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THE LIFECYCLE OF IIP AND DT TRUSTS – A PRACTICAL GUIDE

Meg Saksida

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About Meg Saksida

Megan Saksida BA FCA CTA (Fellow) TEP runs her own business lecturing, examining and writing about private client taxation issues. Her speciality is inheritance tax and trusts and estates.

Megan writes widely on income tax, capital gains tax and inheritance tax. She regularly contributes to:

- Tax Insider;
- Property Tax Insider; *and*
- Tax Insider Professional.

1 What is a trust?

A trust, although seen as a separate legal entity or taxable 'person' in itself, is simply a relationship between two separate owners of an asset. Usually, if we own an asset, we have all the risks and rewards of that ownership. We legally own it, and we are able to use it. Let's take the family home, for instance. If we legally own it, we are registered as the titleholder at the land registry. As the owner, we wish to protect our asset, so we insure it; we pay for necessary repairs and make renovations and improvements. If the house is damaged, it is we, in our capacity as owners, that lose out. These are our obligations or risks. At the same time, because we own it, we also have the advantages of ownership; we can use it. The home keeps us warm, dry and protected from the elements. These are the benefits of ownership.

In the distant past, ownership, as a notion, combined these two concepts, that of legally owning and being able to benefit from an asset, into one concept of ownership. This is the holding in common law. However, in the Middle Ages, around the time of the medieval Crusades (it is alleged), there became a need to split the legal and beneficial components of owning an asset.

As women were unable to own property at this time, when the Crusaders went off to fight, they sought a way to protect their assets while they were gone. To this end, they entrusted a friend (a *feoffee*) to legally own the asset for them, on the understanding that it was really the Crusader's asset; the '*feoffee*' was simply a trustee and only looking after it for the Crusader until they returned. Some have also attributed the emergence of trust to be the result of the Franciscan monks who arranged to grow their fortunes through a trustee such that they did not break their vow of poverty.

The practice of creating a trust splits the ownership of the asset into two parts: the legal ownership, with the friend (the trustee) and the beneficial ownership, which rested with the Crusader or the monk (the beneficiary). This was the rudimentary start of the modern trust system. Legal ownership descends from common law and beneficial ownership was born out of equity.

In the textbook *Law of Trusts and Trustees* by Underhill and Hayton, known as the bible and font of all knowledge on trusts, a trust is defined as:

"...an equitable obligation, binding a person (called a trustee) to deal with property (called trust property) owned by him as a separate fund, distinct from his own private property, for the benefit of persons (called the beneficiaries or in old cases cestuis que trust), of whom he may himself be one, and any one of whom may enforce the obligation".

Article 2 of the *Hague Convention on The Law Applicable to Trusts and on their Recognition 1985*, which was incorporated into English law by the *Recognition of Trusts Act 1987*, defines a trust as:

"...the legal relationships created– intervivos or on death– by a person, the settlor, when assets have been placed under the control of a trustee for the benefit of a beneficiary or for a specified purpose."

2 The parties to a trust

2.1 The settlor

The settlor is the party that transfers or gifts assets into the trust. Anyone can be a settlor and there is no restriction apart from the ability to own the property that they intend to be transferred into trust.

It is important to understand that these assets, once gifted or transferred into trust, are no longer the property of the settlor. They are, hereafter, legally the property of the trustees. The settlor's role is thus very short-lived, as their only formal task is to make the initial transfer.

The settlor and the trustees will subsequently work together to create the rules of the trust which are found inside a document called the 'trust deed' (also known as the trust instrument). This document sets out the type of property the trustees hold, whether, when and how said property can be distributed to the beneficiaries, and other important rules and regulations to be observed in the running of the trust. These rules are set out in 'clauses.'

Practical point

Settlors may be reticent, having transferred their hard-earned property into the trust, to be, henceforth, uninvolved in the trust. The settlor can thus draw up some express provisions in the trust deed to allow them some future say about the destiny of the trust property. However, beware; it will depend on the extent of the powers given in the trust deed to the settlor, as to whether the settlor is considered to have actually disposed of their interest in the trust property. If they retain too much power, they will be deemed to be continuing to benefit from the property supposedly given away and may find themselves in an unwanted tax situation or the trust being defined as a sham.

2.2 The trustees

The trustees are the party to whom the settlor has entrusted the trust property. The trustees can be anyone the settlor chooses, including the settlor themselves, as long as they have mental capacity.

There is no minimum number of trustees required for a trust, although if the settlor wants the trustees to give a valid receipt for the proceeds of a sale of land, for example, they will need to number at least two. There is also no maximum but if it is a trust of land, the land can vest in no more than four trustees. In the case that there are more than four trustees, in accordance with the *Trustee Act 1925*, it will vest with the first four named trustees willing and able to hold the land. There are no restrictions on the number of trustees holding personalty.

The job of the trustees is to legally own the property and protect it for the benefit of the beneficiaries (see 2.3). The requirement to be trustworthy is called their 'fiduciary duty', and they have a duty of care under the *Trustee Act 2000* to exercise reasonable care and skill when dealing with the trust property.

The interest which the trustees have in the trust property is called the 'ownership interest', and the trustees will have the rights over the trust property 'in rem'. This means that the trustees can dispose of the property *inter vivos* by sale, gift or on death by will. They may also mortgage trust property. The trustees will also have obligations of ownership including insuring, repairing, and paying any appropriate taxes and fees.

