in a trust
- Assets being transferred out of a trust

An individual can transfer up to £325,000 and a couple can transfer up to £650,000 into a trust without incurring an inheritance tax liability. Qualifying business and agricultural assets may also be transferred without inheritance tax being payable.

Income tax and capital gains tax

A charge to capital gains tax can arise when assets are transferred to or leave a trust (whether by sale or distribution to a beneficiary). However, hold-over relief – which is effectively a way of postponing a capital gains tax charge – may be available for disposals of business assets, or disposals to or out of certain qualifying trusts. Where hold-over relief is available, the recipient of the assets (whether the trustees on their transfer into the trust, or the beneficiary when they are distributed out of the trust) acquires the assets at the value at which the transferor acquired it and so pays no capital gains tax at this point.

How income tax applies to trusts depends on whether there is entitlement to income. The beneficiary entitled to the income arising in such a trust will pay income tax on it at the rate appropriate to their individual circumstances. Any income arising in a trust where no one has an entitlement to income is subject to tax at special trust rates payable by the trustees (currently 38.1 per cent on dividends and 45 per cent on other income, for all income over £1,000).

Please speak to us for detailed advice on the tax position of a particular trust.

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