How to be a trustee

Inheritance tax and trusts



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Lauren Marlow and Rachel Bevan provide a simple guide setting out how to be a trustee

Key Points

What is the issue?

A trustee is the legal owner of assets in a trust fund, which they hold for the benefit of one or more individuals called beneficiaries. Ten of the most typical questions relating to the undertaking are set out below.

What does it mean for me?

Legislation and case law set out the duties, responsibilities and powers of a trustee. Some of these can, however, be amended in the trust document, so you must be sure to read the trust instrument carefully and be sure you fully understand it.

What can I take away?

As a trustee, you are responsible for reporting on and paying tax on behalf of the trust. You have to register the trust with HMRC once the trust becomes liable for tax and file annual returns.

If you are appointed as a trustee, it is important to understand clearly the position you have accepted.

Below we set out responses to ten typical questions that we are asked to provide a simple overview on how to be a trustee. This guide is not a substitute for legal advice on your specific circumstances.

1. What is a trustee and who can be one?

A trustee is the legal owner of assets in a trust fund, which they hold for the benefit of one or more individuals called beneficiaries. Trustees have a legal obligation to deal with the trust assets in accordance with the trust instrument.

In simple terms, anyone who has the capacity to hold property can be a trustee. It is possible to be both a beneficiary and a trustee, although this may not always be appropriate. A trust may have just professional trustees, just lay trustees or a combination of the two.

There are a few situations where people cannot act as trustees: a person who has been declared bankrupt; a person disqualified from acting as a company director; or a person convicted of any offence of dishonesty cannot be a trustee of a charity or pension fund. These individuals are not automatically excluded from acting in respect of a private trust but the appointment would be questionable as they may be deemed ‘unfit’. In the event that the trust holds a British ship or an aircraft registered in the UK, then it would not be possible for a foreign national to be a trustee of that trust.

2. How do I become a trustee?

The initial trustees would typically be expressly appointed in the trust instrument and be a party to the deed. If the trust was established under a will, then the trustees may not necessarily be aware of the appointment in advance. It would be best practice for the testator to ask whether the individuals are willing to act at the time of making the will.

Subsequent trustees can be appointed by deed during the trust period. This may be required if a trustee dies, loses capacity or no longer wishes to act. It is also possible for the court to remove a trustee who fails to comply with their duties and responsibilities.

3. What should I do when I first become a trustee?

You should familiarise yourself with the trust and ensure that you have read and understand the trust documents. You should check whether any beneficial interests have changed and find out about the beneficiaries. You will also want to find out about the trust assets and confirm that they have been transferred to the trustees; this includes ensuring the ownership changes every time the trustees change. If the trust was in existence prior to your appointment, you will want to enquire as to whether there are any outstanding breaches by the existing trustees.

4. What are my responsibilities?

Legislation and case law set out the duties, responsibilities and powers of a trustee. Some of these can, however, be amended in the trust document, so you must be sure to read the trust instrument carefully and be sure you fully understand it as you are under a duty to follow the trust instrument’s terms.

It is important that you do not put yourself in a position where your own interests conflict, or there is a real possibility that they will conflict with those of a beneficiary. Likewise, you must act impartially between the beneficiaries and balance the competing interests, which may be particularly challenging when you have different beneficiaries entitled to capital and income.

You must keep clear and accurate accounts for the trust, as well as keeping records of the decisions taken. In making decisions, you must act unanimously unless the trust deed provides for decisions to be made by majority. If you disagree with other

trustees in respect of the management of the trust, it may be necessary to apply to the court.

You owe a duty of care when exercising your powers as a trustee. This means that a trustee must exercise such care and skill as is reasonable in all the circumstances, having particular regard to any special knowledge or experience that you have. You also owe general duties of honesty, integrity and good faith to the beneficiaries.

This is by no means an exhaustive summary of your responsibilities.

5. What are my reporting obligations?

As a trustee, you are responsible for reporting on and paying tax on behalf of the trust. You have to register the trust with HMRC once the trust becomes liable for tax and file annual returns. The taxation of a trust is predominantly dictated by the structure of the trust but will also be affected by the decisions you make as a trustee.

For example, if you decide to sell trust assets there may be a gain to declare or if you purchase property there will be stamp duty land tax to pay. In respect of a discretionary trust, there will be ongoing inheritance tax implications, including the need for the trust to be revalued every ten years; depending on the value of the trust, there will be a tax payment due.

As a trustee, you are personally liable for paying the tax and it is therefore vital that you ensure all the trust's tax obligations are complied with. You may wish to instruct an accountant to file the returns or a trust manager to ensure all requirements are met.

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6. How should I handle requests from a beneficiary?

This will largely depend on what the request is for and who the beneficiary is.

If the trust is a discretionary trust, then no one within the class of beneficiaries has an absolute right to the trust fund; the distribution is solely at your discretion. This

means that you can choose to appoint funds but can also quite rightly choose not to. You have a responsibility to consider the circumstances of each member of the class and you have a duty to act fairly but this does not mean that you have to treat each member of the class equally. On the other hand, it might be that the funds are held for a minor and you are approached by the parent to fund school fees, for example, or the beneficiary may become entitled to the funds at 25 but has asked for money to purchase a house at 23. The decision there is whether the advancement of the funds is in the beneficiary's best interests as opposed to whether they should benefit at all.

