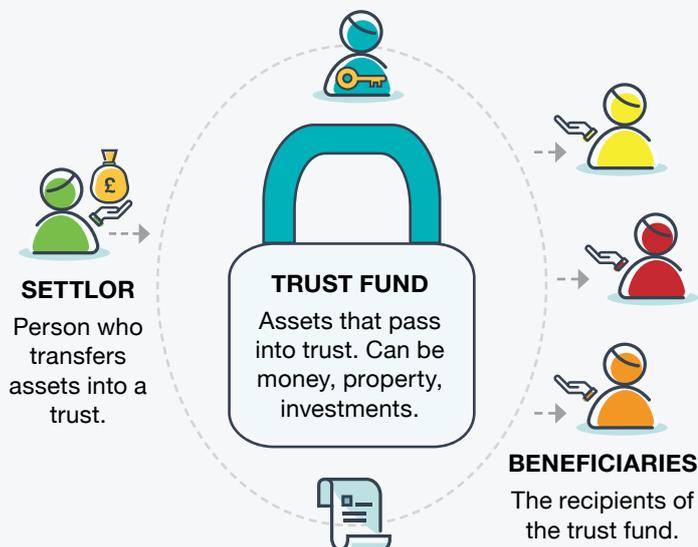


Using Lifetime Trusts as part of your Estate Planning

What is a Lifetime discretionary trust?

TRUSTEES

Appointed in the trust deed. Legally responsible for managing the trust.



SETTLOR

Person who transfers assets into a trust.

TRUST FUND

Assets that pass into trust. Can be money, property, investments.

BENEFICIARIES

The recipients of the trust fund.

TRUST DEED

Sets out the legal terms of the trust and who may benefit. An accompanying letter of wishes can be helpful guidance to trustees.

Trusts can be used for a wide range of purposes, including asset protection, inheritance tax planning, and enabling a legacy to be shared by multiple generations.

This guide provides an overview of how discretionary trusts established during your lifetime can be part of your estate planning strategy. The terms of a trust and its tax implications can vary, so it is essential to seek professional advice to clarify the specific consequences for your situation.

What is a lifetime discretionary trust?

A lifetime discretionary trust is a legal arrangement that enables you ('the settlor') to transfer assets into trust for your chosen beneficiaries. Discretionary trusts are a structure for preserving wealth within families. If you are setting up a trust, there should be no reasonable foreseeability that you may require residential care or be at risk of insolvency.

Key Points

 Once you transfer the assets into a trust, the trustees become the legal owners. They are responsible for protecting the assets, applying the terms of the trust deed, and complying with legal and tax requirements.

 You can act as a trustee if you wish to have this responsibility. It is also possible for beneficiaries to act as trustees; however, they must act fairly and impartially. You may want to appoint a professional for their neutrality and expertise.

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To be effective for inheritance tax planning, the general rule is that you cannot benefit from the asset you transfer into a trust. It takes seven years from the transfer date for the value to move out of your taxable estate on death.



If you continue to benefit from assets transferred into the trust, the value of the asset will be part of your taxable estate unless you have paid the market rate for its use.



Discretionary trusts can last for a maximum of 125 years, allowing multiple generations to benefit. If the trustees decide that the trust is no longer needed, they can close the trust and distribute the remaining assets to the beneficiaries.



Discretionary trusts have their own tax rules. The value of the asset going into the trust, as well as at ten-yearly intervals, will determine the charges incurred for inheritance tax purposes. During the trust period, the trustees may also need to pay income tax and capital gains tax. The tax rates can be subject to annual change. Getting professional advice can enable tax-efficient planning.

Why use a lifetime discretionary trust?

Protect assets that you care about.

Secure your legacy by transferring assets you have now for your chosen beneficiaries.

Safely provide for young or vulnerable beneficiaries so that inheritance can be managed wisely.

Flexibility - Trustees can make decisions based on the needs of beneficiaries and tax rules at the time.

Inheritance tax – After seven years, the value of assets entering the trust will be excluded from your taxable estate providing you do not benefit from the trust.

Wealth preservation for multiple generations. Assets held in the trust can be used for a range of beneficiaries and be better protected from third parties e.g. if a beneficiary gets divorced, faces bankruptcy etc.

Tax planning – A discretionary trust can be part of your estate planning strategy and avoid increasing the taxable estate for your beneficiaries who may already have an inheritance tax liability.



Example 1: Pete has an inheritance tax liability.

His sons are at university, and he does not want to give them cash to squander. He transfers £250,000 that he does not need into a discretionary trust and names his sons as beneficiaries.

Pete and his sister are the trustees. They can decide on how to invest the money and when to make payments to Pete's sons.

Pete and his sister must ensure that they register the trust with HMRC and fulfil their tax reporting obligations. They can do this themselves or get professional help with the administration of the trust.

Expenses for professional services are payable from the trust fund; therefore, this is often the preferred option for trustees to ensure compliance with the rules and minimise their time and personal liability.

If Pete survives seven years from the date of transfer, the £250,000 gift into trust will not reduce his nil-rate band allowance available on death. Any growth from investing the funds also sits outside of Pete's estate.

