BUCKLES
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Private Client

Trusts

What is a Trust and who is involved with the creation and administration of a Trust?

Put simply, a Trust is a means of handing an asset over to someone whilst being able to tell them what to do with it.

A Trust separates out legal ownership and beneficial ownership – the legal owner is the formal owner of an asset (for example, the named person on the Title Deeds of a property) whereas the beneficial owner is the person who has the right to enjoy or benefit from the asset (for example, the right to live in that property rent-free).

A Trust is distinct from an outright gift because the recipient of an outright gift can do what they like with the asset, whereas the Trustees of a Trust must deal with the asset in accordance with the terms of the Trust.

Consider that:

- A Trust is created by someone (**the Settlor**)…
- handing someone else (**the Trustees**)…
- an asset or assets (**the Trust Fund**)…
- and telling them who is to benefit from the Trust Fund (**the Beneficiaries**)…
- in accordance with the terms of the Trust (**the Trust Deed**)…
- during the lifetime of the Trust (**the Trust Period**)

Think of a Trust like a safe…

The Settlor

The Settlor is the person who creates the Trust and transfers the Trust Fund to the Trustees, after which the Trust Fund ceases to be part of the Settlor's estate (although may remain part of the Settlor's taxable estate).

(A Trust is also known as a Settlement hence the person who creates the Trust is the Settlor.)

The Settlor hands the safe and its contents (being the Trust Fund, a list of the Beneficiaries and the Trust Deed) over to the Trustees…

The Trustees

The Trustees are in charge of administering the Trust – whilst the Trust Fund will be held in the names of the Trustees, it is not part of their estate (for example, in the event of their death, divorce, bankruptcy or claiming means-tested benefits).

The initial Trustees are the persons who receive the Trust Fund from the Settlor, but the number and identity of the Trustees may change over time as Trustees are appointed, retire or die. A Settlor can also be a Trustee.

(A Trust of land/property must have a minimum of two Trustees and a maximum of four Trustees; any other Trust need only have one Trustee but will typically have more.)

The Trustees are the ones with the combination to the safe, and so only they can open it to access the Trust Fund – you could even say that each Trustee has part of the combination to the safe because ALL Trustees must agree with all decisions, including accessing the Trust Fund, otherwise nothing can happen…

The Trust Fund

The asset(s) given to the Trustees by the Settlor will be the initial Trust Fund, but this can be changed by the Trustees over time. The Trust Fund could be almost anything that an individual can invest in such as cash, land/property, shares, investments or a business.

The Trust Fund is kept in the safe by the Trustees, and is reviewed periodically to make sure that it is suitable for the Trust…

The Beneficiaries

The Beneficiaries can be specifically named (e.g. "John Smith") or defined as a group (e.g. "all the children and remoter issue of the Settlor"), and can include the Settlor depending on the purpose of the Trust.

If the Trustees were to allow anyone who is not one of the Beneficiaries to benefit from any part of the Trust Fund then this would be a breach of trust for which the Trustees would be personally liable.

How, if, and when the Beneficiaries benefit from the Trust Fund depends on the type of Trust, the powers given to the Trustees within the Trust Deed, and how the Trustees choose to exercise those powers.

The safe contains a list of the Beneficiaries, and the Trust Deed will tell the Trustees if they have a duty to distribute funds to the Beneficiaries or a discretion on whether or not to do so…

The Trust Deed

A Trust is put in writing to make it clear that it is a Trust (as opposed to, say, an outright gift). The terms of the Trust are set out in the Trust Deed which will cover such things as the Trust Period and Trustees' duties and powers (in addition to those provided by the law, such as the Trustee Act 2000).

The duties and powers of the Trustees include what they can do with the Trust Fund for the benefit of some or all of the Beneficiaries, with these being very much determined by the type of Trust used.

In the safe is the Trust Deed which is the Trustees' "rule book" on how they must administer the Trust for the benefit of the Beneficiaries…

The Trust Period

A Charitable Trust can last forever, but the maximum period any other Trust can last is 125 years (which was increased from 80 years in 2009).

The Trust Deed can specify a shorter Trust Period than the maximum 125 years, such as the lifetime of a named beneficiary.

Trustees can generally choose to bring a Trust to an end before the end of the Trust Period (and often do).

The Trustees can generally choose to pay the Trust Fund out of the safe during the Trust Period, but are duty-bound to pay the Trust Fund out of the safe at the end of the Trust Period…

When is a Trust created?

A Trust will typically be created during the lifetime of the Settlor (a Lifetime Trust) or on the death of the Settlor (a Will Trust or a Statutory Trust on intestacy).

