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Trusts, Traps, and Wills

A Guide provided by Rod Jones of Convenient Wills

1 Welcome

Thank you for requesting this guide. I hope you find it helpful and informative.

Trust law is a complex area of law. Many books have been written on the topic; this short guide is not designed to replace the sizeable technical books available from a quality Law library. For most people though such detailed understanding is not required. This guide aims to provide general information relevant to the narrow field of estate planning and the even narrower field of the Last Will and Testament ("Will").

The only way for us to be 100% sure the content contained in this guide is relevant to you specifically is for us to undertake a complete fact-find interview to establish your circumstances and wishes. For this reason this guide must be regarded as an information tool, and nothing more. The guide's purpose is to equip you with information about Trusts so that you can then use this information when discussing your affairs with a professional adviser -- at which time you can verify the information contained in the guide and qualify any implied recommendations it contains.

This report is provided on that basis. We regret we cannot accept any responsibility or liability for any adverse outcomes for you or your family, no matter how caused. In addition, we do not accept any liability for any mistake, error, or omission from this guide. We take care to ensure the technical accuracy of these guides and reports but, despite our best efforts, mistakes can occur and the laws relating to estate planning can change (and often do so with very little notice).

This guide is one of a number of guides and reports available from our web site www.convenient-wills.co.uk; they cover a wide range of aspects dealing with estate planning in general, and making your Last Will & Testament and Lasting Powers of Attorney in particular.

All our downloadable guides and reports use hyperlink technology. This allows you, if you are reading the document direct from a computer with access to the Internet, to click on a hyperlink (indicated with blue, underlined text) and you will be taken through to the appropriate article. Please note that the guide is not designed to be printed off; if you wish to print off the guide please [contact us](#) and we will send you an amended version.

If you require further information or clarification on any aspect of this guide then please do not hesitate to contact me. I will be only too pleased to help.

And finally, as you read this guide you may realise that it would be a lot easier, quicker, and simpler for a professional to just get on with making your Will for you. We would like to help. Please [click here](#) to read the full features and benefits of our home visit service, or [click here](#) to register your interest (without obligation) in our services.

Rod Jones

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Proprietor of **Convenient Wills**

2 Guide Objectives

This guide aims to:

- ♦ enhance your general knowledge of what is achievable with a trust in estate planning;
- ♦ highlight some of the possible advantages, dangers, and risks that a trust can create; and
- ♦ draw your attention to the pros and cons of the different types of Will trust.

3 Glossary

- ♦ **Trust:** Simplistically ... A trust is a legal arrangement whereby the ownership of an asset is separated from 'enjoying the benefit' of the asset. Assets are owned by a person or persons (called the trustee or trustees) for benefit of someone else (the beneficiaries).
- ♦ **Trustee:** The person who has responsibility for the assets of the trust. The trust will 'own' its own trust property. The trustee is the person responsible for looking after the trust's property in accordance with the trust document.
- ♦ **Settlor:** The person who, prior to the trust, previously owned the assets of the trust.
- ♦ **Beneficiary:** The person or persons who benefit from the assets of the trust, either while the trust exists, or when the trust is dissolved. (See also 'Remainderman'.)
- ♦ **Beneficial Interest:** a person can be said to have a 'beneficial interest' in a property. That person may have legal ownership of the property, an equitable right to the property, or a partial share of the property. Whichever of those three options is correct it is covered by the term 'beneficial interest'.
- ♦ **Remainderman:** with 'interest in possession' trusts the ultimate beneficiaries are known as the 'remainderman'.
- ♦ **Interest in possession trusts:** the trustees hold the assets for the remainderman but allow the beneficiaries to enjoy the income from the assets in the interim period (for example: In a life interest trust a husband (the settlor) may grant his wife (a beneficiary) the 'right to reside' in his share of the family house (his beneficial interest) until her death. The 'right to reside' is the income of the trust. On her death his share of the property (i.e. His beneficial interest) goes to his children (the remainderman.).)
- ♦ **Discretionary trusts:** the trustees hold the assets for the beneficiaries. The trustees decide which, if any, beneficiary or beneficiaries are to enjoy an income from the trust's assets and which if any beneficiary or beneficiaries are to enjoy the capital.
- ♦ **Trust property:** the assets owned by the trust. The 'trust property' can be money, physical assets (such as a house) or just a 'right' to [say] use an asset for their own benefit. Where a person enjoys the benefit of the trust property (e.g. By being given the right to reside in a house) this is called the trust's income. The underlying assets of the trust's property (e.g. A house in a right-to-reside trust) are called the trust's capital.
- ♦ **Trust document:** the source document that sets up the trust at the outset. This could be a trust deed (if the trust is set up during the settlor's lifetime), a Will (if the trust was set up following the settlor's death), or a statutory trust (for example where a minor child inherits under the terms of a Will, the child has to attain age 18 by Law before they can inherit. The assets are held on trust for them). With a statutory trust the law sets out the terms of the trust, and the powers the trustees have etc.

