

Discretionary Trusts

Flexibility to control who inherits, when they inherit and how much they inherit, can be very useful. For example, what would happen where money is left or given to a child who later gets divorced or goes bankrupt? Or suppose a client is estranged from one of their children and excludes them in their Will, but things change in the future? Is it wise to leave money to somebody who has an addiction to gambling or drugs?

Assets left on discretionary trusts are protected in the above situations. The inheritance of the child who gets divorced, would not pass to his spouse. The monies intended for the child who later goes bankrupt, would not be lost through the bankruptcy.

As well as protecting assets, the assets held in trust remain outside the beneficiaries' estates for tax purposes and are disregarded in calculating means tested benefits, this makes discretionary trusts particularly suitable where a beneficiary is vulnerable or disabled.

The future is uncertain, providing an inheritance (or lifetime gift) through a flexible discretionary trust, can be far more effective than transferring assets directly to beneficiaries.

WHAT ARE THE BENEFITS?

GREATER FLEXIBILITY

If you are unsure of how to distribute assets in your will, you could instead allow trustees to decide what to do for the best after you have passed away.

PROTECT ASSETS

Assets held on trust are protected against changes in beneficiaries circumstances, keeping assets in the family even if a beneficiary goes bankrupt or gets divorced.

REDUCE TAX

Due to their flexibility, there are many ways that discretionary trusts can be used in the long term to reduce Income Tax, Inheritance Tax and Capital Gains Tax.

AVOID CHALLENGES

Instead of excluding a person in your will why not make them a beneficiary of a discretionary trust. That way your trustees can decide what to do in the long term.

KEEP CONTROL

By providing your trustees with details of how you would like the trust assets used, you can keep control even after making the gift, ensuring assets are used as you wish.

How do they work?

Settlers may transfer property to a trustee to be held on trust during their lifetime or instead through their will when they pass away. Where the trust is created in a person's will (a will trust), the settlor is usually referred to as the testator.

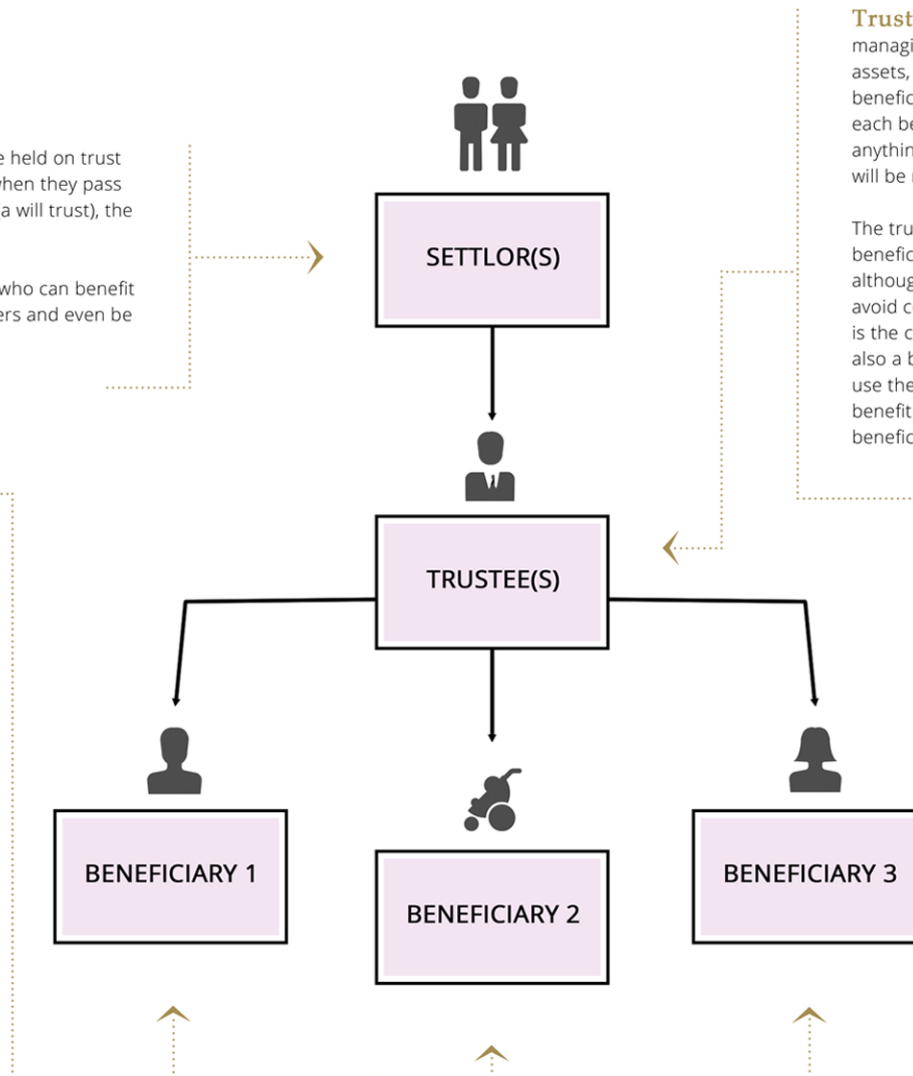
The settlor decides who the trustees shall be and who can benefit from the trust. The settlor may retain certain powers and even be a trustee himself.

