

# Nucleus Discretionary Gift Trust

Adviser guide

Edition

05

# Introduction

## This document consists of six sections:

1. The Nucleus Discretionary Gift Trust: an overview
2. Inheritance tax (IHT) planning and the Nucleus Discretionary Gift Trust
3. The suitability of the Nucleus Discretionary Gift Trust
4. The Nucleus Discretionary Gift Trust provisions in detail
5. The UK tax implications of the Nucleus Discretionary Gift Trust
6. Frequently asked questions

Please note that the term 'settlor' refers to both settlors in joint settlor cases.

# 1. The Nucleus Discretionary Gift Trust: an overview

## 1.1 The aim

The aim of the draft Nucleus Discretionary Gift Trust is to enable a person to undertake effective and flexible lifetime inheritance tax (IHT) planning. The draft trust is provided on the basis that it will achieve the objectives and have the tax consequences specified in this document. However, it is essential that each client should confirm with their legal and professional advisers that the draft is suitable for their purposes.

## 1.2 Who is it for?

The types of investor who may be interested in using the Nucleus Discretionary Gift Trust could be:

- new investors contemplating an investment in collective investments in a Nucleus General account (referred to in this guide as 'collectives') or a Nucleus Onshore or Offshore Bond.
- investors already holding collectives in a Nucleus General account.
- investors who already hold a Nucleus Offshore Bond provided by RL360 Insurance Company Limited or a Nucleus Onshore Bond provided by Sanlam or by Scottish Friendly Assurance.

An investor using the Nucleus Discretionary Gift Trust is called the settlor. By using the discretionary gift trust with cash intended for a new investment, an existing bond or a holding of collectives, the settlor(s) will be making a gift of the cash or asset(s) transferred into trust.

For a new investment, the gift is of cash and the trustees will collectively apply for the intended investment in the Nucleus wrap.

For existing investments, the ownership of the investment will be transferred to the trustees.

The trust can be used regardless of whether the gift is to be made by one individual or two jointly. A 'joint gift' will be made when the cash is coming from the joint account of a couple or an existing bond or the general account is owned jointly. For IHT purposes, each of the joint settlors is then treated as a separate settlor who has created a separate settlement of half the value of the cash or investments transferred to the trust.

## 1.3 Tax effectiveness and flexibility

The trust is 'discretionary' which means that there is no need to decide at outset which beneficiary is entitled to what or when they become entitled to it. There are several classes of beneficiary and the settlor (and, following their death, the trustees) as the 'appointor' under the trust has a discretion as to which of those beneficiaries should receive what, how much and when. On completing the trust deed the settlor can add a class of beneficiary(ies) to the pre-designated list. Further beneficiaries can be added by the settlor notifying the trustees in writing at any time.

When a settlor creates a discretionary gift trust (with cash or existing investments), the gift will be a chargeable lifetime transfer for IHT purposes to the extent that the cash invested (or the market value of the existing investment transferred to the trust) exceeds the settlor's available annual exemption(s) (£3,000). However, provided the value of the gift is below the settlor's available nil rate band (£325,000 until April 2021) no actual IHT charge will arise when the trust is made (see section 5 of this guide for further details).

To ensure that the discretionary gift trust is effective for IHT purposes, the settlor cannot benefit from the trust assets under any circumstances.

The settlor can choose whether to include their spouse or civil partner as one of the beneficiaries. Although this would have no adverse IHT implications, it has important income tax implications. Where there are married settlors neither can be a beneficiary.

Full details of the UK tax implications of the Nucleus Discretionary Gift Trust can be found in section 5 of this guide.

## 1.4 Avoiding probate (confirmation in Scotland)

As well as the important tax benefits, the investment that is held by the trustees in a Nucleus Discretionary Gift Trust will not be an asset of the settlor's estate for probate purposes. This means that, in the event of the death of the investor, the trustees can carry on dealing with the investment without waiting for probate on the settlor's estate.

However, to ensure that this is possible, there must be at least one trustee who survives the settlor. Under the Nucleus Discretionary Gift Trust the settlor is automatically one of the trustees and further trustees are appointed in the trust deed. If any of the additional trustees retires or dies before the settlor, a replacement trustee should be appointed.

If all of the additional trustees have resigned, died or have been removed so that there is no surviving trustee on the death of the settlor, the settlor will be the sole trustee at the time of their death. The trust will nevertheless continue to exist and be effective for IHT, but the personal representatives of the deceased settlor will assume the role of trustee. This means that although the trust investments will not be part of the settlor's estate for IHT or probate purposes, securing probate to the settlor's estate will still be necessary to ensure that the personal representatives can act as trustee under the discretionary gift trust.

It is very important that additional trustees are appointed who are likely to survive the settlor so as to ensure that any delay in being able to deal with the trust investments are avoided.

An appointment of an additional trustee is particularly important if the settlor is domiciled in Scotland as, without an additional trustee, the trust may not be validly created under Scots law.

## 2. IHT planning and the Nucleus Discretionary Gift Trust

Only outright gifts to individuals and gifts into bare (absolute) trusts or into trusts for the disabled are treated as potentially exempt transfers (PETs).

All other lifetime gifts to a trust are treated as chargeable lifetime transfers (CLTs) and the trusts themselves fall into what is called the 'relevant property regime'. However, provided the gift, when added to the settlor's cumulative total of CLTs in the previous seven years, does not exceed the nil rate band (£325,000 until April 2021) there will be no tax to pay when the trust is established. Other charges can also arise in respect of 'relevant property' trusts every 10 years and when benefits are paid out of the trust to the beneficiaries (see section 5 of this guide for further details). However, provided the value of the trust fund, when added to the settlor's seven year cumulative total of transfers made up to the date that the trust is created but not including the transfer to the trust itself, is below the nil rate band there will be no tax to pay.

