

This document is intended for clients of financial advisers. It covers a complex subject and we recommend that you seek advice from your adviser.

# The Discretionary Loan Trust

Fidelity Adviser  
Solutions  
Trusts  
Investor Guide

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**IMPORTANT NOTE:**

Adviser Solutions cannot give advice regarding the legal or tax effects of the Adviser Solutions Trusts, and will not accept responsibility for any loss occurring from their use. Investors are strongly recommended to seek independent legal advice before completing the trust deed to ensure the Trust meets their needs. Once established, trusts may be difficult to unwind and gifting money or assets into certain trusts will mean you cease to have access to the money or assets.

## 1. What is the Adviser Solutions Discretionary Loan Trust?

A trust is a legal relationship which exists when an asset is held by a person or persons (called the Trustees(s)) for the benefit of another person or persons (called the Beneficiary(ies)). The Trustees have the control and legal ownership of the asset but must use it for the benefit of the Beneficiaries.

Based on this principle the Fidelity Adviser Solutions Discretionary Loan Trust can provide a way of holding an investment, be it single premium life assurance investment bonds ("Bonds") or holdings of shares or units in unit trusts, OEICs and/or SICAVs ("investment funds"\*) for the benefit of another individual or individuals. Please note that the value of investments and the income from them can go down as well as up. Some investments, such as Individual Savings Accounts (ISAs) and personal pension plans cannot be held in a trust such as this Discretionary Loan Trust.

The Fidelity Adviser Solutions Discretionary Loan Trust is an inheritance tax planning arrangement which is made up of three parts:

- a Trust;
- a loan; and
- an investment in Bonds and/or investment funds.

It is well known that potential inheritance tax liabilities may be reduced by making lifetime gifts of assets. It is equally well known, however, that not many individuals can realistically give up all access to their assets, in which case effective inheritance tax planning becomes more difficult.

The Fidelity Adviser Solutions Discretionary Loan Trust has been designed for investors who wish to carry out some inheritance tax planning but cannot afford to give up all access to the assets intended to be used in the planning. However, they would be prepared to give up access to any future investment growth on these assets.

Under our Discretionary Loan Trust an individual lends a sum of money to the Trustees of the Trust which he or she has established with the specific purpose of receiving such a loan, and the Trustees use the loan to invest in Bonds and/or investment funds. These are the trust assets held by the Trustees for the Beneficiaries. However, the Lender (who is also the Settlor of the Trust) retains the right to have his or her loan repaid to him or her at any time, in full or in part. A series of regular loan repayments could therefore be used to create an additional stream of cash payments which could be used to supplement income, although it is important that regular repayments are not made in a way that it could be argued the loan is one repayable by instalments over a fixed term.

As there is no initial gift, there is no immediate reduction in the Settlor's estate for inheritance tax purposes (as the outstanding loan remains payable to the Settlor's estate) but, as the investments held in the Trust grow in value, all the investment growth will be outside the Settlor's estate for inheritance tax purposes and held for the Beneficiaries of the Trust. The Settlor can request the repayment of the whole outstanding loan or a part of it at any time and as repayments are made by the Trustees, and spent by the Settlor, the Settlor's taxable estate will also reduce for inheritance tax purposes. Thus, the Adviser Solutions Discretionary Loan Trust is able to freeze the potential inheritance tax liability payable on a portion of the Settlor's estate whilst also enabling a gradual reduction in the potential inheritance tax liability.

The Trust is a Discretionary Trust under which the Trustees have the power to decide who (from the classes of Beneficiary specified in the Trust Deed) should benefit and when. If no appointments are made by the end of the Trust period then the individual or individuals named by the Settlor as the Default Beneficiaries will benefit.

## 2. Why should you use our Discretionary Loan Trust?

You should consider using our Discretionary Loan Trust if you:

- wish Bonds and/or investment funds to be held in trust for your Beneficiaries but do not wish to make a gift of your investment;
- have, or expect to have, total assets in excess of your inheritance tax nil rate band allowance and are concerned about future inheritance tax liabilities;
- need to retain access to the capital you intend to invest for your own benefit but can afford to give up access to the investment growth; and
- are not entirely certain at this stage who you wish to benefit from the Trust i.e. you wish to retain flexibility over which of your Beneficiaries will ultimately benefit from the trust fund, by how much and when.

