CLARENCE TRUSTEES

WILLS, TRUSTS, & PROBATE

An Introduction to Trusts

Tel: (01702) 333337

Fax: (01702) 414922

Email: mail@clarence-trustees.co.uk

Southend Office:
Estuary House, 37 Clarence Street,
Southend, Essex, SS1 1BH

AN INTRODUCTION TO TRUSTS

Trusts are often used in estate planning to assist with Inheritance Tax Planning or to ensure certain individuals (who might be minors or vulnerable) are adequately provided for so that their interests may be protected. Sometimes they may also be used to protect assets.

There is much mystique around trusts and this guide tries to set out in simple terms what a trust is, who the various parties to it are, and when they can be used.

1. WHAT IS A TRUST ?

A trust is a legal agreement under which one person (the Trustee) holds assets “on trust” for another person (the Beneficiary). The Trustee will be the legal owner of the assets (which might be cash, property or investments) but, under the terms of the legal agreement, he will own them for the benefit of the Beneficiary.

When a trust is first established, a person (called the “Settlor”) contributes the assets into the trust – and when he does this, he does not expect to receive anything in return for his contribution to the trust. This means there is no Consideration.

Consideration is where one party to an agreement agrees to do something in return for which the other party makes some kind of payment.

The fact that there is no Consideration in a trust is important - because it has an impact on the type of legal agreement that must be used to establish the trust.

Most legal agreements are simple contracts.

A simple contract will only be valid if it contains Consideration.

Given that a trust does not contain Consideration, the legal document establishing it cannot be a simple contract. Instead it must be a Deed.

SUMMARY SO FAR:

- A trust is established by a legal agreement called a Trust Deed
- The Settlor is the person who puts the assets into the trust
- The Trustee is the person who is the legal owner of the assets
- The Beneficiary is the person on behalf of whom the Trustee holds the assets.

2. SELECTING A TRUSTEE

When a trust is created, the Settlor names someone to serve as the Trustee and to assume legal ownership of the property funding the trust.

It is clear, from all the above, that the choice of Trustee is very important. The Trustee must be trustworthy. Further, they must be someone capable of performing the role of Trustee.

A close friend, family member or loved one who is familiar with the family and cares about the Beneficiaries may be a good choice for a Trustee. In addition, a Trustee who is honest and above reproach will command the respect of the Beneficiaries.

Being a Trustee carries certain responsibilities and, quite often, knowledge of the law and taxation will be required to make sure nothing is done with the trust assets that could cause a loss to the Beneficiaries. It is therefore advantageous for the Trustee to have business and financial skills.

However, the Trustee may engage the services of professionals to assist in carrying out their responsibilities.

Although such professionals will charge a fee (which will need to be paid by the trust and which will ultimately reduce the assets available to benefit the Beneficiaries) it may still be better in the long run to use such professionals.

Use of professionals can prevent the trust suffering losses as a result of a lay Trustee taking steps not permitted by law or that might have adverse tax consequences.

3. DUTIES OF A TRUSTEE

There are many duties of a Trustee that are commonly accepted, and a list of some of these duties is shown here:

DUTY OF LOYALTY:

A Trustee must administer a trust solely in the interest of the Beneficiaries. The most fundamental duty of a Trustee is not to engage in acts of self-dealing.

The Trustee has a fiduciary duty always to act in the best interests of the Beneficiaries. This is an overriding duty which is enshrined in 300 years of trust law.

DUTY OF ADMINISTRATION

A Trustee must administer a trust in accordance with its terms, purpose and the interests of the Beneficiaries. A Trustee must act prudently and exercise reasonable care, skill and caution.

DUTY TO CONTROL AND PROTECT PROPERTY

A Trustee must take steps to control and protect the trust assets.

PROPERTY SEPARATION & RECORDS

Trustees must keep trust property separate from the Trustee's own property. They must also render clear and accurate records with respect to trust administration.

DUTY OF IMPARTIALITY

Where there are two or more Beneficiaries, a trustee must act with complete impartiality with respect to investing, managing and distributing the trust assets.