The safe is generally either created whilst the Settlor is alive, or by the Settlor signing a Will during his or her lifetime which has the effect of creating the safe on death…

What are the different types of Trust?

There are many different types of Trust, but they will either be express Trusts (created intentionally by the Settlor) or Trusts imposed by law (Statutory Trusts, Resulting Trusts and Constructive Trusts).

Express Trusts can take many forms, including:

- Bare Trusts
- Trusts for Bereaved Minors
- 18-25 Trusts
- Disabled Persons' Trusts
- Interest in Possession Trusts
- Discretionary Trusts

The most frequently used are:

- An Interest in Possession Trust – this provides for the payment of an income to the Income Beneficiary for life and then on his or her death for the payment of the capital of the Trust Fund to the Remaindermen
- A Discretionary Trust – this provides the Trustees with the discretion during the Trust Period (typically 125 years) whether or not to pay capital or income from the Trust Fund to any of the Beneficiaries

One type of mixed Trust is a Flexible Interest in Possession Trust which is a combination of the above two Trusts – it provides for the payment of an income to the Income Beneficiary for life and then on his or her death for the payment of the capital of the Trust Fund to the Remaindermen, whilst at the same time giving the Trustees the discretion during the Trust Period (typically the Income Beneficiary's lifetime) whether or not to pay capital from the Trust Fund to any of the Income Beneficiary and/or the Remaindermen.

Letters of Wishes

Where Trustees are given a discretionary power within the Trust Deed (for example, with a Discretionary Trust or a Flexible Interest in Possession Trust), there will typically be a Letter of Wishes signed by the Settlor which sets out how he or she would like the Trustees to exercise that power.

The Letter of Wishes is a confidential document and so will only be seen by the Trustees unless the Trustees choose to reveal part or all of the content to anyone else.

Given the extensive powers given to Trustees of a Discretionary Trust or a Flexible Interest in Possession Trust, and the fact that the content of a Letter of Wishes is not binding on them, choice of Trustees by a Settlor is crucial.

Why would someone set up a Trust?

Trusts are NOT simply the preserve of the very wealthy; they offer control and asset protection in a variety of situations, such as for:

- Those who have been married more than once, and want to provide for their current spouse whilst ensuring that assets will ultimately pass to their children from a previous marriage
- Those who are concerned that if they die then their spouse may remarry, and thereby prevent their children from ultimately inheriting the estate
- Those who want flexibility in determining the distribution of their estate without needing to make multiple Wills over time
- Those who want privacy in relation to their wishes (given that a Will becomes a public document once admitted to Probate)

- Those who are concerned about the potential for a beneficiary to die, divorce, go bankrupt or claim means-tested benefits
- Those who want to provide for a disabled or vulnerable person whilst at the same time having the funds administered by someone on behalf of that disabled or vulnerable person, and prevent the loss of their means-tested benefits and/or Local Authority care and support
- Those who want to guard against a claim against their estate by an excluded beneficiary
- Those who want to protect assets from care home fees
- Those who want to avoid Probate on death (and thereby reduce costs)
- Those who want to undertake tax-planning, including grandparents who want to pay school fees for grandchildren

Tax-planning, and specifically Inheritance Tax (IHT) planning, is often a reason for setting up a Trust. An outright gift would work just as well as establishing a Trust for avoidance of IHT (in that the value of the gift – whether outright or to a Trust – falls outside of the taxable estate of the person making the gift after a period of seven years), and so the purpose of the Trust is in fact to allow the Settlor an element of control over the subject matter of the gift once it has been given away.

How is a Trust run?

The Trust is administered by the Trustees, and so it is their responsibility to comply with the Trust Deed and all applicable laws. This will include:

- Regular reviews
- Obtaining financial advice
- Ensuring tax compliance
- Complying with record-keeping requirements

Our separate 'Guide to being a Trustee' and guide to 'Trustees: record-keeping, tax and investment responsibilities' provide further details.

The taxation of Trusts

A Trust is not a separate legal entity (unlike a company, which is) and so a tax liability may fall on the Settlor, the Trustees or the Beneficiaries depending on the circumstances and the type of Trust.

In brief, however, the position is as follows:

- The Settlor may incur a personal tax liability when making payments into the Trust
- The Trustees have a joint and several liability to pay the tax in the Trust during the Trust Period, albeit the tax can be paid from the Trust Fund
- The Beneficiaries may incur a personal tax liability when receiving income or capital from the Trust, and can even be subject to tax as though they owned the Trust Fund outright depending on the circumstances or the type of Trust

The relevant taxes include:

- Income Tax
- Capital Gains Tax
- Inheritance Tax

These taxes apply in different ways to different types of Trust. Detailed information is available on request.