



Trusts – Your Questions Answered

What are Trusts?

A Trust is:

- (1) an obligation that binds a person who is then called a “Trustee” ,
- (2) a device to enable someone to deal with the Trust assets in a particular way,
- (3) for the benefit of one or more “beneficiaries”

What is a “Trustee”?

Trustees are the legal owners of the Trust Assets. They are legally bound by the terms of the Trust document to look after the property of the trust in a particular way and for a particular purpose. Trustees administer the trust and make decisions about how the property in the trust is to be used.

What are “Trust Assets”?

Trust assets can include money, investments such as shares, land and property and other assets, such as furniture.

What is a “Beneficiary”?

A Beneficiary is the person or persons who by the terms of the Trust document can benefit from the trust assets. Each Beneficiary may benefit from the trust in a different way. One Beneficiary may benefit from income only, one from capital only and the other from both income and capital.

What is a “Settlor”?

A Settlor is the person who has put the Trust Assets into the trust. Some trust assets have to be put into the trust when it is created. Additional assets can be added later.

How and when can a Trust created?

A Trust is normally created by a document called a Trust Deed. The Deed sets out the terms of the trust and confirms how the Trust Assets should be looked after and dealt with.

A Trust can be created during lifetime or by the terms of your Will. A Trust can also arise if a person dies without leaving a will under the Intestacy Rules.

Sometimes the Courts will create a trust. This might arise if assets need to be held for the benefit of a child or an incapacitated person who cannot manage his or her own affairs.

Why should I create a Trust?

Flexibility and tax savings:

If you decide to make a gift to someone, by creating a Trust it can allow flexibility as to who ultimately benefits. Sometimes creating a Trust can achieve tax savings.

Protection:

By creating a Trust you can gift assets to children, young adults or other vulnerable beneficiaries and protect them for their benefit. A young child cannot hold assets themselves. Therefore someone must look after those assets for them, particularly if one or both of their parents have died. A vulnerable person may also become subject to the influence of persons who may not have their best interests at heart.

Control of succession:

Trusts can be used to control the destination of assets. For example a person may wish to benefit both his current spouse or civil partner and the children from his first marriage

How are Trusts taxed?

Inheritance Tax (IHT):

Since March 2006, there are two main types of trust for IHT purposes

- (1) Interests in possession (under the old IHT regime)

If a person is given an interest in possession it means they have the right to enjoy the Trust Assets (e.g. live in a trust property rent free) or receive the income that the Trust Assets produce.

If such a trust was created before the changes announced on 22nd March 2006 and there have been no alterations to the trust terms since then, the Trust will be subject to the “old” IHT regime. The old regime provided that a Beneficiary entitled to an interest in possession was, for IHT purposes, treated as owning the Trust Assets and therefore those assets formed part of their estate even though they did not actually own those assets.

The old regime also applies to an “immediate post-death interest” (IPDI). This is an interest in possession arising under the terms of a Will or, where someone dies without a will, under the Intestacy Rules. It is also possible to create an IPDI through a Deed of Variation or a Deed of Appointment from certain types of Will Trusts within two years after death.

(Except for limited rules on trusts for the disabled it is now impossible to create a lifetime trust which is within the old IHT regime.)

(2) Other lifetime trusts

On the creation of such Trusts, an IHT charge of 20% may arise on the value gifted. Whether such a tax charge arises will depend on whether you have made any gifts in the previous 7 years and the value of the gift. If you have not made any gifts in the previous 7 years, the value of the gift would have to be more than the then Nil Rate Band (in 2008/09 this is £312000) before any IHT arises. If the value of the gift is over this amount only the value above the then Nil Rate Band will be taxable at 20%. An additional 20% becomes payable if you die within 7 years of setting up the Trust.

A Trust created during lifetime since 22nd March 2006 (whether a beneficiary has an interest in possession or not) will now be within the relevant property regime and will be known as a Relevant Property Trust (RPT).

The relevant property regime has always applied to Discretionary Trusts and other trusts where no individual had the right to income.

RPT's pay a maximum of 6% IHT on the value of the trust assets every 10 years. The full 6% 10-year charge may not apply, because the Trust may have its own nil-rate band allowance up to the current £312,000 threshold.

With RPT's there is also an “exit charge” when capital is given to a Beneficiary out of the Trust. This charge is at a fraction of 6%, proportionate to the time that has passed since the last 10-year anniversary of the trust.

There are also other forms of Trust which can be created by the provisions of your Will or the Intestacy Rules. These include Trusts for bereaved minors (BMT's) and for beneficiaries who are aged between 18 and 25 years (18 to 25 Trusts). These trusts usually arise only under the Will or Intestacy of a parent, for the benefit of their minor children. There is no IHT while the child is under 18.

A BMT must end on the Beneficiary's 18th birthday. An 18 to 25 Trust is subject to a modified form of the relevant property regime to the extent assets stay within the trust after a Beneficiary turns 18.

The final type of Trust is a Bare trust. These are effectively a mere nominee arrangement where the Trustees hold the Trust Assets for the absolute benefit of the Beneficiary. The Beneficiary could insist on the Trustees transferring the trust assets to him at any time. Usually, for tax purposes, the Bare Trust is "transparent" and the Trust Assets are treated as being owned by the Beneficiary and not the Trust.

Capital Gains Tax (CGT):

CGT applies to trusts in a similar manner to how it applies to individuals. However the creation of a trust and the transfer of assets out of a trust can trigger a CGT liability.

CGT can be payable when you gift an asset either absolutely to an individual or to a Trust. The amount of CGT payable will depend on the value of the asset gifted when you bought it and how much the asset is worth at the time of the gift.

Trusts have only half the annual CGT exemption given to individuals and this exemption is subdivided further where the Settlor of the trust has also created other Trusts.

Income Tax (IT):

Three different Income Tax regimes can apply.

(1) Settlor Interested Trusts.

Where the Settlor of a Trust is also a beneficiary or a potential beneficiary, the trust's income is taxed as if it were the Settlor's own income.

(2) Non Settlor Interested Trusts where a Beneficiary has an Interest in Possession.

Where a beneficiary is entitled to the income of a trust (or to a share of that income) the income is directly taxed as that individual Beneficiary's own income.

(3) Non Settlor Interested Trusts which are Discretionary Trusts.

If there is nobody with the right to receive the income from the Trust Assets, the Trustees pay a "trust rate" of Income Tax which is currently 40%. From 6 April 2011 this will increase to 45%.

As and when income is distributed from the trust to individual Beneficiaries, it then becomes the Beneficiaries' own income for Income Tax purposes and, subject to various complex rules, the Beneficiaries may sometimes claim credit for the tax that the trustees have paid.

If you would like to discuss any aspect of this information sheet then please contact:

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Alternatively, please call in to any of our offices to arrange an appointment.

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