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Nucleus Flexible Gift Trust

Adviser guide

Edition 05

Introduction

This document consists of six sections:

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

The following points should be noted in respect of this document:

(a) The term 'spouse' includes registered civil partner.
(b) The term 'settlor' refers to both the settlor and the lender.

1. The Nucleus Flexible Gift Trust: an overview

1.1 The aim

The aim of the draft Nucleus Flexible Gift Trust is to enable an individual to undertake effective and flexible lifetime inheritance tax (IHT) planning whilst providing a named beneficiary or beneficiaries with an income. The draft trust is provided on the basis that it will achieve these objectives and have the tax consequences specified in this document. However, it is essential that each individual should confirm with their legal and professional advisers that the draft is suitable for their purposes before adopting it.

1.2 Who is it for?

The type of investor who may be interested in using the Nucleus Flexible Gift Trust is likely to be;

- a new investor contemplating an investment in collective investments in a Nucleus General account (referred to in this guide as collectives) which distribute income; or
- investors already holding distributing collectives in a Nucleus General account in the Nucleus wrap;

and, in either case, looking to make a gift of those investments so that the income from them is paid to a specified beneficiary(ies) while retaining flexibility over the timing and destination of the capital value of the investments.

In principle the flexible gift trust can also be used by persons contemplating investment in, or who already hold, a Nucleus Offshore Bond provided by RL360 Insurance company or a Nucleus Onshore Bond provided by Sanlam or by Scottish Friendly Assurance in the Nucleus wrap. However, as bonds are non-income producing assets, they will not achieve the aim of providing a beneficiary with an income, nor will they offer income tax advantages that interest in possession trusts offer with other investments (see later). Where bonds are to be used, then a discretionary gift or bare gift trust may be more appropriate.

An investor using the Nucleus Flexible Gift Trust is called the settlor. By using the flexible gift trust with cash intended for a new investment, an existing bond or a holding of collectives, the settlor 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 with the funds being transferred to Nucleus by the settlor.

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 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

For tax purposes the flexible gift trust is an 'interest in possession' trust. This is because under this type of trust a named beneficiary is entitled to the trust income as it arises and the technical term for this is 'interest in possession' (IIP).

The trust is 'flexible' which means the appointor can change the named beneficiary (the beneficiary entitled to income). In addition, the appointor can choose which beneficiary will be recipient of the trust capital. Until such an appointment is made no beneficiary is entitled to the capital.

There are several classes of potential beneficiary and the settlor (and, following their death, the trustees) as the 'appointor' under the trust has discretion as to which of those beneficiaries should receive future income or capital, 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 flexible gift trust (with cash or existing investments), the gift will be a chargeable lifetime transfer for inheritance tax purposes to the extent that the cash invested (or the market value of the existing investments transferred to the trust) exceeds the settlor's available annual (£3,000) exemption(s). However, provided the value of the gift is below the settlor's available nil rate band (£325,000 in tax years 2009/10 to 2020/21), no actual IHT charge will arise when the trust is made (see section 5 of this guide for full details).

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

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

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

1. The Nucleus Flexible Gift Trust: an overview

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 Flexible Gift Trust will not be an asset of the settlor's estate for probate purposes which 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 Flexible 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 flexible gift trust.

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

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

2. IHT planning and the Nucleus Flexible 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). Until 2006 gifts to flexible trusts were treated favourably (also as PETs) but this no longer applies. Flexible trusts created on death are also treated in a different way for IHT purposes but this is not relevant for lifetime gifts.

All other lifetime gifts to a trust are treated as chargeable lifetime transfers (CLTs) and for inheritance tax (IHT) purposes 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 in tax year years 2009/10 to 2020/21) there will be no tax to pay when the trust is established. Other charges can also arise in respect of 'relevant property' trusts every ten years and when benefits are paid out of the trust to the beneficiaries (see section 5 of this guide for full 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 then 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 as otherwise the gift with reservation of benefit rules will apply. The Nucleus Flexible 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 therefore effective for inheritance tax purposes.

