Summary of trusts

May 2020

Lancaster Knox

INTRODUCTION

Trusts remain a popular vehicle for tax and succession planning. Set up appropriately, they can continue to form an effective part of estate planning. However, this is a highly complex area of tax law and expert advice is of paramount importance.

A raft of changes to the taxation of trusts in recent years means the landscape is now as complex as it has ever been. Nonetheless, trusts can still be an efficient tool for private clients, in the right circumstances. At Lancaster Knox we have extensive experience in this area of taxation, and are pleased to share an overview of trusts , including the potential benefits below:

WHAT IS A TRUST?

A trust for English purposes is effectively a structure comprising three parties:

- The **settlor**, being the person who contributes assets to the trust. This could be cash, shares, property etc. There can be more than one settlor.
- The **trustees**. These are the people (either individuals, a professional corporate trustee, or a combination) who take legal ownership of the assets contributed by the settlor. In family situations, members of the family (including the settlor) are often the trustees; in more complex situations, a professional trustee may take on the sole trustee role.
- The **beneficiaries**, being the people who can benefit from the trust's assets and income. The beneficiaries can be named specifically (e.g. "John Smith and Jane Doe") or can be as a 'class' of beneficiaries (e.g. "the children and grandchildren of John Smith"). Charities can also be beneficiaries.

DIFFERENT TYPES OF TRUSTS

There are different types of trusts, and each have different properties depending on what the settlor wishes to achieve. In broad terms, common types of trusts include:

- **Discretionary trusts**, where none of the beneficiaries have any absolute entitlement to the assets or income of the trust. Instead, the trustees (often guided by a non-binding letter of wishes from the settlor) have discretion to apply the income and assets of the trust for the beneficiaries as they see fit. The trustees have a fiduciary duty to properly manage the trust assets and to treat all beneficiaries fairly.
- Trusts where a beneficiary is entitled to income of the trust or use of assets during their lifetime, but do now own the assets. These can be structured in different ways but are known as **life interest** or **interest-in-possession** trusts.
- **Bare trusts**, where the beneficiaries are the ultimate beneficial owners of the income and assets of the trust. This is actually a very common type of trust and includes - to use a simple exercise - a parent opening a bank account for one of their children under the age of 18.

WHAT ARE THE POTENTIAL BENEFITS OF A TRUST?

Trusts are very flexible and can be drafted to achieve different outcomes depending on the settlor's wishes. For example, specific beneficiaries can be included (or, indeed, excluded). There are generally very few restrictions on the type of assets trusts can hold. They can include assets in the UK and overseas. As well as potential tax benefits (see below), trusts can be used for other commercial or family reasons:

- To provide for husbands, wives or civil partners after a spouse passes away, while also protecting the interests of children. This can be particularly the case for families where there are children from previous marriages
- To protect family or business assets and to help succession planning or wealth transfers
- To protect the inheritance of young children until they are old enough to take responsibility for their own affairs
- To provide for vulnerable relatives who are unlikely to be able to look after their own affairs

UK Taxation of Trusts

The UK taxation of trusts broadly depends on:

- The domicile of the settlor
- The residence of the trustees
- The type of trust established

UK Taxation of Trusts

In the case of discretionary trusts, if the settlor is domiciled in the UK when the trust is established, the trust will be within the "relevant property" regime for UK Inheritance Tax ("IHT") purposes. This means it will potentially be subject to IHT charges:

- 20% on the value of assets contributed to the trust
- Up to 6% of the value of the trust's assets every ten years
- A pro rata charge on distributions of capital made from the trust

Discretionary trusts may benefit from reliefs from IHT, such as Business Property Relief and Agricultural Property Relief. The settlor's nil-rate band (currently up to £325,000) may also be available. The trust's IHT position does not generally depend on the residence of the settlor of the trustees.

Income Tax

Trusts that are resident in the UK are subject to UK income tax, generally at the highest rate of tax that would be applicable to individuals (currently 45% for most income and 38.1% for dividends).

Non-UK resident trusts are generally subject to UK income tax only on UK-sourced income. However, specific anti-avoidance rules means that the settlor or beneficiaries may be subject to income tax instead, either on the trust's underlying income directly or when the beneficiaries received distributions.

A trust will usually be non-UK resident:

- If none of the trustees are resident in the UK for tax purposes; or
- Where only some of the trustees are resident in the UK and, when the trust was set up, the settlor was:
    - Not resident in the UK
    - Not ordinarily resident in the UK
    - Not domiciled in the UK

Capital Gains Tax

UK resident trusts are subject to Capital Gains Tax ("CGT") at the top rate applicable to individuals.

Non-UK resident trusts are not generally subject to CGT (except on gains disposal of UK land and property), but anti-avoidance provisions means in certain circumstances, either the settlor or beneficiaries may be subject to CGT.

International & Other Considerations

The tax and legal status of trusts is not widely aligned across jurisdictions. For example, many European civil law jurisdictions simply do not recognise the UK common law concept of trusts; their cross-border tax position therefore often has to be analysed on a case-by-case basis.

The UK's Transfer of Assets Abroad ("TAA") anti-avoidance legislation can impose or impute tax charges on individual settlors or beneficiaries, but this varies on a case-by-case basis and must be analysed each time.

Where individuals are trustees, and they are internationally-mobile or choose to move abroad, it is vital to consider the impact this has on the residence of the trust and the associated tax consequences.

Choosing trustees is an important exercise as they can have significant control over the activities and assets of the trust. Matters such as complexity, family dynamics and experience of the proposed trustees should all be taken into account.

Some settlors also consider appointing a Protector. This is a trusted person who may have the ability to veto certain trustee decisions, appoint new trustees and so on. Specific consideration needs to be given to the implications for both the trust and the Protector.

Trusts may be required to register with the UK tax authority, HM Revenue & Customs ("HMRC"), or another country's tax authority. They may also have reporting obligations under international Automatic Exchange of Information Agreements, such as the Common Reporting Standard ("CRS") and the US Foreign Account Tax Compliance Act ("FATCA").

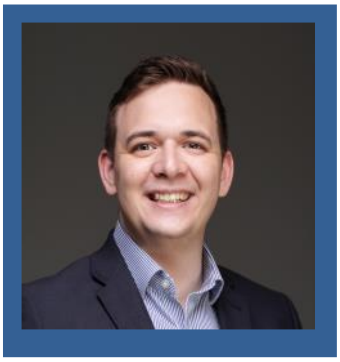
How Lancaster Knox Can Help

Poor estate planning can risk wiping out 40% of your family's inheritance, plus the administrative and emotional burden of dealing with assets not appropriately structured can be exhausting. At Lancaster Knox, we understand that IHT and estate planning can be highly sensitive topics, which is why we approach them in a delicate, discreet and professional manner. Set-up appropriately, trusts can continue to form an effective part of estate planning, however expert advice is of paramount importance.

Our team of experts spend time at the outset to fully understand the clients' individual circumstances, goals and aspirations to obtain a clear picture. This includes estate reviews and wealth health checks to ascertain if current trust structures remain fit for purpose, and will advise on restructuring where appropriate.

Contact Us

James Heathcote is Director of Private Client Advisory at Lancaster Knox, advising high net worth individuals and families across the spectrum of personal taxes. He is a member of the Association of Tax Technicians, the Chartered Institute of Taxation and the Family Firm Institute. He would be delighted to discuss your circumstances with you.



James Heathcote ATT CTA

Director
Private Client Advisory

james@lancasterknox.com

London: +44 (0)203 75 75 669

York: +44 (0)1904 293 120

M: +44 (0)755 764 7543

Lancaster Knox

Chartered Tax Advisers