

TRUSTS ONE SIZE DOES NOT FIT ALL

Clients and their adviser sometimes feel that an investment needs to be placed into a trust, but are often unsure of which one is the most suitable.

Our response is usually to ensure that the following questions have been considered to help ascertain what the client's actual requirements are:

- What is the client's **domicile**?
- What are the client's **objectives**?
- Will the client require **access** to the income or capital and, if so, how much?
- Does the client have **fixed** beneficiaries in mind which will never change, or do they require that the trustees have **flexibility** as to who should benefit?

So why is it important that these questions are considered?

DOMICILE

If the client is UK domiciled, then the transfer will be a tax event for UK Inheritance Tax (IHT) and depending upon the trust terms, there could be an immediate UK IHT liability.

If the client is non-UK domiciled, the question could arise as to how the creation of the trust is viewed by the tax authorities of their country of residency.

Consideration needs to be given as to whether the trust should be structured in a particular way to ensure it is fit for purpose and not going to have an adverse effect on the client in the future.

OBJECTIVE

Is the client's objective to remove assets from the client's taxable estate, achieve specific succession planning or to simply avoid the requirement for obtaining Isle of Man probate following death?

Achieving all these objectives with one trust deed might be possible, but not without restrictions being placed on the settlor's access or the possibility of having to pay a tax charge.

A common misconception is that using a trust will allow effective UK IHT planning to be achieved whilst retaining access to the original capital.

For UK domiciled clients this would be considered a 'Gift with Reservation'. However, for non-UK domiciles who are looking at moving to the UK it is possible, but you have to know the correct trust to use, and more importantly, the assets that can and cannot be held within it.

ACCESS

Where a UK domiciled individual is concerned, having access to the trust fund results in this being deemed part of their estate and therefore subject to UK IHT irrespective of whether they actually benefited or not.

As such, where UK IHT planning is concerned, access must either be prohibited altogether or restricted to certain rights.

For example, where an outright gift is made under a trust, the settlor/donor is usually excluded from any benefit; however, under structures such as **Loan Trusts** or **Discounted Gift Trusts**, access by the client is allowed, but there are restrictions. Any access outside of these restrictions would be a 'Gift with Reservation'.

FIXED OR FLEXIBLE BENEFICIARIES

This decision will usually be based on tax reasons or succession planning requirements.

Transfers into trusts by UK domiciled individuals fall into two categories:

Bare Trusts have Fixed Beneficiaries. The transfer into the trust is a Potentially Exempt Transfers (PET).

To qualify as a PET there must be fixed beneficiaries which cannot be changed. If the donor survives seven years from the date of the transfer, the amount transferred is exempt from UK IHT. There is no IHT payable at the time of the transfer, irrespective of the amount.

Discretionary Trusts have Flexible Beneficiaries.

The transfer into the trust is a Chargeable Lifetime Transfers (CLT).

Where there are flexible beneficiaries the transfer will be a CLT and subject to an immediate IHT charge where the value, plus any CLT's in the last 7 years, exceeds the settlor's/donor's available nil rate band (currently £325,000).

A discretionary trust, in most cases, is classed as a relevant property trust. Therefore IHT charges can also apply when:

- Property is transferred out of the trust (Exit charge)
- A ten-year anniversary occurs

The decision for UK domiciles is whether reduced tax and no on-going charges are more important than flexibility to make amendments to the beneficiaries.

Where the donor is non-UK domiciled, tax may be less important. However, the settlor/donor may still have concerns as to who should ultimately benefit from the trust. In some circumstances, having discretionary beneficiaries may be more important to ensure flexibility.

A client concerned that his children may squander their inheritance may lean towards a flexible trust so that the trustees can determine whether or not a beneficiary is financially and mentally capable of using the distribution, in accordance with the original wishes of the client.

A discretionary trust can also have drawbacks as the beneficiaries can direct the trustees to hand over the trust property if:

- All the beneficiaries are ascertained
- There is no possibility of further beneficiaries
- They are all of full age and capacity, and
- There is a unanimous agreement of all the beneficiaries

On the other hand, where a savings plan is funded to pay for a specific child's future education needs (and where there are concerns that other family members may try and get access), the plan might be better placed in a trust with fixed beneficiaries so that only that child could benefit.

Fixed beneficiary trusts can also be useful in jurisdictions with forced heirship rules, as they can provide for individuals who would otherwise be excluded from benefiting directly from an estate. However, care is required in this particular area of planning.

OTHER POINTS

A trust deed is a legal document evidencing the transfer of ownership from one party to another. Therefore, should it transpire that the client needs the capital back in the future, it's not simply a case of destroying the trust deed and pretending that it has never existed.

Unwinding a trust can be an expensive and lengthy process which can involve the matter going to court.

Should court be the only option, it must be understood that all supporting documents evidencing the original intentions for the planning will be reviewed and, therefore, it is unlikely that a trust would be declared null and void just because a client's personal circumstances have changed.

RL360 has a range of trust deeds which are provided as draft wording for legal consideration; these are free to use with our products.

Each trust that we offer has a defined purpose. In most cases, unless the client is prepared to pay significant legal fees to have a specific trust drafted for their exact circumstances, there has to be a compromise.

Whilst the RL360 trust deeds are not suitable for everybody, they will usually do the job for most clients providing they understand what they are signing up to.

IMPORTANT NOTES

For financial advisors only. Not to be distribution to, nor relied on by retail clients.

Please note that every care has been taken to ensure that the information provided is correct and in accordance with RL360's current understanding of the law and HM Revenue and Customs (HMRC) practice as at November 2023.

You should note however, that RL360 cannot take on the role of an individual taxation adviser and independent confirmation should be obtained before acting or refraining from acting upon the information given. The law and HMRC practice are subject to change.