The settlor's spouse may be included as a beneficiary if the settlor so desires 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 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 a couple were to effect their own separate flexible gift trust under each of which the other were a beneficiary.

The inclusion of the settlor's spouse as a beneficiary under the trust would, however, give rise to income tax implications – see section 5 of this guide.

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

3. The suitability of the Nucleus Flexible Gift Trust

3.1 Suitability

The Nucleus Flexible 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 the money intended for a new investment in the Nucleus wrap;
- wishes to provide a named beneficiary(ies) with an income from the investments (which also avoids the need for the trustees to pay tax on the trust income at higher rates) but wishes to retain the flexibility to direct that all or part of the future income should go to another beneficiary and retain the right to decide which of the beneficiaries should benefit from the capital in the trust fund;
- understands that they will not be able to benefit from the investment under any circumstances; and
- would like the benefits of the investment to be outside their estate for probate purposes when they die.

In principle the Flexible Gift Trust can be used with the Nucleus General account (except where the general account holds accumulation units or shares) as well as Nucleus bonds. However, the income tax benefits of this trust (see below) will only be apparent with investments in collectives that produce a distributable income and which are held within the general account. Perhaps of more fundamental relevance, though, is the fact that, as bonds are non-income producing assets, one of the key settlor requirements (the provision of income for a beneficiary or beneficiaries) would not be satisfied.

3.2 Matters to consider before establishing the Trust

A flexible gift trust is suitable to hold cash or investments owned by one person or a couple, 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 flexible gift 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
- 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 then IHT nil rate band.

Before recommending the Nucleus Flexible 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;
- other practical objectives of the investor. Namely, how much flexibility is required, who the named and potential beneficiaries should be and, in particular, whether the settlor's spouse (in single settlor cases), should be included amongst the beneficiaries;
- the need to provide a beneficiary with an income from the trust that is paid out and that there is no desire to accumulate the income;
- that the settlor is happy to give up all future access to the investment;
- the size of the intended gift; and
- the choice of the intended investment (i.e. primarily income-distributing collectives)

If the gift causes the settlor to exceed their available nil rate band for IHT there will be an immediate 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.

The Nucleus Flexible Gift Trust will not be suitable for an investor who:

- requires some beneficial access to their investment; or
- has chosen to invest in accumulation units or shares as they prefer to have all the trust income accumulated and added to the trust capital for future use; or
- does not wish to grant any beneficiary a right to income and prefer to leave income distributions to the discretion of the trustees; or
- has decided that the sole investment of the trust should be a bond that does not produce any income.

However, other trusts offered by Nucleus, (e.g. the discretionary gift trust or bare gift trust, loan trust or discounted gift trust) may be suitable.

The choice of trust or combination of trusts should always be discussed with professional advisers. Nucleus provide a 'trust selector' to assist in this process.

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

4. The Nucleus Flexible Gift Trust – The trust provisions in detail

For tax purposes the Nucleus Flexible Gift Trust is an interest in possession (IIP) settlement.

This means that the named beneficiary(ies) is/are entitled to the trust income as it arises. However, no beneficiary is entitled to the trust capital unless and until the appointor makes an appointment in their favour. Furthermore, the appointor has power to appoint future income to another of the beneficiaries at any time but any income that has arisen prior to such an appointment cannot be taken away from the named beneficiary who was entitled to it when it arose.

The appointor (initially the settlor and then the trustees, following the settlor's death) may appoint the trust benefits (capital or future income) to any of the potential beneficiaries. These beneficiaries include the settlor's widow/er, children and grandchildren, brothers and sisters and their issue.

The following is a summary of the key provisions as they appear in the draft Nucleus Flexible 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 potential beneficiaries and the named beneficiaries.

The potential 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, their spouses, 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 and any charity. The settlor can add any other individuals (apart from themselves) not covered by the standard wording.

