

Testamentary Trusts for Children Factsheet

For clarification purposes, this factsheet deals specifically with **Bare Trusts, Bereaved Minors Trusts and Age 18-25 Trusts only**, other trusts such as Disabled Minors Trusts, Discretionary Trusts or even an Immediate Post Death Interest (IPDI) which is defined by s49A of the Inheritance Tax Act 1984 as an interest in possession (IIP) are dealt with under other or future factsheets.

For anyone considering leaving assets to their children there are various considerations to make, do you want the child(ren) to inherit straight away so that the assets left to them belong to them immediately, do you want the inheritance to only be theirs once they become 18 years old or even do you want to protect the assets further still, perhaps feeling age 18 is too young to inherit substantial assets and prefer they inherit the assets at 21, 23 or even 25 years old? Importantly are the children your own children or grandchildren In any case forewarned is forearmed so this factsheet sets out the various options for making provision for minors and the current tax consequences of each.

Where a Will sets up a trust for children of the deceased, who will inherit subject to the condition that they attain the age of 18, this will normally create a 'Bereaved Minor Trust' or inherit subject to the condition they are over 18 but no older than 25 would create an '18 – 25 Trust'. In the situation where the gift is made without any age restriction or left absolutely to a child but directed to be paid to them when they are older would instead create a 'Bare Trust' whereby the gifts belong to the child or children from the start. In other words, the Bereaved Minor trust and the 18-25 Trusts must be distinguished, specifically detailed within the Will or the gift that happens to be left to a minor will be held in a Bare Trust until they are 18 but will also potentially have significantly different tax implications.

Bare Trusts - (Children to inherit at 18 or younger)

In a bare trust situation, the only issue stopping a child or children from taking their inheritance at your death is their minority. At 18, the minor would be able to claim the inheritance that had rightly belonged to them personally, in all senses, since you had died, (it should be noted in Scotland it could be claimed at age 16, however this factsheet concerns Wills made in England and Wales only).

Accordingly, even though it had been held in trust for them upon reaching majority it had always been their property, their asset and so if the minor died or faced claims against their assets, the inheritance would be the minor's asset and to all intents and purposes pass under the English intestacy rules (absent any non-UK connections).

It would also form part of their estate for Inheritance Tax (IHT) purposes. Income or capital of the inheritance could be applied for the minor's benefit at any time before the 18th birthday. Any income or gains generated by the inheritance between your death and their 18th birthday would be income or gains taxable on the minor (and a tax return may need to be completed for them) but often minors pay relatively low rates of tax as their other income and gains are limited, especially if their Income Tax personal allowance and Capital Gains Tax (CGT) annual exemption are fully available. The transfer of the inheritance into the minor's name at age 18 would then not trigger IHT or CGT as they had been already been taxed as income or as gains since effectively receiving it since it was bequeathed to them.

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Bereaved Minor Trusts (for parents only – not available to grandparents)

Where a Will sets up a trust for children of the deceased, who will inherit subject to the condition that they attain the age of 18, this will normally create a 'Bereaved Minor Trust' it can also be created on intestacy (in the absence of a Will). Due to a change in the law, Bereaved Minor Trusts can now only be created for assets left by parents for their own children or stepchildren. Any money left to grandchildren, nephews and nieces or other minor beneficiaries will create either a Bare Trust or a Relevant Property Trust. Under the Bereaved Minor Trust, the child must become entitled to the capital of their inheritance at age 18 but it can be also paid out for the child's benefit before their 18th birthday. The trustee's discretion on whether to pay out the trust income or not can be directed within the Will but income can only be applied for that child's benefit. Any income that the trustees retain will be subject to higher trust Income Tax rates and accumulated income will pass to the child at age 18. The inheritance does not belong to the child until their 18th birthday, so cannot be subject to claims against the child. The terms of the Trust usually govern what happens to the inheritance in the event that that child dies under 18 – it is not governed by the intestacy rules as they do not formally hold or inherit the asset until they reach majority but rather the use of the asset and any income derived from it if so allowed.

There are no IHT charges applicable during the life of a bereaved minor trust, unlike other options and any gains triggered by the ending of the trust on the child's 18th birthday can be deferred (hold over relief).

Age 18 – 25 Trusts (Again, for parents only – not available to grandparents)

Where a Will delays the age that a child of the deceased can inherit, to age 25, or earlier, this can create an '18 to 25' Trust. The tax treatment of these trusts for income tax and capital gains tax are the same as for Bereaved Minor Trusts, however there are IHT charges applicable in an 18-25 trust from when the child reaches the age of 18.

