Providing and protecting: the case for family trusts

Christmas is a time for giving and, as a result, one that often turns our thoughts to how we can effectively "give" to the next generation. Trust funds can combine flexible long-term provision with a high degree of protection. Here we take a look at how trusts work and what benefits they can bring.

"People's motives tend to be fairly constant," says Lesley Britton, a client director at Handelsbanken Wealth Management, "providing for loved ones and protecting family assets tend to top the list, with tax benefits coming a distant third, though a trust can still help you give in a tax efficient way."

A trust fund can be set up in your lifetime or be provided for in a will. The trustees you appoint become the legal owners of the assets but the 'beneficial owners' are those your trust is created to help. These can be one or more individuals, or a group such as children or grandchildren. Provision can even be made for those yet to be born.

Three types of trust

The simplest form of trust is a so-called 'bare' or 'absolute' trust. This is a caretaking arrangement with no separate legal identity and involves merely moving money into an account which is set up in the beneficiary's name. The beneficiary will, however, not acquire the right to capital or income from the trust until they have turned 18, at the earliest.

An absolute trust provides a safeguard in that the beneficiary can only access funds held in the trust once they are a certain age and with the trustees' permission. This arrangement is, as a result, often used in instances where the beneficiary may, at least initially, need a little more structure in order to help them manage their money.

A discretionary trust takes safeguarding a step further by granting trustees the power to use their own judgement as to how the beneficiary is best supported by the trust. Trustees often, for example, provide funds to the beneficiary in occasional or regular instalments, which can be spread over a beneficiary's lifetime, and allow the beneficiary access to income, or capital, or both, as the trustee sees fit. Whilst trustees have absolute discretion over how the trust is managed, they generally aim to operate with regard to any wishes you have set out.

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Lesley explains that “a discretionary trust can be the ideal way to protect a child, teenager or young adult who may not yet have developed a strong sense of effective money management. The trustees provide protection and guidance until he or she can take charge of their own affairs.” Alternatively, the discretionary model can help keep wealth within the family protecting it for future generations; for instance, some trusts exclude former spouses from the list of beneficiaries in the event of a divorce. “A discretionary trust is a highly flexible instrument. There is no need to make any decisions at the outset, you can issue precise instructions later in the light of changing circumstances. Take a case where your children are prospering; you might then decide to skip a generation and allocate the trust’s assets to your grandchildren.”

Another form of discretionary trust is one which grants an ‘interest and possession’ and is typically used to ensure that a surviving spouse is provided for. He or she will enjoy certain benefits from trust assets during their lifetime, such as living in the family home and dividends from shares. But ownership of the underlying assets rests with the trust until the time comes to pass it onto the ultimate beneficiaries.

Tax benefits?

“The taxman has treated trusts less favourably since 2006,” says Lesley. “It is now much more difficult to add significant value to trusts without immediate tax costs in the form of, for example, inheritance tax (IHT) or capital gains tax.”

Generally speaking, you cannot put lots of value into a trust without paying IHT – or not all at once anyway.

Anyone can give away as much as they want free of inheritance tax to another individual/s, providing they live for seven years after making the gift.

Additionally, we all have the ability to make regular gifts to a trust over and above what’s needed to maintain our standard of living, again without limit. Whilst there must be an intention to carry on making those gifts on a regular basis, there’s no obligation to carry on should circumstances change.

Tax breaks also do still exist in special circumstances. For example, trusts being set up for disabled people can be eligible for special tax treatment, and there are helpful arrangements for protecting a family business.

Help for trustees

Choosing the right trustee or trustees requires careful thought. Though the law requires only that a trustee be at least 18 and of ‘sound mind’, the responsibilities can prove onerous. Preparing accounts and tax returns, valuing assets, and deciding on distributions can all be part of the job and there’s a legal requirement to ensure that the trust is managed in the best interest of the beneficiaries.

Lesley explains, “A solicitor or trust management company can act for you but many people prefer to appoint a family member with a more intimate knowledge of the beneficiaries and their needs.

“Handelsbanken Wealth Management can provide support in such circumstances, from advising on investments, to reclaiming tax, preparing tax returns and accounts and general tax planning, freeing trustees to focus on the more personal aspects of their role.”