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Discretionary Family Trusts

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Solicitors For Older People Scotland
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Many people are unfamiliar with the concept of a “Trust”. It is however a relatively simple legal concept whereby property is owned and managed by one party - the trustees - for the benefit of others - the beneficiaries. The trustees have legal title to the property but they are required to deal with the property in the interests of the beneficiaries. The beneficiaries do not have legal title to the property. The property in the trust can be anything – a dwellinghouse, money, heirlooms or investments.

The arrangement is set up by a document called a Deed of Trust. The person or persons who set up the trust are called the “settlor”. The Deed of Trust will state who the trustees are and will contain a list of the powers of the trustees i.e. what they can and cannot do with the property. It is of critical importance however that the powers are exercised at the trustees’ discretion is left to the trustees if this type of trust is to work properly. The deed will also state who the beneficiaries are and why the trust was set up.

So far so straightforward – you can think of the three separate roles, settlor, trustees and beneficiaries. However just to make things a little more complex somebody could set up a trust (making him or her a “settlor”) but he or she could also be a trustee operating the trust and a beneficiary as well! So why then would anyone bother to set up a trust making themselves trustees and beneficiaries?

The reason people do this is that trusts can be very useful devices for many families. Separating the ownership and control of assets legally from the people who are entitled to use and enjoy these assets can produce various benefits. It is perhaps easier to explain these by first describing what happens in a standard Discretionary Family Trust – which sometimes is called variously a “Property Protection Trust” or an “Asset Protection Trust”. These latter two names effectively describe the overriding benefit of such trusts – which is that by being in a trust, an asset can be protected from threats which might affect it were it to be held by individuals.

What actually happens when a family discretionary trust is set up? Typically the settlors will be a married couple and they will appoint themselves and one or more of their children as trustees, but they will probably appoint professional parties as trustees also e.g. solicitors. A group of trustees acts just like a committee in charge of something, and the trust deed will usually set out rules as to how decisions should be made by trustees. Usually the settlors will ensure that they make up a majority of the trustees (eg. themselves and one professional trustee) so that they effectively keep control of the assets albeit they are owned by the trust. Usually the beneficiaries in the trust will be all the settlors’ children and the settlors themselves but of course every case is different. Like all committees, trustees should meet or communicate to keep the trust live and operating. If there is a large amount of property in the trust with lots of decisions to be taken there may be more regular meetings or communications between trustees. If there is perhaps only a dwellinghouse in the trust with few on-going decisions to make trustees may meet or communicate very infrequently.

Once the trust is set up and the property (say a dwellinghouse) is transferred into the trust, no individual owns that property. The trust deed would normally include a provision that the settlors can live in the property throughout their lives. The trustees’ duties to the beneficiaries include looking after and preserving the assets in the trust. With a professional party as a trustee, guiding the other trustees, clearly sensible decisions should be made which would help preserve the assets in the trust.

This set up is therefore better in some ways than for example transferring property to children or relatives as individuals. There are always dangers in passing property to individuals who may become vulnerable. Even a trusted child may become enmeshed in debt and may even lose the property to creditors. There is always the potential problem of “sideways disinheritance” where a property transferred to a child may move out of a family by reason of divorce or separation. That potential problem is also solved if the property stays in the trust.

Most importantly the property is not owned by settlors so if one or both of that couple have to be assessed for care costs the value of the house will not normally be taken into account. Provided the relevant Council does not decide that there has been a deliberate “deprivation of assets” for the purpose of avoiding care costs, the Council cannot force a sale of that property to pay for care costs. Of course it is important that the trust deed is well written and it is quite clear that the trust was not set up just to avoid paying care costs. The timing of the transfer of the assets is important also – putting it crudely, the earlier the assets go into the trust the better, and preferably well before any party is likely to need to go into care.

The typical family protection trust would stay in place till the second death of the settlors. At that point the trust would normally be wound up and the assets passed on to the surviving beneficiaries. Remember, on the death of each of the settlor couple, the assets in the trust are not part of their estate. What assets each possesses would be transferred in accordance with their wills. However the winding up of these estates should, all other things being equal, be cheaper and quicker than if the main assets they held had not been transferred to a trust. In certain circumstances it might be desirable for the trust to continue – for example if the individual beneficiaries were very young children or parties for some reason unable to look after themselves. Each family situation will be different.

Because the trustees have discretion, the settlors may write a “letter of wishes”. This is a letter by the settlor stating to the trustees the wishes of the settlor on how the trustees should exercise their various discretionary powers. Letters of Wishes are not binding on trustees, but should be very persuasive, particularly on the actions of any “professional” trustee. Many settlors do not proceed with these Letters of Wishes but some do, and they can be very helpful.

Before setting up a trust there are a lot of issues to consider. Each family situation will be different and different families will take different approaches. Not all will be comfortable with the trust route – others will be very keen on it. Nobody should opt for a trust without a full review of all relevant circumstances with a professional advisor. Care costs are becoming a major worry for many families, principally because these costs are now extremely high. Figures show that in the UK 1 in 3 women and 1 in 4 men will spend a period of time in full time care and this can devastate family finances. Sadly many houses are sold in the UK each year to pay for accommodation and care costs. Currently a beneficial effect of a properly written discretionary family trust is to offer some protection against the necessity to sell a house to pay for care, although a discretionary family trust should never be set up just for this purpose. This “care costs” position may or may not continue into the future – but it is something that should encourage all householders to think ahead and plan positively for the future.