Answer by, **Dean Ryan Private Client Solicitor at Payne Hicks Beach** first published by Financial Times online on 24 September 2019 and reproduced with kind permission
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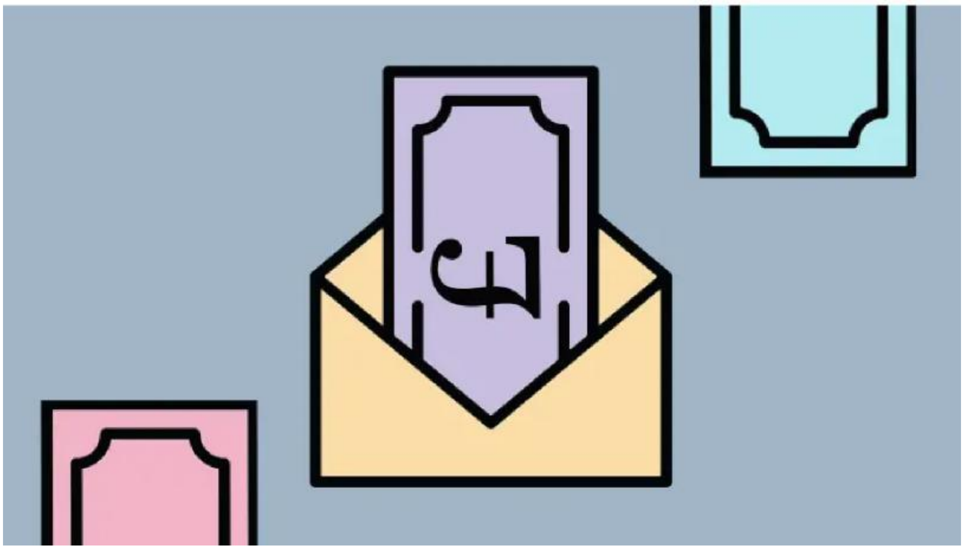
FINANCIAL TIMES

Your Questions **Personal Finance Advice & Comment**

Can I create a trust fund for alternative investment profits?

I want to put aside money for my children that I have made by buying and selling jewellery



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Lucy Warwick-Ching 5 HOURS AGO

I invest in alternative investments, including watches and jewellery, and am becoming quite successful. I would like to channel the profits into a trust for my two young children. Is this the best way to safeguard the money for them?

Dean Ryan, solicitor at Payne Hicks Beach, says the creation of most trusts will trigger a 20 per cent IHT charge if you put more into trust than your IHT nil-rate band in seven years. Additional IHT may be due if you die within five years of creating a chargeable trust.

The simplest form of trust, a bare trust, similar to an outright gift, will not trigger this 20 per cent charge but, like any other gift, IHT may be due if you die within seven years, having given away more than £325,000 in the seven years before death.

However, if you can show that giving away your investment profits would not reduce your living standards, you could transfer these into trust exempt of IHT. It would be best to do this according to a pre-arranged plan with some regularity but certainly with good records kept so that your executors will be able to prove this and that the payments did not adversely impact your standard of living. If you do not need the profits from your investment business, this could be useful relief.

Dean Ryan, solicitor at Payne Hicks Beach © Handout

Under a bare trust, trustees would hold your investment profits for your children. Assets in the trust would not count towards your IHT chargeable estate, but all income in the trust would be taxable on you while your children are under 18. Bare trusts give limited scope for safeguarding assets because your children would be entitled to take control at 18. A capital gains tax liability may arise if you create a bare trust with assets other than cash.

If control into early adulthood is important, then a discretionary trust or age-contingent trust may be suitable. These trusts are subject to a complicated tax regime and the trust's details will need to be reported to HM Revenue & Customs. IHT charges of 6 per cent apply every 10 years. If the value of trust assets plus distributions in the 10-year period and the value of other gifts or payments into trust by you do not exceed £325,000, then it is possible the 10-year charge will be nil.

There will be additional IHT charges on capital distributions to your children under a similar calculation. If both parents contribute to the trust, then it could be that a £650,000 trust could be created at no IHT cost. Trustees will pay tax on trust income, dividends and capital gains at additional rates, but you would need to report any income distributions to your children while under 18 or for their benefit (such as payment of school fees) on your own tax return.

Irrespective of the tax cost, the clear safeguarding advantage is that the children's trust fund can be managed for them by trustees of your choosing.

Aidan Grant, associate at law firm Collyer Bristow, says trusts are a good way of protecting assets for future generations. There are various types of trust, which carry a range of asset protection and tax considerations. Most relevant in your case are discretionary trusts and bare trusts.

A discretionary trust keeps assets completely out of the hands of the beneficiaries until the trustees — of which you could be one — exercise their discretion to distribute funds. Control is entirely with the trustees, which provides maximum safeguarding of the assets.

By comparison, a bare trust is akin to a nominee relationship. The assets would belong to your children for all tax purposes, and at 18 your children would have the right to demand the assets from you. Until then, you would hold the funds on their behalf and you could only apply them for their benefit, for example to pay school fees. Bare trusts provide less asset protection, only marginally more than simply giving the cash outright to them.

However, the greater protection offered by a discretionary trust comes with potentially a more onerous tax treatment.

Cumulative transfers into trust over £325,000 will incur inheritance tax at 20 per cent, and death within seven years of the transfer would result in a "top-up" charge of up to a further 20 per cent. Inheritance tax is also charged every 10 years at, broadly speaking, 6 per cent on the value over £325,000, and on capital distributions from the trust.

If you are buying and selling watches and jewellery at a fast enough rate, it may mean that you are considered to be trading — which will have income tax implications. This may mean that you can also take advantage of the inheritance tax exemption for normal expenditure out of income. Essentially, if you have surplus income, you can transfer it into trust without an inheritance tax implication.

The tax treatment of a bare trust is simpler. Provided you survive the creation of the trust by seven years, there is no inheritance tax to pay, irrespective of the total sum gifted. There are also no ongoing inheritance tax charges — instead, the tax is deferred until the death of your children. However, bear in mind that you will be taxed on any income arising on the assets held on trust while your children are under 18.

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