Tax Overview Discretionary Trust

Exclusively Wills LIMITED

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This guide is to help you understand the key points of how Discretionary Trusts arising from Wills are taxed and is based on the current 2021/2022 tax year rules and therefore may be subject to change.

Discretionary Trusts provide flexibility over how the trust fund is used. Trustees can make decisions based on the circumstances of beneficiaries at the time and can be guided by a letter of wishes.

Managing the legal and tax requirements of a discretionary trust can be complicated. Many trustees will seek professional help with this and pay the expenses from the trust fund.

Inheritance Tax (IHT)

- The starting value is the value of the trust fund received from the deceased's estate.
- If the starting value is less than the Nil Rate Band (currently £325,000) then no exit charges will apply in the first ten years.
- The trust fund will be revalued every ten years and IHT charged up to 6% of the value if the amount exceeds the Nil Rate Band and reliefs at the time.
- When the trustees make payments to beneficiaries, an exit charge may be applied if the value of the trust exceeds the Nil Rate Band. The amount payable will be calculated based on the length of time held in trust since commencement or if after ten-years has passed the most recent ten-year anniversary date.

- Within the first two years of the deceased's death,the trustees may avoid exit charges by utilising s. 144 of the Inheritance Tax Act. If the trust contains residential property owned by the deceased, the trustees may choose to appoint out the property to qualifying beneficiaries for the Residence Nil Rate Band to be claimed.
- After this time, trustees may make distributions from the trust fund without an exit charge within the first quarter of every ten-year interval.

Capital Gains Tax (CGT)

- The death of the testator does not create a charge to CGT.
- The trustees receive the trust fund at Probate value-known as the trustees base cost.
- Charges to CGT arise when property or other assets (providing not exempt) are sold or transferred to beneficiaries and where there has been an increase in value above the trustees base cost.
- Trustees have an annual allowance of £6,150. If there are multiple trusts, the allowance is shared between them.
- The CGT rate for trustees is 20% and 28% for residential property.

Income Tax

- On the first £1,000 of income received annually, the trustees will pay tax on this at the standard rate of 20% and 7.5% on dividends.
- After this, trust income is taxed at 45% and 38.1% on dividends.
- If the trustees make an income payment, the net amount is passed to the beneficiary. The trustees must keep sufficient funds to pay the tax and issue the beneficiary with an R185 form that can be used in his/her own self-assessment.
- Depending on the beneficiary's income tax rate,he/she may be able to reclaim some or all of the tax paid by the trustees.

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