4 Trusts - Overview

Trusts are a phenomenon of UK law. Many countries do not have the equivalent facility.

There are many definitions of a trust; the one above is one of the simplest. Some definitions are very long. Understanding the mechanics and workings of a trust is probably more useful than having a word perfect definition of what a trust actually is.

The responsibilities and duties of the parties to a trust must not be confused, and can not be diluted even where a person is undertaking two roles. For example: A person may be an executor of a Will, the trustee of the trusts created by that Will, and a beneficiary of those same trusts. That person has three distinct roles and responsibilities as executor, trustee and a beneficiary. He cannot 'cut corners' in his duty as a trustee simply because he is also the beneficiary.

So a husband can create a trust in his Will in which he:

- ♦ places his own beneficial interest in the family home into a trust;
- ♦ appoints his wife and eldest child as a trustee of the trust; and
- ♦ makes his wife a beneficiary of the trust, and stipulates any remaining 'residue' at her death is to go to his children.

In this example the wife and eldest child (as trustees) have the responsibility of looking after the trust property (her husband's share in the family home) - in accordance with the trust document (her husband's Will). The wife can enjoy the income of the trust property (i.e. her husband's share in the family home) but cannot sell it or materially alter it (the trust's capital) - because that power vests with the trustees (i.e. the wife and eldest child). If the wife fails in her duties as a trustee she will be in breach of trust. The eldest child, who has a vested interest in the property in that he/she will obtain a share of any remainder at his/her mother's death, will also be in breach of trust if he/she fails to undertake his/her duties as trustee.

In this common example you can see there is a potential conflict of interest; the child has a vested interest in maximising the value of property [perhaps at his mother's expense] for his own ultimate benefit.

5 Uses of Trusts in Estate Planning

Trusts in estate planning can be used to achieve a number of outcomes. The more common uses are:

- ♦ **Making full use of Inheritance Tax (IHT) allowances and exemptions** - with a view of reducing an IHT tax bill in the longer term;
- ♦ **Protecting your children's inheritance;** how often do you hear or read of children not inheriting from their parents because after the death of one of their parents the surviving parent remarried?
- ♦ **Allowing a person to stay in, and enjoy, a property** - even though the person (the tenant) does not own the property. The tenant can be a wife or husband, or a parent who has given their house to their children, or an adult child who has been orphaned but needs a roof over their head until they have [say] finished their university education.
- ♦ **Protecting your property from your creditors.** Although frowned upon by the Courts it is possible to place your property into a trust fund and by so doing you ring-fence your assets from your creditors for the benefit of your family.
- ♦ **Protecting your property** from being used to pay for the funding of your spouse's long-term-care costs. This is a common concern for most elderly couples.
- ♦ **To provide for your minor children and grandchildren.**
- ♦ **To protect your disabled child's inheritance.** A severely disabled child (child here refers to a son or daughter of any age, rather than a person who is under the age 18) may qualify for means tested benefits from Social Services due to the severity of their disability. Upon receipt of an inheritance for their parent these means-tested benefits are often withdrawn because the child now has assets that take them over the Social Services threshold. To stop this happening the child's inheritance can be placed into a trust; the outcome is then that the child never 'owns' the assets and can therefore continue to legitimately receive the benefits from Social Services, but the child can benefit from the trust - in accordance with the trust document.
- ♦ **To make the decision as to who should benefit from your estate at the time of your death,** rather than trying to guess what you will have to give away at the time of your death. This is particularly important for business owners whose business may now be worth [say] £1,000,000, but could be worth 10 xs that, or be valueless at the time of death. Further, business owners should maximise the opportunities available with BPR (Business Property Relief). Creating a 2-year trust in a Will allows the distribution to be affected by the executors - who make the decision at time of death in accordance with guidance notes set out by the testator.
- ♦ **To protect your property from a perceived forthcoming divorce.** Lets suppose you suspect your child's marriage was on the rocks ... What would happen if you died? Your estate would go to your child, and if their marriage subsequently failed their spouse would receive half of your child's inheritance as a part of the divorce settlement. This outcome is not the preferred outcome for most parents. The solution is to create a trust in the parent's Will that allows their executors to release the trust funds to the testator's child at some future date of the trustees choosing - and the trustees can hold the monies if they think the child's marriage might fail in the short-term.

