



A DISCRETIONARY TRUST FOR A VULNERABLE BENEFICIARY

WHAT IS A DISCRETIONARY TRUST?

A Discretionary Trust is a legal obligation imposed by the creator of the Trust (the Settlor) on the person(s) who will manage the trust (the Trustees) to manage the funds or property under their control for the benefit of a group of persons (beneficiaries). The Trust is set out in a legal document called a Trust or Settlement and it is usually accompanied by a Letter of Wishes, making the Settlor's wishes clear to the Trustees.

A Discretionary Trust differs from other Trusts such as Life Interest Trusts because Discretionary Trusts do not give any one beneficiary an absolute right to the funds or property. A Discretionary Trust gives the Trustees discretion as to who benefits.

These trusts are a very useful way to protect a vulnerable person against financial abuse.

WHAT ARE THE ADVANTAGES?

For families who want some certainty for the future care of a vulnerable beneficiary, Discretionary Trusts provide a flexible answer. They can provide financial responsibility to chosen Trustees for the benefit of the vulnerable person for his/her life. Particular benefits include:

- While they are in the Trust, the funds are protected from financial abuse, divorce claims, and creditors of the beneficiaries;
- The money/property/investments in the Trust do not belong to any one beneficiary, so the funds are not taken into account for means-testing. This means that a beneficiary's benefits are not affected;
- The funds are not subject to inheritance tax when one of the beneficiaries dies;
- The Settlor can regulate how the Trust is to operate, who will benefit and under what circumstances;
- They can be used by parents, grandparents, other relatives or friends who want to make a gift to the beneficiary;
- The Trustees will be able to make all financial decisions for the beneficiary and take full responsibility to ensure that the funds are well invested and used for the beneficiary's well-being and future care;
- If all money belonging to a beneficiary both now and in the future is invested in a Discretionary Trust for his/her benefit then this avoids having to obtain a Deputyship Order from the Office of the Public Guardian;

- The family are able to appoint Trustees who they trust to take responsibility for the beneficiary and to ensure that his/her needs are taken care of for the rest of his/her life;
- The Trustees can use the funds to buy property for the beneficiary if this would be appropriate and in accordance with the family's wishes. The property would then be put in the name of the Trustees but the beneficiary could occupy it with carers if necessary;
- This type of Trust can be created by Will or it can be set up in the Settlor's lifetime:

HOW DOES IT WORK?

BY WILL: a Discretionary Trust can be set up in a Will. Parents usually leave their estate on the death of the last parent, to their children equally. If one of their children is a vulnerable adult or special needs' child then that child's share of the estate can be put into a Discretionary Trust for the benefit of the child. However for a Discretionary Trust to work, there must be a group of beneficiaries so that it cannot be said that the funds belong to the child. The group would usually include the child's siblings, and the children's children (i.e. the grandchildren of the Settlers) even though they may not have been born yet. Other friends or relatives can be included and also charities if the Settlor wishes.

The Trustees would know that the child is the Primary Beneficiary because the Letter of Wishes (see below) would make this very clear. However on the child's death, if there are funds left in the Trust, the Letter of Wishes will say how the Trustees are to exercise their discretion to benefit other beneficiaries who are named and in what order.

LIFETIME TRUST: sometimes it is recommended that Trusts should be set up during the parents' lifetime. This may be for tax reasons or to ensure that a Trust is in existence to receive gifts from other members of the family or friends (e.g. grandparents). The parents who have set up the Trust will then be sure that the Trustees are suitable (the parents can be Trustees with other Trustees during the parents' lifetime) and they can be sure that all money or gifts are dealt with in a manner that they find acceptable.

A Lifetime Trust which is set up in advance to receive gifts or benefits in the future is sometimes called a Pilot Trust. These Trusts are Discretionary Trusts, as mentioned above, but they are kept "empty" until an expected inheritance or benefit is given to the Trust for the child's benefit. In order to set up the Trust a £10 note is pinned to it. As there is no income, there is no need for Trust accounts or for the Trust to be registered with HMRC – so no Trust tax returns are needed. Consequently, there are no on-going administrative or legal costs until funds are paid into the Pilot Trust.

If the Trust is set up to receive an inheritance, then it is essential that the person's Will (e.g. the parents or grandparent's Will) states that the gift is paid into the Trust and not to the child. From that point, the Trustees of the Trust take over the running and administration of the funds in accordance with the Trust Deed and the Letter of Wishes.

LETTER OF WISHES

The Letter of Wishes, which should be prepared with every Discretionary Trust, sets out the Settlor's guidelines for the Trustees to follow saying how the Settlor wishes the Trust Fund to operate. Parents will want their child to be the primary beneficiary and for the Trustees to manage the Trust in their child's best interests. Parents may not want any of the other beneficiaries to benefit from the Trust during the lifetime of their primary beneficiary.

The Letter can include parents' hopes and wishes for their child's future wellbeing and how they would want their Trustees to make decisions for their child's future. If there are any particular matters which parents feel strongly about, these should be included in the Letter.

The Letter should also say what parents would want to happen in time on their child's death. If their other children and grandchildren are also beneficiaries under the Trust, they may want to say whether they are all to be treated equally and whether the parents have any concerns about the age they would want them to take responsibility for their inheritance. Parents may also want their Trustees to be vigilant for such things as marriage breakdown, addictions, creditors' claims and financial abuse which may affect beneficiaries of all ages. In this way the Trustees can protect the funds and ensure they are available for the beneficiaries in a tax-efficient way with a minimum risk of loss of capital, but at the same time ensuring that the beneficiaries receive income and/or capital (depending on their personal circumstances).

THE TRUSTEES

If the Trust is a Lifetime Trust then the parent(s) may want to be the Trustees with others. It is important that the Trustees are financially responsible and sensitive to the parents' wishes. If you wish, you may appoint The SRB Trustee Company Limited. This is a non-profit making Trust corporation which is regulated by the Solicitors Regulation Authority and covered by our professional indemnity insurance. The SRB Trustee Company Limited can act alone if you wish. It is not advisable to appoint Trustees who are also beneficiaries in the discretionary group (e.g. your other children).

TAX IMPLICATIONS

- The Trust fund is not subject to Inheritance Tax if one of the beneficiaries dies;
- If the Trust fund is kept below the Nil Rate Band (currently £325,000) there is no set-up tax, no exit tax and no periodic charges;
- There is no tax while the Trust is dormant (before a death);
- Income on the Trust will be taxed in the usual way for Discretionary Trusts.

FOR MORE INFORMATION, JUST ASK

We will gladly advise you on your own particular circumstances and, if appropriate, recommend a type of Discretionary Trust which would suit you. We can also advise you on the Trustees and their role. We will prepare the Trust Deed and the Letter of Wishes.

We will be pleased to provide any more information, please contact us and ask for the *private client team*.

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