

THORNLEYS SOLICITORS

TRUSTS INCLUDING DISCRETIONARY WILL TRUSTS



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WHAT IS A TRUST?

A Trust is the formal transfer of assets such as property, shares or cash to a small group of people or a trust company (who are called “the Trustees”) who own and hold the assets and property which are incorporated in the trust for the benefit of others. Trusts can be created in a person’s lifetime by way of “a Settlement” or created upon death by “a Will Trust”.

The Settlement or Will states who are to be the individuals who will be responsible for looking after the Trust Fund (“the Trustees”) and who are the persons to benefit under the Trust (“the Beneficiaries”).

A trust can last for many years, for example, until such time as a child attains a certain age or perhaps during a person’s widowhood. The terms of the Trust are laid down clearly in the Trust document. The Government has over the past recent years been gradually clamping down on the use of a number of Trusts and therefore great care needs to be taken in deciding which Trust suits your requirements. But the rules have become much more complicated and it is very important that professional advice is taken before any decisions are made.

WHAT KINDS OF TRUSTS ARE THERE?

The type of trust depends on the way it is created. Following the Finance Act 2006, most Trusts created by will or deed after 22nd March 2006 are “relevant property trusts”.

RELEVANT PROPERTY TRUSTS

Trusts already in existence on 22nd March 2006 continue under the old rules, with some exceptions. The main exception is for Accumulation and Maintenance Trusts. These cannot be created after 22nd March 2006. All Accumulation and Maintenance Trusts still in existence at 30th October 2008 will be treated as Relevant Property Trusts.

IMMEDIATE POST DEATH INTERESTS

These are Trusts created by Will which arise on death and in which an individual has an interest in possession.

THE GENERAL DISCRETIONARY TRUST

The General Discretionary Trust is a very flexible type of Trust. The beneficiaries nominated to be included in the Trust need not even be born at the time that the Trust is created under the Will and can include children, grandchildren, great-grandchildren that may be born in the future. This type of Trust is often useful if you are unsure which of the beneficiaries will need help and the extent of such help they may require in the future.

The Trustees are given power in the Will to pay out Capital or Income of the Trust to any one or more of the beneficiaries entirely at their discretion, hence the term 'Discretionary Will Trust'. As no beneficiary has the right to demand Income or Capital from the Discretionary Trust, they are not considered by the Inland Revenue as 'owning' any of the Trust assets and do not have an 'interest in possession' on their death and are not therefore taxed accordingly upon such assets.

A Discretionary Trust in favour of all your children and grandchildren would allow your children the choice of taking the benefit themselves or passing it on to their own children if preferred. In addition to your children the surviving spouse could also be included as a potential beneficiary of the trust so that capital and income becomes available for his or her use if necessary.

It is important to note that the beneficiary under a Discretionary Will Trust is not entitled to receive anything from the Trust and any payments which the beneficiary receives will be entirely at the discretion of the Trustees.

WHY MIGHT I INCLUDE A DISCRETIONARY TRUST IN MY WILL?

There are very good tax planning reasons why a Discretionary Trust may be beneficial to you and included in your Will, particularly if Inheritance Tax (IHT) is or may be payable on your estate. A substantial amount of IHT may be saved by including such provisions. IHT arises when the value of an individual's estate on death is cumulated with any chargeable lifetime gifts made by the deceased seven years before his or her death (with the exception of certain exempt transfers) and these exceed the 'Nil Rate Band' (otherwise known as the 'Nil Rate Threshold'). The Nil Rate Threshold as from the 6th April 2009 is £325,000 and is increased annually by Parliament in line with inflation.

The full rate of IHT payable on transfers above the Nil Rate Threshold is currently 40%. Lifetime gifts made by an individual into a 'Discretionary Trust' and which at the time of the gift exceed any unused Nil Rate Band of the transferor, are immediately chargeable to IHT at the lower rate of 20%. If the transferor then dies within seven years, additional tax will become payable on the gift passing into the Discretionary Trust, but the value of the gift is frozen at the time it was made.

In many cases the Nil Rate Band is wasted by married couples on the death of the first spouse. Often couples choose to leave all of their estate to their surviving spouse, to ensure that he or she has sufficient assets to live on for the remainder of his or her life, without thinking about the tax consequences.

Transfers between a husband and wife either made during their lifetime or on death are exempt from IHT (subject to certain exceptions where the surviving spouse is not domiciled in the UK when the Nil Rate Band is £55,000). Therefore no IHT is payable when the first spouse dies if all the assets are left to the surviving spouse. However, when the surviving spouse dies, the combined estate becomes chargeable for IHT if it exceeds the Nil Rate Band.

When all the estate is left to the surviving spouse, the deceased's Nil Rate Band is 'wasted', unless the deceased made lifetime gifts to individuals other than his or her spouse within 7 years of his death, and in so doing used all or part of his or her Nil Rate Band.

WHAT INHERITANCE TAX SAVINGS COULD I MAKE BY INCLUDING A DISCRETIONARY WILL TRUST IN MY WILL?

If the Nil Rate Band were to be used fully by including a Discretionary Will Trust in your Will you could save up to a maximum £300,000 in IHT (ie 40% of £325,000), at present rates.

