

Discretionary Trusts

A discretionary trust is a type of trust where the trustees are given complete discretion to pay or apply the income or capital of the assets for the benefit of one or all of the beneficiaries. They have control over how much to distribute at any given time, when to make distributions and who to make them to. No particular beneficiary has an interest in the trust or an entitlement to the trust funds – they only have a *potential* interest until the trustees actually exercise their discretion in their favour.

As the trustees have complete discretion over the trust funds, it is advisable for the testator to write a letter of wishes accompanying the Will which provides some guidance to the trustees in how they would like the assets to be distributed. It is important to note that letters of wishes are not a legally binding document and therefore there is no obligation placed on the trustees to follow them.

The aim of this type of trust is to provide flexibility. This could mean that trustees have the flexibility to adapt the money paid to beneficiaries in accordance with their changing needs etc.

What are the benefits of this type of trust?

- Protects a beneficiary's share where they are financially unstable
- Tax saving reasons
- Protecting the benefits of a vulnerable beneficiary
- Safeguarding money from a beneficiary who is currently going through or likely to go through a divorce.

Taking each point above in turn, some beneficiaries may not be trusted to manage large inheritances and the testator may be worried that it will all be spent at once. The benefit of using a discretionary trust here is that the trustees will manage the fund, giving money to the beneficiary as and when they will require it and can essentially drip feed funds. Let us not forget the trustees do have complete discretion, so if a beneficiary with spending habits wants to purchase a top of the range sports car, the trustees are well within their remit to refuse this request.

Holding funds in the trust will also protect the money from the beneficiary's creditors or potential bankruptcy. It is also useful where the beneficiary has a drink, drug or gambling problem and the testator does not want to gift the monies to them directly for fear it could exacerbate their addiction.

A discretionary trust can be used to ensure agricultural property relief or business property relief is used.

A discretionary trust can also be used to preserve funds for a minor until they attain an age where they can manage the money for themselves, or to protect funds for beneficiaries beyond their age of majority – even if there are no concerns of addiction. Some beneficiaries may have already reached the IHT threshold and do not want the inheritance they are to receive to increase the size of their own estate. In this situation, the trustees could simply lend the money to the beneficiary.

These types of trusts are also commonly used by those looking to drip feed money to vulnerable beneficiaries to avoid them from losing any benefits they are entitled to.