Chartered Financial Planners

thewealthnet Top Financial Planning Companies 2019

vouchedfor 250 IFAs

BUCKINGHAM GATE

YOUR GUIDE TO BLOODLINE TRUSTS

This communication is for general information only and is not intended to be individual advice. It represents our understanding of law and HM Revenue & Customs practice. You are recommended to seek competent professional advice before taking any action.

INTRODUCTION

Trusts have been used for generations to protect assets for direct family descendants and can be traced back as far as the Middle Ages.

While many people look to Trusts as a way to mitigate against Inheritance Tax, they actually fulfil a much more important role in ringfencing assets from less obvious scenarios such as divorce, remarriage, bankruptcy and care home fees that could result in all of the assets being lost to unintended beneficiaries.

CONTENTS

03 What is a Trust?

04 What is the difference between a Will and a Trust?

06 Why should I use a Trust?

08 Reducing Inheritance Tax

09 Can I rely on a Trust?

10 What else do I need to consider before setting up a Trust?

11 Conclusion

WHAT IS A TRUST?

In simple terms, a Trust is the donation of an asset by an individual (the settlor) to other individuals (trustees) for the benefit of others (beneficiaries).

The role of the trustee is crucial in administering the Trust, and as long as the individual is over 18, of sound mind and not bankrupt, both the settlor and the beneficiary can be a trustee. While there is nothing that prevents a settlor being named as a beneficiary, this will negate many of the benefits of setting the Trust up in the first place and in almost all circumstances should be avoided.

In legal terms, there are two main types of Trusts – those with an enforceable interest and those with a prospective interest. Trusts with an enforceable interest will have clearly defined beneficiaries and include Trusts such as:

- **Life Interest Trust –** one person has the right to income for their life (life tenant), and others (the remaindermen) are entitled to the capital on the death of the life tenant.
- **Flexible (or Power of Appointment) Trust –** the Trust has two classes of beneficiaries (actual and potential) and the trustees have the power to replace an actual beneficiary with somebody from the list of potential beneficiaries, for example if the actual beneficiary has passed away.
- **Bare (or Absolute) Trust –** a beneficiary has an immediate and absolute entitlement to both capital and income which cannot be revoked.

The main type of Prospective Interest Trust is a Discretionary Trust which is similar to a Flexible Trust but differs in that it has no actual beneficiaries i.e. all of the beneficiaries are potential beneficiaries only. This gives the trustees full flexibility to decide who benefits from the Trust, as well as controlling how much they will receive and when payment is made.

The wide ranging flexibility available to trustees within a Discretionary Trust means that there are very few circumstances in which the Trust assets could not be distributed to a beneficiary of some description, and almost all Trusts used in relation to financial planning are set up as Discretionary Trusts.

There are a wide range of Discretionary Trusts and in simple terms, they are differentiated by the assets they hold. For example, an Asset Preservation Trust is used to receive pension lump sum death benefits and death in service payments while a Beneficiary Protection Plan would typically hold investments.

Various options exist when considering assets to be transferred into Trust and the options will depend on whether or not the asset produces an income. For income producing assets, broadly speaking, you can gift the capital and the income, or gift the capital and retain some income, or various combinations of the above.

WHAT IS THE DIFFERENCE BETWEEN A WILL AND A TRUST?

A Will is a legal document that directs who will receive all of an individual's property on death, while a Trust will only deal with any assets where ownership has been transferred to the Trust.

The main difference between a Will and a Trust is that a Will only comes into effect on death – up until that point, a Will can be rewritten at any time, and can be automatically revoked in certain circumstances including marriage, unless written in contemplation of marriage (English & Welsh Law). A Trust is established during a settlor's lifetime and comes into effect as soon as it is created – this makes a Trust much more difficult to contest compared to a Will as it is much clearer that a Trust is in keeping with the creator's wishes, which may not be the case with a Will.

