

Trusts for Disabled Persons

Parents of disabled children will be concerned to ensure that after their death their child is well looked after. This applies whatever the age of the child because he may be unable to manage his own financial affairs himself, whether through mental or physical disability.

Without the correct Wills in place:

- **The child's means-tested State benefits and entitlement to other local authority funding could be adversely affected**
- **The child could be vulnerable to financial abuse or exploitation from others**
- **A court appointed deputy may be required, incurring considerable expense**
- **Local authorities could challenge arrangements where insufficient financial provision is made for the child**

The answer for many parents is to set up a discretionary trust in their Wills safeguarding their child's future security. Such trusts are a way of putting financial arrangements in place for their child and they are particularly useful for disabled people.

The two key reasons for having such discretionary trusts are:

- So that there is a way of managing money or other assets for a disabled person, and
- To avoid that person's benefits and care funding being stopped.

What is a Trust?

A trust is a legal arrangement whereby money, property or other assets ('the trust fund') are held and managed by persons ('the trustees') for the benefit of others ('the beneficiaries'). There are many different types of trust but the two discussed here are Discretionary Trusts and Disabled Person's Trusts.



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Trustees

Trustees are the legal owners of the trust fund and as such are legally bound to deal with it in accordance with the terms of the trust as set out in the Will. They administer and manage the trust and make decisions as to how the trust fund - capital and income - are to be used.

Beneficiaries

A beneficiary is anyone who stands to benefit from the trust fund in some way. There can be one or more beneficiaries.

How is a trust created?

Trusts are usually set up as part of writing a Will. The terms of the Will specifically provide for the creation of the trust which comes into effect on the death of the person whose Will it is.

What is a Discretionary Trust for a disabled person?

A discretionary trust is the most flexible form of trust and therefore is particularly appropriate for benefiting disabled persons, as it enables trustees to adapt to meet changing circumstances in the future.

The defining features of a discretionary trust are that:

- Trustees have a discretion as to how the trust assets are used – so trustees are free to make all the decisions
- The person intended to benefit from the trust (the disabled person) must not have a right to the income and capital
- The intended beneficiary must not be the sole beneficiary – i.e.: must not be the only person named as a beneficiary

Without these features the trust would not be classed as discretionary and the disabled person would be treated by the authorities as though he owned the trust property outright, with the potential consequential loss of benefits.



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As will be seen the disabled person is not the sole beneficiary. There has to be a class of beneficiaries. The disabled person will be named in the trust as the 'primary beneficiary' but there will be others named too – usually family members (such as brothers and sisters of the disabled person) or others whom the parents may wish to include, or it could be charities.

It is a matter entirely for the trustees to decide who amongst the beneficiaries will benefit from the trust and to what extent. The trustees have wide powers ('discretions') to do as they think fit at any given time. This flexibility allows for decisions to be made after the parent's death and is an essential feature so that trustees can adapt not only to changes in the disabled person's circumstances but also to any future changes in legislation or benefit rules. For example, it may at some future point be that the property where the disabled person is living becomes unsuitable and that he would be better off living in sheltered housing or elsewhere. Trustees need discretion in order to be able to sell the property and allow a move if in their opinion this is in the disabled person's best interest.

This discretion means that the disabled person has no absolute right to any of the trust fund, either income or capital (and neither of course do any of the other beneficiaries). He only has the potential right to benefit.

The assets that comprise the trust fund belong to the trust and not to the disabled person whom it is intended to benefit. He may receive payments or gifts from the trust, but he cannot be said to own the fund himself. Because of this the trust fund is not taken into account when assessing entitlement to state benefits, such as income support or local authority obligations to fund care.

How the Trust Operates

Choice of trustees

Given their wide powers the choice of trustees is crucial. Usually there will be between two (the minimum required) and four trustees appointed, or else a sole corporate trustee. Trustees can be relatives, friends or professionals and they can themselves be beneficiaries of the trust - which is usually quite sensible as this will give them a direct interest and involvement in the family's financial affairs.

When considering who to appoint as trustees it is useful to have a mix of people, including:

- One or two family members who know the disabled person well, are aware of his needs and concerned with his welfare, and
- One or two adults who are able to manage money and capable of dealing with the administration of financial matters

Finding suitable trustees can sometimes be difficult in which case professional trustees (usually solicitors) can be appointed but of course they will require payment for their time. Usually this will be met as an expense out of the trust. Non-professional trustees cannot charge for their time and are entitled only to expenses. Parents need to be aware of the possibility that a conflict of interest might arise where trustees appointed are also family members and beneficiaries of the trust. Where anticipated that this could be a problem it would be sensible to appoint an independent trustee who can hold the balance.

Where a trustee dies or does not wish to continue acting, the remaining trustees can appoint a new trustee in his place.

The class of beneficiaries

As well as the disabled person who is referred to in the trust as 'the primary beneficiary', it is usual to include his/her spouse and children or other descendants (if any) as well as the other beneficiaries who it is intended should inherit the trust fund at the end of the trust period. Often this will be the disabled person's siblings or other relatives and sometimes charities.

Trustees are therefore able to make payments to any of those other beneficiaries on behalf of the disabled person, for example to pay for holidays or the purchase of a car, without any adverse consequences for the disabled person in terms of State benefits.

What do trustees do?

