DISCRETIONARY TRUSTS

CALCULATING PERIODIC CHARGE / EXIT CHARGE

This guide will explain how periodic and exit charges could apply to trusts that are subject to the relevant property regime.

The calculations in this guide can be complex. Example calculations assume that there is only one discretionary trust in existence.

Where the client has an existing discretionary trust, or has created multiple trusts on the same day then this guide may not be suitable.

PERIODIC CHARGES

A periodic charge will apply if the **value** of the trust fund immediately before the ten-year anniversary exceeds the available Nil Rate Band (NRB) for the trust.

The periodic charge is calculated as a percentage of the trust fund. The maximum rate that can apply is 6% and would apply where the available NRB for the trust is zero.

CALCULATING THE AVAILABLE NRB

The available NRB for the trust is calculated by deducting:

1) the value of any chargeable lifetime transfers (CLT) made in the seven years prior to creating the trust, and
2) the value of any withdrawals from the policy that were distributed to the beneficiaries during the ten-year period prior to the anniversary, from the current full NRB.

NB: Withdrawals that were payments to the settlor under a Loan Trust or Discounted Gift Trust arrangement do not need to be deducted from step 2.

Example:

Full NRB at ten-year anniversary, minus	£325,000	
Chargeable lifetime transfer (CLT) in seven years prior to creating trust, minus	£175,000	
Distributions from trust fund to the beneficiaries during the ten-year period prior to the anniversary.	£0	
Available NRB	£325,000 - £175,000 - £0	**£150,000**

CALCULATING THE VALUE OF THE TRUST FUND

The following is a basic outline of how the values of different discretionary trusts are calculated at each ten-year anniversary.

1 Gift Trust

- The value of the trust the day before the date of the ten-year anniversary, **minus**
- the NRB available to the trust.

2 Loan Trust

- The value of the trust the day before the date of the ten-year anniversary, **minus**
- the value of the outstanding loan owed to the settlor, **minus**
- The NRB available to the trust.

RL360°

3 Discounted Gift Trust

The situation is different depending on the whether the settlor is alive or not at the date of the ten-year anniversary.

Settlor Deceased

- The value of the trust the day before the date of the ten-year anniversary, **minus**
- the NRB available to the trust.

Settlor Alive

Where the settlor is alive, the situation can be more complex as it is necessary to calculate a revised discount to determine the value of the trust fund. HM Revenue and Customs (HMRC) have confirmed that a discount based on an addition of ten-years to the settlor's age or rated age at outset of the policy is permissible.

The chargeable value can be reduced by deducting an Open Market Value (OMV) of the trust fund and the settlor's rights to future withdrawals for the rest of their lifetime.

PERIODIC CHARGE

Mr Smith settled £100,000 into an RL360 Gift Trust on the 01 September 2013. He had previously made a chargeable transfer of £100,000 in June 2010. Distributions of £10,000 have been made to the beneficiaries in the last ten years. The current value of the trust fund is £250,000

NRB available to the trust	£325,000 - £100,000 - £10,000	£215,000
Value of trust fund - NRB available	£250,000 - £215,000	£35,000
Tax on trust fund over NRB	£35,000 x 20%	£7,000
Effective rate of IHT	(£7,000 / £250,000) x 100	2.8%
Periodic charge is 30% of effective rate	2.8 x 30%	0.84%
IHT payable is value of trust fund x periodic charge	£250,000 x 0.84%	**£2,100**

PERIODIC CHARGE - MAXIMUM EFFECTIVE RATE

Mr Smith settled £400,000 into an RL360 Gift Trust on the 01 September 2013. He had previously made a chargeable transfer of £325,000 in June 2010. The current value of the trust fund is £450,000.

NRB available to the trust	£325,000 - £325,000	£0
Value of trust fund - NRB available	£450,000 - £0	£450,000
Tax on trust fund over NRB	£450,000 x 20%	£90,000
Effective rate of IHT	(£90,000 / £450,000) x 100	20%
Periodic charge is 30% of effective rate	20 x 30%	6%
IHT payable is value of trust fund x periodic charge	£450,000 x 6%	**£27,000**

NO PERIODIC CHARGE

Mr Smith settled £100,000 into an RL360 Gift Trust on the 01 September 2013. He had previously made a chargeable transfer of £100,000 in June 2010. Distributions of £10,000 have been made to the beneficiaries in the last ten years. The current value of the trust fund is £190,000

NRB available to the trust	£325,000 – 100,000 - £10,000	£215,000
Value of trust fund - NRB available	£190,000 - £215,000	£0
Tax on trust fund over NRB	N/A	£0
Effective rate of IHT	N/A	0%
Periodic charge is 30% of effective rate	N/A	0%
IHT payable is value of trust fund x periodic charge	N/A	**£0**

EXIT CHARGES

When distributions are made to the beneficiaries, an exit charge could apply. Distributions could include withdrawals, surrenders, assignment (segments or in full) as well as the trustees using certain powers of appointment contained within the trust deed, even where nothing leaves the trust.