DUTY TO FURNISH INFORMATION

A Trustee must keep the trust Beneficiaries reasonably informed about the administration of the trust and of any material facts necessary for them to protect their interests.

DUTY OF PRUDENT INVESTMENT

A Trustee who invests and manages trust property has a duty to comply with the 'prudent investor rule' unless otherwise stated in the Trust Deed.

DUTY TO ENFORCE & DEFEND CLAIMS

A Trustee must take reasonable steps to enforce any claims of the trust and to defend any claims made against the trust.

4. TYPES OF TRUSTS

There are many different types of trusts, and far too many to explain in this simple guide.

However, we explain below the trusts that are most often used in estate planning and inheritance tax planning.

STANDARD DISCRETIONARY WILL TRUST

Basic Information:

- Usually written into a will (as opposed to being a separate trust deed)
- Comes into effect on the death of the testator of the will
- The testator is obviously the Settlor
- Distribution of the trust property is left to the absolute discretion of the Trustees.

Benefits of this type of trust:

Beneficiary not wise with money

The testator of the will may wish to protect such Beneficiaries by placing their inheritance into trust where the Trustees can apply the trust assets appropriately depending on the circumstances at the time.

Beneficiary likely to divorce

The testator may wish to protect such Beneficiaries from losing their inheritance (or a significant part of it) in a divorce by placing their inheritance into trust where the Trustees will have the discretion to pay out the trust assets once the Decree Absolute is finalised.

Beneficiary is vulnerable and means tested

It may be that one of a testator's intended Beneficiaries is a disabled person. Under these circumstances a Disabled Persons Will Trust would usually be established because it can have significant tax benefits (see below). However, where a Disabled Persons Will Trust is set up, the assets of the trust will be taken to be the assets of the disabled Beneficiary when assessing the disabled Beneficiary's right to means tested benefits. Under these circumstances a Standard Discretionary Will Trust might be more appropriate to avoid the loss of means tested benefits.

DISABLED PERSONS WILL TRUST

Basic Information:

- Usually written into a will (as opposed to being a separate trust deed)
- Comes into effect on the death of the testator of the will
- The testator is obviously the Settlor
- The Trustees have the power to advance, in their absolute discretion, all of the trust income and/or capital for the benefit of the Primary Beneficiary in their lifetime.

Benefits of this type of trust:

Beneficial tax treatment

The Disabled Persons Trust receives favourable tax treatment. Income generated by the trust is only taxed at a rate of 20% as opposed to the usual trust rate of 45%. Further, the Disabled Persons Trust is not “Relevant Property Trust.” This means it escapes the charge to Inheritance Tax that is usually applied to trust assets on every 10th anniversary of the trust and on any funds which are withdrawn from the trust. To qualify for this generous tax treatment, the Primary Beneficiary must qualify as a disabled person under s89 (4) of the Inheritance Tax Act 1984.

Protection for the Primary Beneficiary

The Disabled Persons Trust provides security for the Primary Beneficiary for their lifetime. The trust income and trust capital can be paid to the Primary Beneficiary for as long as they are alive. The powers surrounding payments of both income and capital are discretionary in nature, which means that the Trustees may pay funds to the Primary Beneficiary as and when they need it. This means that the Primary Beneficiary will not hold large sums of money in their name which they may struggle to manage, or may not physically or mentally be capable of managing.

PROPERTY PROTECTION TRUST

Basic Information:

- Usually written into a will (as opposed to being a separate trust deed)
- Comes into effect on the death of the testator of the will
- The testator is obviously the Settlor
- Puts the testator’s half of the family home into trust and gives the deceased’s spouse the right to live in it until they pass away, at which point the property then passes to the individuals specified in the will.

Benefits of this type of trust:

Can prevent “Sideways Disinheritance”

Sideways disinheritance is simply the common act of the spouse/partner of the deceased remarrying and deciding to favour the new family in their Will. This can result in the intended beneficiaries of the deceased (who will usually be the deceased’s children) receiving a smaller share (or even no share) of the property. The Property Protection Trust can prevent this from happening.