The settlor can choose whether to include their spouse in the class of potential beneficiaries. This will have important income tax implications if the investments of the trust are collectives – see section 5 below. The settlor is excluded as a beneficiary. In the case of joint settlors, because the spouse will already be a settlor, they cannot, by definition, be a beneficiary.

The class of potential 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 named beneficiary(ies) is the individual(s) who are entitled to the trust income as it arises. They will also benefit from the trust capital 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 otherwise they will benefit equally.

Part 3 – The main Trust terms

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

As previously indicated, the power to appoint capital and future 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.

Unless and until the power of appointment is exercised, the named beneficiary is entitled to any income arising from the assets held by the trustees. The trustees have no choice in the matter, i.e. cannot accumulate any trust income. For this reason investments in accumulation units or shares are not appropriate for this trust.

If not all of the trust property has been appointed by the end of the 125 year trust period then the named beneficiaries (or their estates if they have died by then) 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.

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.

4. The Nucleus Flexible Gift Trust – The trust provisions in detail

Part 4 – Trustees' administrative powers

The trustees also 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 their number. 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 the trustees. The settlor, whilst alive and of full mental capacity, also has the power to dismiss any trustee provided at least one trustee other than the settlor and/or the settlor's spouse 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 deal mainly 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 also liable for negligence.

There are also comprehensive provisions excluding the settlor from all benefit (and the settlor's spouse unless the settlor specifically included the spouse as a 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 compulsion 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 Flexible Gift Trust

In what follows it is assumed 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

(i) 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.
- For existing investments in the Nucleus Wrap the value of the gift will be the value of the assets in the general account or the value of the bond that is or are made subject to the trust at the time of the gift. For new investments it will be the amount invested.

To the extent that the gift exceeds the settlor's available annual exemption, currently £3,000 for each settlor (£6,000 maximum 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 per cent 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 per cent could arise on the gift if the settlor dies within seven years of making the transfer – see (iii) below for full details.

(ii) 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 then receive the trust and Estate Tax Return, Form SA900, which they have to complete under self-assessment if they have any liability to capital gains tax, or unusually to income tax.

In addition, where a person makes a gift that is a CLT (e.g. to a flexible gift trust) they may need to report it to HMRC on IHT Forms 100, 100a and D34 (the last one only for existing bonds).

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 by them in the previous seven years.
- Where the gift is of all other assets (e.g. a bond), it causes the settlor to exceed 80 per cent of the then nil rate band taking account of CLTs made in the previous seven years or the amount gifted exceeds the then nil rate band less CLTs made in the previous seven years.

  Trustees of flexible trusts may also have to submit special IHT returns on ten-yearly anniversaries and when distributions from the trust are made even though IHT charges may then not apply. The forms to use here are Form IHT 100 and Form 100c (for exit charges) and Form 100d (for ten-yearly 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.

(iii) What are the IHT implications of the settlor dying within seven years of establishing the Flexible 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 would, however, arise on the initial gift if the value of the gift to the trust, after deducting any available exemptions, caused the settlor to exceed their available nil rate band. In such circumstances a liability at 20 per cent of such excess would arise at that time. On the death of the settlor within seven years a further tax liability at 20 per cent of the excess would arise although taper relief would 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 made by the settlor 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 Flexible Gift Trust

(iv) What are the IHT implications for the Trust?

As indicated above, the special IHT charging relevant property rules apply to the flexible gift trust. Under these rules there may be IHT charges:

- on every ten-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 ten-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 ten-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 ten-year anniversary and the value (when created) in any other related trusts set up on the same day (the assumed transfer), and
- 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 ten 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 per cent, 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 ten 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 ten-year anniversary. Any excess over the then nil rate band will suffer IHT at an effective rate of 6 per cent.

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 flexible 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 ten 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 then £550,000.

The IHT charge will be calculated as £50,000 @ 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 next section). 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.