The above are some examples of the use of trusts in estate planning, and in a Will in particular.

I, personally, often see a trust as 'continuing to control your assets from your grave'.

6 Weighing Up the Pros and Cons of Trusts

The inclusion of a trust in your Will can achieve a number of outcomes that are beneficial to your preferred beneficiaries. But where someone benefits, others can lose out. The question is then ... Is the inclusion of a trust 'right' for you?

You need to be aware of the drawbacks to including such trusts in your Will, the risks, and the potential costs.

The drawbacks of including a trust can include:

- ♦ **A loss of control for the person most dear to you.** For example: A surviving spouse may no longer have full control over their property; they may have to liaise with trustees;
- ♦ **A surviving spouse may be vulnerable to trustee abuse;**
- ♦ **Additional costs** may be incurred using the services of a solicitor or other professional e.g. An IFA. These professional services may be needed to avoid 'breach of trust' by the trustees who lack the necessary expertise to run the trust, and are therefore unavoidable. These costs can be substantial.
- ♦ **Additional paperwork and administration** may be required e.g. An annual tax return may be needed to be completed. The trustees may need to meet together in person, annually.
- ♦ **The trust may not work.** Over recent years we have witnessed an on-going battle between tax planning specialists and HM Revenue and Customs regarding inheritance tax ("IHT") and tax avoidance; numerous schemes involving trusts have been disallowed by the taxman with the result that the testator (the person making the Will) has incurred significant costs setting up these schemes but for no benefit. Similarly, we are seeing local councils increasingly challenge schemes designed to protect property from being forcibly sold to fund the long-term care costs of a surviving spouse; this is likely to get worse as financial pressures build on local councils in the aftermath of the 'credit crunch'. Where a successful challenge occurs then a surviving spouse will have lost control of their house (and all the uncertainty this creates), and the children will still not benefit.
- ♦ **The interaction of taxes.** Few people take into consideration when using a trust that a trust is subject to tax (income and capital gains taxes, or discretionary trust charges). These need to be factored into the decision making process as trust fund 'tax thresholds and allowances' are often less than an individual's allowance.

7 Trust Types

Trusts generally fall into one of two types;

- ♦ Discretionary; and
- ♦ Interest in possession

Within each type names have been given to indicate their desired outcome of the trust. So for example

- ♦ Discretionary trusts include IHT Nil Rate Band trusts, IHT gift clause trusts, IHT Debt trust, 2-year trusts, Disabled Child trusts, and more. These trusts all work in the same way though: the trust property is disposed of by the trustees - at their discretion. They choose who should benefit, and when.
- ♦ Interest in possession trusts include life interest trusts, short-term tenancy trusts, property protection trusts, protective property trusts, asset protection trusts, spousal bypass trusts. Simplistically, these trusts work by allowing the trust property (which is owned by the trust) to be used exclusively by the beneficiary (subject to certain conditions) and they have the use of the asset until a certain event occurs e.g. Their death with a life-interest trust. On the occurrence of that event the ownership of the asset reverts to the long term beneficiary (the remainderman) - and the asset never forms part of the life tenant's estate.

