FARRER&Co

An introduction to trusts

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What is a trust?

Trusts have been used for centuries as a flexible alternative to an outright gift. A trust is an arrangement resulting from a transfer of assets (**'the trust fund'**) by a person (**'the settlor'**) to one or more persons (**'the trustees'**) for them to hold for the benefit of specified persons (**'the beneficiaries'**). Note that trusts can be made during the settlor's lifetime or included in his or her will.

What are the trust terms?

Normally the trust terms are set out in a trust deed or will and include the names of the beneficiaries and how they can benefit from the trust fund. Different types of trust include the following:

Fixed interest trusts – where the beneficiaries may be given a right to income and/or capital, perhaps on the occurrence of a specified event.

Discretionary trusts - where the trustees have wide powers to decide how the beneficiaries benefit from the trust fund. The settlor of such trusts often provides the trustees with a letter of wishes to give them some guidance when exercising their powers.

Bare trusts - where the beneficiary has an outright entitlement to the trust fund and any income it may yield. Bare trusts are often used to benefit children under 18, who do not have capacity to hold the legal title in their own name. However, note that a child beneficiary can demand that the assets be transferred to him or her on reaching 18.

What is the trustees' role?

The trustees, who could be individuals or a trust company, are the legal owners of the trust fund which may include cash or other property. The trustees hold the trust fund in accordance with the trust terms and general trust law. Importantly, the trustees have an overriding duty to act in the best interests of the beneficiaries when exercising their powers under the trust.

How long does a trust last for?

In England a trust may continue for 125 years, although the trustees normally have power to end the trust during this period, if appropriate.

Why use a trust?

Trusts are used for many reasons. Some of the key advantages are as follows:

If you require further information on anything covered in this briefing, please contact a member of our Private Client Team or your usual contact at the firm on 020 3375 7000. Further information can also be found on the Private Wealth page on our website.

Succession

To retain assets within a family for the benefit of future generations. This may be particularly relevant in the context of a family business.

Vulnerable persons

To hold assets for the benefit of a person who does not have capacity to hold them in his or her own name, due to being under 18 or subject to a disability. Alternatively, if there is a concern that a person may be tempted or induced to fritter away funds, a trust can provide financial support while preserving the capital for the beneficiary's long-term benefit.

Changing circumstances

To allow the changing financial circumstances of beneficiaries to be taken into account. In particular, a trust lets a beneficiary retain access to funds, without such funds automatically forming part of the beneficiary's estate for tax or succession purposes. In addition, the use of a trust allows people who were not born at the time of the gift to be included as beneficiaries.

Asset protection

To give some protection against potential claims in the event of a beneficiary's bankruptcy or divorce, or if he or she requires paid care.

Probate

To the extent that assets are settled in trust, there is no need for wills to be drawn up (or for probate to be obtained) in respect of the assets on the death of family members. This allows assets to pass to the next generation easily and efficiently.

Charity

To allow for some control to be exercised as to the ultimate destination of charitable gifts. Moreover, gifts to a charitable trust are free of both inheritance tax and capital gains tax.

How is a trust taxed?

Trust taxation is a relatively complex area. A brief summary of the tax implications when a trust is established is set out below, however please contact us if you would like further details of how trusts are taxed.

Lifetime trusts

Trusts cannot be taxed in the same way as individuals, since they have different characteristics. Although lifetime trusts made by UK domiciled/deemed domiciled settlors can have significant tax disadvantages on creation, there are exceptions to this. These include trusts of business assets, agricultural property and large regular gifts of surplus income, as well as insurance policy trusts. For some prospective settlors, trusts of assets valued at less than the threshold for inheritance tax are also attractive.

Bare trusts are transparent for tax purposes and therefore have no tax consequences. In addition, for some non-UK domiciled settlors, trusts of any non-UK assets can have taxation benefits if carefully drawn up.

Will trusts

Taxation consequences of creating will trusts, which take effect on death, are more attractive than lifetime trusts since the major tax disadvantage to UK domiciled individuals of the latter is not applicable on death. Consequently, will trusts are used widely for many of the reasons listed above.