To ensure that the settlor makes an effective gift for IHT purposes, the settlor must not retain any benefit (actual or prospective) under the trust, otherwise the gift with reservation of benefit rules will apply. The Nucleus Discretionary Gift Trust is expressed as being irrevocable and the only persons who can benefit are the beneficiaries specified in the trust deed. As the settlor is not and cannot be a beneficiary, the trust is effective for IHT purposes.

The settlor's spouse or civil partner may be included as a beneficiary if the settlor wishes and this by itself will not have any adverse IHT implications (i.e. it will not amount to a gift with reservation of benefit). However, great care should be exercised if any payments are to be made from the trust to the settlor's spouse or civil partner during the settlor's lifetime. If in such circumstances the settlor enjoys a direct or indirect benefit (for example if the funds were used for common family expenses), the trust could then be caught by the gift with reservation of benefit provisions thus making it ineffective for IHT purposes.

If a married couple jointly created a trust then, as they would both be settlors in relation to that trust, neither could be a beneficiary under the trust.

The gift with reservation of benefit provisions could also apply if each of the couple were to effect their own separate discretionary gift trust, under each of which the other was a beneficiary.

The inclusion of the settlor's spouse or civil partner as a beneficiary under the trust would, however, give rise to income tax implications (see section 5 of this guide for further information).

For a detailed consideration of the IHT implications of the discretionary gift trust see section 5 of this guide.

## 3. The suitability of the Nucleus Discretionary Gift Trust

### 3.1 Suitability

The discretionary gift trust may be suitable for an investor who:

- would like to make a gift of collectives held in an existing Nucleus General account or of a Nucleus Onshore or Offshore Bond in the Nucleus wrap, or the money intended for a new investment in the Nucleus wrap.
- would like to retain control and flexibility over who should benefit from the investment.
- understands that they will not be able to benefit from the investment under any circumstances.
- would like the benefits of the investment to be outside their estate for probate purposes when they die.

### 3.2 Matters to consider before establishing the trust

A discretionary gift trust is suitable in relation to cash or investments owned by one person or jointly who, after discussion with their legal and/or other professional advisers, are happy that the legal and tax implications of the trust are suitable for them and that the trust will help them to achieve their objectives in relation to tax and financial planning. In particular, the settlor should understand that when a gift is made into a discretionary trust, to the extent the gift exceeds the available annual exemption(s), it will be a chargeable lifetime transfer (CLT) for IHT.

There will be no IHT liability if the value of the gift (less any exemptions available to the settlor and plus the value of all CLTs made by the settlor in the seven years immediately preceding the creation of the trust) is not more than the IHT nil rate band at that time.

Before recommending the Nucleus Discretionary Gift Trust, it would be appropriate to determine:

- the potential IHT liability on the investor's estate (including the history of previous gifts) if no action is taken.
- the practical objectives of the investor. Namely, how much flexibility is required, who the potential beneficiaries should be and, in particular, whether the settlor's spouse or civil partner (in single settlor cases), should be included amongst the beneficiaries.
- that the settlor is happy to give up all future access to the investment.
- the size of the intended gift.
- the choice of the intended investment (i.e. onshore or offshore bond or collectives).
- if the investment is to be in collectives, whether the income from the collectives should be accumulated or distributed.

If the gift causes the settlor to exceed their available nil rate band for IHT there will be a 20% liability on the excess. Usually a settlor should not make CLTs that cause the available nil rate band to be exceeded and so result in an immediate IHT liability.

If the intention is to invest in collectives and distribute income to beneficiaries then, in order to avoid having to pay income tax at the (higher) trust rates on income received and paid by the trustees, the Nucleus Flexible (Interest in Possession) Trust may be more appropriate.

In cases where an investor is happy that their choice of beneficiary is certain, will not need to be changed and they would prefer to secure PET treatment for their gift, the Nucleus Discretionary Gift Trust is not suitable but a Nucleus Bare Gift Trust may be.

The Nucleus Discretionary Trust is not suitable for an investor who requires some beneficial access to their investment, however other trusts offered by Nucleus may be suitable. Nucleus provides a trust selector to assist in this process. The choice of trust should always be discussed with professional advisers.

Full details of the tax implications of the discretionary gift trust are set out in section 5 of this guide.

## 4. The Nucleus Discretionary Gift Trust provisions in detail

For tax purposes the Nucleus Discretionary Gift Trust is a discretionary settlement. The trust gives the appointor power to appoint benefits under the trust among a wide class of beneficiaries. The settlor is the first appointor and, after the settlor's death (or mental incapacity), the appointor will be the trustees. No beneficiary is entitled to any benefit until the appointor decides. The ultimate default beneficiaries named in the trust will benefit only if no other appointment has been made by the end of the trust period, which is 125 years.

The following is a summary of the key provisions as they appear in the draft Nucleus Discretionary Gift Trust.

### Recital

The deed, if thought to be suitable, would be executed by the settlor and the named additional trustees. Their details, and the date the trust deed is to be executed are all required in this 'opening' part of the trust deed.

### Part 1 – Declaration

The trust applies alternative provisions depending on whether a new investment is contemplated or an existing investment is being transferred to the trustees.

The settlor also chooses the name for their trust.