Their main tasks are:

- To manage the trust fund – e.g.: invest any money and ensure that any property they hold is well managed and maintained
- To make payments to or for the benefit of the disabled person
- To keep records and accounts of the trust assets, which may involve completing tax returns and paying any tax due

The trust fund is commonly used to pay for extras or luxuries for the disabled person that the normal welfare benefits or social services system may not provide – e.g. holidays, clothing, pocket money, or services that can improve the quality of his life.

The trust can also own property, including the parental home where the long-term plan may be for the disabled person to continue living as long as possible after his parents' death.

It is recommended that when drawing up their Wills parents also write a 'letter of wishes' to their trustees setting out their intentions in creating the trust and outlining how they would like the trustees to act in the future. Such a letter can be very helpful in explaining to trustees what it is hoped will be achieved but it is for guidance only and is not legally binding. The letter will be completed at the same time as the Will and stored with it.

How much shall I leave in trust?

This is a personal decision for parents. A starting point where there are several children is an equal share for each child. Some parents will then decide either to increase or to decrease their disabled child's share depending on how they assess their children's respective needs.

Alternatively instead of leaving a share of their estate in trust, parents may prefer instead to leave a fixed amount of money. There is no minimum but obviously the amount would need to be enough to ensure that the running of the trust is financially viable. For this reason we would not recommend setting up a trust for less than £20,000.

What happens when the disabled person dies?

It is usually envisaged that on the death of the disabled person the trustees will bring the trust to an end and distribute the remaining trust funds (if any) between the surviving beneficiaries according to the terms of the Will.

Disabled Person's Trusts

This type of trust provides an alternative to a discretionary trust but is a much less flexible option. It is primarily used by parents who have only one child, being the child with the disability.

It is only appropriate for disabled persons who:

- Are incapable by reason of mental disorder of managing their own financial affairs; or
- Are in receipt of Attendance or Disability Living Allowance at the medium to higher rate

As with discretionary trusts there is a class of beneficiaries, however during the lifetime of the disabled beneficiary the income of the trust can only be paid to that person (and no other beneficiary) and whilst the capital can be paid to other beneficiaries any such payments must be matched pound for pound with an equivalent payment to the disabled beneficiary. This could impact on the disabled beneficiary's benefit entitlement.

This sort of trust is therefore more restrictive in operation than a discretionary trust.

Taxation Consequences

The trusts as described here are not suggested for tax planning purposes.

For Inheritance Tax (IHT) purposes, a discretionary trust will not be subject to tax when the disabled person dies as the trust does not belong to him. However, if the value of the trust funds exceeds the tax threshold (currently £325,000) the excess value will be subject to tax at 6% when the trust reaches a 10 yearly anniversary and also when capital is distributed out of the fund to beneficiaries (exit charges).

Disabled Person's trusts are treated differently for IHT purposes. Whilst they are not liable to 10 yearly or exit charges, they will be liable to 40% IHT on the death of the disabled person as the fund is treated as belonging to his estate.

For income and capital gains tax purposes, Disabled Person's Trusts are treated more favourably than discretionary trusts, in that special tax treatment allows trustees to elect as if the disabled person owned the trust fund himself so the fund will be taxed accordingly. Discretionary trusts may be liable to the higher income tax trust rate (currently 50% for income in excess of £1,000) and the available Capital Gains Tax allowance will be halved.

Which Trust to choose?

Generally speaking discretionary trusts will be preferable for most people due to their flexibility. They can be viewed as 'family trusts' providing not only for the benefit of the disabled beneficiary but also for other family members as well, if appropriate. For instance, the disabled person's circumstances may be such that he has limited need for financial support from the trust fund, in which case the trustees may feel that it could be used more advantageously in supporting other family members in need. This would not necessarily be possible with a Disabled Person's Trust.

What if I do nothing?

Not to make any financial provision for a disabled person on the grounds that another family member will 'look after' him or that the State will provide, may not be wise.

First, family members may change their mind about looking after the disabled person, or their own circumstances may change e.g. through death, divorce or bankruptcy, all of which could jeopardise the disabled person's care. Formal provision through a trust is a much safer option. Second, failing to provide adequately in your Will for a disabled child may result in a claim on his behalf by the local authorities under the Inheritance (Provision for Family and Dependants) Act 1975. This could turn into an unpleasant and costly legal dispute after your death. Local authorities will not challenge a discretionary trust in this way.

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Disadvantages of Trusts

It is important that people fully understand the implications of setting up a trust in their Will.

Parents may be concerned at the wide discretionary powers of trustees and the fact that their disabled child will not have an absolute right to the trust fund.

Placing assets in trust will inevitably result in increased administration and record keeping by trustees. Trust law and the taxation of trusts is complex and Trustees may therefore need professional help, which will incur additional costs.

Conclusion

No one likes to think how their children will manage after they have died and for parents of disabled children this is all the more worrying. It is essential for them that the best possible arrangements are in place for the long-term care of such disabled persons. This will usually be achieved through establishing a trust.

The discretionary nature of trusts, whilst causing reservation for some parents, is an essential feature if the trust is to be flexible and fully effective in providing for the disabled person. The alternative to a trust is leaving their inheritance to the disabled person outright, but this is unlikely to be practical where that person is unable to manage his own affairs and/or is in receipt of State benefits.

The information in this document is intended as guidance only. It is not intended to be comprehensive nor to provide specific legal advice and should not be relied on as doing so.

Further legal advice appropriate to your individual circumstances should be obtained from our Legal Department, telephone us on 01934 836159.

