TRUSTS GUIDE

FROM VITALITYLIFE

Trusts guide

THIS IS INTENDED TO PROVIDE A GENERAL OVERVIEW OF TRUSTS INCLUDING WHO ARE THE MAIN PARTIES, KEY TAXATION POINTS AND ALSO A SELECTION OF TRUSTS USED IN WIDER ESTATE PLANNING.

VitalityLife provide a draft Absolute trust and draft Discretionary trust for use with our VitalityLife plans and a suite of draft trusts for use in conjunction with our Business Protection proposition. Specialist legal and taxation advice should be sought before any estate planning is undertaken.

What is a trust?

A trust is an arrangement which allows you to gift an asset to an individual or group of people but without giving the intended recipient total control and legal ownership of it.

With a trust, you transfer the legal ownership of an asset to someone you trust, “the trustees” (which can include you, the settlor). They manage the asset and hold it for the people that you want to benefit, “the beneficiaries”.

Benefits of using a trust

Setting up a trust can be easier than you think and can add real value to your clients estate planning:

1

TAX PLANNING

When an asset is held in a valid trust, it will not be subject to inheritance tax (IHT) as part of your taxable estate on death instead it will be subject to its own regime. If the assets were held as part of your estate, up to 40% could be lost to the taxman on any part of an estate valued over £325,000.

2

FLEXIBILITY OF GIFTS TO FUTURE GENERATIONS

When an asset is held in trust, sometimes you can influence the way the assets are distributed and which beneficiaries they are distributed to either as acting as co-trustee or via a private side letter of wishes after death.

3

PROTECTION

Trusts can provide a layer of protection from third party claims. While funds are held in a discretionary trust none of the potential beneficiaries has any right to them. The trustees can hold the funds back until a more suitable time for the intended beneficiaries to benefit.

Trusts glossary

ABSOLUTE TRUSTS
Created in favour of specified beneficiaries, the interests are fixed at inception and the beneficiaries and their shares cannot be changed. Should a beneficiary predecease before they become entitled to the assets, their estate will benefit when the entitlement arises. (See the Adviser Guide to the VitalityLife Absolute trust for more detailed information).

BENEFICIARIES
The individuals or charities who benefit from the trust assets.

DEFAULT BENEFICIARIES
Discretionary trusts require default beneficiaries. If the trustees have not paid all of the funds out at the end of the trust period, the default beneficiaries would become entitled to the remaining trust assets. Not to be confused with the potential beneficiaries of the trust who may benefit within the trust period.

DISCOUNTED GIFT TRUST
The settlor transfers capital into the trust for their beneficiaries usually gaining an immediate reduction of the settlor's estate for IHT purposes. They also receive a pre-defined regular stream of income in a tax efficient manner from the trust. Any growth on the capital remains outside of their estate for IHT purposes.

DISCRETIONARY TRUSTS
Discretionary trusts are an increasingly popular solution for estate planning with versions used for discounted gift trusts and loan trusts. The trust is created in favour of a class of potential beneficiaries, the trustees can exercise their discretion to benefit anyone within the class, by how much and when. This trust offers greater flexibility than the Absolute trust and typically operates alongside a non-legally binding letter of wishes to enable the settlor to provide guidance to the trustees on distributions.

When the funds are held in the Discretionary trust, they do not form part of any of the potential beneficiaries' estates and the trust is subject to tax charges as part of the Relevant Property Regime. (See the Adviser Guide to the VitalityLife Discretionary trust for more detailed information).

The gift to the trust will be a Chargeable Lifetime Transfer (CLT). On entry, if the value of the gift exceeds the settlor's available nil rate band, the excess will be chargeable to IHT at 20%.

EXCLUDED PROPERTY TRUST
Suitable for non-UK domiciled individuals with assets abroad and certain UK assets. The settlor retains access to the trust assets and if they subsequently become UK domiciled the funds remain outside of the UK tax net.