It is the job of the settlor to appoint the initial trustees. Once the trust has been running for a while, existing trustees can appoint new trustees, and the administration surrounding this will be outlined in the trust deed (see 4.4.a).

Like the settlor, as long as the trustee is able to legally own property, they can be appointed as a trustee. There are no other limitations. As minors are not able to give a valid receipt for property, this will exclude any persons under the age of majority. It will, however, include corporate entities as long as they have the power in their memorandum and articles to act as a trustee.

2.3 The beneficiaries

The beneficiaries are the lucky ones. The settlor gives the property away; the trustees are only allowed to legally own it and cannot obtain any benefit from it but the beneficiaries, as the name suggests, are the parties that can benefit from the trust property. If the trust property is a house or a boat, the beneficiaries can live in it or sail it. If that house or boat is let out by the trustees, the beneficiaries can have the rental income. If the trust property is cash in a bank account or shares in a company, the beneficiaries can have the interest or the dividends. The extent to which the beneficiaries can benefit from the income and capital of the trust will be determined, in part, by the type of trust.

The beneficiaries will need to be made known to the trustees by the settlor at the time of the settlement of the trust in order for the trustees to allow them to benefit from the trust property.

Depending on the type of trust, the beneficiaries may or may not have an immediate right to the trust income but in all cases, they have the right to ensure the terms of the trust (as set out in the trust deed) are enforced. This is called their '*personam*' right, which gives the beneficiaries a right to enforce the behaviour of the legal owner (the trustees). This *personam* right only allows them to enforce their rights against the legal owner and a limited class of third parties. As long as the terms of the trust deed are being enforced correctly by the trustees, the beneficiary has no further right to influence how the trust is administered.

Example 1 – Beneficiaries' rights

Madeline is the trustee for the Hopson Discretionary Trust. The trust was set up by her grandfather in 2011 and holds the following property on trust for her grandfather's former colleagues:

	£
Agricultural land in Bradford on Avon	300,000
Rental property in Bath	600,000
Term deposit with Botnets Bank	1,100,000
Total trust property	2,000,000

In August 2023, the neighbour's horse escaped and broke the fence around the Bradford on Avon land. A week later, the Bath house, which was between tenants, was broken into and the door was damaged (the property was fully insured). Finally, the trustee gave £1,000 of the term deposit funds to a third party who was not a beneficiary.

Can the beneficiaries do anything?
As the beneficiaries are not the legal owners of the land, the rental property, or the deposit funds, they are unable to litigate for the damage by the horse or to claim on the insurance policy for the damage to the rental property in their capacity as beneficiaries. The trustee, however, not only has the ability to litigate as a result of the horse damage and to claim on the insurance for the broken door (these are their legal rights 'in rem') but as a result of their duty of care, they *must* begin proceedings or make a claim, in order to protect the trust property on behalf of the beneficiaries. Because of the beneficiaries' personam right, if the trustee does not sue for the damage or claim on the insurance, the beneficiary could use this right to compel them to do so.

As the trustee has the legal title to the funds on term deposit, even though the transfer to the particular recipient was unlawful according to the terms of the trust, they were able to legally withdraw the funds and pay them over to the third party.

If the third party has no idea that the £1,000 came from the trust and delivered full money's worth for the cash (say, the trustee bought an asset worth £1,000), the only remedy to the beneficiaries is to claim for damages against the trustee under their personam right.

If the £1,000 was a gift to the third party, then the beneficiaries' equitable ownership will prevail over the third party's legal ownership of the cash, and therefore, if it can be traced, the beneficiaries can, in theory, obtain an order that the £1,000 be transferred back to the trust by the third party.

Practical point

Sometimes, a 'protector' may be appointed by the settlor. The precise role, if there is a protector, will be set out in the trust deed. A protector works on behalf of the beneficiaries, making sure the trustees are following the terms set out in the trust deed. They have no legal title in the trust assets, no ability to deal with the trust assets, and no beneficial interest in the trust assets; they simply oversee the activities of the trustees. In some cases, they may be given power in the trust deed to veto the decisions of the trustees, or their consent may be required for certain trustee actions, such as the appointment of new trustees. Protectors are primarily creatures of offshore trusts, being much less usual with respect to onshore English law governed trusts.

3 The types of trusts that exist

Some trusts are created in life (*inter vivos*) and some on death, either in a deceased's will or by the laws of intestacy.

3.1 Trusts that are created by legislation

Some trusts are created as a result of legislation. For example, if an individual dies intestate (i.e., not having made a will), the provisions of the *Inheritance and Trustees' Powers Act 2014* require the creation of statutory trusts for child beneficiaries under the age of 18.

3.2 Express trusts

Express trusts are created when the settlor consciously and deliberately transfers property on trust. It is the settlor's unambiguous intention to settle the funds on trust and can be made *inter vivos* or in their will on death (a will trust). It can be made by deed, in writing, orally or by will.

3.3 Trusts that are inferred from the courts or arise due to the operation of the law

Implied and resulting trusts are very similar to each other and often indistinguishable. These trusts are a 'result' of the 'implied' wishes, objectives or intentions of the settlor and are instances where a trust deed is not necessary. For example, a resulting trust (on behalf of the settlor) occurs if the settlor has tried to settle a trust but it fails for some reason. For example, the beneficiaries might not be able to be discerned, and the trust terms may have been against public policy or did not