Asset Preservation

There may be concerns over asset preservation in the event of one or other of a married couple requiring long term care in the future. The largest asset in the estate is usually the property in which they reside and most couples will want to preserve the worth of it in order to maximise the inheritance passed to their chosen beneficiaries. A Property Protection Trust offers protection following the 'first death' by passing the deceased's share of the property into trust rather than directly into the estate of the survivor. This means that if the survivor requires long term care in the future then they do not have the deceased's share of property calculated as part of their wealth, but they do have a lifetime interest in it so they can enjoy it as if it is their own.

ASSET PROTECTION TRUST

Basic Information:

- Established by a trust deed during the Settlor's lifetime
- Assets in the personal ownership of the Settlor(s) are transferred irrevocably to the ownership of the Trustees
- The trust deed gives the Settlor the right to occupy any house in the trust and the right to enjoy the income from any capital, but not a right to the capital itself.
- Other than the preceding bullet, anything else done with the trust assets can only be done in the absolute discretion of the Trustees.

Benefits of this type of trust:

Can prevent "Sideways Disinheritance"

Sideways disinheritance is simply the common act of the spouse/partner of the deceased remarrying and deciding to favour the new family in their Will. This can result in the intended beneficiaries of the deceased (who will usually be the deceased's children) receiving a smaller share (or even no share) of the property. The Asset Protection Trust can prevent this from happening.

Inheritance Act claims

Sometimes a testator may wish to exclude someone from benefitting from their will. Under the Inheritance (Provision for Family & Dependants) Act 1975 such excluded people may be able to make a claim on the estate. However, assets placed into the Asset Protection Trust during lifetime will be out of reach of that act.

Flexibility

Assets in the Asset Protection Trust would not need a Grant of Probate. Because the trust assets are outside the estate, the Trustees of the trust can manage them immediately without waiting for a Grant of Probate.

Protection from other third party claims

A by-product of setting up an Asset Protection Trust is that it can, for example, place assets outside of any assessment for care home fees for the Settlor - although this should not be the primary motivation for establishing the trust.

CARE SHOULD BE TAKEN WITH ASSET PROTECTION TRUSTS AND PROFESSIONAL ADVICE SHOULD ALWAYS BE SOUGHT. FOR DETAILED INFORMATION SEE OUR SEPARATE GUIDE ENTITLED, "THE BACKGROUND TO APTs".

SPOUSAL BYPASS TRUST

Basic Information:

- Established by a trust deed during the Settlors' lifetime
- Purpose is mainly to accept death in service benefits and insurance pay outs on death
- Distribution of the trust fund capital and income to the potential beneficiaries is completely at the discretion of the trustees
- The trust must have multiple potential beneficiaries. They are usually the surviving spouse /partner, the children, the grandchildren or anyone else who the settlor chooses.

Benefits of this type of trust:

Outside the Estate for IHT

Because the trust is entirely discretionary no potential beneficiary has any absolute right whatsoever to the trust assets. This means the trust fund cannot be considered to be part of their estate for IHT purposes. This can result in significant IHT savings.

Surviving Spouse can Benefit

The trust will allow the surviving spouse to receive, at the discretion of the trustees, benefits from the trust. One such benefit could be that the trust could advance a loan to the surviving spouse. This would enable the survivor to enjoy the benefit of any cash in the trust during their life. On the death of the survivor this loan would be a liability on their estate and would reduce the value of their estate for IHT purposes. The personal representatives of the survivor's estate would collect the debt and distribute it to the remaining potential beneficiaries.

Can prevent "Sideways Disinheritance"

Sideways disinheritance (previously explained) can be prevented by using the Spousal Bypass Trust. The trust can be utilized to take the place of a direct payment to the surviving spouse. Then the trustees can make decisions on whether to benefit the spouse or not.

5. HOW WE CAN HELP

Clarence Trustees provides a fast, efficient and modern trust service.

We can advise you if a trust is the most appropriate way to achieve your aims, and if it is we can advise on exactly which trust should be used as well as providing all the drafting and assisting you with the execution.

Please contact us now about our trust service.

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