### Part 2 – Definitions

In this part of the trust the terms used throughout the trust are defined to avoid repetition. The most important definitions are those of the discretionary beneficiaries and the default beneficiaries.

The discretionary beneficiaries are those in favour of whom the trustees may make appointments of benefits. They include:

- the widow or widower of the settlor.
- the children and the remoter issue of the settlor.
- the settlor's spouses or civil partners.
- the brothers and sisters of the settlor and their issue.
- anybody who would benefit from the estate of the settlor on the settlor's death.
- any person nominated in writing to the trustees by the settlor.
- any charity.

The settlor can add any other individuals not covered by the standard wording.

The settlor can choose whether to include their spouse or registered civil partner in the class of discretionary beneficiaries. This will have important income tax implications if the investments of the trust are collectives (see section 5 for further information). The settlor is excluded as a beneficiary. In the case of joint settlors, because the spouse or civil partner will already be a settlor, he or she cannot by definition be a beneficiary.

The class of discretionary beneficiaries is therefore very wide and can be added to by the settlor; all that is necessary is a written notification of a 'new beneficiary' to the trustees. However, the settlor cannot add themselves to the class at any time.

The default beneficiary(ies) is the individual(s) who will benefit if the power of appointment is not exercised by the appointor by the end of the trust period, i.e. 125 years from the time the trust is created. They are named by the settlor in the trust deed at outset. At least one person must always be named and, if more than one is named, the shares in which they are to benefit must be stated. This is necessary to make sure the trust is valid and the property will not return to the settlor or the settlor's estate.

### Part 3 – The main trust terms

In this part the power of appointment is defined as well as the default entitlement if the power of appointment is not exercised.

As previously indicated, the power to appoint capital and income under the trust is vested in the appointor. This is the settlor during their lifetime whilst they have full mental capacity and then the trustees. The power is exercisable at the appointor's discretion and includes the power to appoint further trusts in favour of beneficiaries.

The trustees have power to accumulate any trust income. The accumulation can be made without time limit if the trust is governed by English law, and for 25 years if the trust is governed by Scots law (this is the maximum period allowed under Scots law). Such income is then reinvested.

If not all of the trust property has been appointed by the end of the 125-year trust period then the default beneficiaries will benefit.

There is also a special provision dealing with any potential conflict of interest. In many cases the trustees of the trust would be family members who would also be beneficiaries under the trust. If an appointment of benefits were to be exercised in favour of a beneficiary who is also a trustee then a suspicion of conflict of interest could arise. For this reason there is a provision in this trust which states that if a beneficiary is also one of the trustees, the trustees (as appointor after the settlor's death) can only make an appointment in favour of that beneficiary if there is at least one other trustee who does not benefit directly or indirectly from the appointment being made.

## 4. The Nucleus Discretionary Gift Trust provisions in detail

The trustees have wide powers included in the trust to advance capital from the trust fund to the beneficiaries and to make loans to beneficiaries. The power to lend may be more appropriate than the power to advance in many circumstances.

### Part 4 – Trustees’ administrative powers

The trustees have wide administrative powers to deal with the trust fund and to reinvest the proceeds of any investment in any way they wish. They also have the power to borrow funds, to make payments to parents or guardians of minor beneficiaries and to delegate certain powers. There is a useful power to delegate any administrative functions in connection with investment of the trust fund to any two of the trustees. In such a case only two of the trustees will need to sign any instructions, e.g. to sell assets.

### Part 5 – Appointment, dismissal, retirement and remuneration of trustees

The power to appoint new or additional trustees is vested in the appointor, i.e. the settlor during their lifetime and with full mental capacity, and after their death in the trustees. The settlor whilst alive and of full mental capacity also has power to dismiss any trustee provided at least one trustee other than the settlor and/or the settlor’s spouse or civil partner remains after such a dismissal.

There is no power to dismiss a trustee after the death of the settlor and it must be remembered that trustees under an English trust must act unanimously. In Scotland trustees can make decisions by a simple majority.

If two persons are joint settlors, they exercise their powers jointly during their joint lives and after the death or mental incapacity of the first of them the survivor exercises the settlors’ powers alone.

There are also powers dealing with the retirement of trustees and corporate trustees.

Trustees who act in their professional capacity are entitled to charge fees.

### Part 6 – Further trust provisions

These mainly deal with the trustees’ liability for any loss to the trust fund.

The liability of individual trustees is limited so that they will not be held liable for any loss to the trust fund provided they act in good faith. Trustees who are paid for their services are liable for negligence.

There are also comprehensive provisions excluding the settlor from all benefit (and the settlor’s spouse or civil partner unless the settlor specifically included the spouse or civil partner as a discretionary beneficiary at outset).

### Part 7 – Proper law

The trust gives the settlor the choice of law to govern it, either the law of England or the law of Scotland. Those domiciled in Scotland will usually choose Scots law to apply to their trusts but there is no requirement to choose the law of the settlor’s domicile.

The tax implications of the trust are the same throughout the UK.

### The schedule

The asset(s) being transferred to the trust is (are) identified in the schedule.

### Part 8 – Signatures

The trust deed is executed by all the parties by signing and having their signatures witnessed.

## 5. The UK tax implications of the Nucleus Discretionary Gift Trust

The following information assumes that the settlor, the beneficiaries and the trustees of the trust are UK resident and domiciled. Special rules apply where this is not the case.

### 5.1 Inheritance tax (IHT)

#### 5.1.1 Establishing the trust

For IHT purposes a transfer of value (a gift) takes place at the time the trust is created.