GWR OR GIFT WITH RESERVATION OF BENEFIT
Generally speaking making a gift 'with strings attached' will not be effective for IHT purposes and the value aggregated with the estate of the individual when calculating their estate on death.

IHT OR INHERITANCE TAX
Inheritance Tax is the tax paid on an individual's estate when they die. It also applies to some lifetime gifts into certain types of trust. There are ongoing charges to some trusts which fall within the Relevant Property Regime. IHT is assessed on the value of the assets in excess of the nil rate band threshold (£325,000 currently). (See the IHT guide for more information).

INTEREST IN POSSESSION TRUST
This type of trust provides a beneficiary with the right to income for a specified period or for their lifetime, after then other beneficiaries will become entitled to the capital. Since 2006 this type of trust, if created during lifetime, became subject to the Relevant Property Regime rules.

LETTER OF WISHES

Operates alongside a discretionary trust. The trustees usually have complete discretion as to who to benefit within the usually broad class of potential beneficiaries, by how much and as to timing. The letter of wishes enables the settlor to provide guidance to the trustees as to how they would like them to exercise their discretion in a non-legally binding way. They can update this as their circumstances change. They can also set out issues to consider such as the primary beneficiaries and also perhaps funds being available for educational and medical needs. Usually the trustees do not deviate from the guidance set out unless there is a good reason.

LOAN TRUST

The settlor transfers capital into the trust by way of an interest free loan. Any growth on the capital remains outside of their estate for IHT purposes but they retain access to the original capital lent, should they require this. They will not be able to access any growth the original gift produces. The loan is repayable on demand.

PROTECTOR

Sometimes trusts may allow a person appointed under the trust deed to direct or restrain the trustees in relation to their administration of the trust. The powers vested in the protector will vary according to the trust deed but they may include the power to remove and appoint trustees and the power to approve the addition or removal of beneficiaries. The concept of a trust protector is to protect beneficiaries from a rogue trustee and they are popular with offshore trusts.

RELEVANT PROPERTY REGIME

Special IHT regime which applies to trusts which count as Relevant Property trusts, such as discretionary trusts. Inheritance Tax may be due when:

- assets are transferred in to trust (entry charges)
- assets are transferred out of a trust (exit charges)
- a ten year anniversary occurs (periodic charges)

SETTLOR

The individual who creates the trust by making a gift of funds or assets to the trustees to hold on behalf of the beneficiaries on specific terms usually set out in a trust deed.

SPLIT TRUSTS

A split trust enables the settlor to retain some benefits and gift others for the benefit of their dependants in an IHT efficient manner. The retained benefits that the settlor has access to need to be clearly defined to avoid a Gift With Reservation of Benefit.

SPOUSAL BYPASS TRUST

Frequently used for the payment of pension death benefits. Typically using a discretionary trust settled with a nominal amount by the pensions scheme member, the trust usually includes their spouse, children and other dependants as potential beneficiaries. They then request that the pension scheme trustees pay the death benefits to the trustees of the bypass trust rather than outright to any of the intended beneficiaries. The spouse is able to access the funds, at the discretion of the trustees, should they need to, without the funds being aggregated with their own estate and taxable on the event of their death, when the funds are available to the children or other beneficiaries. The discretionary trust would be subject to the usual periodic and exit charges where applicable.

TRUST PERIOD

The maximum trust period for a non-charitable trust is 125 years in England and Wales.

TRUSTEES

The trustees become the legal owners of the trust assets and hold the assets on behalf the beneficiaries until they become entitled. They must act within the terms of the trust and act impartially and fairly in their administration of the trust.

VULNERABLE PERSON TRUST

Created in favour of an individual with a mental or physical disability. You do not have to pay IHT on the transfer of assets into a trust for a disabled person as long as the person making the transfer survives for seven years after making the transfer. These sorts of transfers are called 'potentially exempt' transfers.

They do not form part of the Relevant Property Regime which means that there is no periodic charges. Exit charges do not apply while the assets remain in the trust as the 'interest' of the vulnerable beneficiary.

Discovery
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