

PENGILLYS

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A guide to
protecting your family

Trusts



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Your guide to Trusts

A Trust is an arrangement where persons you trust ([the Trustees](#)) are given assets to look after for the benefit of others.

There are various types of Trust for different purposes and may be for the benefit of one or more persons either for their lifetime or absolutely or at a certain age or time or with the Trustees having discretion as to when and what payments may be made and to whom.

In recent years Trusts have been used for mitigating certain taxes.

Trusts are also used to protect assets that might otherwise pass out of the family or where a beneficiary would not be able for whatever reason to look after them or where there might be divorce or bankruptcy proceedings.

The most frequent reasons for using Trusts:

- A. To try and reduce a potential inheritance tax bill
- B. To pass wealth to beneficiaries while retaining control over it
- C. To pass wealth to beneficiaries but have protection against difficulties of the beneficiary
- D. To keep wealth in the family
- E. To set up a charity

A Trust is either created by a deed when it is effective immediately ([a Lifetime Trust](#)) or in your Will in which case it is only effective if you die and as your Will can be changed at anytime before then so can the Trust. In either case the deed or Will sets out the rules or legal basis on which the Trust will operate. It defines the purpose of the Trust, the Trustees who manage it, what funds there are to start with and who is to benefit from the funds and when.

The person providing the funds is the [Settlor](#). By putting money, investments or property ([called the Trust Fund](#)) into the Trust the Settlor is legally transferring ownership of that fund from his or herself to the Trustees. Whilst the Settlor can be a Trustee of a Lifetime Trust the Settlor cannot ask for his or her money back or indeed benefit in any way from the Trust (for instance if the Trust is of a house the Settlor cannot carry on living there for the Trust to be effective).

The management of the Trust and the Trust Fund is given to up to 4 Trustees nominated in the Trust deed or Will. The Settlor can be a Trustee of a Lifetime Trust. The actions of the Trustees are regulated by the Trust Deed or Will and by law under the Trustee Acts.

A [Discretionary Trust](#) is one where the Trust Deed or Will authorises the Trustees to invest the Trust Fund and deal with any income and/or the capital itself as they see fit i.e. at their discretion. They can therefore retain all the income within the Trust and allow it to roll up or they can pay out all or some of the income and/or capital to beneficiaries.

A Discretionary Trust will contain a list of people to whom payments could be made. These are the beneficiaries and may include descendants who are as yet unborn.

In a [Bare Trust](#) the beneficiaries will be specific persons. In a [Life Interest Trust](#) there will be a specific person or specific persons to benefit during their lifetimes and different beneficiaries afterwards.

Taxation of Trusts

Tax on establishing the Trust

A Trust in a Will is taxed on death according to your estate and gifts to a spouse are tax free whether absolute gifts or gifts into a Trust for the spouse's lifetime. Capital gains tax is not payable on death.

In respect of a Lifetime Trust then inheritance tax is payable at half rate (currently 20%) if the amount going into the Trust is over the Settlor's tax free nil rate band (currently a maximum of £325,000). If assets are being given into a lifetime Trust there may be capital gains tax which in the case of a transfer into a Discretionary Trust can usually be deferred.

If the Settlor in the case of a Lifetime Trust does not survive over 7 years from the time of the gift then the value of the gift will be brought into account in respect of the value of his or her estate on death in the same way as if you make a gift of over £3,000 in a tax year you usually have to survive 7 years before it is taken out of your estate for tax purposes.

Tax on assets in the Trust

Bare Trusts are usually taxed on the beneficiary. Trusts for a spouse for lifetime in the Will of the other spouse are taxed on the beneficiary and most other Trusts are taxed as Discretionary Trusts. This means income and capital gains are charged at the top rate and every 10 years the value in the Trust has to be reassessed and taxed paid (at a maximum of currently 6%) on a Trust value in excess of £325,000. Gifts out of the trust are also included for tax purposes.

If you have a number of Trusts they will only have one tax free amount of £325,000 between them.

Income and capital gains taxes on the Trust have to be paid by the Trust. In the case of income that is then paid to a beneficiary that beneficiary will have a tax credit and may be able to recover some of the tax paid in his or her own tax calculation.

A Discretionary Trust can last 125 years. Other Trusts will usually last as long as the longest living beneficiary or until the beneficiary reaches a certain age.

Trusts are complicated but can be effective in a number of situations:

In the case of a second marriage

you may wish to leave assets to your spouse for his or her lifetime and then onto your children so that those assets benefit the surviving spouse but do not pass out of the family.

If you wish to leave money or assets to a person under a disability

then a Trust is essential for protection purposes both of the assets and of the individual.

Warning Setting up a Lifetime Trust will be a gift for inheritance tax. It may also result in capital gains tax.

The gift into Trust in a Will is subject to inheritance tax but may help the next generation as the value in the Trust will be outside their Estate.

The Trust itself will be taxed at top rates if discretionary or taxed as a discretionary trust and on payments out and also every ten years. If not taxed as a Discretionary Trust it will be taxed on death as part of the beneficiaries' estate.

Please note that transferring your house or other assets into a lifetime Trust to try and avoid home fees in the future will not work and will not work for inheritance purposes. There is no time limit of transfers or gifts with the intention of avoiding home fees.

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We hope that this short guide has helped you in understanding more about Trusts. We would be pleased to meet with you to discuss any questions that you may have.

Please call:

Christopher Berry **Principal** fee £275 per hour **over 30 years' experience**

Katherine Ashley **Principal** fee £275 per hour **over 15 years' experience**

Sherry Foot **Associate Solicitor** fee £250 per hour **over 7 years' experience**

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