BEACON PRIVATE TRUST
Independent Financial Advisers

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BEACON TRUSTS & INHERITANCE TAX

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WHAT IS A TRUST?

A trust is a legal arrangement where you, as the settlor, transfer assets (money, property, or investments) to a group of people or an institution, called trustees. The trustees manage these assets for the benefit of one or more individuals, known as the beneficiaries.

Think of a trust as a financial "safe box." The assets you put into it are held and managed according to your instructions, which can be set out in the trust deed. For example, you might want your grandchildren to receive a sum of money for university fees when they turn 18. A trust allows you to control how and when your assets are distributed, even after your death.

WHAT IS A TRUST AND HOW CAN IT MINIMISE YOUR INHTERITANCE TAX BILL?

When it comes to inheritance tax (IHT), many individuals in the UK worry about how much of their hard-earned wealth will actually pass on to their loved ones. With inheritance tax charged at 40% on estates over the tax-free threshold (£325,000 for individuals, or up to £1 million for married couples with certain allowances), it's no wonder people are seeking ways to reduce this burden.

One of the most effective tools in inheritance tax planning is a trust. Trusts may sound complicated, but in essence, they are simply a way to protect and manage your assets for the benefit of others. This blog will explain what a trust is, how it works, and how it can help you minimise your inheritance tax bill while securing your family's future.

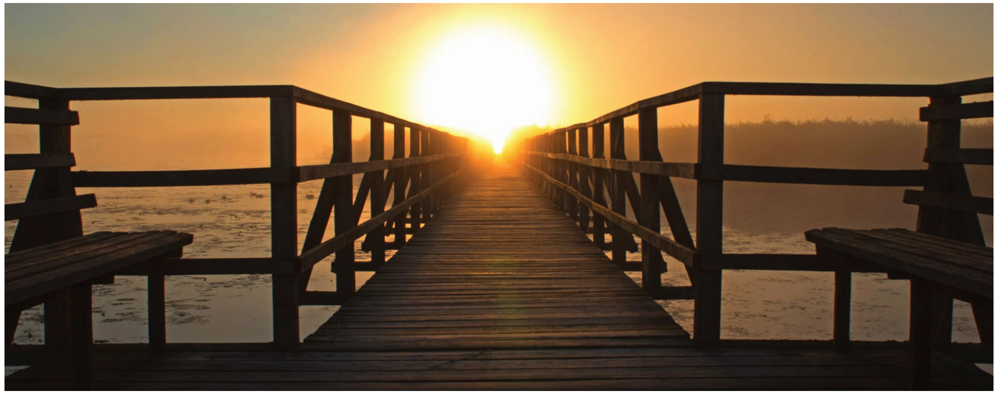
HOW DOES A TRUST WORK?

Trusts operate by legally separating the ownership of the assets from the settlor. The trustees become the legal owners of the assets and are responsible for managing them according to the terms of the trust. However, the beneficiaries retain the right to benefit from these assets.

There are several types of trusts, and the right one for you depends on your goals and circumstances. Here are the most common ones used for inheritance tax planning:

1. Bare Trusts: These are simple trusts where the beneficiaries are entitled to the assets as soon as they reach legal adulthood.
2. Discretionary Trusts: The trustees have discretion over how the assets are distributed, which provides flexibility to meet beneficiaries' changing needs.
3. Interest in Possession Trusts: The beneficiary has a legal right to the income generated by the assets but not the assets themselves.
4. Life Interest Trusts: Often used for property, these allow a beneficiary to live in a property during their lifetime, with the asset passing to others later.

Each type of trust has different tax implications, which is why seeking professional advice is crucial.



HOW CAN A TRUST MINIMISE INHERITANCE TAX?

The key benefit of a trust is that it removes assets from your estate, reducing the amount of inheritance tax your family might have to pay. Here's how trusts help:

1. Removing Assets from Your Estate

When you place assets into a trust, they are no longer considered part of your estate for inheritance tax purposes, provided you survive for seven years after making the transfer. This is known as the seven-year rule, and it can significantly reduce your taxable estate.

For example, if you place £500,000 into a discretionary trust and live for another seven years, this amount will not be subject to inheritance tax when you die.

2. Effective Use of the Nil-Rate Band

The nil-rate band (£325,000 per individual) is the amount of your estate that is not subject to inheritance tax. By setting up a trust, you can use your nil-rate band strategically. For instance, a married couple could set up a trust to ensure both partners fully utilise their allowances, doubling the tax-free threshold.

3. Protecting Assets for Future Generations

Trusts ensure that your assets are passed down in the way you want. For instance, a trust can prevent assets from being squandered or misused by a beneficiary, offering peace of mind that your wealth will be preserved for future generations.

4. Gifting with Flexibility

Trusts allow you to make gifts without giving up control entirely. For example, in a discretionary trust, you can decide who benefits, how much they receive, and when. This is particularly useful if your beneficiaries are young or have specific needs.

5. Avoiding Double Taxation

Without careful planning, your wealth could be taxed twice: once as inheritance tax when you pass away, and again as income or capital gains tax when your beneficiaries access it. Trusts can help mitigate this by providing tax-efficient structures for holding and distributing assets.

ARE TRUSTS COMPLETELY TAX-FREE?

While trusts can reduce inheritance tax, they are not entirely tax-free. Depending on the type of trust, you may encounter the following taxes:

- Initial Charge: If the value of assets placed into a trust exceeds the nil-rate band, an immediate inheritance tax charge of 20% may apply.
- Periodic Charges: Discretionary trusts are subject to periodic inheritance tax charges (up to 6%) every 10 years on the value of the trust exceeding the nil-rate band.
- Exit Charges: A small inheritance tax charge may apply when assets are distributed to beneficiaries.

Despite these charges, trusts can still provide significant tax savings, especially for larger estates.

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IS A TRUST RIGHT FOR YOU?

Trusts aren't suitable for everyone, but they are an excellent option for those with significant wealth who want to:

- Reduce inheritance tax.
- Protect assets for vulnerable beneficiaries.
- Retain control over how assets are used.

However, setting up and managing a trust requires careful planning. The rules surrounding trusts are complex, and getting it wrong can lead to unexpected tax liabilities.

NEXT STEPS

If you're considering using a trust as part of your inheritance tax planning, here's what you should do:

1. Assess Your Estate: Calculate the value of your assets to understand your potential IHT liability.
2. Clarify Your Goals: Determine what you want to achieve with the trust, such as protecting assets or reducing taxes.
3. Seek Professional Advice: Work with a qualified accountant or estate planning expert to choose the right type of trust and ensure compliance with UK tax laws.

CONCLUSION

Trusts are a powerful tool for inheritance tax planning, helping you reduce your tax bill while ensuring your wealth is distributed according to your wishes. While they require careful planning and professional guidance, the peace of mind they provide for you and your loved ones is well worth the effort.

If you'd like to explore how trusts can benefit your estate, contact us today for a consultation. Together, we can create a plan that protects your legacy and minimises tax burdens for your family.