(i) First ten years

There will be no exit charges within the first ten years following the creation of the flexible 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.

(ii) After the first ten-year anniversary

The amount of any exit charge occurring after the first ten years will depend on the rate of tax charged at the last ten-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 flexible gift trust, there will have been no periodic charge (see above) at the last ten-year anniversary and so no exit charge would arise.

Example

Let's assume that on the first ten-year anniversary of Christine's trust a periodic charge of 0.5 per cent was charged (see above) and the nil rate band remains the same.

On 2 January 2035, six full years since the first ten-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 x 0.5% x 24/40 = £150

5. The UK Tax implications of the Nucleus Flexible Gift Trust

No IHT charge will arise on property paid out of the trust if there was no IHT charge at the last ten-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 depend on which asset is held by the trustees. In most cases under the flexible gift trust, it will be income distributing collectives in the general account (see 5.2.2.1 below). However, it is possible (although not likely, as they are unlikely to be appropriate investments for the flexible gift trust) that the investments held by the trustees may include an onshore bond or an offshore bond – section 5.2.2.2 below deals with the taxation implications of such a situation. The only assets that should never be held by trustees of a flexible gift trust are those collectives which produce income but the income is accumulated.

Under the flexible gift trust the trust income will generally be assessed on the beneficiary entitled to it, rather than the trustees, although where the trustees actually receive gross income they will have a basic rate liability (20 per cent on savings income and 7.5 per cent on dividends) effectively paying this tax on behalf of the beneficiary, who is still taxed at his marginal rates, receiving credit for the tax paid by the trustees. If all the trust income is paid directly to the beneficiary, the trustee liability is avoided. The position was different until 5 April 2016 when income was paid with tax deducted at source or a tax credit which franked basic rate liability. Different rules apply where the settlor's spouse is a potential beneficiary – see below.

If all income is paid directly to the beneficiary and not via the trustees, so that there is no income tax assessment on the trustees, this also avoids or helps minimise trust administration, as there will be no need for the trust income tax returns to be made by the trustees.

In the unlikely event that the trustees invest in an onshore or offshore bond (these being non-income producing assets) no income tax considerations arise for the trustees until the bond is encashed. Similar considerations will be relevant to offshore non-reporting funds – see below.

5.2.1 Creation of the Trust

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 the settlor's income.

Although unlikely to occur, 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 on transfer.

5.2.2 During the Trust's existence

5.2.2.1 Income arising to the trustees from an investment in collectives

As the named beneficiary is entitled to the trust income, any income must either be paid over to the beneficiary, or at least be identified and be capable of being held absolutely for the said beneficiary. For this reason, collectives where income is produced but is accumulated are not suitable for this trust and should be avoided.

The income tax position will depend on whether the settlor's spouse is included as a potential beneficiary

(i) UK funds and offshore reporting funds

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

Under a flexible gift trust the named beneficiary(ies) is/are entitled to income when it arises and they are taxed on that income at their marginal rate(s) as if they had received it directly, i.e. the income is taxed as dividend income or savings income as appropriate, rather than 'trust income', Personal Savings Allowance and Dividend Allowance are available to the beneficiary.

The trustees are only taxed on any income that they receive and even then only at basic rate and not at the special 'trust' rates.

(b) Where the settlor's spouse may benefit under the trust

If the settlor chooses to include their spouse as a potential beneficiary under the flexible gift trust (and is in fact married), all trust income will be taxed on the settlor at their personal rate(s) of income tax, despite the named beneficiary's entitlement to the said income. This means that the income received by the named beneficiary will not be subject to tax in their hands but will be assessed on the settlor. The settlor will not be able to claim this tax back from the trust.

This rule does not apply if only the settlor's widow or widower can benefit.

Special rules apply if the settlor is non-UK domiciled and trust income arises on overseas investments but this is not something contemplated with investments in the Nucleus Wrap.