Where there are two settlors, each is normally treated as making a gift of one half of the value transferred.

The value of the gift will be the value of the assets in the general account or the value of the bond that is made subject to the trust at the time of the gift. For new investments it will be the amount invested.

To the extent the gift exceeds the settlor's available annual exemption (currently £3,000 for each settlor or a maximum of £6,000 for each settlor if the exemption for the previous tax year has not been used), it will be a chargeable lifetime transfer (CLT). This means that a liability to IHT at 20% will immediately arise to the extent that the value of the gift to the trust plus the value of all other CLTs made by the settlor in the previous seven years, causes the settlor's nil rate band at the time the trust is established to be exceeded. A further tax liability at 20% could arise on the gift if the settlor dies within seven years of making the transfer (see section 5.1.3 for further details).

#### 5.1.2 Does HMRC need to be informed about the discretionary trust?

The trust must be registered using HMRC's online trust registration service when it first becomes liable to any of the following taxes:

- Capital Gains Tax
- Income Tax
- Inheritance Tax
- Land and Buildings Transaction Tax (in Scotland)
- Stamp Duty Land Tax
- Stamp Duty Reserve Tax or Stamp Duty

The relevant deadline for registration is, in the case of income tax or capital gains tax, 5 October following the end of the tax year in which a liability first arises. For the other taxes listed above, the relevant deadline is 31 January following the end of the tax year in which a liability first arises.

Each year the trustees will receive the Trust and Estate Tax Return (form SA900), which they have to complete under self assessment if they have any liability to income tax or capital gains tax.

In addition, where a person makes a gift that is a CLT (e.g. to a discretionary gift trust) they may need to report it to HMRC on IHT forms 100, 100a and D34 (note that form D34 is for existing bonds only).

Whether a gift will need to be reported depends on the amount of the gift and the nature of the assets gifted. The gift will need to be reported if:

- where the gift is of cash or quoted shares, it causes the settlor to exceed the then nil rate band, taking account of CLTs made in the previous seven years.
- where the gift is of all other assets (e.g. a bond), it causes the donor to exceed 80% of the nil rate band at that time, taking account of CLTs made in the previous seven years or the amount gifted exceeds the nil rate band at that time less CLTs made in the previous seven years.

Trustees of discretionary trusts may also have to submit special IHT returns on 10-year anniversaries and when distributions from the trust are made, even though IHT charges may then not apply. The forms to use here are IHT 100, form 100c (for exit charges) and form 100d (for 10-year anniversary (periodic) charges). In practice, given the amounts involved before any reporting is required, it is unlikely that Nucleus investors will have to satisfy these requirements.

#### 5.1.3 What are the IHT implications of the settlor dying within seven years of establishing the discretionary gift trust?

On the death of the settlor, at any time, the assets in the trust will be outside of the settlor's estate for IHT purposes.

IHT may however arise on the initial gift. This would be the case where the value of the original gift to the trust, after deducting any available exemptions, caused the settlor to exceed their available nil rate band so that a liability at 20% arose at that time. On the death of the settlor within seven years a further tax liability at 20% of the excess would arise on the gift although taper relief will be available to reduce the IHT liability if the settlor has survived the gift by at least three years.

If the value of the original gift (taking account of gifts within the previous seven years) is within the available nil rate band, no liability will arise on the gift itself either at the time it was made or on death within seven years of the gift.

Regardless of whether the original gift itself triggered a charge to IHT, to the extent that the original gift fell within the available nil rate band, then for the seven years following the making of the CLT, the CLT will use the whole or a part of the nil rate band (as appropriate) that would otherwise be available to the settlor's estate to determine the liability arising on that part of the settlor's estate that passes to non-exempt beneficiaries.

## 5. The UK tax implications of the Nucleus Discretionary Gift Trust

### 5.1.4 What are the IHT implications for the trust?

As this is a discretionary trust, this means that the special IHT charging relevant property rules apply. Under these rules there may be IHT charges on every 10-year anniversary of the trust – the ‘periodic charge’ – and/or whenever property leaves the trust (e.g. when capital is advanced to a beneficiary) – the ‘exit charge’.

If there are joint settlors, the trust is effectively treated as two separate trusts, with each settlor deemed to have established a trust for 50% of the total amount contributed for all IHT purposes.

#### The periodic charge

Periodic charges at 10-yearly intervals from the creation of the trust are, broadly speaking, applied to the value of the assets in the trust at the time of the relevant 10-year anniversary. The effective rate of IHT will be determined based on an assumed transfer by an assumed transferor.

This will mean that it will broadly be necessary to take account of:

- the value of the property in the trust on the 10-year anniversary and the value in any other related trusts set up on the same day (the assumed transfer).
- the settlor’s cumulative total of CLTs made immediately before the trust was established (or immediately before any property was added to the trust) plus any sums paid out of the trust in the 10 years prior to the anniversary (the cumulative total of the assumed transferor).

The maximum liability will, in effect, be 6% of the value of the trust property above the available nil rate band. This means that, in many cases, the effective rate on the whole of the trust property will be much lower than 6%, possibly nil.

In cases where the settlor has not made any CLTs in the seven years before the trust is created, no payments having been made out of the trust in the previous 10 years, there are no related trusts and there has been no added property, there will be no liability provided the value of the trust does not exceed the nil rate band applicable at the 10-year anniversary. Any excess over the nil rate band at that time will suffer IHT at an effective rate of 6%.

If the capital in the trust fund at the anniversary includes income that has been accumulated by the trustees and added to the trust capital, there will be a reduction in the IHT rate that applies to this capital to allow for the period of time before which the accumulated income was added to the capital.

