Discretionary Trust (settlor excluded) Reasons Why

This document has been compiled to provide you with some information and reasons why to use this type of trust for your client, which you may wish to incorporate within your recommendation letters. These sample paragraphs are for your information and consideration only. You will, of course, need to relate the sections you select to your client's own circumstances as they may not all be relevant. This wording has been produced to help you, as a financial adviser, draft your own material. We accept no responsibility for ensuring that it meets with your own regulatory requirements and you should arrange for approval in accordance with your regulator's rules within your own firm.

Aim of the trust

The trust is designed to help reduce your inheritance tax (IHT) liability where you do not require any access to the trust fund. You can be a trustee which will enable you to retain some control over the trust fund. After seven years there would be no additional IHT to pay on death but the trust fund would still be subject to periodic and exit charges in the future years. Should you die within seven years you may be entitled to taper relief which would reduce the inheritance tax (IHT) payable.

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You can confirm that this February 2024 version is the latest by checking the document library on our website at ***quilter.com***

Mitigation of UK inheritance tax

In order to mitigate inheritance tax, you can consider giving assets away under trust to your family. However, if an asset is to be inheritance tax efficient, you must no longer have access to or receive benefits from it. If benefit is reserved, the gift will be known as a 'gift with reservation' and inheritance tax will be due on death.

The gift into trust will be known as a 'chargeable lifetime transfer' (CLT). If the original owner then survives for seven years following the transfer, there will be no further inheritance tax liability on the original gift. The trust however will still be subject to periodic and exit charges. Many people are not prepared to give up access to their assets.

Currently, only assets above the nil rate band (NRB) of £325,000 (frozen until the end of the 2027/28 tax year) and the residence nil-rate band (RNRB) where available, are liable to IHT on death. Individuals who are married or in a civil partnership each have an allowance.

For investments into trust over the nil rate band, an immediate charge to IHT would occur at half the death rate, ie 20%, on the excess above the NRB. A tax charge may also occur every 10 years and on any exit payments during the trust period.

For a detailed explanation of how chargeable lifetime transfers are taxed on entry and exit, and of periodic charges for single or multiple investments under trust, please read ***'Taxation of Discretionary Trusts - quick reference guides'.***

Through the use of trusts and single premium investments, inheritance tax can be reduced.

What is a Discretionary Trust?

The Discretionary Trust is a trust where the Settlor(s) are excluded from benefiting from the trust. The trust assets are held for the benefit of the beneficiaries by the trustees who have discretion on who will benefit from the trust.

This trust can be set up with the Collective Investment Bond. The transfer of the asset would be a chargeable lifetime transfer (CLT) for inheritance tax purposes. As the trust excludes the Settlor from benefiting under the arrangement, all growth will be outside the estate from day one.

The trust is extremely flexible and will allow the spouse or civil partner to potentially benefit from the arrangement without affecting the inheritance tax efficiency as long as they are not a Settlor as well. No one individual has a defined right to the trust assets. The trustees can hold the assets for a wide class of beneficiary which means the assets can pass down generations easily.

The trust can also be used as a death in service bypass trust. Subject to the trustees of the pension scheme having the power to, and agreeing such a request, the death in service benefits could be directed from a pension trust to this trust and avoid forming part of the spouse's or civil partner's estate and becoming liable to inheritance tax inside the remaining partner's estate if he or she were to die.

Where bonds with capital protected death benefit cover are used with this trust, not only does the initial premium potentially reduce the individual's estate, but any extra life cover, payable on death, can be distributed from the trust to the beneficiaries. When the benefits are distributed from the trust they may suffer an exit charge. If the assets are retained they may suffer a periodic charge at the tenth anniversary and an exit charge on any future payment.

The wording of the trust allows the trustees, at their discretion, to grant loans to beneficiaries with or without interest. If the trust is constructed in the right way, these loans may be paid to a remaining partner and may be repaid by their estate on death. This could significantly reduce the remaining partner's inheritance tax liability further.

Advantages of a Discretionary Trust

- No beneficiary has an interest in possession or absolute entitlement.
- Trustees can apply their discretion on appointing benefits.
- The trust does not need to change when a new individual enters the beneficiary class, eg birth of an additional child.
- Ideal for individuals prepared to give up access to original investment and growth.
- Can be used alongside death in service benefits.
- Easy and simple.
- Pre-owned asset tax (POAT) friendly.

What are the risk factors?

You may not reduce your inheritance tax liability if the HM Revenue & Customs (HMRC) interprets existing legislation differently or if legislation or HMRC practice changes.

Investors should be aware that the value of unit-linked contracts is not guaranteed as the prices of units may fall as well as rise.

The Financial Services Compensation Scheme acts as a safety net for customers of financial services providers. If Quilter cannot meet it's liabilities, the Financial Services Compensation Scheme may arrange to transfer your policy to another insurer, provide a new policy or, if these actions are not possible, provide compensation.

Full details of the Collective Investment Bond (CIB) are available from your Quilter consultant, the Sales Support Centre or at ***quilter.com***.

This information is based on Quilter's interpretation of the legislation as at February 2024. While we believe this interpretation is correct, we cannot guarantee it. Tax relief and the tax treatment of investment funds may change in the future. The value of any tax relief will depend on the investor's financial circumstances.

Quilter cannot accept responsibility for any losses or liabilities arising from actions taken as a result of the information contained in this document.

Trust registration

A trust must register with HMRC's Trust Registration Service (TRS) if it is considered UK resident or has a UK tax liability, unless an exemption applies.

- A trust must register within 90 days of the date of the trust deed.
- The trustees must submit evidence of registration (available from the TRS) or confirm exemption from registration to Quilter within 90 days of the trust date.

Further details regarding trust registration can be found here: ***quilter.com/TrustRegister***

Their Financial Services register numbers are 165359 and 207977 respectively. VAT number 386 1301 59.

QIP 00937/107/6041/February 2024