

Spotlight on Family Trusts

Do you want to preserve some of your assets for the benefit of the family for as long as possible?

Do you want to retain some control over them whilst transferring their value out of your estate as quickly and as tax efficiently as possible?

A trust will meet all these requirements but different kinds of trusts have different tax consequences.

Bare Trust

This is not much different from an outright gift if all the beneficiaries are of age as they can bring the trust to an end at any time. It would simply be an arrangement whereby you would remain the legal owner of the assets for their benefit for a period of time. The assets would in essence be theirs. The income and capital gains of the assets would be those of the beneficiaries. However, you could use it as a way to get value out of your estate and retain control for a time.

A bare trust for minors has a particular tax treatment. The capital gains are those of the minors but the income is taxed as yours if you are their parent.

In all cases the gift into trust is a potentially exempt transfer (“PET”). The gift will fall out of your estate after seven years and taper relief may be available to reduce any tax payable as a result of your death within that period.

There may be a capital gains tax (“CGT”) liability on the disposal into trust if the assets are showing gains.

Discretionary Trust

This is the most flexible option. The assets would be held by you and at least one other as trustees for the benefit of a class of beneficiaries, for example, your children, grandchildren, future grandchildren and anyone else you wish to include.

The gift into trust would be a chargeable transfer not a PET and would therefore attract an immediate charge to inheritance tax (“IHT”) at 20% on the excess of the value of the gift over your available nil rate band. Any other chargeable transfers made by you in the last seven years would be taken into account in calculating that band. Additional tax may be payable if you die within seven years of the gift and taper relief may be available in certain circumstances. In some cases, the tax can be paid by instalments.

In addition, the trust would be subject to “periodic charges” and “exit charges” to IHT. The periodic charge is levied every ten years and exit charges are levied when capital leaves the trust. These are, however, relatively low. For example, the ten year charge is currently a maximum of 6% on the value of the assets which exceed the nil rate band. It is often lower than 6%.

Income and capital gains of the trust are taxed at the trust rate which is 40%, provided you and your spouse/civil partner do not retain an interest in it.

Sometimes people choose the medium of a discretionary trust where they want to hold over considerable capital gains. This is possible because of the availability of CGT holdover relief on a gift into a discretionary trust.

Accumulation and Maintenance ('A & M') Trust

This is a type of discretionary trust specifically set up for beneficiaries (usually grandchildren) who are under 25 years of age. They must attain an interest in either capital or income on or before that age. In the meantime, income must be accumulated insofar as it is not used for their maintenance, education or benefit.

An accumulation and maintenance trust used to have a special IHT treatment and there are transitional rules for such a trust created before the 2006 Budget. Otherwise, IHT treatment is now the same as for a discretionary trust. Income and capital gains of the trust are taxed at the trust rate.

Interest in Possession Trust

Under this kind of trust the beneficiaries have a right to income as it arises or the right to immediate occupation of a property with the capital being deferred either to a later age or perhaps to the next generation. An example would be where you put a property into trust for your children for life with the capital passing to your grandchildren. Obviously, this type of trust is not so flexible because of the obligation to pay income (eg rents to the beneficiaries as it arises. There is no option, for example, to accumulate it. The distribution of capital can, however, be flexible because you can give the trustees the right to advance capital to the beneficiaries in the trustees' discretion.

The IHT treatment is the same as for a discretionary trust. The capital gains of the trust are taxed at the trust rate.

For further information please contact Helen Robertson on hrobertson@vwl.co.uk.

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For further information please contact us:

0117 925 2020

Orchard Court, Orchard Lane, Bristol BS1 5WS
DX 7831 Bristol

www.vwl.co.uk

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