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What is a Trust and Why Do I Need One?

What is a Trust?

To clear up one thing at the start, you will also see some things called settlements. There is no real difference. A settlement is a trust.

A trust is a very flexible tool, which can be used for a range of different purposes.

A trust is a separate legal entity run by its trustees, in much the same way that a company is a separate legal entity run by its directors.

You what?

OK, an example. The simplest and most common type of trust is found in most Wills.

If both parents die while their children are too young to inherit, something has to happen with the money until they are older.

It is given to at least two people – the trustees – who hold it and manage it under a strict set of rules for the benefit of the children – the beneficiaries.

Under this trust, as each child reaches the age set in the Will, his or her share is handed over.

Is that it?

No.

There is what is usually called a life interest trust. This allows you to give someone the right to use assets for their life, or for some shorter period, but then to pass them on to someone else at the end of that period.

There is also a discretionary trust. In this type of trust, no-one has a right to anything from the trust. The trustees have a list of potential beneficiaries and the trustees decide who receives income or capital from the trust and when, entirely at their discretion – hence “discretionary trust”.

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These basic types can be combined together in different ways to do different jobs.

Aren't Trusts complicated and expensive to run?

The answer to that is: "it depends". It depends on what you want the trust to do.

For many purposes, we can design the trust to run with absolutely minimal administration and minimal overheads, often none at all.

If there is more administration to be done, and if there is a cost to that administration, that will usually be because the trust is being used to protect a beneficiary or the trust assets from some threat, so the extra complication and expense are being incurred for a limited time and for a very good reason.

But what is a Trust for?

There are five key features of trusts which make them really useful.

- Ownership. The assets in a trust are technically owned by the trustees, not by any beneficiary of the trust.
- Control. That means that they are controlled by the trustees, not by any beneficiary.
- Protection. Those two elements mean that the right sort of trust, used in the right way, can insulate assets from many of the threats to which they would be exposed in the hands of an individual beneficiary.
- Flexibility. The right sort of trust allows the assets it holds to be managed by the trustees flexibly over time, in response to changing needs and circumstances.
- Tax. Assets held by the right sort of trust are not subject to Inheritance Tax on the death of any beneficiary, and can be immune from any Inheritance Tax at all for the lifespan of the trust, which can be up to 125 years.

OK, but why do ***I*** need one - what about specific examples?

Very well. Here are just some of the things you can do with a trust.

- **If you want to make provision in your Will for a parent or other elderly relative**, but you don't want those assets to be subject to Inheritance Tax again when that person dies, give it to the right sort of trust, instead.

- **If you have a child who needs protecting flexibly from himself or from those who might exploit him**, do not leave money to him on your death; leave it instead to carefully selected and properly-briefed trustees.

- **If you have a disabled child** and you want to make sure that he is financially secure after your death, that the assets are properly managed, and that his entitlement to means-tested benefits is not compromised, leave the money to an appropriate trust.

- **If someone is injured or is a victim of medical negligence, and receives an award of damages**, those damages can be paid into a special trust, to be managed by trustees, and without damaging that person's entitlement to means-tested benefits.

- **If you want to make provision for your spouse or partner** after your death, **but you want to make sure that your assets definitely reach your children after that person dies**, leave your assets to the carefully-selected and properly-briefed trustees of the right sort of trust.

- **If you live with someone and have children**, but you aren't married or in a civil partnership, and you want to leave assets to your partner, a trust is the only way to **avoid double-taxation**: once on your death, and again when your partner dies.

- A trust set up in your lifetime allows you to **give assets away**, getting them out of your estate for Inheritance Tax, **but keeping control over what happens to those assets**.

- That trust can not only get assets out of your estate for Inheritance Tax on your death, it can also **insulate the value of those assets from Inheritance Tax on anyone's death for up to 125 years**.

- On your death, if you leave money to an individual person, that person becomes wealthier and the money will be subject to Inheritance Tax in the individual's estate on his or her death. **Money you leave to a trust will not be subject to Inheritance Tax on anyone's death for up to 125 years**.

- **If you inherit**, you become wealthier and the value you inherited will be subject to 40% Inheritance Tax on your death. If that money had been left to a trust which passed it on to you in the right way, it would not be subject to Inheritance Tax on your death.
  If you inherit in person, you can redirect that inheritance through a trust – so you still have it, but it is not part of your estate for

Inheritance Tax – but you can do this only if you act within two years after the death.

- **If you have company death-in-service benefit or a life policy**, the proceeds will be paid out tax-free on your death. However, when the person who receives it dies, it is subject to 40% Inheritance Tax in their estate. A trust will prevent that.

- **If you have a pension fund**, the money in that fund can be paid out on your death, tax-free if you are under 75, subject to some tax if you are older. Again, when the person who receives it dies, it is subject to 40% Inheritance Tax in their estate. Again, a trust will prevent that.

- **If you own shares in a private company**, a trust allows you to pass at least some of the value of those shares to others on your death in a form which will not be subject to 40% Inheritance Tax on the recipient's death, even if the company is later sold.

- **If you own shares in a private company which is being sold**, trusts can (in the right circumstances) allow you or your spouse
  - to maximise the use of Capital Gains Tax Entrepreneur Relief and
  - to pass some at least some of the proceeds to your children or others, free of Inheritance Tax when you make the gifts and for 125 years after that.

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