Guidance: Importance of Trusts

This factsheet provides details on the importance of trusts and should be read in conjunction with your suitability report and any provider documentation.

Glossary of Terms

- **Settlor** - The person who creates the trust and provides the trust property.
- **Beneficiaries** - The people entitled to benefit from the trust property.
- **Default Beneficiary** - A beneficiary who, if no other appointment is made by the trustees, will benefit (also known as a Named Beneficiary).
- **Potential Beneficiary** - A beneficiary who at the trustee's discretion may become entitled to a beneficial interest.
- **The Trustees** - The people who control the trust and ensure it is being managed in the interests of the beneficiaries.
- **Gift with Reservation** - A gift where the donor is deemed to continue to derive benefit from the gifted asset. For the purposes of Inheritance Tax this is not treated as a gift at all.
- **Interest in Possession** - A current entitlement to trust income or enjoyment of trust property.
- **Potentially Exempt Transfer** – a lifetime transfer to an individual or an absolute trust after which the transferor lives for at least seven years and contains no reservation of benefit by the donor. It has no immediate IHT charge.

What is a Trust?

A trust is a way of transferring ownership without giving up complete control of the trust property. A trust is usually created by a document, the trust deed, which names the people involved and sets out the terms of the trust.

Trusts are often used in Inheritance Tax planning as a means of removing assets from the settlor's estate without losing control of, and possibly the benefits from, those assets. However, care must be taken to ensure that any such transaction does not fall foul of the HM Revenue & Customs' 'gift with reservation' rule.

What are the Main Types of Trust?

Bare Trust

A bare trust, also known as an 'absolute' trust, is one where the beneficiary gains immediate, absolute right to the assets in the trust and the income generated. The settlor placing funds into trust must be certain that the assets in the trust will go directly to the beneficiary or beneficiaries they choose. Once this trust has been set up, the beneficiaries cannot be changed. Where the beneficiary is a minor, they can demand to take ownership of the assets on attaining the age of 18.

Discretionary Trust

A discretionary trust enables the trustees to have discretion about how the trust's income and/or assets are used. In a discretionary trust, the trustees are legal owners of the assets in the trust. They must run the trust to benefit the beneficiaries. They also have the power to appoint new beneficiaries.

Under a discretionary trust, when a claim is made on the policy, there may be tax charges on the policy proceeds. This will depend on when the benefits are paid out and on how long the policy proceeds are held within the trust. It is therefore recommended that professional tax advice is sought when assets held within a trust are to be distributed.

Split Discretionary Trust - Life & Critical Illness

A discretionary trust enables the trustees have discretion about how the trust's income and/or assets are used. In a discretionary trust, the trustees are legal owners of the assets in the trust. They must run the trust to benefit the beneficiaries. They also have the power to appoint new beneficiaries.

With a form of discretionary trust called a 'split' trust, the life insurance proceeds will go to the chosen beneficiaries. If any of the specified critical illnesses is diagnosed, the policy proceeds return to the life assured.

A discretionary trust enables the trustees to appoint and vary the beneficiaries. The trustees can also decide who will receive some or all of the assets, and when.

Under a split discretionary trust, when a claim is made on the policy, there may be tax charges on the policy proceeds. This will depend on when the benefits are paid out and on how long the policy proceeds are held within the trust. It is therefore recommended that professional tax advice is sought when assets held within a trust are to be distributed.

What are the benefits of trusts?

- **Protection in the event of bankruptcy** – Any asset held under trust will not be viewed as forming part of the settlor's estate.
- **Ability to retain control** – Trusts enable people to retain control over gifted assets.
- **Certainty of affairs** – Trusts provide peace of mind that assets will be distributed in accordance with wishes.
- **Speed of payment** – The proceeds can be paid before the granting of probate.
- **Avoidance of Inheritance Tax** – There are many ways in which trusts can be used to avoid the payment of Inheritance Tax.

Responsibilities for Trustees

Where our recommendations have included the use of trusts, you will need to choose trustees with care.