Another important difference is that a Will needs to pass through probate while a Trust does not. Probate is the process of ensuring that the Will is valid, ensuring that any Inheritance Tax due has been paid and that the remainder of the estate is paid in accordance with the contents of the Will – this process can often take in excess of six months and in complex cases can run into several years. Assets held within a Trust are not included in the probate process, and assets can often be distributed to beneficiaries in a matter of days.

"THE MAIN DIFFERENCE BETWEEN A WILL AND A TRUST IS THAT A WILL ONLY COMES INTO EFFECT ON DEATH."

MY LAST (ABSENT) WILL AND TESTAMENT

Based on an article published by Unbiased Ltd, this is what a Will looks like for those who haven't made one!!

I, Arthur Sleep, being of sound but absent mind, do hereby forget to make my Last Will and Testament. I revoke, annul and cancel all previous good intentions to get around to doing this one of these days. I am happy for all my worldly goods to be shared out with no regards to my wishes according to a law made in 1925, and I am prepared for my beneficiaries to pay the maximum amount of Inheritance Tax possible. Hope they're not too upset by that...

Because I have appointed no executor, my next of kin will end up being responsible for my estate – this happens to be my sister who I haven't spoken to for a number of years after a family dispute and now lives in Australia. At least this way it will cost a lot more, and cause everybody concerned much more inconvenience and distress. Just a bit of a shame that Dave, my old mate from school, will now have to sit and watch while all of this goes on as he would have been a brilliant executor.

I would have liked my partner of 10 years to have benefitted from my estate, but because we never got around to getting married, she won't get a penny. I'd also like her to be the legal guardian of my two teenage children that have lived with us both for most of their lives rather than see them being sent into the care of social services (or even worse my sister!) while the Courts mull over what to do with them.

Our home is in my name, and on my death will pass to my children and be held on trust for them until they turn 18, with my sister being responsible for the trust until then. Not sure that I'm overly happy with the thought of both of them having such a lot of money at such a young age, but never mind – I'm sure that they wouldn't be able to spend all of it partying.

My partner and sister have never seen eye to eye (hence the reason why we haven't spoken for so long), and it's likely that my sister will sell the house as soon as she possibly can, and so leave my partner homeless.

I also admit that because of the delay in gaining access to my estate, my partner will have to pay for my funeral out of her own pocket – she'll probably have to borrow the money for this, as all of our joint bank accounts have been frozen since my death.

No hang on, I've just remembered that I do have a Will filed away somewhere! What a relief! I made it 20 years ago naming my partner as my sole beneficiary, Oh but wait ... that was a different partner who I haven't seen in years – now she'll get the entire estate and my kids won't get anything. I suppose I'll just have to live with that – well not live, but you get the point.

That settles it – I really am going to sort out a new Will on Monday morning, I promise. I'll do it straight after the cut price bungee jump that we're all doing for Dave's stag party this weekend.

WHY SHOULD I USE A TRUST?

The primary use of Trusts for bloodline planning is to retain as much of the estate as possible for direct family members.

They seek to protect assets from attack from scenarios such as:

DIVORCE AND REMARRIAGE (BLOODLINE PROTECTION)

Many people whose spouse has passed away will get remarried but many of these second marriages will end in divorce. If assets have been inherited directly by the surviving spouse, then up to 50% of this inheritance could be lost on divorce.

A natural course of action in the event of remarriage is to write new Wills (especially as any existing Wills are automatically revoked on marriage, unless they are written in contemplation of marriage), but unless great care is taken in creating these Wills, all of the assets from the first marriage could be lost to the offspring of this relationship.

EXAMPLE

David and Lisa are married and have two sons – they both created Wills which named their spouse as the sole beneficiary of their estates, and assets to pass to both children if they were to both die.

David passes away in his early forties and Lisa receives all of his assets including his share of the family home. After a few years, she meets Leon and they get married – Leon has two daughters and they agree to create new Wills nominating the other in the event one of them should pass away, and for their joint estates to be split equally between all four children on second death.