Beneficiaries are those who can benefit from the trust assets. A discretionary trust will always have more than one beneficiary, often there will be several named beneficiaries or a group of beneficiaries ('my children and grandchildren' for example).

Each beneficiary has only a 'hope' of benefiting under the trust as it is the trustees who decide to whom distributions of capital and income should be made.

It is the ability to control the timing of distributions from the trust that can be especially useful, for example, if a beneficiary was going through financial problems or a divorce for example, in order to avoid assets being passed to third parties the trustees would likely wait before making distributions to that particular beneficiary.

The inherent flexibility, coupled with the fact that no particular beneficiary is absolutely entitled under the trust that gives the discretionary trust its protective qualities.



Trustees are responsible for managing and distributing the trust assets, they decide which of the beneficiaries will benefit, how much each beneficiary will receive (if anything) and when the distributions will be made.

The trustees themselves are often beneficiaries under the trust, although care should be taken to avoid conflicts of interest where this is the case, as the trustee who is also a beneficiary may be inclined to use the trust assets for their own benefit over that of the other beneficiaries.

Q & A

Do I need a Discretionary Trust?

Almost everyone can benefit from a Discretionary Trust. However, there are circumstances in which it would be prudent to have this provision added to a will or used during a client's lifetime for the transfer of a gift. Some common situations that may warrant the use of a discretionary trust are where:

- A beneficiary is likely to 'waste' funds through lack of maturity or 'lose' money for lack of financial acumen; or
- There is the possibility of a beneficiary divorcing in the future; or
- Potential beneficiaries have addictions to gambling, alcohol or drugs for example; or
- Beneficiaries receive means tested state benefits or support; or
- The client wishes a child, partner or spouse to be excluded from benefit; or
- There is uncertainty as to whom of a group of beneficiaries (children for example) will require financial support; or
- A beneficiary is wealthy and may not want an inheritance in the future as it would increase tax liabilities.

Can I decide who benefits?

Trustees use their discretion and decide who should benefit. However it is common to provide trustees with an 'Expression of Wishes' that states your wishes as the Settlor. This is not binding but if you have selected your trustees wisely, they should consider your wishes before making any future decisions.

How does the trust protect assets?

Within a discretionary trust structure, the beneficiary does not own any assets in the trust, instead they have an expectation that they will be considered when the trustee decides to make a distribution of monies from the trust.

Having no interest in the trust property means that if a beneficiary was to become bankrupt or subject to a debt claim, a creditor would have difficulty in obtaining an order against the trust property. Equally should a beneficiary divorce, the trust assets would not be part of any financial settlement. Also where a beneficiary needs state support such as residential or social care, the trust assets will not affect their entitlement.

EXAMPLE

Example 1

Anna is a beneficiary of the discretionary trust setup by her late parents; the trust owns what was their home, a property in which Anna now resides. Anna is made redundant and as a result is unable to service her financial commitments, resulting ultimately in her bankruptcy. Whilst Anna's personal assets can be taken to satisfy her liabilities, her creditors have no right to the family home as it is owned by the trust.

Example 2

Jack and Mark are beneficiaries of a discretionary trust which consists of £300,000; money that was gifted to the trust by their grandparents. Both Jack and Mark are trustees of the fund and use the money to pay for holidays and other luxuries. Jack gets divorced from his wife Jill; this does not affect the trust fund. In later life Mark has a stroke and needs residential care, trust funds cannot be taken to pay for his care.

What are a Trustee's responsibilities?

The role of a trustee is to hold the trust assets (a property for example) for the benefit of the beneficiaries of the trust in accordance to express provisions of the trust document and also in accordance to statutory law.

Fundamentally trustees have a duty to act in good faith and with honesty and integrity with the beneficiaries' best interests always at the forefront of their minds. They should also work to avoid any conflict between their personal interests and those of the beneficiaries. In addition trustees should keep records of their actions; they should consult beneficiaries where necessary and invest the trust assets (money for example) for the long term benefit of the beneficiaries.

Can a Trustee benefit from the trust?

Unless a Trustee is also named as a beneficiary they are not able to profit from the trust, even though they are legal owners of the trust assets, although they can claim reasonable expenses in order to administer the trust. Professional Trustees however can charge for their time as professional services.

Who can be a Trustee?

In general, anyone who has the capacity to hold the trust property can be appointed as a trustee (effectively anyone who is over 18 years of age and of sound mind). A common misconception is that a beneficiary cannot be a trustee, this is not the case, indeed beneficiaries are often trustees of their own trusts. Clients will often appoint lay trustees (i.e. friends and family) as trustees, although professionals such as accountants, lawyers and trust companies can also be appointed.

When does the Trust end?

The trust period is often defined by the Settlor when the trust is initially created or drafted, it could be 20 years for example or could instead be defined based on the occurrence of a future event, a child reaching the age of 25 for example. In practice trusts end when all of the trust assets have been distributed or the beneficiaries have passed away. Irrespective of the Settlor's wishes the *Perpetuities and Accumulations Act 2009* provides that a trust cannot run for longer than 125 years.

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