



## Uses of Trusts

Trusts are used in Wills primarily for:-

- ring-fencing assets to protect them for intended beneficiaries
- protecting the interests of disabled or incapacitated beneficiaries
- supporting a dependent who lives with you.

## Types of Trust

There are two types of trust used in Wills:

- **“Discretionary”** and
- **“Interest in Possession”**

Discretionary trusts are used primarily for protecting the interests of disabled children.

In a Discretionary Trust, you set out a list of beneficiaries in your Will, but it is up to the trustees to decide which of those beneficiaries will actually benefit, when, and in what proportions, although you may give additional guidance in a separate letter of wishes.

Interest in Possession (IIP) trusts are used primarily for ring-fencing assets where there is no IHT threat. With an IIP trust, you set out the rules defining who benefits, when, and in what proportions in the Will and the trustees have no discretion over it.

One beneficiary will have sole use of the trust assets until a certain time, often for their lifetime, after which the trust is divided among its ultimate beneficiaries as prescribed by the Will.

## The Nil Rate Band (“NRB”)

The NRB is your IHT allowance. For 2010-11 the NRB is £325,000, but it increases each year in line with prices inflation.

## NRB Discretionary Trust

By using a NRB Discretionary Trust, the first NRB's worth of your estate goes into a discretionary trust free of IHT.

The NRB Trust comes into force only on the death of the first spouse.

## “IOU” Schemes

Traditionally, up to one NRB's worth of assets in your own name would form the NRB Discretionary Trust.

However, an “I.O.U. Scheme” allows your executors the option to satisfy the trust by means of an IOU given by your surviving spouse, which may be secured by way of a legal charge on your assets.

This means that your actual assets pass freely to your spouse, who therefore has the use of them, while still maintaining the IHT and other benefits of the trust. The value of the NRB trust does not subsequently form part of your spouse's estate on the second death.

When your spouse dies their estate will be valued and IHT will be charged on the amount by which its value exceeds the NRB applicable at that time (subject to certain allowances and reliefs).

## Transferable NRB

In his October 2007 Budget the Chancellor introduced a new concept allowing any unused NRB on the first death to be claimed on the second death. This has come to be known as a Transferable NRB and it appears to knock out the need for NRB Will Trusts as described above.

While we agree that the Transferable NRB appears to be mathematically more valuable than the NRB Trust, we do have some reservations.



- ⦿ Relying on the Transferable NRB fails to achieve any degree of ring-fencing, whereas a NRB Trust could have ring-fenced up to £325,000 of your assets (or more if you had business interests that could have been added on top of the NRB amount)
- ⦿ It is conceivable that the idea of a Transferable Allowance may be removed or capped by a future administration, which may diminish its ultimate value.
- ⦿ The mathematical advantage currently enjoyed by the Transferable NRB relies on the assumption that the NRB itself will always continue to be uplifted with inflation, which can not be taken for granted.

Many customers are now choosing to rely on the Transferable NRB because it offers a simpler solution that appears to be just as, or even more, valuable than the NRB Trust. But, we encourage customers to consider the NRB Trust option, which still offers significant benefits. . .

### More Benefits

- ⦿ Assets transferred into the NRB Trust do not belong to the surviving spouse after the first death, which means that they cannot usually be “lost” if your spouse remarries.
- ⦿ Also, such assets do not count as belonging to your spouse in the event of their needing Long Term Care, or in the event of financial difficulties.
- ⦿ If you have young children, then it will be important to provide financial support for any guardians that may be caring for them. By including guardians as ‘potential beneficiaries’ of the NRB trust you provide a flexible mechanism whereby your trustees can use the assets of the NRB trust to support the guardians in whatever way is most appropriate at the time.

Customers with significant Business Assets can leave those to the Trust, avoiding IHT because of Business Property Relief. That relief may be lost if those assets are transferred to a spouse who subsequently “cashes them in”.

### Assets In Excess of the NRB

Typically, assets in excess of the NRB pass absolutely to your spouse, free of IHT if both of you are British.

However, for even greater protection, the excess assets can go into a separate IIP trust for your spouse’s lifetime, passing to the ultimate beneficiaries (typically your children) on the second death.

That has no further IHT benefit, but is very effective in ring-fencing those assets to protect them against the other threats mentioned above.

### IIP Trusts

IIP trusts are most typically used in connection with all or part of the house. They bring no IHT benefit and are used to ring-fence a share of the house (or all of it) in case the surviving spouse remarries or requires some form of Long Term Care.