Ten years later, Lisa passes away and Leon receives all of Lisa's assets including the money that she had inherited from David. Leon and the two boys have always had an uneasy relationship, and during the probate process they have a falling out – Leon then changes his Will to leave everything to his daughters meaning that Lisa and David's children will not receive a penny from the assets that their parents built up during their lives.

CARE HOME FEE PLANNING

With the cap in care home fees now being delayed until 2020 at the earliest, it remains the case that for those with assets in excess of £23,250 they must pay for the cost of their own care even if it means the sale of the family home.

Research suggests that residential nursing home fees in the South East can average almost £850 per week and wouldn't include items such as toiletries, clothing and personal items. With the average stay in a care home at around 2 1/2 years, this means that the cost of care could be well in excess of £100,000.

The local authority can in theory claim all of the assets that an individual owns to pay these fees, and this includes the family home if it is owned solely by them and will be empty if the individual goes into care (which is the situation in most cases where a person dies and leaves everything to the surviving spouse).

Any assets held in a Trust for the benefit of an individual cannot be claimed by the local authority, and as long as the transfer of assets into a Trust is not deemed to be a deliberate deprivation of assets, then these assets are protected. This includes the family residence that is partly owned by a Trust, as in practical terms the local authority can't sell half a property.

EXAMPLE

Martin has an estate of £1 million which includes £400,000 of his share of the family home that he owns with his wife Jenny on a joint tenants basis (they both own the property, and on first death ownership transfers to the survivor automatically – any gift of their share of the property within a Will to anybody other than the surviving owner would be ineffective).

They both set up new Wills with Trusts to receive their assets on death naming the surviving spouse as the beneficiary, and change the ownership of the property to tenants in common. This means that they each own half of the property, and this share is inherited under the terms of their Will.

Three years after Martin's death, Jenny requires residential nursing care – the value of her home has increased to £900,000, but because she only owns half of this property (the Trust owns the other half), the local authority cannot force the sale of this property to meet the costs of care.

REDUCING INHERITANCE TAX

Any assets on death above the nil rate band (currently £325,000) are subject to Inheritance Tax of 40%.

It is possible to inherit a nil rate band from a spouse who has passed away, and so for a married couple looking to pass on assets to their children, the nil rate band on second death could be £650,000. From April 2017, the residential nil rate band was introduced, which could be £175,000 by April 2020.

For those with larger estates in excess of the nil rate band, they could look to gift assets during their lifetime – after seven years this gift will not be deemed to be part of the donor's estate, and would not be liable to InheritanceTax on their death. While outright gifts to individuals can be made, they are liable to claims from third parties in the event of divorce, bankruptcy etc in a similar way that inheritances can be attacked. A gift into a Trust would allow the donor to control access to this gift during their lifetime, and leave instructions as to the management of these assets after their death.

In many cases where a Trust receives assets from a Will, it is quite common for the assets to be immediately distributed as soon as probate has been granted and the Trust dissolved. It is typical for wealthy individuals to have wealthy children, and in many cases they have assets well in excess of the nil rate band in their own name so any inheritances from their parents only add to their own estate planning headaches.

Any inheritance received and then passed down to the next generation (i.e. the original donor's grandchildren) could also be subject to Inheritance Tax. In our seminar, we go through a scenario where a £2 million estate is reduced to just over £500,000 over three generations.

A Trust can exist for a maximum of 125 years and while it may not save Inheritance Tax at outset, if assets are transferred to the Trust on death, it could mean a substantial tax saving for the next three or four generations. Assets can be loaned to a beneficiary on an interest-free basis and these are repayable on their death – as loans are deducted before any Inheritance Tax is calculated, this means that the beneficiaries estate is reduced and so the tax payable is lower.

CAN I RELY ON A TRUST?

With HMRC spending a great deal of resources pursuing aggressive tax avoidance schemes, many people are concerned that putting assets into a Trust could be attacked by HMRC in the future.

While tax evasion is illegal, it is perfectly acceptable for an individual to arrange their affairs in such a way that reduces tax payable – the fact that Trusts have been in existence for 900 years means that they are a well established tool for financial planning.