The trust must provide that, on or before their 25th birthday, a child takes the capital of their inheritance outright. Income can either be paid to the child as it arises from a certain age (perhaps 18) (the child's personal allowance and tax rates apply from that point onwards) or be paid to, or for the benefit of, the child, at the trustees' discretion, at any age before 25 (higher trust Income Tax rates apply but the child may be able to reclaim some Income Tax following distribution). The income must be applied for the child's benefit or accumulated and distributed to the child at the age of 25 at the latest.

As with the Bereaved minor trust any capital distributions will trigger CGT but, if the trustees transfer over the inheritance in the form of the assets themselves (i.e. they do not liquidate the inheritance first) the gain can be deferred until such time as the child chooses to liquidate the assets.

Usually if Will Trust income is not payable to a beneficiary as it arises (i.e. it is payable at the trustees' discretion instead), the trust is subject to periodic IHT charges throughout the lifetime of the will trust. Bereaved Minor Trusts and 18 – 25 Trusts differ from other trusts in the way that they are treated for inheritance tax purposes. Even if the value of the trust exceeds the nil rate band there will be no assessment for inheritance tax on a distribution at age 18 or at ten yearly intervals during the trust period. In an 18-25 Trust, when a child over 18 receives a payment from the trust there may be a charge to inheritance tax if the trust fund exceeds the nil

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rate band. The charge will be a fraction of 6%, with the amount depending on how long after the age of 18 the payment is made. For example, if the child inherits at age 21 the inheritance tax rate will be 1.8%. If the child inherits at age 25 the maximum inheritance tax rate will be 4.2%

There will be no ten yearly anniversary charges to inheritance tax during the trust period, but when the child attains the specified age, there may be a charge to inheritance tax if the trust fund exceeds the nil rate band.

If the Will sets up a trust whereby a child inherits a share of the estate at age 18, a further share at age 21 and a further share at age 25, these will be treated as one trust for tax purposes. There will be no charge to inheritance tax at age 18. Distributions to the child after that age will be subject to an inheritance tax charge, if the trust exceeds the nil rate band. The rate of tax will depend on the age of the child at the date of the distribution. 18 – 25 Trusts are given favourable treatment because only a scaled down version of the IHT regime applies to them, which means that if capital is retained in trust until the child's 25th birthday, the IHT charge payable when the inheritance leaves the trust is at most 4.2% of its value at that time therefore the rates of inheritance tax applicable are very low and should be balanced against the advantage of additional control over funds left to young adults who may not be capable of handling large sums of money sensibly. Protection over tax considerations is often important and the will trustees have discretion to distribute capital from the trust to or for the child's benefit at any time before age 25 and so can consider the level of IHT charge, in balance against the level of financial maturity demonstrated by the child and the parent's wishes.

Pointers for 18-25 trusts

- Inheritance tax (IHT) is paid on any assets forming part of the residuary estate over the nil rate band and Resident nil rate band (RNRB). The RNRB may be available because your children (or their respective descendants, if a child dies before you) are qualifying beneficiaries.
- If your children are already over 25 when you die, they are entitled to the assets and no trusts arise.
- If your children have not reached 25 when you die, if the children receive their share of the estate no later than the age of 18, no additional IHT charges arise.
- If your children only take their share later (at any age up to 25), IHT charges may arise once the child turns 18. For example, the child takes their share at age 21. In this case, there is three years' worth of tax to pay when they do so (from age 18 to age 21) that is payable when the child turns 21 and takes their share or 7 years IHT if left until 25 years of age,

Remember though, the level of IHT for this type of trust is extremely low. In the worst-case scenario, the tax rate when inheriting at age 21 is 1.8%, and if paid out on the child's 25th birthday, the IHT charge payable when the inheritance leaves the trust is at most 4.2%, effectively 0.6% per year IHT is charged per year over 18 up to 25 years old

- There may be good reasons why you do not wish your children to inherit at 18. However, for maximum flexibility, your will can give your trustees power to pay out the children's shares early. If your trustees

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paid the shares out to children aged 18 or under, the IHT charge would be avoided altogether, which could be particularly useful if tax rates were to rise in the future.

- You should also consider whether income alone is available from the trust fund or the capital as well, bearing in mind the 18-25 trust only allows any payments to the child or for the benefit of the child.

Rest assured, LegalAsk make sure that the Will or Wills are drafted to reflect your specific requirements so that you and your family's interests can be protected for the future, no matter the complexity of your estate. We hope this factsheet and the others on our website have helped you think about making a Will and what needs to be considered beforehand.

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