

Trusts - single or joint settlor - a case study

Synopsis: When recommending trusts for clients, should you suggest a joint settlor trust or single settlor trusts and does it matter?

Date published: 14.09.2022

When setting up a trust, the settlors can choose whether to set this up as a joint settlor trust or a single settlor trust.

So, does it matter which way the trust is set up and is there any advantage of using single settlor trusts instead of joint settlors?

As you know inheritance tax (IHT) applies to each individual and, where a joint settlor trust is set up, HMRC assumes the transfer is made equally by each party unless there is evidence to the contrary.

Where a transfer is made to an absolute (bare) trust it creates a potentially exempt transfer (PET) and where a transfer is made to any other trust during lifetime it creates a chargeable life-time transfer (CLT).

Absolute trusts

An absolute trust is one where the beneficiary is chosen at outset and cannot be changed. The beneficiary takes ownership of the trust assets at the age of majority which is 16 in Scotland and 18 in the rest of the UK.

Joint settlor absolute trust

The transfer into this trust will be a PET for each of the settlors and the settlors are excluded from any benefit from the trust fund whatsoever. Remember the beneficiary is chosen at outset and cannot be changed.

Single settlor absolute trust

It makes no difference to the position whether there is one joint settlor trust or two single settlor trusts. Each settlor will be creating a PET on their individual estates for the amount of their transfer.

This means that, if only one settlor sets up the trust, the PET will fully be assessed on them at the date of the transfer.

Where making a gift, the settlor needs to survive seven years before the gift falls outside their estate. Thus, consideration should be given to the health of the settlors when choosing who makes the transfer.

Discretionary trusts

A discretionary trust is one where the trustees decide who gets what and when from the trust fund. There is a built-in class of beneficiaries within the trust deed and the trustees can allocate funds to anyone within the class of beneficiaries. The

beneficiaries cannot demand anything from the trust fund. It is up to the trustees to decide.

Joint settlor discretionary trust

The transfer into trust will be a CLT for each of the settlors and, where there are joint settlors, HMRC assume the transfer is 50/50 unless evidence shows otherwise. This means that each individual settlor ought to ensure that they keep below £325,000 individually, otherwise an entry IHT charge may apply. This means that, under a joint settlor trust, up to £650,000 can be placed into trust without triggering an entry IHT charge.

The trust itself will have a nil rate band (NRB) to use at the periodic charge point of two times the available NRB at the ten-year anniversary.

Single settlor discretionary trust

Again, for IHT purposes, it makes no difference to the position whether there is one joint settlor trust or two single settlor trusts. Each settlor will be creating a CLT on their individual estates up to the value of the transfer.

However, under a single settlor trust you will usually find the surviving spouse/civil partner is included in the class of beneficiaries as a widow or widower. This can be very useful in certain circumstances for your clients. You should always check the trust deed to make sure this is the case.

Case study

Josh and Rose want to put some money aside for their children, grandchildren and future generations. They have excess capital which they do not need now or in the future. However, Josh is worried about what will happen if he dies first. He has a healthy final salary pension, but it reduces substantially on his death. He does not want Rose to be worried about money as she gets older.

You suggest that Josh sets up a discretionary gift trust using an international (offshore) bond which will meet their needs now and in the future. You suggest using the grandchildren as lives assured to ensure the bond will last through future generations. Also, by utilising the maximum number of segments available, that will allow the trustees flexibility to spread the gain between beneficiaries by assigning segments (to adult beneficiaries). On assignment of segments, the gain will be taxed on the beneficiaries at their marginal rates of tax on surrender.

More importantly, you explain to Josh that, as he is the settlor of the trust, he cannot benefit from the bond now or in the future as there is a settlor's exclusion clause within the trust deed which makes it IHT effective. However, when Josh dies, Rose automatically becomes a beneficiary under the trust as the built-in class includes widows and widowers.

This means that the trustees of the trust can allocate funds to anyone in the class of beneficiary including Maureen should she need it.

This gives Josh peace of mind that, should he die first, even when his pension reduces, the trustees can make sure that Rose is taken care of for the rest of her life. You also suggest that Josh completes a letter of wishes, which is a non-binding instruction to the trustees, to guide them as to what he wants to happen, when he dies, to the trust fund.

Conclusion

A discretionary trust offers far more flexibility than an absolute trust and, as you can see, can also offer peace of mind for those of your clients who are nervous about tying up all of their cash indefinitely. By setting up the trust on a single settlor basis, it gives access to the surviving spouse/civil partner which can be particularly useful where income may be an issue on first death.

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