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The strategic role of trusts in estate planning and financial planning

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There are many variables at play in wealth preservation planning and, with more options and information available in the digital age, it can feel harder to make decisions. Amid the array of options, the basics rarely change and these should always be considered from the outset.

Estate planning

Estate planning ensures the effective transition of wealth to loved ones. This is best achieved by taking a holistic approach and considering all available possibilities and partnering with an advisor with a wealth of knowledge and experience will make a significant difference to this process. It is also important to know how a person's financial planning will affect their estate when they pass on.

Key considerations

Within an estate plan, you should consider:

- Your last Will and Testament;
- Your marital status and how any antenuptial contract affects your estate;
- Your life insurance and how it is structured;
- Your balance sheet (assets and liabilities) and what will happen with your finances when you die;
- Liquidity to administer your deceased estate;
- Business interests and any shareholder agreements;
- Taxes at death; and
- Family trusts - letter of wishes and other practical matters.

Financial planning

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Financial planning is the process of obtaining relevant financial and personal information about a person or entity, creating a roadmap on how to reach specified goals and advising on appropriate products and structures.

The aim here is to maximise growth and minimise losses, therefore it's important to know what type of assets provide the best growth – for example, the stock market will outperform cash over a long period of time – and also to know where losses occur. It is also crucial to understand the effect of tax on your wealth and then plan accordingly. If you are saving for retirement, for example, it may be better to save in a retirement product than normal savings as there are associated tax benefits. A more advanced discussion would be how to structure ownership of wealth, as this too has benefits and drawdowns.

Key considerations

Within a financial plan, you should consider:

- Your monthly or annual budget;
- A debt servicing plan;
- Saving for a specific goal, like retirement or a planned vacation;
- Medium- and long-term investments;
- Investment vehicles, like companies or trusts
- Emergency savings;
- Tax-free investments;
- Life insurance that covers debt and responsibilities;
- Disability insurance; and
- Critical illness insurance;

It's important to partner up with certified advisors when estate planning and financial planning, as things are not as straight forward as you may think.

Where trusts fit in

Background

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Benjamin Franklin once said that two things in life are certain; death and taxes. Knowledge of the laws that relate to death and taxes may help you grow your wealth more efficiently and to protect what matters most. Certified Financial Planners (CFP®) and Trust- and Estate Practitioners (TEP®) are deemed to be specialists in financial planning and estate planning respectively. They have a solid understanding of the laws and taxes in their respective fields and are well placed to provide stable and current advice.

Why people use trusts

The settlor or founder of a trust can fund the trust by way of donation and can arrange for the trustees to manage those funds on behalf of the beneficiaries or for a specific purpose. The assets of the trust are separate from the assets of the person managing it and the beneficiaries of the trust also never get any rights to trust assets unless the trust instrument stipulates it (or until the trustees vest assets on the beneficiaries). This means that, unless indicated otherwise, persons can benefit from a trust without owning the underlying assets.

This is significant in estate planning, as ownership of assets in a private capacity is taxed in most jurisdictions. For example, inheritance tax in the UK is 40% (on any amount above £325,000), which is the same rate as estate tax in the USA (where non-residents are only eligible to $60,000 tax-free). In South Africa, the estate duty rate is a maximum of 25% (the first R3.5 million of the net estate is tax-free, then up to R30 million net value is taxed at 20% and anything over that at 25%).

A trust can provide for more efficient estate succession, as the settlor or founder can fund the structure and the growth of the trust assets are not included as part of their personal estate. The jurisdiction of the trust is also a consideration, as different jurisdictions tax trusts in different ways. Funding a trust is however a slippery slope and it is best to chat with a specialist before you begin the journey.

Types of trusts

There are many types of trust, but in general trusts are distinguishable by the different types of control and rights of beneficiaries. Here are some types of trusts to consider:

1. Discretionary trusts: the trustees have a discretion on who gets which benefit from a trust and can choose from the pool of individuals who qualify to benefit from the trust, whether they are named or whether they form part of an identified group of people.

2. Fixed interest / vested trusts: this is where the settlor or founder creates the trust by setting out specific rules of how beneficiaries may benefit from the trust. The settlor or founder may create age limits, provide for ratios for benefitting and may distinguish between benefitting from income or capital.

3. Charitable trusts: these are created for philanthropic purposes and can also be registered as a charity.

4. Testamentary trusts/will trusts: these are created at the death of the testator and encapsulated in their last will and testament.

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The efficiency of the trust itself

As stated, the jurisdiction of the trust is relevant to the planning process, as different jurisdictions have different regulations and tax laws.

As an example, trusts can only be created in South Africa by way of formal registration with the Master of the High Court, whereas in other jurisdictions it may be done by way of verbal settlement. The taxation also affects the efficiency of the trust. This is mainly because some jurisdictions tax trusts more extensively than others. A double tax agreement may also be of interest, but be careful of the real benefit of this if the jurisdiction concerned has a flirty relationship with the FATF grey list. For example, it may be better to structure a trust in a reputable, tax-friendly jurisdiction than in the domestic jurisdiction of the wealth creator.

Conclusion

Whether or not to use a trust as part of estate planning is a key consideration for many, especially those who are accumulating wealth for the next generation.

To ensure you move forward in the best possible way, it is sensible to seek expert advice by talking to a specialist. To chat to a member of our team, call us on +44 (0)1481 700550 or email us at guernseytrust@collascrill.com

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COLLAS CRILL

For more information please contact:



Sonia Bourgaize

Operations Director | Guernsey

t: +44 (0) 1481 734255 | **e:** sonia.bourgaize@collascrill.com

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