#### Example

Christine creates a discretionary gift trust on 1 January 2019 by investing £300,000 in a Nucleus General account. She has made no chargeable transfers in the previous seven years. No payments are made out of the trust in the first 10 years.

On 1 January 2029 the trust fund (i.e. the value of the collectives in the general account) is worth £600,000 and the nil rate band is £550,000.

The IHT charge will be calculated as £50,000 at 6% = £3,000. This equates to 0.5% of the total value of the trust fund.

If all the trust fund is distributed before the tenth anniversary, no tax charge will usually arise (see ‘The exit charge’ below for further information). If assets remain in the trust after a distribution (or if further assets are added to the trust), the trustees will need to seek specialist tax advice.

#### The exit charge

Exit charges will be based on the value of property leaving the trust.

#### First 10 years

There will be no exit charges within the first 10 years following the creation of the discretionary gift trust if the cumulative total of the settlor’s CLTs in the seven years immediately prior to creating the trust, when added to the value of the property transferred to the trust, is below the nil rate band when the trust is created and no assets have been added to the trust. If an exit charge does arise, it will increase according to the number of quarters that have expired since the trust was created.

#### After the first 10-year anniversary

The amount of any exit charge occurring after the first 10 years will depend on the rate of tax charged at the previous 10-year anniversary (if any) and the length of time (in quarters) that the property has been in the trust since the last periodic charge. In many cases with a discretionary gift trust, there will have been no periodic charge (see ‘The periodic charge’ for further information) at the previous 10-year anniversary and so no exit charge would arise.

#### Example

Let’s assume that on the first 10-year anniversary of Christine’s trust a periodic charge of 0.5% was charged and the nil rate band remains the same.

On 2 January 2035, six full years since the first 10-year anniversary, the trustees of Christine’s trust sell some shares from the general account and pay £50,000 to a beneficiary. The IHT charge will be  $£50,000 \times 0.5\% \times 24/40 = £150$ .

## 5. The UK tax implications of the Nucleus Discretionary Gift Trust

No IHT charge will arise on property paid out of the trust if there was no IHT charge at the last 10-year anniversary.

The occasion of a periodic charge and transactions that can give rise to an exit charge, such as capital payments to the beneficiaries, may also need to be reported to HMRC on forms 100c (exit) and 100d (periodic) if they exceed a certain amount.

### 5.2 Income tax

The income tax implications of the discretionary gift trust depend on whether the asset held by the trustees is an onshore or offshore bond (see section 5.2.2.1) or collectives in the general account (see section 5.2.2.2 below).

#### 5.2.1 Creation of the trust

The transfer of an existing onshore or offshore bond into a trust does not give rise to a chargeable event and so there are no income tax implications.

There are no income tax implications on the transfer of a collective into trust except in the case of offshore non-reporting funds, in which case the gain (based on the market value of the investment at the date of transfer, less the acquisition price but without the benefit of the annual exemption) will be taxed as your income.

#### 5.2.2 During the trust's existence

##### 5.2.2.1 Chargeable event gains under a bond (onshore or offshore)

When a bond held subject to a discretionary gift trust is encashed (fully or partially), a chargeable event gain can arise that will be subject to income tax. Who that gain is taxed on depends on whether the settlor is alive or not and whether they are UK resident.

During the settlor's lifetime and in the tax year in which the settlor's death occurs.

For income tax purposes, any chargeable event gains arising under the bond will be assessed on the settlor provided the settlor is alive and UK tax resident. If there are joint settlors, each will be assessed on one half of the gain. A 20% tax credit will apply if the bond is a Nucleus Onshore Bond, which means that a liability will only arise if the settlor is a higher rate (40%) or additional rate (45%) taxpayer. This credit will not be available for gains made under offshore bonds. Please refer to the relevant Nucleus Onshore and Offshore Bond literature for full details of the relevant bond taxation.

After the end of the tax year in which the settlor's death occurs or in a year in which the settlor is non-UK resident.

Any chargeable event gains arising in a tax year after that in which the settlor died (or in a year in which the settlor is non UK resident) will be assessed on the trustees if they are UK resident. The first £1,000 of gain (assuming the settlor has not made other trusts) is taxed at the 'standard rate' which is 20% and the rest at the special rate of 45%. A 20% tax credit will apply if the bond is an onshore bond but this credit is not available for offshore bonds.

If the trustees are not UK resident there are special rules and specialist advice should be sought if this is the case.

##### 5.2.2.2 Income arising to the trustees from investments in collectives

The income tax position will depend on the type of collective in question and whether the settlor's spouse or civil partner is included as a discretionary beneficiary.

#### UK funds and offshore reporting funds

##### (a) If the settlor's spouse or civil partner is excluded from benefit under the trust

If the spouse or civil partner of the settlor is excluded from benefit under the trust (the settlor will always be excluded), then for income tax purposes the trustees are taxed as the owners of the trust investments and are assessed to income tax on any trust income (e.g. dividends).

Taxation of income has changed from tax year 2016/17 and tax rates depend on whether the income is treated as dividend or interest distribution.

Individual taxpayers are entitled to two tax allowances: the Personal Savings Allowance (PSA) and the dividend allowance. Neither of these allowances are available to trustees.

The first £1,000 of gross income in a tax year is taxed only at a 'standard' rate. The tax rates on income falling within the standard rate band are 7.5% for dividends and 20% for savings income. Tax credit on interest distributions will cover the 20% tax. But as dividends are now paid gross and without tax credit, the trustees will have to pay the 7.5% on dividends received. The rates above the standard rate are 38.1% for dividends and 45% for other income.