## 3. When should our Discretionary Loan Trust not be used?

Our Discretionary Loan Trust should not be used if you:

- are not interested in inheritance tax planning; or
- can afford to make a gift of the capital used in the planning without retaining any access; or
- wish to retain total control and access to the whole investment not just the original capital; or
- are certain that a named individual, or individuals, should be absolutely entitled to benefit under the Trust and that you will not want to change your mind.

In such cases, we offer a range of other trust wordings that may better suit your circumstances. Please ask your financial adviser for further details.

## 4. How is our Discretionary Loan Trust established?

Our Discretionary Loan Trust is based on three elements.

- First, a trust is established by the investor specifically with the intention of making a loan to the Trustees. There is no need for a gift to be made and it is accepted that under English law, a valid trust can be created in this way.  
  
Our Discretionary Loan Trust is suitable only for a single Settlor, i.e. it cannot be set up jointly. This is because a joint loan trust can become highly complex and cause adverse inheritance and inheritance tax problems. The Trust is established by the Settlor and the additional Trustees completing the Trust Deed. The Settlor is one of the Original Trustees together with the additional Trustees.
- Once the Trust is established, the Settlor makes a loan to the Original Trustees of the capital that he or she wishes to pass to the Loan Trust. The loan is made on an interest-free basis, repayable on demand and is formally documented using the Loan Agreement. The intention is that the Trustees will invest the loan monies in Bonds and/or investment funds. To avoid the need for the Trustees to open a bank account to accept the loan monies, the Loan Agreement requests that the Settlor provides the Trustees with his or her cheque made payable directly to the investment provider e.g. Fidelity.
- If the intended investment is a Bond, the Trustees will make an application for the policy on the joint, or multiple, lives of the Settlor and/or some of the Beneficiaries.  
  
If investing in investment funds, the Trustees purchase the shares, or units, in the selected fund(s).

\*References to the income and capital gains taxation of 'investment funds' in this guide do not apply to offshore funds which do not hold HMRC reporting fund status. Offshore income and gains arising from such funds are taxed under the income tax regime. Further details are available from your financial adviser.

The draft Adviser Solutions Discretionary Loan Trust Deed provides for a maximum of four Trustees (including the Settlor).

Once the investment is purchased by the Trustees, any subsequent dealings with the investment will be between the Trustees (as the legal owners) and the relevant investment company.

## 5. Key provisions of our Discretionary Loan Trust

- During the Trust period of 125 years the Trustees may appoint the Trust benefits (capital and/or income) to any of the Discretionary Beneficiaries. These Beneficiaries include the Settlor's widow, widower or registered civil partner, children and grandchildren, brothers and sisters and their issue as well as any person nominated by the Settlor to the Trustees in writing.
- The Settlor can choose whether to include his or her spouse amongst the Beneficiaries. The term "spouse" in the Trust Deed and other guides includes a registered civil partner.
- As the Trust is a Discretionary Trust, no Beneficiary is entitled to receive any benefits until the Trustees make an appointment in his or her favour. If any income arises to the Trustees from the trust investments (not relevant while the sole trust asset is a Bond) they can distribute it to or for the benefit of any of the Beneficiaries. If they choose not to, income can be accumulated. The Trustees may need to consider opening a trust bank account if investment income is received.
- The Settlor cannot benefit from the Trust in any circumstances (except that he or she is, of course, entitled to loan repayments at any time).
- The Settlor names (as Default Beneficiaries) the individual or individuals who are to benefit from the Trust Fund at the end of the 125 year trust period (if no appointment is made before then), and, if more than one, the shares in which they are to benefit.
- The Trustees have wide powers to invest including reinvestment in other assets and generally dealing with the trust property.
- The value of the Trust Fund available for the Beneficiaries will increase as the value of the investment grows.
- The Settlor remains entitled to have his or her loan repaid at any time and the amount of the outstanding loan remains in his or her estate for inheritance tax purposes.
- To be effective for inheritance tax purposes, the loan must be repayable on demand and interest-free. From time to time the Settlor may request part repayments of his or her loan which will be made by the Trustees after making withdrawals of capital from the Bonds and/or investment funds held in the Trust. The Settlor would normally spend these loan repayments so as to reduce the value of his or her taxable estate at that time.

## 6. The law of the Trust

The Trust is governed by the law of England.