5. The UK Tax implications of the Nucleus Flexible Gift Trust

(ii) Offshore non-reporting funds

Although an investment in these non-income producing investments is unlikely under the flexible gift trust, where the collective is an offshore non-reporting fund there will normally not be any real income distributions from the fund. Clearly, if the settlor wishes the beneficiary to receive the trust income and to achieve the tax advantage of there being no income tax assessment on the trustees, then such an investment will not be suitable. However, as with bonds (see below), since no real income will be produced for the trustees, there will be no added difficulties for the trustees if they find themselves holding such a fund.

When units/shares in an offshore non-reporting fund 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 capital gains tax exemption. This means that any income that arises to the fund effectively suffers income tax when an offshore income gain is made by the investor.

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

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

As the offshore income gain is not 'real' income, it does not belong to the named beneficiary and so it will not be assessed on the named beneficiary. Instead, the trustees are liable to tax at the special rate of 45 per cent on offshore income gains. Any part of the offshore income gain that falls within the £1,000 standard rate band will be taxed at 20%, with income in excess of £1,000 being taxed at 45 per cent.

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

(b) Where the settlor's spouse may benefit under the trust

If the settlor chooses to include their spouse as a potential beneficiary under the flexible gift trust (and is in fact married), offshore income gains will be taxed on the settlor at their personal rate(s) of income tax in the same way as trust income (see above). This rule does not apply if only the settlor's widow or widower can benefit.

However, despite this, the trustees will still be liable at the 45 per cent 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 per cent) rate taxpayer and the trustees have paid income tax on the income at 45 per cent, the settlor can reclaim any excess tax paid by the trustees from HM Revenue and Customs. Even if the settlor is a higher rate (i.e. 40%) taxpayer, but not a 45 per cent taxpayer (i.e. taxable income is less than £150,000), they will be able to recover the 10 per cent tax difference. Any tax recovered must be paid to the trustees.

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

As can be seen from the above tax rules, offshore non-reporting funds are not really suitable for a flexible gift trust as (a) they do not produce real income for the intended income beneficiary and (b) they do not avoid the 45 per cent trust rate paid by the trustees.

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

5.2.2.2 Chargeable event gains under a bond

In the unlikely event that the trustees of the flexible gift trust invest in a bond, when a bond is encashed 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 UK resident and, if so, whether the settlor is still alive:

- 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 per cent 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 per cent) or additional rate (45 per cent) 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.

If the settlor is non-UK resident and the trustees are UK resident then the trustees are assessed to tax:

- After the end of the tax year in which the settlor's death occurs.

Following the settlor's death, any chargeable event gains arising in a tax year after that in which the settlor died will be assessed on the trustees if they are UK resident.

5. The UK Tax implications of the Nucleus Flexible Gift Trust

The first £1,000 of gain (assuming the settlor has not created any other settlements) is taxed at the 'standard rate', which is 20 per cent, and the rest at the special rate of 45 per cent. A 20 per cent tax credit will apply if the bond is an onshore bond but this is not available for offshore bonds.

If the trustees are not UK resident there are special rules to tax UK resident beneficiaries when and to the extent that they receive benefits – specialist advice should be sought if this applies.

It is, however, re-iterated that investment in an onshore or offshore bond by the trustees of a flexible gift trust is unlikely to be appropriate.

5.3 Capital gains tax

5.3.1 Creation of the Trust

When collectives in the Nucleus General account are transferred to the flexible 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 per cent and/or 20 per cent depending on the level of the settlor's taxable income.

As the transfer to the flexible gift 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 or minor child(ren) can benefit under the trust.

For a transfer of cash, an offshore non-reporting fund or an onshore or offshore bond to the flexible 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 5.2.2.1(ii) above.

- Unless the settlor has created more than one settlement the trustees are entitled to an annual CGT exemption equal to £5,850 in 2018/2019 (i.e. equal to 1/2 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. If the settlor has created more than one settlement since 1978 the annual exemption is divided between such settlements, but will not fall below one tenth of the full exemption available to individuals, i.e. £1,170 for each settlement.