## 5. The UK tax implications of the Nucleus Discretionary Gift Trust

The income that exceeds the standard rate band £1,000 limit is assessed on the trustees at a special trust rate which is either 38.1% (on dividends) or 45% (on other income).

Where income is to be distributed to a beneficiary, the trustees must first have paid 45% income tax on the income they have actually received regardless of its source. For these purposes tax already paid by the trustees on 'received' income will count. Where the trustees have paid insufficient tax on the income (perhaps because the income fell within their standard rate band or was taxed at the lower dividend rate in the hands of the trustees), they may have to pay more tax to cover the beneficiary's tax credit.

The beneficiary will then be taxed on the income received from the trust grossed-up to take account of the tax credit in respect of the tax paid by the trustees. Where the beneficiary is not an additional 45% rate taxpayer, a tax reclaim may be made. However, as this income is classed as "trust income" neither the PSA nor the dividend allowances will be available.

If the beneficiaries include the settlor's minor unmarried children who are not in a civil partnership and any income from the collectives held in trust is actually paid to such a child, or for their benefit, it will be assessed to tax on the settlor if this income and income from all other gifts the settlor has made to or for the benefit of that child exceeds £100 gross in a tax year. In such cases the settlor will be entitled to use his PSA and /or dividend allowance.

### (b) If the settlor's spouse or civil partner is included as a beneficiary under the trust

If the spouse or civil partner of the settlor is included as a discretionary beneficiary under the trust all trust income will be treated as income of the settlor. However, the trustees will still be liable to income tax at the trust rates which are 38.1% on dividend income and 45% on non-dividend income on income in excess of the standard rate band. The trustees will therefore effectively pay tax on behalf of the settlor. If the settlor pays a lower amount of tax on the income than that paid by the trustees, the tax overpaid by the trustees can be reclaimed from HMRC. Any such reclaimed tax must be paid back to the trust. In such cases the settlor will be entitled to use his PSA and /or dividend allowance.

Because trustees normally pay income tax at the highest rate, this means that for those settlors who are not additional rate taxpayers (i.e. those whose taxable income does not exceed £150,000) the inclusion of the settlor's spouse or civil partner may result in a reduced overall income tax liability. However, it will not reduce the amount of administrative work for the trustees. While the tax consequences will be relevant there are likely to be other factors contributing to the settlor's decision as to whether to include their spouse or civil partner as a beneficiary under the trust.

### Offshore non-reporting funds

Where the collective is an offshore non-reporting fund there will normally not be any real income distributions from the fund. Instead, when units/shares are disposed of, e.g. on sale, the gain (known as an offshore income gain) realised by the investor (the trustees) will be taxed as income. The offshore income gain will be calculated in the same way that a capital gain would be calculated but without the benefit of the annual exemption from capital gains tax. This means that any income that arises to the fund effectively suffers income tax when an offshore income gain is made by the investor (the trustees).

Who is assessed to tax on an offshore income gain made by the trustees depends on whether the settlor's spouse or civil partner can benefit under the trust or not.

#### (a) Where the settlor's spouse or civil partner is excluded from all benefit under the trust

The trustees are liable to tax at the special rate of 45% on offshore income gains. Any amount of the offshore income gain that falls within the £1,000 standard rate band will be taxed at 20%, within income in excess of £1,000 being taxed at 45%.

Where a payment is made out of the trust by the trustees to a beneficiary it is treated as capital without any further liability to tax.

#### (b) Where the spouse or civil partner of the settlor may benefit under the trust

If the spouse or civil partner of the settlor is included as a beneficiary under the discretionary gift trust, all trust income (including offshore income gains) will be taxed on the settlor at their personal rates of income tax. This rule does not apply if only the widow or widower of the settlor can benefit.

However, despite this, the trustees will still be liable at the 45% trust rate described above, effectively paying tax on behalf of the settlor. The settlor will receive a credit for the tax paid by the trustees. If the settlor is not a higher rate or additional (45%) rate taxpayer and the trustees have paid income tax on the income at 45%, the settlor can reclaim any excess tax paid by the trustees from HMRC. Even if the settlor is a higher rate (i.e. 40%) taxpayer, but not a 45% taxpayer (i.e. their taxable income is less than £150,000), the settlor will be able to recover the 5% tax difference. Any tax recovered must be paid to the trustees.

Where a payment is made out of the trust by the trustees to a beneficiary it is treated as capital without any further liability to tax.

Special rules apply if the settlor is non-UK domiciled and offshore income gains arise but this is not something contemplated with investments in a Nucleus wrap.

## 5. The UK tax implications of the Nucleus Discretionary Gift Trust

### 5.3 Capital gains tax (CGT)

#### 5.3.1 Creation of the trust

When collectives in the Nucleus General account are transferred to the discretionary gift trust this will be a disposal for CGT purposes, treated as having been made at the market value of the investments transferred to the trustees on the date they are transferred. Any gain will be calculated in the usual way (using the market value as the disposal price) and, subject to the deduction of the settlor's available annual exemption (£11,700 in 2018/19), taxed at 10% and/or 20% depending on the level of the settlor's other taxable income.

As the transfer to the discretionary trust is also a chargeable transfer for IHT purposes, any chargeable capital gain can be held-over, i.e. deferred until a subsequent disposal by the trustees. However, a claim for hold-over relief will not be possible if the settlor's spouse/civil partner or minor child/children can benefit under the trust.

