ProTrust
Trust Management

Trust Management Options (for children inheriting from a Discretionary Trust)

Guidance Notes for Trustees and Beneficiaries & Frequently Asked Questions

ProTrust
Trust Management

25 North Row
Marble Arch
London W1K 6DJ
0207 123 6189
Email: info@protrustconsulting.co.uk
Website: www.protrustmanagement.co.uk

Introduction

This leaflet is a brief guide to Trustees and Beneficiaries as to the standard options available within most Discretionary Trust structures.

These notes are particularly to guide adult children inheriting a parent's estate via the Discretionary Trust format.

Discretionary Trusts are generally described as 'protection boxes' in which assets are protected and then passed to chosen people (beneficiaries) so that they benefit in the best and most efficient way. The Trust is often designed to protect inheritance value for the beneficiary against 'attack' or 'claim' on the value received by the beneficiary. That protection can be in the form of any of the following:

- protection of the wishes of the parent that assets pass down 'family lines' from children to grandchildren/great grandchildren,
- protection for the beneficiary against a future divorce after assets are inherited/received,
- protection against a future bankruptcy/insolvency of beneficiary
- ringfencing assets from being subject to Inheritance Tax on the death of the beneficiary and/or care fees claims during their lifetime.

Whilst protection from any or all of the above is desirable, it is also usually equally desired by the parent that there shall be little or no impact on the beneficiary/child in their own ability to use or spend the inheritance. The parents wish for 'full use' but with as much protection as possible from outside attack on the assets passed down.

The usual best method of providing both 'full use' and yet some 'protection' is by making a lifelong loan to the beneficiary instead of making an outright gift. The 'loan' becomes attached to the beneficiary's net assets as a liability and thus provides a degree of protection which an outright gift does not provide. The loan although repayable in law, it is usually not enforced by the Trust until the death of the beneficiary, whereupon it is usually designed to pass down the beneficiary's family lines (for a child, it would be to their own children – ie the grandchildren of the parent). If there are insufficient assets to repay the loan, then so be it, the amount of loan that cannot be repaid is 'written off' by the Trust.

©ProTrust Consulting Ltd 2022

Administering Trusts is an important task and responsibility. It is often a matter delegated to an experienced, trusted advisor who can provide stable, independent, expert attention to the best way to ensure the wishes are fully protected.

Some usual questions regarding administering a Trust on death are covered below but if there are other questions, please contact us.

Some Usual Questions

1. Why use a Discretionary Trust format to make a loan?

The Discretionary Trust structure establishes the primary fact that any named beneficiary is just one of a list of potential beneficiaries, none of whom are individually automatically entitled to receive the estate. One benefit of that structure is to prevent a situation arising where, say, a loan is made from the Trust to a beneficiary who is automatically entitled to receive the asset as a gift, such that loan might be deemed a sham transaction as the beneficiary could have no legal liability to repay the loan as he/she has the right to claim it as an outright entitlement. Therefore, under a discretionary trust, the beneficiary as one of a class of beneficiaries is not automatically entitled to receive, and thus it is not a sham for the beneficiary to receive a loan of the capital as a discretionary beneficiary and therefore the loan should be robust and protect as far as is possible against third party claim on the assets being received.

2. How do Discretionary Trusts operate?

The Discretionary Trust accompanies the Will and it is the Trust that receives assets from the Will. The process enables the deceased to pass all or some of the assets via the trusts to chosen Beneficiaries in whatever method is the best suited.

3. What are the options within the Trust to pass estate to children?

- **Gifts**: capital or property gifts can be made to beneficiaries;
- **Life Interests**: alternatively, trusts can provide a use of ‘income’ or a right to live in a property, with the underlying asset protected for ultimate beneficiaries such as children;

©ProTrust Consulting Ltd 2022

- **Loans**: Often, the best use of Trusts is the ability to 'loan' the assets to the Beneficiaries, rather than gifting it outright such that the value is protected for subsequent Beneficiaries or against 3rd party attack.

4. How are "loans" made and dealt with?

A child receiving a loan shall receive a set of documents to sign off to reflect the existence of the loan. The loan can either be unsecured (effectively an IOU) or secured against a property asset either passing from the estate to the child or on the child's own property.

- **Unsecured**: The document is called a Deed of Promissory Note and represents simply a promise to repay the value on demand of the Trustees.
- **Secured**: The usual document to record this is a Deed of Equitable Charge which is recorded at the Land Registry against the title as a restriction 'notice'.

We would usually recommend the Equitable Charge (or Legal Charge) rather than an unsecured Promissory Note. That is often set up to provide that it will not impact on the child beneficiary's own ability to mortgage or re-finance their own property – still therefore providing the child beneficiary with full use of the money or asset(s) received.

5. What is the advantages of a secured (al Legal Charge or Equitable Charge) rather than an unsecured (Deed of Promissory Note) loan?