Distributions do not include any withdrawals that are paid to the settlor(s) under a loan trust or discounted gift trust arrangement.

Exit charges during the first ten-years

If the trust was created during the settlor's lifetime and an IHT entry charge was payable at outset, exit charges will apply in the first ten years.

If there was no IHT charge payable at outset, there should be no IHT exit charges on any distributions of capital to the beneficiaries in the first ten years unless there have been additions to the trust in the same period. The position can change on death if a failed potentially exempt transfer (PET) causes a subsequent CLT to exceed the available NRB.

Exit charges after the first ten-years

- After the first ten-year anniversary, exit charges are based upon the settlement rate of tax charge at the previous ten year anniversary.
- If there was no periodic charge at the last ten year anniversary, then there will be no IHT exit fee in the next ten years.

In order to calculate the exit charge, the settlement rate of tax needs to be established that applies to the trust at outset (if within the first ten years) or at the last ten year anniversary (if after the first ten years).

This rate is then applied to the amount of the distribution and is then proportionately reduced for the number of complete quarters since either outset or the last 10-year anniversary, whichever is relevant.

Exit charge calculation:

Value of distribution to beneficiary x settlement rate of tax at outset or previous ten-year anniversary x X*/40.

*X is the number of complete calendar quarters since the last ten-year anniversary, with 40 being the total number of quarters in a ten-year period.

Example Calculations

DISCRETIONARY GIFT TRUST

- On the 01 September 2011, a client gifts £106,000 into a discretionary gift trust.
- The first £6,000 was exempt as this used the annual exemption allowance for that tax year and the previous tax year, leaving a CLT of £100,000.
- The NRB was £325,000 at this time and the client made no other CLTs in the previous seven years, therefore no lifetime IHT charge applied at outset.
- On the ten-year anniversary, the trust is valued at £173,000.

Periodic charge

- As the value is below £325,000, **no periodic charge will apply**.

Two years later, the trust then is wound up and the monies fully distributed to the beneficiaries.

Exit charge

- As there was no periodic charge at the last ten-year anniversary, no exit charge will apply to the distributions to the beneficiaries.

DISCRETIONARY GIFT TRUST

- On the 1 September 2011, a client gifts £216,000 into a discretionary gift trust.
- The first £6,000 was exempt as this used the annual exemption allowance for that tax year and the previous tax year, leaving a CLT of £210,000.
- The NRB was £325,000 at this time and the client made no other CLTs in the previous seven years, therefore no lifetime IHT charge applied at outset.
- On the ten-year anniversary, the trust is valued at £452,000, no distributions have been made to any beneficiaries.

Periodic charge

NRB available to the trust	£325,000 - £0	£325,000
Value of trust fund - NRB available	£452,000 - £325,000	£127,000
Tax on trust fund over NRB	£127,000 x 20%	£25,400
Effective rate of IHT	(£25,400 / £452,000) x 100	5.62%
Periodic charge is 30% of effective rate	5.62 x 30%	1.69%
IHT payable is value of trust fund x periodic charge	£452,000 x 1.69%	**£7,639**

Two years later, the trust then is wound up with a value of £520,000 and the monies are fully distributed to the beneficiaries.

Exit charge

Effective rate of IHT at previous ten year anniversary	1.69%	
Number of Quarters since last ten year anniversary	8	
IHT payable on capital leaving the trust	£520,000 x 1.69% x 8/40	**£1,757.60**

IMPORTANT NOTES

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Every care has been taken to ensure that the information provided is current and in accordance with our understanding of current law and HM Revenue and Customs (HMRC) practice. You should note that we cannot take on the role of an individual taxation adviser and independent confirmation should be obtained before acting or refraining from acting upon the information given. The law and HMRC practice are subject to change.

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