For a transfer of cash, an offshore non-reporting fund or an onshore or offshore bond to the discretionary gift trust, no CGT liability will arise.

#### 5.3.2 Trust capital gains (only relevant to collectives held in the general account)

- The trustees are assessed to CGT on any capital gains arising when they sell the shares/units held as trustee investments in the Nucleus General account or transfer those shares/units to a beneficiary. The fact that the investments are held by the nominee company is ignored. However, where the fund is an offshore non-reporting fund the gain will be subject to income tax (see section B of 'Offshore non-reporting funds' in 5.2.2.2).
- Unless the settlor has created more than one settlement the trustees are entitled to an annual CGT exemption equal to £5,850 in 2018/19 (i.e. equal to half of the exemption available to individuals) before any tax is actually payable. The trustees will pay tax at a special trustee rate which is 20% on capital gains that exceed their available annual exemption. There is a higher rate, 28% where the asset disposed of is an interest in residential property. If the settlor has created more than one trust (ignoring bare trusts) since 1978 the annual exemption is divided between such trusts, but will not fall below one tenth of the full exemption available to individuals, i.e. £1,170 for each trust.

### 5.4 Advancement of assets out of the trust

Instead of encashing collectives or onshore or offshore bonds prior to advancing capital to a beneficiary (assuming an absolute appointment in the beneficiary's favour has been made) the trustees could transfer the actual investments 'in specie' to the beneficiary.

The tax effect of this would depend on the asset advanced.

#### (a) Onshore or offshore bond

The advancement to an appointed beneficiary would not give rise to a chargeable event and so there could be no income tax liability at the time of the advancement.

Any gains arising on subsequent encashment by the 'receiving' beneficiary would be subject to tax at the rate of tax relevant to that beneficiary.

#### (b) Collectives

The appointment of a collective to a beneficiary would be a disposal for CGT purposes deemed to be at the market value of the investment at the time of appointment (with the exception of shares/units in an offshore non-reporting fund when the gains would be subject to income tax as offshore income gains) with the usual consequences for the trustees as described above. However, as the transfer out of a discretionary trust is also a chargeable transfer for IHT purposes, any chargeable capital gain (but not an offshore income gain) can be held-over, i.e. deferred until a subsequent disposal by the beneficiary, when the beneficiary's own annual CGT exemption would be available. For this purpose the fact that the beneficiary may be a child or a spouse/civil partner of the settlor is not relevant.

It would be necessary for a new general account to be opened in the name of the beneficiary and for the shares/units to be re-registered in the beneficiary's name.

## 6. Frequently asked questions

### Who can be a trustee of the discretionary gift trust?

The settlor will automatically be a trustee. Additional trustees must be appointed and this is contemplated in the trust deed at outset. Anyone over 18 years old and of sound mind may be appointed. It may be appropriate to appoint a professional adviser, such as a solicitor or accountant, as a trustee, although such a person is likely to charge a fee for acting as trustee. It is essential that at least one additional trustee survives the settlor if the need for probate is to be avoided following the settlor's death to determine who the successor trustee will be.

### Why is it necessary to name a default beneficiary?

The settlor must name (as 'default beneficiaries') the individual or individuals who the settlor would like to benefit from the trust fund if no other appointment is made during the trust period. As this is 125 years from the date the trust is created, this is an unlikely outcome. Nevertheless, this is necessary, not just to ensure that there is certainty as to who is a beneficiary at all times, but also to avoid potential unwanted tax implications. If there is no certain default beneficiary under a trust, there can be a 'resulting trust' in favour of the settlor. Although this will not upset the IHT treatment of the trust, for income tax purposes the trust may then be treated as a 'settlor-interested' trust, even if the spouse or civil partner of the settlor is excluded from all benefit. This means that there may be a risk that the POAT (pre-owned assets tax) income tax charge may arise.

### What investments can be held in the discretionary gift trust?

The discretionary gift trust is only available for use with investments held in a Nucleus wrap: collectives in a General account or the Nucleus Onshore or Offshore Bond. The trustees are free to reinvest elsewhere if they so choose in due course. Once the trust is created, the nature of the underlying investments does not impact on the validity of the trust.

### Should each of a couple set up their own individual discretionary gift trust?

This is not recommended except where neither can benefit under the trust created by the other. If the settlor's spouse or civil partner is included as a discretionary beneficiary under each trust, the trusts could then be regarded as reciprocal arrangements and so cause the IHT gift with reservation of benefit provisions to apply.

### Is the discretionary trust available for joint settlors?

Yes, but only where the couple are married or registered civil partners. In those circumstances the funds for investment must come out of a joint account or the settlors must already jointly hold a Nucleus General account or a Nucleus Onshore or Offshore Bond.

Each will normally be treated as settling 50% of the assets. In these circumstances the settlor's spouse or civil partner would not be specified as a category of discretionary beneficiary.

### Is stamp duty payable?

With effect from 1 December 2003, stamp duty on documents was abolished which means that a declaration of trust no longer needs stamping. A transfer of shares/securities is normally subject to stamp duty but transfers for no consideration (i.e. gifts) are exempt. The notice of trust to the nominee company (see below) includes the relevant certification to this effect.

### What is the role of the nominee company and why is the notice of trust necessary?

The nominee company holds the legal title to the collectives held in the general account. The notice of trust applies only to collectives held in a general account. As the underlying investments of the general account (i.e. shares and units in collectives) are held in the name of the nominee (as the 'legal owner'), what the investor actually holds is a 'beneficial title' to those assets and it is this beneficial title that the settlor transfers to the trustees. In order to perfect the gift the settlor must also instruct the nominee company to re-register the beneficial title in the name of the trustees. This is done by giving the 'Notice of trust and direction to the nominee' to the nominee company. A form of words to effect this is included in the trust deed and takes effect when the trust deed is sent to Nucleus.