While there is nothing to prevent the Government outlawing Trusts tomorrow and to declare all existing Trusts to be illegal, the chances of this actually happening are remote.
All of the Trusts that we set up for clients are registered with HMRC at outset, and in previous cases where Trust legislation has been changed, it has rarely been retrospective.

The legal framework behind our Trusts are developed by counsel along with our legal partners Mills and Reeve LLP, one of the top law firms in the UK, and none of our Trusts require DOTAS (disclosure of tax avoidance schemes) disclosure.

"THE FACT THAT TRUSTS HAVE BEEN IN EXISTENCE FOR 900 YEARS MEANS THAT THEY ARE A WELL ESTABLISHED TOOL FOR FINANCIAL PLANNING."

WHAT ELSE DO I NEED TO CONSIDER BEFORE SETTING UP A TRUST?

Probably one of the most important decisions to make when creating a Trust is choosing the trustees.

The most important criteria in selecting a trustee is to choose people whom you know well and that you can rely on to carry out your wishes after your death – ideally this should be somebody that is the same age, or even younger than you, to try to ensure that they are still alive to deal with your estate on your death.

In the vast majority of cases with Bloodline Trusts, the trustees are direct family members who are usually beneficiaries of the Trust (i.e. your spouse and any children over 18), and professional trustees are only ever required if there could be family disputes with regards to the distribution of assets.

While there is a great deal of legislation regarding the statutory powers and duties that a trustee must adhere to, the role of a trustee is relatively straightforward, and it is common for one of the trustees to also take on the role of Executor of the Will and deal with probate. Trustees cannot be paid for the work carried out administering the Trust (with the exception of professional trustees), but many solicitors who draft Wills will name themselves as Executors of the estate so that they can deal with the probate and charge the estate for this work.

Once assets are transferred to a Trust, the trustees have to ensure that all beneficiaries are treated fairly and that the investments are suitable, but many of the decisions regarding the ongoing monitoring of investments can be delegated to a financial professional if the trustees do not have the necessary expertise.

A Discretionary Trust has it's own nil rate band and if the value of the Trust exceeds this, then the Trust may incur a tax charge (periodic charge) of up to 6% of the value above the Trust allowance on every 10 year anniversary of the Trust (not your death) e.g. if the Trust fund was £50,000 above the allowance, £3,000 could be payable every 10 years by the trustees. The potential ongoing cost would be a small percentage of the overall tax benefits.

It is important that trustees take advice on periodic charges once assets are received by the Trust, and to make provision for the payment of ongoing charges by withholding a proportion of the Trust fund if required.

It is part of our role to provide advice to the trustees to help minimise, and preferably eliminate, any tax that the Trust will have to pay to the extent that this can be done legitimately within current legislation.

CONCLUSION

We hope that this guide has given you an overview of the many benefits of Bloodline Trusts. If you would like to find out more, please come to one of our Estate Planning seminars that we host free of charge, or request a discovery meeting at our offices.

Please also note that Trusts and Estate Planning are not regulated by the Financial Conduct Authority, and are not covered by the Financial Services Act.

FREE INHERITANCE TAX PLANNING SEMINARS

Buckingham Gate Chartered Financial Planners hold regular Inheritance Tax Planning seminars in Central London. The seminars are **FREE** to attend, but places are limited.

If you would like to reserve places please email us at **events@buckinghamgate.co.uk** or call us on **020 3478 2160**

THE SEMINARS WILL COVER:

- How to update your will to save thousands in inheritance tax.
- Ways to reduce the inheritance tax liability on your estate.
- How to protect your assets for your loved ones.

Buckingham Gate
Chartered Financial Planners
25A Northumberland Avenue,
London WC2N 5AP

Tel: 0203 478 2160
Email: contact@buckinghamgate.co.uk
Web: www.buckinghamgate.co.uk

GTBT01/21

Financial Planners
Chartered