Assuming the value of the combined estates of a Husband and Wife exceed the Nil Rate Band, it is tax efficient to use up that Nil Rate Band and for a Husband and Wife to provide for a Discretionary Trust in the Will of the first spouse to die. This type of trust is called a '**Nil Rate Band Discretionary Will Trust**'; the size of the trust can be less than the Nil Rate Band if appropriate.

The Trustees can be given wide powers to use their discretion over the capital to help the surviving spouse in case of need, to include not only capital advances, but also interest-free loans if this would be more tax efficient.

HOW CAN I PROVIDE FOR MY SURVIVING SPOUSE?

Firstly, the surviving spouse can be included as a beneficiary of the Discretionary Trust. Secondly, you can leave a '**letter of wishes**' to your Trustees, which is read alongside your Will, with instructions that you wish your spouse to have priority to your estate over and above your remaining beneficiaries. Your Trustees can also be instructed to make, at their discretion, Income or Capital payments to your surviving spouse. He or she can therefore benefit from such payments out of the Trust without actually 'owning' any part of the Trust assets. The letter usually instructs the Trustees as to what is to happen to the assets of the Trust when your spouse dies, e.g. that the Trust Funds are to pass to the remaining beneficiaries who are often the children.

With a Relevant Property Trust the Capital representing the Trust fund is not added to the surviving spouse's estate on his or her death and is therefore not charged to IHT.

WHO SHOULD I APPOINT AS MY TRUSTEES?

It is essential that you should choose trusted family members or close friends. You may prefer to appoint a professional Trustee, such as your solicitor to act for you or a combination of both.

It is also important that you check that the people you appoint as your Executors and Trustees are willing to act for you. Executors and Trustees' duties are onerous.

WHAT TYPE OF PROPERTY CAN BE INCLUDED IN A DISCRETIONARY TRUST?

It is preferable, if possible, not to include the matrimonial home as an asset of the Trust especially if you own it jointly with your spouse. There are certain complications in Trustees owning property jointly with a spouse.

If you own business or agricultural property, which qualifies for IHT relief at 100%, there may be good reasons for including such property in the Discretionary Trust, because such property can be transferred into the Trust free of IHT. In such a case there is no limit as to the value of the property being transferred into the Trust provided that it qualifies for 100% IHT relief.

It is very important however when placing funds in a Discretionary Trust that you are not depriving dependants of Income or Capital that may be needed by them. Not only will this cause them unnecessary distress after your death, but may also lead to a claim for financial provision from your estate under the Inheritance (Provision for Family and Dependants) Act 1975. Any type of property can be transferred into a Discretionary Trust and cash and investments are particularly easy to transfer.

HOW DOES A DISCRETIONARY TRUST OPERATE?

The Assets forming the Discretionary Trust are passed to the Trustees by the Executors during the course of administration of the estate. Usually, the Executors and the Trustees under the Will are the same people. Their role simply changes from Executors whilst administering the estate to Trustees when the Trust is set up. They simply own the property as Trustees as opposed to Executors.

Once the Discretionary Trust is set up, it is the duty of the Trustees to register the Trust with the Inland Revenue by completing a short Trust form and sending this on to the Inland Revenue. Once the Inland Revenue receives this form they will register the Trust.

IS THE TRUST SUBJECT TO TAX?

Having registered the Trust with the Inland Revenue, they will issue annual Trust Tax Returns for completion by the Trustees and the filing of deadlines and dates for the payment of tax are the same as for individuals.

The Trustees are subject to Income and Capital Gains Tax (CGT) in the same way as individuals. After deducting management expenses of the Trustees, trust income is currently taxed at 40% (32.5% for dividends). Also, CGT is taxed at a flat rate of 18% after deducting the Trustees annual allowance which is currently half that of an individual.

Distributions of income to any beneficiaries of the Trust, including a surviving spouse, will suffer Income Tax in the hands of the beneficiaries but they will receive a credit for tax paid by the Trustees and are issued with a tax form (R185) for use in their own Tax Returns.

THE PERIODIC CHARGE

A Discretionary Will Trust is also subject to IHT every 10 years after the Trust has been created. This is known as 'the periodic charge'. The rate at which tax is paid at current rates is not more than 6% of the market value of the Trust's assets at the time of the charge. A Nil Rate Discretionary Trust often escapes tax altogether.

FURTHER CONSIDERATIONS IN MAKING YOUR WILL

It is most important that you fully understand the implications of including a Nil Rate Band Discretionary Will Trust in your Will. It is important to ensure that all areas are considered by you and your instructions to your Trustees are clear, to ensure that they will administer the Trust in accordance with your wishes and instructions.

It is also important that you review your Will regularly. The Law Society recommends that you review your Will every three to five years or if your family circumstances or relationship changes. It is essential that you review your Will in the event of separation or divorce. Many people are

unaware that marriage or re-marriage generally revokes a Will in its entirety, which may leave children of a former marriage without any claim on your estate.

It is vital that before you embark on any kind of tax planning which may include a Discretionary Will Trust, that you fully discuss this with a solicitor and if appropriate, your Will can be prepared to meet your requirements and incorporate effective tax planning.



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FOR FURTHER INFORMATION:

On Wills generally please see our **Fact Sheet 1 - Wills** on appointing Guardians please see our **Fact Sheet 2 - Appointing Guardians in your Will** and on Inheritance Tax Planning please see our **Fact Sheet 3 –Inheritance Tax**

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