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Bare Trust / Absolute Trust – Overview

Overview
The term ‘bare trust’ applies to an arrangement where the legal ownership of property is in a different name from that of the person beneficially entitled to it.

How It Works
A bare trust is the simplest form of trust and exists where the trustee holds property for a beneficiary who is absolutely entitled to the income and capital of the trust. The person entitled to it has absolute rights to both capital and income, but the legal owner will conduct the management of it. Where the beneficiary is of full age and capacity, the trustee is obliged to transfer the trust fund on request to the beneficiary, or as the beneficiary directs. The trustee is not otherwise obliged to comply with any other directions given by the beneficiary, for example to sell trust assets, unless the obligation is itself contained in the instrument creating the bare trust.

IHT Treatment
For the purposes of IHT, a bare trust is not treated as a trust at all as it does not meet the definition of a settlement unless a restriction is imposed. Where there are no restrictions and the beneficiary under the bare trust is an individual other than the transferor, the gift into trust will be a potentially exempt transfer (PET). If the settlor survives seven years from the date of the gift, the value transferred will usually fall outside the settlor’s estate for inheritance tax purposes. Additionally, since a bare trust is not within the definition of settled property, the exit charges and ten-year periodic charges of the relevant property regime do not apply to property held on bare trust.

Income Tax Treatment
In all cases except where the assets derive from a living parent (see below), income arising is taxable on the child and benefits from the child's personal allowance. Since children rarely have substantial income, it is likely that the amount of income from the bare trust will fall within the personal allowance.

Special anti-avoidance provisions apply in cases where a parent establishes a trust and their minor child (who is not married or in a civil partnership) is entitled to the income of the trust. In such cases, if the income to which the child is entitled exceeds £100 gross in a tax year, all of the income will be assessed to income tax on the parent who set up the trust.

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Capital Gains Tax Treatment
In contrast to the income tax regime, the CGT legislation sets out the treatment of chargeable gains arising from the disposal of property held by the trustee of a bare trust. Under those rules, the trust's existence is ignored and:

- the beneficiary is taxed as the owner of the trust property, and

- the actions of the bare trustee are regarded as the actions of the beneficiary

Additionally capital gains are assessable on the child, even where the assets derive from a parent. The child benefits from their own annual exemption and lower rates of CGT.

As outlined above and subject to the caveats for tax purposes, the beneficiary is generally treated as owning the assets outright, and so typical uses include:

- Gifts for children or grandchildren
- Junior investment planning
- Simple succession arrangements
- Holding assets until a beneficiary reaches adulthood
- Suitable For
- Clients comfortable making outright gifts
- Parents/grandparents planning for minors
- Smaller estates with simple objectives
- Clients not requiring ongoing control

Usually Unsuitable For:
- Asset protection planning
- Complex family situations
- Beneficiaries with financial immaturity
- Divorce protection concerns
- Long-term dynastic planning

Advantages:
- Simple and inexpensive
- Straightforward administration
- PET treatment rather than CLT treatment
- No ten-year or exit charges
- Beneficiary taxed personally

Disadvantages:

- Loss of control
- Beneficiary entitlement becomes absolute
- Poor asset protection
- Limited flexibility
- Assets become part of beneficiary's estate
- Key Professional Advice Issues
- Settlor-interested anti-avoidance rules
- Minor children income rules
- CGT hold-over relief considerations
- Timing of gifts
- Interaction with nil-rate band planning

Case Study – Helping a Grandchild onto the Property Ladder

Scenario

John and Mary are aged 72 and have a combined estate worth approximately £2.8 million.

They have two grandchildren aged 12 and 15.

They would like to:

- Reduce their estate for IHT purposes.
- Set money aside specifically for their grandchildren.
- Ensure the funds are managed responsibly until the grandchildren are older.
- Avoid the complexity and ongoing costs of a discretionary trust.

After taking advice, they establish a Bare Trust for each grandchild.

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The Planning
John and Mary transfer:

Beneficiary	Amount
Grandchild A	£100,000
Grandchild B	£100,000
Total Gift	**£200,000**

The funds are invested by the trustees who control the investments while the grandchildren are minors.

The grandchildren are the absolute beneficiaries from the outset and there are no restrictions in the trust deed.

Inheritance Tax Position
The transfers are Potentially Exempt Transfers (PETs), meaning that provided John and Mary survive seven years from the date of the gifts:

Item	Amount
Value gifted	£200,000
IHT saving at 40%	£80,000

Growth Outside of the Estate
If we assume the investments grow from £200,000 to £350,000 over ten years:

Item	Amount
Original gift	£200,000
Investment growth	£150,000
Fund value	£350,000

The £150,000 growth occurs outside John and Mary's estates and therefore provides an additional IHT saving of £60,000 (£150,000 x 40%), compared to allowing funds to grow in John and Mary’s estate before making the gift.

Access To Funds
When the grandchildren reach age 18 (England and Wales), they become absolutely entitled to the trust assets.

If Grandchild A uses the fund towards a first home deposit:

Item	Amount
Trust value at age 18	£175,000
House deposit used	£100,000
Remaining investments	£75,000

Taxation of a Bare Trust

For tax purposes, the beneficiary is generally treated as owning the trust assets directly. This means that income and capital gains arising within the trust are normally assessed on the beneficiary and can benefit from their personal tax allowances and rates.

However as stated above where the beneficiary is a minor child and the trust was created by a parent, special anti-avoidance rules may apply, which can result in income above £100 per annum being taxed on the parent instead. These rules do not generally apply to gifts made by grandparents or other relatives, which can make bare trusts particularly attractive for intergenerational planning.

The beneficiary is typically treated as the owner of the assets throughout the life of the trust, both before and after attaining age 18, with the principal change at age 18 being that they become legally entitled to take control of the trust assets.

Advantages

✓Simple trust structure
✓ Low administration costs
✓ PET treatment rather than CLT treatment
✓ No ten-year charges
✓ No exit charges
✓ Growth outside the estate
✓ Useful for grandchildren planning

Risks

✗ Beneficiary gains absolute entitlement
✗ No long-term asset protection
✗ Funds vulnerable to future divorce or bankruptcy
✗ Trustees lose control when beneficiary becomes entitled