8 Trust Traps

During this guide we have occasionally warned you about traps to avoid. For discretionary trusts, and inheritance tax planning in particular, you must consider:

- ♦ 'Gift with Reservation' rules;
- ♦ Pre-Owned Asset Tax (POAT);
- ♦ Sham Trusts; and
- ♦ Lack of Experience.

Gift with Reservation of Benefits (GROB)

One of the biggest challenges to overcome is the Gift with Reservation of Benefit (GROB) rule when considering estate planning and inheritance tax planning in particular.

The Inland Revenue web site's IHT manual [www.inlandrevenue.gov.uk/manuals/ IHTmanual](http://www.inlandrevenue.gov.uk/manuals/IHTmanual) explains that if the donor receives any benefit from the gift they have given away then the 'gift with reservation of benefit' rules apply. These rules state that if the donor receives any benefit from the gift after having given the gift away the gifted asset is regarded as still forming part of the donor's estate - even though the asset is no longer owned by the donor when he or she dies. The outcome is that the gift will still be included in the valuation of the deceased's estate and charged for IHT accordingly.

Therefore, for effective IHT planning, the settlors of trust property must exclude themselves as potential beneficiaries of that trust if the gift into settlement is to be effective for IHT.

Similarly, care must be taken where residential properties [in which the donor continues to live] are the subject of a gift.

Pre Owned Asset Tax

In the past complicated trust structures have been set up that resulted in the original owner of an asset becoming the new owner of the same asset (e.g. Their house) for a second time - but this time the ownership was regarded as being outside of the IHT legislation. Obviously the Government could not allow this loophole and so POAT was introduced.

POAT stands for 'Pre-owned Asset tax'. POAT is effectively an income tax charge of 6% a year on the net value of the asset you previously owned. So, if the asset was your house valued at say £300,000 the POAT would require you to pay £18,000 a year income tax.

Following the introduction of POAT people caught by the tax could alternatively elect for the asset to be returned into their estate for IHT liability purposes - a course that most people took.

Example of POAT AND GROB

As an example of the application of these taxes consider the following: A parent sells their own property, then gifts the sale monies to their children in an attempt to reduce their net worth below the IHT threshold. The children then purchase a new, bigger property and allow the parent to come and live with them.

This gift will potentially fall foul of the GROB rules, and might fall foul of the POAT rules - so caution is needed.

Sham Trusts

All discretionary trusts need to be properly conducted - in accordance with the law. This means that the trustees:

- ♦ Must meet (at least once a year);
- ♦ Review the investment of the trust fund for performance, and consider if [say] lending the trust fund to the surviving spouse is the best form of investment for the assets;
- ♦ Record their meetings, their agreements and concerns etc

Many trustees in the past have failed to undertake the required record keeping (Some have not even had any trustee meetings).

As an example: Potential inheritance tax savings of over £100,000 have been possible using trusts, but when the 2nd-to-die's estate is wound up HMRC (HM Revenue & Customs) have often successfully challenged that the trust was a mere sham and the Courts have ruled in their favour i.e. that IHT is payable on the whole estate. The end result is that the potential tax savings [the family thought they were going to achieve] were lost.

Lack of experience (for the trust's trustees)

Most modern trusts included in the wills for a married couple allow the executors/trustees to decide which is the best method to set up the trust depending upon the circumstances at the time of death of the 1st-to-die. So they could include loans; they might not. Where they do the loan could be registered as a charge against the property [at the land registry], or the loan could be evidenced by an I.O.U. If the correct option is not chosen then the future options for the surviving spouse could be severely curtailed.

It is vitally important that professional advice is sought by the executors/trustees when setting up these trusts.

9 What Not To Do

In this guide so far we have highlighted the potential benefits of using a trust in your Will, and drawn attention to some of the pitfalls. You might decide that trusts are not the way forward, so what are the alternatives?

We often come across people who have already given their property to their children. They happily tell me that IHT and Long Term Care are no longer a problem as they have reduced the value of their estate to below the respective threshold levels. Oh dear ... Their joy evaporates when the reality hits home.

Don't gift away the family home.

Apart from POAT and GROB (listed earlier) they overlooked that the property may now become subject to Capital Gains Tax when it is finally sold or given away by the child. Worse still, if the arrangement is not carried out carefully there is a risk of paying Inheritance Tax on the parents death, and capital gains tax on the ultimate sale as well. A double tax burden.