## 7. The Trustees

The Settlor is automatically appointed as one of the original Trustees. At least one additional Trustee must be appointed at outset. The additional Trustee(s) executes the trust deed with the Settlor. No more than 4 Trustees (including the Settlor) should be appointed at outset.

The Settlor can appoint further Trustees later on and the Settlor may also dismiss a Trustee provided at least one Trustee, other than the Settlor or Settlor's spouse, remains.

Trustees must be aged 18 or over, of sound mind and ready and willing to act as a Trustee.

The Trustees must act unanimously. Unresolved disagreements may be referred to the courts, so it is important to choose your Trustees carefully.

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.

Professional Trustees are permitted by the Trust Deed to charge normal professional fees. The Trustees are permitted to take part in transactions, and Trustees' decisions, in which they have a personal interest.

## 8. Tax implications of our Discretionary Loan Trust

In all cases, it is assumed that the Settlor and the Trustees are UK resident and domiciled – special rules apply where this is not so, and relevant professional advice should be sought. The following is an outline of the key provisions. This section is only intended to provide a brief guide to taxation and precise taxation treatment will depend on types of trust investments and the tax circumstances applicable to an individual trust arrangement.

### INHERITANCE TAX (IHT)

#### Establishment of the Trust

As no gift is made when the Trust is established, there are no inheritance tax implications.

The loan made to the Trustees also has no inheritance tax implications, provided it is interest-free and repayable on demand (as is the case when using the standard Discretionary Loan Trust draft documentation).

#### Death of a Beneficiary

As no Beneficiary is actually entitled to receive any benefits until the Trustees make an appointment, the death of a Beneficiary has no inheritance tax implications for this Trust.

#### Death of the Settlor

On the death of the Settlor the amount of the outstanding loan forms part of the Settlor's estate for inheritance tax purposes. However, the balance of the value of the Trust Fund (effectively, the investment growth accrued by the Bonds and/or investment funds) will be outside the Settlor's estate, as this represents the assets held on behalf of the Beneficiaries.

If the Settlor is married he or she may, in his or her Will, leave the right to the repayment of the outstanding loan to his or her surviving spouse or registered civil partner. In such a case, no inheritance tax will be due on the outstanding loan on the Settlor's death and loan repayments can continue to him or her.

#### Inheritance tax whilst the Trust is in existence

As this is a Discretionary Trust, special inheritance tax charging rules apply. Under these rules there may be inheritance tax charges;

- on every ten-year anniversary of the Trust
  - "the Periodic Charge"; and
- whenever property leaves the Trust (e.g. when capital is advanced to a Beneficiary) - "the Exit Charge".

#### The Periodic Charge

Periodic charges to inheritance tax may be applied to the value of the assets in the Trust at ten-yearly intervals. It is important to note that under our Discretionary Loan Trust, the value of the Trust assets will be determined AFTER deducting the amount of the outstanding loan. Further details are available from your Financial adviser.

#### The Exit Charge

Exit charges may be applied on the value of property leaving the Trust. Further details are available from your financial adviser.

## CAPITAL GAINS TAX (CGT)

### Creation of the Trust

There are no CGT implications on the creation of the Trust as no assets are transferred to the Trust at outset. Instead cash is used to make a loan to the Trustees. A liability could, of course, arise if investments are realised to generate the cash used to make the loan.

### Trust capital gains

Tax on capital gains (CGT) is assessed on the Trustees. Trustees have their own annual exemption (normally equal to one half of the personal exemption but reduced in cases where the settlor has created more than one trust), after which they pay CGT at the rates applicable to trust.

Hold-over Relief may be available to allow the Trustees to transfer assets to beneficiaries – or other Trustees in certain circumstances – without paying Capital Gains Tax. The recipient usually pays the tax when they sell or transfer the asset. The rules for Hold-over Relief can be complicated and individual advice should be sought relevant to the circumstances.

## INCOME TAX

The income tax implications depend on whether the asset held by the Trustees is a Bond (see (a) below) or investment funds (see (b) next page).

### (a) Chargeable event gains under a Bond

#### (i) During the Settlor's lifetime and in the tax year in which the Settlor's death occurs

For income tax purposes (and assuming the Settlor is resident in the UK for tax purposes), any chargeable event gains arising under the Bond will be assessed on the Settlor.