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.

(i) 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 flexible gift 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 at which time 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 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.

(ii) Onshore or offshore bonds

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 chargeable event gains arising on subsequent encashment by the 'receiving' beneficiary would be subject to tax at that beneficiary's tax rate(s). However, as stated above, investment in an onshore or offshore bond by the trustees of a flexible gift trust is unlikely to be appropriate.

6. Frequently asked questions

Who can be a trustee of the flexible gift trust?

The settlor will automatically be a trustee. Additional trustees must be appointed at outset and this is contemplated in the trust deed. 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 to determine who the successor trustee will be is to be avoided following the settlor's death.

What does the term 'interest in possession' mean in relation to the named beneficiary?

'Interest in possession' means the current right to the current income under a trust. This means that the named beneficiary(ies) is/are entitled to the trust income as it arises. In theory it does not follow that the income must be paid over to them but at least it would have to be ring-fenced and kept separately from the rest of the fund absolutely for that named beneficiary, which in practice is not administratively workable. This is why it is important that the trust assets should be collectives that produce and distribute income which can then be paid over to the named beneficiary(ies).

What investments can be held in the flexible gift trust?

The flexible gift trust is only available for use with investments held in a Nucleus Wrap. As indicated above, as the named beneficiary is entitled to income, then if there is any income it must be identified and normally paid over to the beneficiary. Certain investments, such as collectives where income is accumulated, will never be suitable for this trust. In principle, the flexible gift trust can also be used with Nucleus Bonds as these do not produce any actual income so there is no problem with accumulations. However, the income tax benefits of this trust (i.e. avoidance of the higher rate of income tax paid by the trustees of other trusts) will only be apparent with investments in collectives that produce and distribute income and which are held within the general account.

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

This is not recommended except where neither can benefit under the trust created by the other. If the settlor's spouse is included as a potential 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 flexible gift rust 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 per cent of the assets. Obviously, in these circumstances the settlor's spouse would not be specified as a category of potential 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 – see below. The Notice of trust applies only to collectives held in the 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 names 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, because 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, SFA 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 notice of assignment.

6. Frequently asked questions

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 whilst the settlor is alive?

While the inclusion of the settlor's spouse as one of the potential 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 during the lifetime of the settlor.

First, it should be noted that any appointment to the settlor's spouse can only be made by the trustees. Secondly, should the trustees actually exercise their power of appointment in favour of the settlor's spouse, and trust benefits are paid out to the settlor's spouse, 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 5.1(iii) 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 correspondingly reduced.

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 (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

What are the charges associated with an investment in the flexible gift trust?

Nucleus make no charge for the provision of the draft flexible gift trust. 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. If professional trustees are appointed to administer the trust they are likely to charge too.

How do you set up a flexible gift trust?

The settlor and the additional trustees complete the flexible 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. Remember, the flexible gift trust is provided as a draft.

How do the trustees find the 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 uninvested cash (that is not trust income) available in the general account then the adviser charges can be paid from that. To the extent that additional amounts are needed then 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 adviser's fees so as not to deplete the trust funds. As the settlor will, in effect, pay the fees on behalf of the trustees, any such payments will be treated as further gifts (CLTs) made by the settlor which may have IHT consequences as outlined in section 5 of this guide. Professional guidance should be sought in such circumstances.

Important note

Tax law is subject to change. In particular, at the time of publication of this Guide, HMRC is 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 March 2019. Although every care has been taken in the preparation of this Guide and the draft Trust Deed, neither Nucleus nor any of its officers, employees or agents accept responsibility for the operation of the Trust.

This document is provided strictly for general consideration only. Any action taken or refrained from in connection with the Nucleus Draft Discretionary Loan 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 Loan Trust.

client.relations@nucleusfinancial.com @nucleuswrap www.nucleusfinancial.com

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