The trustees become the legal owners of the trust property. They administer the trust for the sole benefit of the beneficiaries. There needs to be at least two trustees. They must administer the trust in accordance with the terms of the trust document and the law that governs the trust.

It's important to choose the right trustees. They need to have good financial knowledge and be someone the settlor can trust. It could be a friend, a member of the settlor's family or a professional adviser. The settlor can appoint a professional trustee who will usually charge for their services.

It may not be a good idea to ask a beneficiary to become a trustee as this could lead to a conflict of interests. This is particularly important in relation to a discretionary trust where the trustees have the power to lend money from the trust fund.

Under the laws of England and Wales a trustee must be over the age of 18. They should be mentally able and have a sound financial history.

The exact responsibilities of a trustee and the powers that they have vary slightly depending on the type of trust. It is important to read the trust document to make sure you understand the responsibilities that trustees are taking on. However, a trustee is also expected to exercise such care and skill as is reasonable in the circumstances.

Anything a trustee does must be authorised by the terms of the trust and the law that governs trusts. If any of the beneficiaries, or trustees, think that the trustee is not acting in their best interests, they can take legal action against a trustee if the trustee is acting outside the terms of the trust.

The main duties and powers of a Trustee

- **Protection in the event of bankruptcy** – Any asset held under trust will not be viewed as forming part of the settlor's estate.
- **To invest the trust fund** – A trustee is responsible for making sure that the trust fund is invested for the beneficiaries until the money is distributed. If the only property in the trust is an insurance plan, there will be no fund to invest until after any claim on the insurance plan. The money from the insurance plan will need to be invested until such a time as it is distributed to the beneficiaries of the trust.
- **To act impartially –** If there is more than one beneficiary, the trustees must not act in a way that will benefit one of them more than another. For example, if one beneficiary is to receive income from the trust but another one will receive the capital, trustees should invest the fund to produce both an income and capital growth. If the trustee invests in a way that produces just one of those, they would not be acting impartially.
- **To take appropriate advice –** Trustees are required to take professional advice before investing the trust fund, unless the fund is so small that the cost of the advice would outweigh any benefit or one or more of the trustees are qualified to give advice themselves. Trustees can ask a professional person to act on their behalf in investing the fund, but the responsibility for the investment would still lie with the trustees.
- **To distribute the trust property –** The trustees should ensure the trust property is passed to the beneficiaries at the appropriate time.

- **To keep the trust's property secure –** Trustees are responsible for making sure that the trust fund is secure. Should the fund include something tangible, such as a house, they are responsible for making sure that it is insured.
- **To keep the trust's records –** Trustees must keep a record of any decisions they make and any actions they take. This includes records of any investments they make and any money they pay out to a beneficiary. Trustees should also keep records of the advice they have received and any costs the trust has had to pay.
- **To not profit from the trust –** Trustees acting in a professional capacity can claim reasonable fees for their services, but they must not manage the trust in such a way that they receive additional remuneration.
- **Other powers –** The trust document may set out other powers a trustee has, such as the power to change the beneficiaries. This can be very useful if the settlor's circumstances change, for instance if they have another child, remarry, or fall out with one of the beneficiaries.

  The trustees of a discretionary trust have the power to lend the trust funds to potential beneficiaries of the trust. It is recommended that the trustees seek appropriate legal and other professional advice before exercising this power.

  While the settlor is still alive they may hold some powers that other trustees don't have, such as the power to appoint or remove trustees. These powers may be handed on to the other trustees if the settlor dies.

Reporting Responsibilities for Trustees

Trustees are required to hold accurate and up-to-date information on their trusts' beneficial owners, including settlors, trustees, beneficiaries (including any potential beneficiaries) and any persons exercising effective control over the trust (e.g. protectors).

In addition to maintaining these records, this information must also be submitted to HMRC in order to be added to the Trusts Registration Service (TRS), an online trusts register.

The reporting responsibilities for Trustees can be found at https://www.gov.uk/trusts-taxes/trustees-tax-responsibilities