If the request is for money, among other reasons you should consider:

- the reason for the request;
- whether there are sufficient funds to meet the request;
- whether such a request should be met from income or capital;
- what formalities are required; and
- the tax implications of giving the funds to the beneficiary.

A beneficiary may make a request for documents such as trustee meeting minutes, accounts, deeds or letters of wishes. Whether the document should be disclosed to the beneficiary largely depends on the type of document requested. If you receive a request from a beneficiary and are unsure whether you have to comply with it, it is important to seek legal advice.

7. What is a breach of trust?

A breach of trust will arise when you fail to comply with the duties imposed upon you. Typical situations include (but are not limited to):

- failing to invest trust funds appropriately;
- failing to distribute to the correct beneficiaries;
- making an unauthorised profit; and
- failing to take advice.

The position of trustee is one of personal liability and thus if you breach your duty the beneficiaries can sue you to restore the trust property or pay compensation for the breach. Being a trustee can be onerous but you can see why it is important to ensure that you act properly and seek professional advice when needed.

8. Will a trust feature in divorce proceedings?

When deciding how to exercise their discretion in order to achieve a fair outcome on divorce, the courts in England and Wales must consider ‘the financial resources which either of the parties to the marriage has or is likely to have in the foreseeable future’. This will include trust interests, but exactly how the trust features will be fact specific.

A court will distinguish between absolute, contingent and discretionary entitlements. Be aware that with discretionary trusts, the court will look at how the trust has operated in practice, and how you, as trustees, have exercised your discretion in the past.

Irrespective of the nature of the trust interest, the provenance of the trust is key. Often, trusts are dynastic and pre-date the marriage, so (as with any gifted or inherited asset) will be considered ‘non-marital’ and therefore not subject to the ‘sharing principle’ in the same way that assets generated during a marriage are.

Where the court deems the trust to be a financial resource, on a practical level they might:

- make a ‘judicious encouragement’ order – an order that encourages the trustees to act in a certain way;
- offset: give the non-beneficiary spouse more of the non-trust assets; or
- adjourn the non-beneficiary spouse’s capital claims, so they can make a claim at a later date.

A beneficiary may make a request for documents such as trustee meeting minutes, accounts, deeds or letters of wishes. If you are unsure whether you have to comply with a request, seek legal advice.

It follows that trustees need to be mindful during the operation of the trust as to how distributions are made. For instance, would it be better to loan funds to a beneficiary rather than advance them outright? If so, make sure the loan is properly documented and, ideally, secured.

It’s common for spouses or future spouses to fall within a class of beneficiaries of a trust. Care needs to be taken not to create a ‘nuptial settlement’ which could then be prey to variation by the court. Variation might involve transferring assets out of

the trust or changing the trustees. The definition of what constitutes a ‘nuptial settlement’ is not straightforward and advice should be taken.

9. As a trustee, what are my disclosure obligations in divorce proceedings?

Parties to divorce proceedings have a duty of full and frank disclosure when it comes to their finances. If one of those parties is a beneficiary under a trust, they will have a duty to disclose their interest to the other party and the court. The duty extends to information that is within their knowledge and control.

Trustees, on the other hand, are not parties to the marriage, nor (usually) to the divorce proceedings, and so are not duty bound to the court in the same way.

The rules regarding disclosure will be jurisdiction specific. For trusts in England and Wales, consider the following principles if you are faced with a disclosure request:

- As a trustee, you have a duty to all beneficiaries, not just the one getting divorced. Consider whether disclosure will impact upon any of them and weigh that into the balance.
- Being deliberately secretive might not ultimately help the beneficiaries. That could lead to the court making adverse inferences regarding the trust and the level of provision likely to be made from it.

If you do not co-operate with disclosure requests, the opposing spouse might seek a disclosure order or summon you as a witness. Alternatively, they might apply for you to be joined as a party to the proceedings (which would bring you under the jurisdiction of the court). Trustees should take independent advice on their positions before engaging with such requests.

If the trust is based offshore, it’s vital to take local advice before acknowledging any correspondence from the English court or engaging in the proceedings in any way. In some jurisdictions, you will need to seek directions from the trust’s local court before making any disclosure, to protect yourself against claims from the other beneficiaries.

10. I’m concerned about the beneficiary’s spouse or partner making a claim against funds advanced from the trust. Is there a way to protect funds that have been distributed to a beneficiary?

Trusts are often used to protect wealth and can be used in conjunction with other wealth protection strategies. (A word of caution on this though: if the court deems that assets have been transferred into the trust with the main objective of defeating the other party’s claims, it has the power to set aside the transaction.)

Before making distributions, always check the relationship status of the beneficiaries and take advice accordingly. Pre- or post-marital agreements can be a very effective way of ensuring that trust assets and other inherited wealth are protected from divorce. This process can take months to do properly, so early advice is key.