

# Trusts and Passing on Wealth

## Factsheet

### February 2025

There are many ways to pass on your wealth to reduce or eliminate the Inheritance Tax payable on your Estate without using Trusts.

But you may prefer the flexibility and control which Trusts can give you when it comes to passing on your wealth in accordance with your wishes.

## What is a Trust?

A Trust is a very simple concept in principle; you (the settlor) transfer assets to be managed by someone else (the trustee) for the benefit of another person (the beneficiary).

There can be more than one person in each role and sometimes one person may occupy more than one. However, for Inheritance Tax (IHT) planning purposes, the settlor (and their spouse) must not be a beneficiary of the Trust. For example, in one typical estate planning scenario, you may be the settlor, you and your adult child may be the trustees, and your grandchildren the beneficiaries.

The settlor creates the Trust by way of a deed, and puts assets into it. Within the Trust deed, they choose both the trustees and beneficiaries, and also set the rules governing how the trustees manage the Trust.

The trustees take legal ownership of the assets in the Trust and manage the assets in accordance with the Trust deed and relevant Trust and tax laws. They must act in the best interests of the beneficiaries.

The beneficiary receives the proceeds from the Trust (assets or income) in line with the Trust deed and on the instruction of the trustees.

Some of the benefits of a Trust to the settlor include:

- The assets put into Trust do not form part of the death Estate after seven years, and therefore become exempt from IHT within your personal Estate (although they may face other charges).
- Whilst you give up possession of the assets put into the Trust, by setting rules and being one of the trustees, you retain control over the future of the Trust, who benefits from the assets, and how they are used.

Trusts also offer a means of holding and managing money or property for people who may not be ready, or able, to manage it themselves (with discretionary Trusts these can also include beneficiaries who are not yet born).

## Main types of trust

Trusts can be used beyond IHT planning, and there are many types of Trust, including:

- Bare Trusts
- Discretionary Trusts
- Interest in possession Trusts (life interest or fixed interest)

There are also many other uses for Trusts including, Trusts for vulnerable beneficiaries, those for life insurance policies and pensions, Will Trusts for bereaved minors and charitable Trusts, although this list is not exhaustive.

## Common tax-planning scenarios

If you are familiar with some of the basics of IHT planning, you will know that one of the main ways to reduce your liability is to gift assets to beneficiaries before you die.

As long as you give up all ownership and associated rights, currently the gift will become exempt from IHT after seven years.

This provision may be perfect for you by itself.

However, depending on your family circumstances, outright gifting may expose your assets to unintended and/or unwanted consequences, as you lose of control over the asset gifted.

Some of the more common situations where Trusts are used (often in conjunction with a Will) are:

- to provide for a spouse after death whilst protecting the interests of any children (particularly useful where there are children from previous relationships);
- to protect the inheritances of young children until they are old enough to take responsibility;

- to provide for vulnerable relatives who may never be able to look after their own affairs;
- to help with succession planning in a family business.

Trusts are particularly useful for inter-generational planning especially where there are complicating factors like divorce, second marriage and marriage breakdowns.

## Bare Trusts

Bare Trusts are the simplest and most rigid of Trust. The beneficiaries are chosen at the outset and cannot be changed.

Most commonly these are used when passing money from parents to children, and the parents act as trustees. But they can be used for any asset or relationship.

The asset put into the Trust is treated as a gift for IHT purposes, so after seven years there would be no tax to pay.

When the children turn 18, the bare Trust will no longer exist and the children have the absolute right to the asset (including any income) whenever they wish, to use in any way they please. Even though the asset is in the name of the trustee, they have no control over how or when the asset is distributed.

One point to note is if a parent has settled money into a bare Trust for a child and it produces more than £100 of income per annum, that income would be taxed as if it were the parents until the child turns 18.

## Discretionary Trusts

A discretionary Trust is potentially the most flexible of Trusts. The settlor prescribes rules that the trustees must follow. There must be at least two trustees and you can have as many beneficiaries as you like (including those not yet born).

The income and capital of the Trust is advanced entirely at the trustee's discretion and no beneficiary has an absolute right to receive anything (only the mere hope of being considered). There is also no stipulation that distributions must be equal, it is entirely a decision of the trustees.

Discretionary Trusts are suitable if you have a particular group of beneficiaries but are unsure who will need help in the future and in what proportions. For example, a grandparent can settle assets onto discretionary Trust for children, grandchildren and future generations (which may include those not yet born).

## Interest in possession Trusts

An interest in possession Trust is where the income or benefit (dividends, interest, rental income, the ability to occupy a property for free) must be given to a specific, named beneficiary (the life tenant) – the income is theirs by right. Sometimes there is one life tenant; in other scenarios there is more than one, but they will all have a fixed entitlement.

These are also referred to as life interest or fixed interest Trusts.

The underlying capital of the Trust then passes to specified beneficiaries at a specified point in the future, for example following the death of the life tenant(s).

This type of Trust is popular in the Wills of people who have married for a second time, each having children from their first marriage. It ensures the spouse is provided for during their lifetime, whilst protecting the capital wealth for their own children.

## Tax considerations

Generally, Trusts created nowadays will fall within the “relevant property” regime, although there are some exceptions; particularly with Trusts created on death. The regime means that IHT will still come in to play in some, but not all, circumstances, for instance:

- when the Trust is initially settled (anything above the nil-rate band is chargeable at 20%)
- every ten-year anniversary of the Trust (broadly at a maximum of 6% of the value above the nil rate band)
- when capital is advanced to beneficiaries (again at a maximum of 6%)

But there are a lot of other factors to take into consideration alongside IHT, and often there are no or minimal charges to IHT.

Trusts are also subject to Income Tax and Capital Gains Tax but the rates of taxation, and who is liable, is dependent on the type of Trust.

There are numerous ways in which Trusts can be used and these can be settled both in your lifetime, or upon your death (via your Will). It is vital to take both taxation and legal advice to ensure that your assets pass in accordance with your wishes.

*This guidance note is based on the law in England & Wales. It is based on current legislation and our understanding of published practice at this time. Our comments do not extend to the delivery of legal or financial advice and is intended for guidance purposes only. Full advice should be taken before taking any action, or inaction.*