

Bare Trusts for Children

In 2006, changes were made to the tax treatment of virtually all trusts made during lifetime with the result that, unless the value of the assets transferred into the trust is within the transferor's inheritance tax nil rate band, a liability to inheritance tax will arise, assuming that none of the inheritance tax reliefs are available. The result of this is that much sound financial planning for the benefit of an individual's family during lifetime can incur an immediate inheritance tax charge at the rate of 20% and, in our experience, that is generally considered to be such a serious inhibition that some alternative strategy is sought.

One of the possible alternatives is the creation of a bare trust. In essence, this is the simplest type of trust known to UK law and it relates to the situation where one person holds a particular asset as pure nominee for another person who is the beneficial owner for all purposes. In tax planning arrangements, bare trusts for adult family members will not be of any particular usefulness since they are tantamount to an outright gift and the bare trustee can have no powers to prevent the beneficial owner dealing with the asset however he or she may think fit.

Bare trusts for children under the age of 18 are, however, of more interest. The tax consequences are briefly summarised below:

1. For inheritance tax purposes, the transfer of an asset by someone during his or her lifetime into a bare trust for a child under the age of 18 is treated as a potentially exempt transfer, so there will be no inheritance tax liability unless the transferor should die within seven years of making the gift.
2. The gift of an asset into the bare trust is a disposal of it for capital gains tax purposes, treated as being made at market value and, accordingly, the capital gains tax position will need to be considered.
3. During the life of the bare trust, any income received whilst the child is less than 18 years old will be either (a) that of the child's parent if the parent was the person who made the bare trust, or (b) that of the child for income tax purposes if the trust was created by some other relative.
4. However, the income tax rules have no relevance for capital gains tax purposes and all capital gains on any disposals of assets by the bare trustee are treated as gains of the infant beneficiary.
5. When the child attains the age of 18 there are no particular tax consequences except that, if up to that time the income has been treated as that of the child's parent, that treatment will then cease to apply.

It is often thought that bare trusts for children must be simple arrangements to which no particular terms can be attached. Whilst it is certainly the case that the child must be fully entitled to call for the transfer of the assets within the bare trust once he or she attains the age of 18, during the child's infancy there is nothing to prevent the bare trustee being given normal trustee powers to administer the assets concerned. In fact, it will often be important to include these powers so that if it becomes advisable to sell an asset within a bare trust, the trustee has full authority to do so.

By the same token, it is considered that normal trustee powers within the legislation relating to trusts can apply to bare trusts. In the case of children's trusts, one of the most important of these is the power to advance the trust funds for the benefit of the child concerned. So capital can be released from the trust for his or her benefit. It has been held by the courts that this power of advancement can be validly used to prevent a child from becoming entitled to trust money at the age of 18 and, instead, transfer it into a long-term trust for his or her benefit. This power is therefore equally available to bare trustees.

Under the Trustee Act, the power to advance capital is limited to one-half of the fund but, on the creation of a bare trust, there is no reason why the trust document should not contain a provision allowing the whole of the fund to be advanced on new trusts.

If the trustees do decide to exercise this power, the inheritance tax position is of some considerable interest. The infant beneficiary does not have any legal capacity personally to deal with the trust assets or to make dispositions of them and, accordingly, there appears to be no occasion of charge within the inheritance tax provisions. Without a disposition by the beneficiary, there is no inheritance tax event and there is nothing to treat the actions of the bare trustees from being attributed to the infant beneficiary. Leading counsel therefore advises that if one starts with a bare trust for an infant child, that trust can therefore be converted to a family trust of which that child will be the principal beneficiary when he or she attains the age of 18; there will then be no inheritance tax liability when the trust is created nor when it is converted to a long term trust, provided always that the original transferor survives the seven year period from the time when the trust was created.

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