By leaving some or all of the house in an IIP trust on first death, it does not belong to your spouse, so the DSS, the Divorce Courts and various other “threats” cannot take it away from them. (See “More Benefits” above in relation to Discretionary Trusts)

IIP trusts can also be used to provide for dependent relatives. For example, if you have an elderly parent living with you, you might leave them a Life Interest in the house so that it is theirs to live in, but not to own. In that way you provide proper support for your dependent relative without any risk of the value of the house being diverted from your children or other beneficiaries.



## Relevant Property Trusts

Most trusts are now treated for tax purposes as Relevant Property Trusts, although there are exceptions. Relevant Property Trusts are outside the scope of this leaflet, but please ask if you feel you need more information.

## Jointly Owned Assets

In order to take advantage of a trust, you must each have sufficient assets in your own name.

Any assets owned jointly with another person will pass automatically to that other person "by survivorship" and cannot be left in trust, irrespective of whether you are married or whether you had a Will or not.

## Severance

Most relevant to Wills, if you own your home jointly it cannot be included in these trusts unless the joint ownership is first "severed".

Severing the joint ownership creates what is known as a Tenancy in Common, which simply means that each of you now owns a defined proportion (usually half) of the house.

As Tenants in Common, the death of one owner does not automatically trigger the transfer of the whole house to the survivor. Instead, you may now transfer your share of the house into a trust in your Will.

Where one or both of you do not have assets in your sole name, ownership of assets can be rearranged in order to put some or all of them into each single name. Titles to houses can be converted into Tenancies in Common and other assets can be split into single names if appropriate.

You are advised to take further advice before rearranging any existing assets in order to avoid penalties, taxes or other charges that may apply.

## Trustees

The surviving spouse will often be one of the trustees, but may not be the sole trustee.

The trustees have considerable influence (particularly under Discretionary Trusts) and great care needs to be exercised when considering who they should be. The trustees can, for example, decide to call in the IOU, which may mean the survivor having to sell the home.

We are able to act as a trustee and may be appointed either solely or in connection with other people including children and other family. As professional trustees, we have the knowledge and experience to advise your family appropriately and to ensure that the trust is conducted correctly.

We charge for trustee services and you need to satisfy yourself that the benefits of using us are worth the extra cost although it is difficult to estimate what professional services might cost in advance because it is impossible to know how much work might be required.

Most customers naturally prefer to use children or other family as additional trustees, but there are significant risks including the following:-

- **Skills** – it is sad, but true that your family and friends are unlikely to have the knowledge or experience to be able to act properly.
- **Conflict of Interest** – particularly with your own children, there is an inevitable conflict of interest when the trustees are also beneficiaries. This is especially pertinent with discretionary trusts where the trustees have real decision-making influence.
- **Personality Clashes** – you probably get on very well now, but the trust is likely to continue for many years and you cannot guarantee that you will always remain on good terms with your trustees, or they with each other.
- **Survival** – your trustees need to be around as long as the trust. With a firm you are much safer because even if one firm goes out of business the role of



trustee would almost certainly be carried on by another firm.

- **Privacy** – many customers prefer to use independent, professional trustees simply to retain a degree of privacy. You don't necessarily want to share your most intimate financial information with your children or other family.

### Risks

- The most significant risk is the relationship your surviving spouse has with the additional trustees.

Your spouse won't control the Trust assets alone and the additional trustees will have significant influence. If your spouse falls out with those trustees there could be unpleasant consequences.

- Tax rules change periodically and it is possible that the IHT or other benefit sought by using a trust is lost by some change of regulations that we cannot envisage now.

This has already been apparent with the introduction of the IOU schemes following a change of emphasis by the Inland Revenue in respect of its view on the traditional use of Nil Rate Band trusts.

For this reason, it is vital that you keep your Wills up to date.

### More Information

This leaflet attempts to set out the basic features, benefits and risks associated with using Will trusts for asset protection.

This document is intended to provide a basic understanding of the principles and consequences of using Will trusts. It is intended to help Gray's customers understand their Wills, but it may not be relied upon as a legal authority and it should not be construed as advice.

**Gray's** ♦

Independent Will Writing Services  
*since 1992*

[www.graysgroup.co.uk](http://www.graysgroup.co.uk)

10 Montpellier Arcade Cheltenham GL50 1SU.

**Tel 01242 255125**