If the Settlor becomes non-UK resident, any chargeable event gains arising in a tax year after that in which the Settlor moved abroad will be assessed on the UK resident Trustees at the rate of tax for trusts. If there are no UK resident Trustees, special rules apply to tax UK ordinarily resident Beneficiaries when they receive benefits from the Trust – specialist advice should be sought if this applies.

#### 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 UK resident Trustees at the rate of tax for trusts. If there are no UK resident Trustees, special rules apply which mean that UK ordinarily resident Beneficiaries are taxed when they receive benefits from the Trust – specialist advice should be sought if this applies.

#### (ii) Loan repayments funded by encashments from the Bond

Loan repayments may be funded by the Trustees making encashments from the Bonds. The Trustees are entitled to withdraw up to 5% of the original investment each year (on a cumulative basis, subject to such withdrawals not exceeding the amount paid into the Bond) without incurring any immediate tax liability. As long as the repayments are kept within these 5% allowances there will be no immediate tax implications for the Settlor or Trustees. Otherwise the rules for charging tax on the chargeable event gains will apply as explained above.

Further details on the taxation of Bonds are available from your financial adviser.

### (b) Income arising to the Trustees from investments in investment funds

(i) As long as the loan remains outstanding, all trust income will be assessed on the Settlor.

(ii) Once the loan has been repaid the following will apply:

If the spouse of the Settlor is excluded from benefit under the Trust, then, for income tax purposes, the Trustees are taxed on income at the relevant rate applicable to trusts according to the type of income.

Where income is to be distributed to a Beneficiary, the Trustees must first have paid relevant income tax on it.

Where the Beneficiary pays a rate of tax lower than that applicable for the Trustees a tax reclaim may be made.

If the Beneficiaries include the Settlor's minor unmarried children, who are not in a registered civil partnership, and any benefit under the Trust is actually paid to such a child or for his or her benefit, it will be assessed 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.

If the spouse of the Settlor is included as a Discretionary Beneficiary (and at all times when any part of the loan remains outstanding – see (c) below), all trust income will be treated as income of the Settlor. However, the Trustees will still be liable at the Trust rates. If the Settlor pays a rate of tax lower than that applicable for the Trustees he or she can reclaim the excess tax paid by the Trustees. However, the Settlor must pay to the trustees any tax repayment obtained.

### (c) Income tax position whilst the loan remains outstanding

Even if the Settlor's spouse is not a Beneficiary under the Trust, the Settlor will be assessed to tax on trust income if he or she is entitled to receive capital payments from the Trust. This includes any loan repayments to which the Settlor is entitled.

This means that, as long as any amount of the loan remains outstanding, any income received by the Trustees will be assessed on the Settlor. If income is accumulated within the Trust (and not paid out) the Settlor may be taxed on that income for 10 years after the loan has been repaid up to the amount of the loan. This will be so regardless of whether the Settlor actually receives any loan repayments from the Trustees.

## 9. Notifying HMRC about a Discretionary Trust

### Income tax and capital gains tax

HMRC operates an online Trusts Registration Service for trustees. This has replaced the previous paper based 41G(Trust) form and the ad hoc process for Trustees to notify changes in their circumstances. Also, trustees must ensure and confirm the Trust Register is accurate and up to date, guaranteeing their obligations under Money Laundering Directives are complied with. Any new trusts with a UK tax consequence will be required to use the registration service to obtain a unique taxpayer reference (UTR). The requirement to register online includes those trusts that have already registered with HMRC using the 41G(Trust) form. Trustees must update the register each year that the Trust generates a UK tax consequence.

You should consult the relevant guidance from HMRC for details concerning the requirement to register and report your individual trust as appropriate to the circumstances of that trust.

### Inheritance Tax

HMRC Inheritance Tax – does not automatically need to know when a new Trust is set up, but they do need to know when a trust incurs an Inheritance Tax charge or if the initial transfer in periodic valuation or amount existing the Trust exceeds certain limits. There are differing rules dependent upon the type of asset being transferred and reference should be made to the guidance notes issued by HMRC.

## 10. Further information

This guide should be read in conjunction with the literature available for the relevant Advisor Solutions and Fidelity investment contracts to be held within the Advisor Solutions Discretionary Loan Trust.

Tax rates and allowances quoted are those for the tax year to 05 April 2024.

