

Why make a Trust?

Trusts have a long history of use as a means for people to safeguard their assets and manage the succession of their assets to others. Protection, control and flexibility are key to understanding the reasons why people use trusts and tax issues may also influence the use of a trust. Trusts may help to mitigate the changes to business property relief from 6 April 2026, for example.

This note explains some of the reasons for using trusts, both during lifetime and on death.

Control

A trust exists where someone (a **trustee**) holds assets for the benefit of others (the **beneficiaries**). The person who transfers assets to the trustees (the **settlor**) creates a framework at the outset and decides the extent of the beneficiaries' interests and the powers available to the trustees. This is the control element, which starts off with the settlor and moves across to the trustees.

Retaining a degree of control over the ultimate destination of assets is an important reason for using trusts. The settlor can immediately divest themselves of ownership and yet the existence of a trust prevents ownership passing straight to the beneficiaries. The settlor and/or trustees decide the timing and extent of the beneficiaries' interests. This way, ownership can be transferred gradually to the next generation.

Retaining control over the management of assets without beneficial ownership is another important reason for using trusts. This can be particularly useful for dealing with succession to family business assets. Business owners may wish to pass on their shareholdings to the next generation without giving up voting control. If company shares are transferred into trust, the trustees have the voting rights and the settlor retains influence if he/she is a trustee.

A settlor may act as a trustee or retain some powers of veto or consent over the trustees' powers, though may not be able to benefit personally from the trust for tax reasons.

Protection

The protection element stems from the fact that legal title to trust assets sits with the trustees, who hold the assets on behalf of the beneficiaries. The trustees are responsible for managing the assets and have a duty of protecting and preserving trust property. Trustees may also have powers to determine the timing and amount of the beneficiaries' entitlements. A trust can be used to protect assets from spendthrift beneficiaries and matrimonial or other risks.

A trust is therefore an ideal solution for someone who wishes to give away assets without passing complete control and ownership to the intended beneficiary. Typical reasons why a person may not want the beneficiaries to acquire outright ownership include:

- Concerns about the age of the beneficiaries who may be too young (or perhaps too old) or at any rate too inexperienced to handle the assets;
- Concerns about beneficiaries being too vulnerable to handle the assets (e.g. beneficiaries who suffer from a disability or incapacity, or beneficiaries who maybe too easily and inappropriately influenced by others);
- Concerns about a possible divorce, where in some circumstances a trust may provide some protection from a financial claim in divorce proceedings;
- Concerns about possible financial difficulties, including possible bankruptcy, although a trust cannot be used to defraud creditors by deliberately putting assets beyond their reach.

Flexibility

Flexibility is another major advantage of a trust over outright ownership. This can be useful for a variety of reasons. In a family business context, for example, a trust may be ideal to provide for the whole family where some members work in the business and some do not. Those who are less directly involved in the business activities can be given a share in the value of the business and may be able to benefit from an income stream, without acquiring the voting control that comes with outright ownership.

Flexibility can also be useful where a settlor is uncertain as to the precise extent of each beneficiary's entitlement at the time he makes a gift. Trusts are often intended to run for many years and need to be sufficiently flexible to cater for changing circumstances. Trusts are particularly popular in Wills which take effect on death and so may not come into force until many years after they are written and so the future needs and circumstances of the beneficiaries will not be obvious at the outset.

The trust terms often distinguish between entitlements to the trust assets and the income arising from those assets. At their most flexible, trusts may be entirely discretionary, giving the trustees power to decide how, when and whom the trust property and its income should benefit.

International aspects

The flexibility offered by trusts can be useful in an international context where families and their assets are situated across a range of different countries, each with their own legal and tax systems. Trusts may be used to centralise a family's affairs in a major international financial centre offering a developed legal and regulatory framework, efficient banking and investment systems, and professional expertise in the relevant cross-border tax and legal issues involved. Other reasons for using trusts include avoiding probate procedures and forced heirship rules in some overseas jurisdictions. Trusts may also provide an element of confidentiality as to the beneficial ownership and nature and extent of the trust assets.

Tax considerations

Tax considerations are relevant for the settlor, the trustees and the beneficiaries, and the precise tax treatment will depend on the type of trust and nature of its assets.

Trusts are designed to pass on wealth and are therefore a key part of UK inheritance tax (IHT) planning. Since the assets of some trusts sit outside the estate of any individual beneficiary, there are special IHT rules for these trusts. Some people prefer this, as a kind of reduced 'pay as you go' system, rather than face a large (40%) IHT bill on a death. Trustees can benefit from the IHT nil-rate band in relevant circumstances, and agricultural and business property reliefs are available.

In particular, at the time of writing, existing trusts holding business property immediately before 30 October 2024 should have their own, full, £2.5m 100% relief allowance, while newer trusts may also benefit from a further £2.5m allowance. This makes trusts especially attractive structures to hold business property. Advice should be taken in light of the recently announced tax changes.

Capital gains tax and income tax are also particularly important to trusts, so advice will be needed on all the tax implications of establishing a trust.

In many cases, however, tax is not the main driver for using a trust. Trusts are more likely to be motivated by the other factors suggested above. The real-life, family reasons for using trusts tend to come before tax considerations. Some people may even prefer to incur a tax charge as a price for accessing the benefits of a trust.

For example, it is common for parents' Wills to leave assets to their children in trust until they reach age 25. This may incur an IHT charge on the children's 25th birthdays, which would not arise if the Will had provided for them to inherit at age 18. However, many parents consider that a proportionately low IHT charge is a small price to pay for properly protecting the assets until their children are mature enough to receive large sums.

The tax consequences of making a trust and the tax treatment applied to a trust during its life and when it comes to an end will have a bearing over any decision to use a trust and will also influence the choice of trust. Anyone interested in using a trust should seek professional advice on its implications.

Contacts

This document is intended to provide a first point of reference for current developments in aspects of the law. It should not be relied on as a substitute for professional advice. If advice on a particular circumstance is required please contact your Boodle Hatfield lawyer or one of the lawyers listed below:



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