And what if their child dies before them? The grandchildren, or a surviving spouse could own the house.

Further, if their child finds themselves in financial trouble and they own the parent's house... Do you think a receiver in Bankruptcy is going to allow the child to continue owning the parent's house? The risk is that the house will have to be sold to clear the child's debts - leaving the parent homeless.

Giving away the family is dangerous; our recommendation is simple: Don't.

10 Other Reading

If you have found this guide interesting and helpful you might be interested in reading our guides on:

- ◆ ['Long Term care -- and defending your assets'](#)
- ◆ ['Inheritance tax -- and how to reduce your liability'](#)
- ◆ ['Severance of tenancy'](#)
- ◆ ['17 Good reasons to make your Will'](#) -- and in particular the sections of protecting your children's inheritance, protecting disabled children's means tested benefits,
- ◆ ['Business person's wills'](#)

11 Summary

Each person's case is different - with factors such as age of the client, their marital status, age of their children, choice of suitable trustees, the size of the potential IHT liability, the potential investment growth, taxation etc. needing to be factored into the decision making process. Once you know the benefits and the drawbacks of the trusts, and also the other options available to you, then you can make an informed decision with guidance from a professional adviser.

And one final word of warning; if your adviser does not explain the drawbacks and downside to including these trusts - but just focuses on the benefits - then we recommend that you DO NOT PROCEED. Many will writers charge an extra £300+ for these trusts, which is a nice income earner for them - but could be made at an unexpectedly high cost to you and your family.

12 Convenient Wills would like to help you

Making your Will can be time consuming and relatively stressful. The more you research into what should be included in a Will the more you realise there is yet more to learn. And even when the task is done you may have nagging doubts about its legality and validity if you have not used the services of a professional.

Using a professional will-writer can be quicker and more cost effective in the longer run.

As part of our home visit will-writing service we identify the trusts that our clients need to be consider, and explore the pros and cons with them of including each such trust in their Will.

Convenient Wills is the only home visit, specialist Lasting Powers of Attorney & will-writing business located in Newcastle-under-Lyme that covers North Staffordshire, South Cheshire and North Shropshire. As you can tell from the content of this guide, we will happily identify the trusts that are relevant to your circumstances, and then advise you of the benefits and drawbacks of including those trusts in your Will.

Convenient Wills, as a specialist home-visit will-writing service, offers you:

- ♦ **convenience:** we come to your home, thereby saving you travel costs, and time;
- ♦ **flexibility:** our appointments are held at times convenient for you, including daytime, evening, and at the weekend. There is no need for you to take time out from work;
- ♦ **a relaxed atmosphere:** the discussions are held in the comfort and relaxed atmosphere of your own home -- and not in an 'oppressive' office in your local (or not so 'local' in some cases) town;
- ♦ **time saving:** our experienced and friendly consultant will advise and guide you through all the options you should consider -- thus eliminating the need for you to undertake any prior research, such as searching the Internet or library to see what you should include;
- ♦ **a bespoke Will:** your Will will be legal and personalised to match your exact wishes. This means, for example, that the names of your children will be included in your Will rather than just referring to them as your 'children'; and we will draft your Will to match your wishes rather than making your wishes fit into one of our pre-formatted template wills.
- ♦ **a fixed fee:** We do not charge extra for the inclusion of, say, a trust in your Will (Unlike some of our competitors). Nor do we do increase our fees if we feel you can 'afford' to pay more; and
- ♦ **protection:** our processes (which includes visiting you twice) ensure your Will can be defended from claims of lack of capacity, undue influence, and fraud.

The full features and benefits of our home visit will-writing service is available on our [web site](#). To register your initial interest (without obligation) just [click here](#).

Not all Will writing services are the same.

No one likes to consider their demise; we though make the task relatively simple. If you would like to join our existing and growing group of satisfied customers please call Rod on:

(Stoke) **01782 639716** or **0800 072 5510** or click on

www.convenient-wills.co.uk

We hope you have found this guide informative. If so then please feel free to share it with others.

More information and helpful, informative guides are available from our web site, or by calling us direct.