Farm Finance

Advice
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Trusting in the future

Setting up a Discretionary Trust fund can be a good option for parents concerned about providing for their children's future

Asset handover: Discretionary Trusts are the most common type of trust where the parents leave all of their assets in trust to their children where the trustees will have the discretion to decide who gets what and when they get it.

Most farmers are asset-rich and not so cash-rich. Protecting one's assets for a variety of reasons is frequently a major concern to people.

In this article I look at what's involved in establishing a trust under the terms of a will; in other words, after you die and particularly if you die prematurely leaving young children.

In my next article (April 21), I will deal with setting up a living trust with a view to protecting your assets while you are alive and possibly after you have gone.

In the case of farming couples with young children, the possibility of both parents making an early departure from this world can be a source of worry. It simply would not be possible at an early stage to make provision in a will for distribution of their assets to their children in a manner that would provide for the welfare of those children while also ensuring the continuity of the farm into the next generation.

If you have a special-needs child your concerns for the future care and provision for that child will be a heightened concern.

While the incidence of both parents dying while their children are still minors is extremely low, I have seen clients die prematurely, but thankfully in all instances the surviving spouse had time to include the necessary provisions in their will.

This may not always be the case and it may be worth considering such provisions while one's children are young and you are still hail and hearty. The will can always be changed at a later stage.

Making provision in the event of your death

What I am referring to in terms of a provision for your children in the event of both parents' death is setting up a trust under the terms of a will.

There are various types of trusts such as discretionary trusts, life interest trusts, bare trusts or fixed trusts.

Discretionary trusts differ from the others in that the beneficiary has no automatic right of entitlement to the trust assets. They only have the right to be considered for a distribution from the trust, which is entirely at the discretion of the trustees.

Discretionary Trusts are the most common type of trust where the parents leave all of their assets in trust to their children where the trustees will have the discretion to decide who gets what and when they get it.

Appointing trustees will require serious consideration because if they are called in to action, they carry a huge responsibility in executing the role of trustee. Trustees will typically be family members or trusted friends and will be of an age that one could reasonably expect that they should be around for a good while to come.

Generally, wills that include provision for a trust will be accompanied by a letter of wishes which sets out what the parents would ideally like to happen with the assets that comprise the trust.

It may specify the age at which they would like the children to benefit and whether the farm should be sold and divided equally or transferred to that family member who had assumed and demonstrated his/her role as a worthy successor.

A letter of wishes has no legal standing and is simply what it says on the tin, wishes, but it can provide worthwhile guidance for the trustees.

Taxation

Trusts can be liable to Income Tax, Capital Gains Tax or Stamp Duty in the same way that these taxes apply to individuals on their profits or on asset acquisitions or disposals.

However, leaving one's assets in trust under the terms of a will does not trigger any capital tax liabilities at the time of making the will, nor does it trigger any capital tax liability on your death. Capital taxes such as gift or inheritance tax (CAT) will apply only when any or all of your assets are handed over to the beneficiaries of the trust.

Discretionary Trust Tax

Discretionary trust tax consists of a once-off initial charge of 6pc of the value of the trust assets and is payable on the later of the death of the person who set up the trust (the settlor) or when the youngest beneficiary reaches the age of 21.

If the trust is wound up within five years, a refund of half of the initial charge is available. Following the initial 6pc charge, a 1pc charge is applied against the value of the trust for each year that the trust remains in existence.

Where a discretionary trust is set up to protect a vulnerable beneficiary, such as a disabled child, an application can be made to Revenue for an exemption from the 1pc charge which will require to be supported by medical evidence.

Where the trust is created by a will, and all of the beneficiaries are over 21, then the liability to discretionary trust tax arises on the date of death, and the estate has four months to discharge this tax.

Capital Acquisitions Tax (CAT)

CAT will fall due for a beneficiary when they receive a distribution from the trustees. If the benefit is made for the support, maintenance or education of a minor child (under 18) where both parents have died, the benefit may be exempt from CAT.

Otherwise the transfer of land, money or other assets will be subject to CAT at the normal rates and subject to the normal allowances and reliefs.

One exception to this is a benefit taken exclusively for the purpose of discharging qualifying expenses of an individual with a disability which is CAT exempt. Qualifying medical expenses are defined as expenses relating to medical care, including the cost of maintenance in connection with medical care.

Capital Gains Tax (CGT)

Where a trust is created by a will no CGT arises on the initial creation of the trust on death as the trustees will inherit the assets at their market value at date of death.

This is the base cost for any future disposal of trust assets. So, if the trustees decide to dispose of assets in order to distribute the proceeds among the beneficiaries, they will pay Capital Gains Tax on the difference, if any, between the sale proceeds and the value at the date of death.

If on the other hand an asset such as land was transferred directly to the beneficiary, no capital gain would arise on that transfer.

Income Tax

Trustees will pay income tax at the standard rate of 20pc on any income earned by the trust and will have no entitlement to normal the tax credits or reliefs.

In addition, a surcharge of 20pc applies to any income accumulated in the trust which has not been distributed within 18 months of the tax year in which the income arose.

Pay-outs to the beneficiaries of the trust income or capital may be subject to Income Tax or CAT or both depending on the nature and frequency of the payment. However, the Income Tax paid by the trustees may be available as a credit against a beneficiary's tax liability on income received from the trust.

Summary

Making provision for the establishment of a trust in your will may be the perfect solution to allaying any fears you may have about your untimely departure.

However, trusts are far from simple both from a legal and taxation perspective and good advice should be sought from a professional who has experience in such matters.

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