The advantage is to flag up the existence of the loan in a public forum (HM Land Registry) so that it does not become forgotten. It also provides an element of protection/security for the child beneficiary in the event of third-party attack on his/her assets.

6. If the child Beneficiary cannot afford to pay back the loan, what happens?

The loan from the Trust is only repayable out of the net estate assets on death of the beneficiary. It is usually a loan for 'life'. To that end, there is no downside as such for the child beneficiary receiving as a loan and indeed positive benefit in doing so as it is more protected against 3rd party attack on that child beneficiary's own assets.

©ProTrust Consulting Ltd 2022

On death of the child beneficiary, if there are insufficient assets to repay the loan, the loan is simply unable to be repaid in full and any amount that cannot be paid from the assets of the beneficiary is written off.

7. Are there any significant disadvantages of the Loan versus a gift?

There are limitations in terms of the value that can pass through a Trust; there are taxes that apply for assets in Discretionary Trusts or similar arrangements (6% over 10 years over £325,000 in value). However, that potential tax situation has to be considered versus the overall benefit in terms of other tax protection and overall protection from 3rd party claims. This might mean that overall taxation is not negatively affected in comparison to other administration options.

There is also some administrative work that is required on death of a beneficiary or if advice is required. That advice will involve some time work and therefore cost. Our view is that both the set-up cost and operation cost of the Trust is extremely cost-effective when compared to the amount of protection potentially provided. There is generally no annual management charge and charges are simply according to time spent in advising or dealing with any requests or agreed reviews.

8. Gifts from the Trust

Usually, the Trust will be flexible so that at any stage a child beneficiary can elect to receive his/her share as an outright gift (by Deed of Appointment) which brings the Trust to an end in respect of that child beneficiary. If the value of the Trust is within the IHT trust tax threshold (currently £325,000) then the gift ought not to be subject to any taxation but please take our advice. If the value is gifted, it will become part of the assets of the child beneficiary and thus more attackable from future or existing 3rd party claims. The Trust is often set up with loans in mind but with flexibility to convert to gifts at any time.

9. Is an annual review or regular administration required?

Generally, yes. When a Trust is established, the Trustees have a duty to review the trust at reasonable periods.

However, Trusts do not have an ongoing review if the whole value has all been advanced by gift (in which case the Trust closes). Also, in cases of a lifelong loan to the children and whether the value of the Trust does not exceed the IHT threshold, there will only need to be occasional reviews. In that circumstance it is due to the fact that the assets are all held and managed by that beneficiary and not by the Trust

©ProTrust Consulting Ltd 2022

itself and therefore a Trust review is often quick and basic, subject to a review on any taxation and reporting requirements. The parameters for reviewing should be agreed between the Trustees and the beneficiaries when the initial Trust work has been actioned (on the making of a loan, for example).

10. Where loans are made, what are usual ongoing administration costs?

In the case where a loan or series of loans to children are made, reviews and costs will vary according to whoever is professionally managing the Trust and what is asked of the Trustees. Usually, Trust administration advice and charges are at prevailing rates according to time spent in advising and acting as Trustee or for the Trustees and for the administration of the Trust. Once any initial work is completed (for example, advice and loan documentation) usually there will be an annual review of the Trust and a meeting or discussion with co-trustees and primary beneficiaries. In that regard the usual standard administration work is between 1-2 hours per annum. If the Trust itself is not registered with the Trust Registration Service (TRS) there is a requirement for it to be registered and then updated annually with any changes of trustees or beneficiaries' details.

11. Where there is more than one beneficiary inheriting from a Discretionary Trust, is there flexibility for each child's payments to be structured according to their individual wishes?

Yes (provided there are no restrictions against doing so in the Trust Deed or stipulated by the Deceased). For example, one child can receive their share by way of a 'gift' and another as a 'loan'. The Trust can often be sub-divided so that separate Trusts can be created for each beneficiary with relevant new trustees for each such beneficiary.

12. How does a secured loan work in the event of a sale of the property?

If a secured loan advancement is made, it will be secured on a property asset either owned by the beneficiary or passing from the deceased to the beneficiary. Subsequently, that property is usually owned by the child beneficiary with full ownership rights at HM Land Registry and therefore with full rights to sell (without the Trust having any rights to compel a sale). Therefore, the child can sell the property at any time. If a new property is purchased from the proceeds of the previous one, the new property can be held on the same basis.

©ProTrust Consulting Ltd 2022

13. Is a Trust future-legislation proof?

No legal instrument or document is fully legislation proof. The benefits can alter according to legislation or by interpretation. However, a Discretionary Trust is by its nature "flexible" and the benefits and options can be adopted or not depending on the tax legislation and other factors as they adapt in future.

These are some of the most usual questions asked by families and trustees. These notes are general in nature and are a general guide only. They do not constitute formal legal advice specific to your own Trust or matter.

Contact Us

If you have any specific questions relating to your circumstances or wish to clarify any area of these notes, please contact us on:

Email: info@protrustmanagement.co.uk

Telephone: 0207 123 6189