### Is the nominee company relevant to Nucleus Offshore and Onshore Bonds?

No, where an existing bond is to be transferred, the asset that is transferred to the trust is the bond itself, i.e. the insurance contract made between the investor and the relevant company (Sanlam, Scottish Friendly Assurance or RL360). Legally this is called a 'chose in action' and the method of transfer of such an asset to the trustees is a legal assignment. Words to effect the assignment are included in the trust deed. In this case a notice of assignment must be given to the relevant life office. The sending of a copy of the trust deed to Nucleus will constitute a notice of assignment.

### Can the trustees encash investments held in the Nucleus wrap and pay the proceeds to the beneficiaries?

This is possible if the appointor first makes an irrevocable appointment of benefits in favour of the beneficiary.

### Why should extreme care be taken in relation to payments made by the trustees to the settlor's spouse or civil partner while the settlor is alive?

While the inclusion of the settlor's spouse or civil partner as one of the discretionary beneficiaries does not constitute a reservation of benefit for IHT purposes, care must be exercised if any benefits are actually paid to the settlor's spouse or civil partner during the lifetime of the settlor.

## 6. Frequently asked questions

It should be noted that any appointment to the settlor's spouse or civil partner can only be made by the trustees. Should the trustees actually exercise their power of appointment in favour of the settlor's spouse/civil partner, and trust benefits are paid out to the settlor's spouse/civil partner, it is absolutely essential that no part of these benefits finds its way back to the settlor in any way, directly or indirectly. If this were to happen, the trust could be seen as one under which the settlor reserved a benefit and this would make it ineffective for IHT purposes. In practice, therefore, it may be advisable to avoid making such appointments altogether whilst the settlor is alive.

### What happens if the settlor dies within seven years of establishing the trust?

This may have IHT consequences as explained in section 5.1.3 above. There may be additional tax to pay if there was a liability on the gift itself. If the initial gift was covered fully or partly by the settlor's nil rate band, the nil rate band available to the settlor's estate will be reduced correspondingly.

### For new investments, can the settlor get their money back under the cooling-off rules?

No. As the application for the investment (be it a bond or general account) will be made by the trustees, if they exercise their right to cancel the refund, a cheque (which may be less than the amount invested) will be sent to the trustees. For full details of the cooling-off procedure please refer to the relevant product literature.

### How do the trustees find cash to pay income tax if they invest in accumulation shares/units in their general account?

If all the funds are invested in accumulation units/shares, the trustees may have to sell some of the shares/units to raise the necessary cash.

### What are the charges associated with an investment in this trust?

There is no charge for setting up the trust. Professional trustees may charge. The charges relating to the Nucleus General account and the Nucleus Onshore and Offshore Bonds are covered in the relevant product literature. The financial adviser is, however, likely to make a separate charge for advice given in relation to the establishment of the trust.

### How do you set up a discretionary gift trust?

The settlor and the additional trustees complete the discretionary gift trust deed. The trustees make an application for the relevant investment if the gift is made with cash, satisfied with a cheque or BACS transfer from the settlor to Nucleus Financial Services.

For a transfer of existing investments into a trust, a new Nucleus wrap account will have to be set up in the name of the trustees and an appropriate transfer form completed.

Both need to be done with the assistance of a financial adviser (and with reference where appropriate, to the settlor's legal advisers) who has access to the Nucleus online processing system. Full details of the procedures are covered in the Nucleus guides on the platform-related processes.

Please remember that the discretionary gift trust is provided as a draft.

### How do the trustees find cash to pay the fees of their investment advisers?

The fee for the initial advice (leading to the investment and the trust creation) will be paid by the settlor. The responsibility for adviser charges made in relation to the trust and trustee investments after its creation will usually be that of the trustees of the trust. As a matter of trust law, such fees are normally paid out of trust capital (not the trust income).

If there is available uninvested cash that is not trust income in the general account then the adviser charges can be paid from that. To the extent that additional amounts are needed, the trustees may have to sell some of the shares/units of the collectives in the general account to raise the necessary cash. If the underlying investment is a bond, the trustees may need to take a part-withdrawal to meet the adviser charges. There will be the usual potential income tax (for bonds and non-reporting offshore funds) or CGT (for collectives other than non-reporting offshore funds in the general account) implications.

Alternatively, the settlor may offer to pay the advisers' fees so as not to deplete the trust funds. As the settlor will, in effect, pay the fees on behalf of the trustees, these payments will be treated as further gifts (CLTs) made by the settlor which may have IHT consequences as outlined in section 5.

## Important note

Tax law is subject to change. At the time of publication of this guide, HMRC are consulting on the IHT taxation of discretionary trusts and changes in this area are likely to take place in the future. The information in this guide is based on our understanding of current law and HMRC practice as at October 2018.

This document is provided strictly for general consideration only. Any action taken or refrained from in connection with the Nucleus Draft Discretionary Gift Trust must be preceded by discussion with the settlor's legal and other professional advisers. Accordingly, neither Nucleus nor any associated or affiliated company nor any of their representatives, officials or employees can accept any responsibility for any loss occasioned as a result of the use of the Nucleus Draft Discretionary Gift Trust in any circumstances whatsoever except as provided by law.



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