



## Discretionary Trusts

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A Discretionary Trust enables assets to be given away without actually giving to any individual.

They have been a feature of UK Trust Law for very many years, and much of the aristocratic wealth in the UK is held in such Trusts.

This is not really for tax reasons but to enable Estates to be protected from spendthrift beneficiaries.

The assets are held by Trustees who have discretion to give the assets or the income from the assets to any one of a class of people named in the Trust Document.

These people are called the beneficiaries and the class described in the Settlement Deed is normally very wide – often expressed as the descendants of grandparents, but a spouse cannot be included while the donor is alive. It is in order to have a widow as a beneficiary.

The Trustees have complete discretion on how the assets and the income is to be dealt with amongst the named class of beneficiaries.

It is, therefore, important to choose the Trustees with care, although it is perfectly in order for the donor, i.e. the person putting the assets into the Trust, to be one of the Trustees.

The Trust will have a perpetuity period of 80 years, and is allowed to accumulate income for 21 years.

The Trust Deed is a legal document, and the Trust has a status independent of the person who put the asset into Trust and the people that can benefit from the asset.

The tax treatment of Discretionary Trusts is, very briefly, as follows:-

An Inheritance Tax Return will need to be submitted to the Capital Taxes Office, and it will be important to establish whether the tax is to be paid by the donor. Additional tax planning is then needed.

### On the creation of the Trust

This is a chargeable life time transfer for Inheritance Tax purposes. It is important to ensure that the net value transferred, i.e. the value of the property going into the Settlement less any business property relief does not exceed £320,000. If it does, then an Inheritance Tax liability arises at 20%.

The disposal of the asset to the Trust will create a liability to Capital Gains Tax. This, however, can be held over so that the Capital Gain for the donor reduces the Capital Gains Tax base value of the asset acquired by the Trust. Indexation allowance and the annual exemption will reduce the donor's gain and, therefore, reduce the amount held over for the Settlement. It will in any case be necessary to prepare a Capital Gains Tax Computation for submission with the donor's Tax Return.

## Ongoing life of the Trust

Income received by the Trust is taxed at 40%, except for dividend income taxed at 32.5% and the Trust will need an annual Self Assessment Tax Return.

Any Capital Gains made by the Trust will also be taxed at 40%.

## Ten Year Charge

All Discretionary Trusts suffer a ten year charge for Inheritance Tax purposes. The amount of tax payable depends, to a large extent, on the cumulative total of gifts made by the settler at the time the Settlement is made. It is, therefore advisable to create the Discretionary Trust as the first Inheritance Tax planning exercise rather than the last. Business property relief can in some circumstances reduce any tax payable through the ten yearly charge. The maximum tax payable on the ten yearly charge is, however, 6% of the value of the Trust's assets at that time.

## Appointments out of the Trust

It is possible for the Trustees to appoint assets in the Trust to beneficiaries of the named class. Such an appointment could, however, have tax consequences and Trustees should always take advice before such an appointment is made.

For further information, please contact Paul Merrell, Tax Director.

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Web/new site 07/Discretionary Trusts

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