If Pete dies within seven years of the transfer into trust, his executors will need to bring the £250,000 gift into account when calculating his available nil-rate band.

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Example 2:

Mandy and Jim own a holiday home worth £500,000 and want it to stay in the family. Mandy

and Jim are aware that they would have a large capital gains tax bill to pay if they gave the property directly to their daughters. They also want to protect the holiday home should their daughters get divorced.

By transferring the property to a lifetime discretionary trust, Mandy and Jim may be eligible for holdover relief, provided they obtain the agreement of the beneficiaries. It means capital gains tax is deferred and not payable until the trustees sell or transfer the property out of trust to the beneficiaries.

Whilst the property is in trust, the asset does not belong personally to their daughters. The trust gives greater protection should their daughters get divorced or face bankruptcy.

To qualify for holdover relief and be outside of Mandy and Jim's estate for inheritance tax after seven years, Mandy and Jim must not continue to benefit from the holiday home unless they pay the market rent for its use.

Are there any tax implications to be aware of?

Although inheritance tax is usually charged when someone dies, transferring assets into a lifetime trust can trigger the payment of a 20% rate of inheritance tax (half the 40% rate).

The value of the assets going into the trust fund is crucial in determining whether inheritance tax is immediately chargeable and whether exit charges will arise when capital payments are made from the trust.

- If the value of the transfer to the trust, together with any similar transfers in the previous 7 years, is £325,000 or less, there is no immediate

charge to inheritance tax and no exit charges within the first ten-year period.

- If the value of the transfer to the trust exceeds the available nil-rate band allowance (current maximum £325,000), exit charges of up to 6% will be applied on payments of trust capital before the first tenth anniversary.

The trust fund is valued again on the tenth anniversary. If the value plus that of similar transfers in the 7 years before set up of the trust is £325,000 or less there is no inheritance tax charge or exit charges for the next ten years. If rather these values exceed together £325,000, inheritance tax at 6% is due on the excess amount, and exit charges will need to be paid by the trustees on later transfers of capital out of the trust.

The trustees may need to pay income tax if assets generate income or capital gains tax if they sell non-exempt assets and make a gain that exceeds the annual exempt amount. Where income is paid to beneficiaries who are non-additional rate taxpayers, it is possible for them to reclaim the difference in income tax paid by the trustees.

Can I transfer my home into a trust and continue to live in it?

A trust can be written to give you rights to remain in the property, with options for trustees to purchase a replacement property if you wish to move in the future. A trust can provide you with more protection compared to simply giving away your home; however, you must carefully consider the advantages and disadvantages. By continuing to live in the property, the value of the property at the time of your death will be part of your taxable estate and so will not reduce your inheritance tax liability. You may also lose the Residence Nil-Rate Band (inheritance tax relief) unless certain conditions are met. The value of the property entering trust and upon each tenth anniversary is vital to consider given the tax summary above.

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What happens to the trust upon my death?

Once the assets transfer to the trust, they no longer belong to you personally. The trustees do not need a grant of probate to use or sell the assets. They may, however, need to complete inheritance tax forms to declare the transfers into trust that you have made.

Can I make multiple lifetime discretionary trusts?

Yes. The simplest way is to make a gift into a trust and then wait seven years to repeat the cycle, so that each trust is outside your taxable estate.

Alternatively, you can set up multiple trusts on different days, allowing each trust to have its own nil-rate band. However, each time a trust is created, a chargeable transfer will occur, reducing the available nil-rate band for every subsequent trust. This is complex estate planning, where detailed individual advice will be required.

What are the main differences between a trust set up during lifetime and by will?

Many people have a combination of lifetime trusts and will trusts as part of their estate planning, ensuring maximum protection for the entire estate.

Lifetime Trusts	Will Trusts
The trust receives assets you own now so there is certainty for your beneficiaries.	Trusts set up in your will can only take assets you own at the time of your death.
Once you transfer the assets into trust, you are no longer the beneficial owner.	Until death, you are free to use or dispose of the assets as you wish.
The trust deed sets out the legal terms.	Your will contains the terms of the trust.
During the trust period, the trustees must ensure that they pay the appropriate rates of income tax, capital gains tax, and inheritance tax applicable to discretionary trusts for the relevant tax year.	Your executors will pay any inheritance tax that is due on your death. Any ongoing taxes that trustees may be required to pay will depend on the type of trust you have included in your will.
The trustees also need to register the trust with HMRC within 90 days of commencement.	Where applicable, trusts established by will must be registered with HMRC within two years of the date of death, unless a UK tax liability arises, in which case the deadline is 90 days.
A grant of probate is not needed to sell the trust property or for the trust to continue.	A grant of probate will generally be required for assets to be transferred into trust or sold by executors/trustees.

Summary

Lifetime discretionary trusts can be a valuable part of your estate planning that helps you to reduce your inheritance tax liability and create a legacy now that can be enjoyed by multiple generations.

A discretionary trust can provide you with peace of mind by offering security for your legacy and flexibility so that your beneficiaries inherit at the right time.

Contact us today