This document is for investment professionals only and should not be relied upon by private investors.

The Discretionary Loan Trust

Adviser guide

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IMPORTANT NOTE:
Fidelity Adviser Solutions cannot give advice regarding the legal or tax effects of the 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 The Discretionary Loan Trust – objectives and suitability

The aim of the draft Discretionary Loan Trust Deed is to facilitate effective lifetime inheritance tax (IHT) planning. Potential users of the Discretionary Loan Trust could be:

- new investors contemplating investments in unit trusts, OEICs and/or SICAVs on the Fidelity Adviser Solutions platform or as Fidelity funds off the platform (in this guide such investments are referred to as "investment funds"*); or
- those investors contemplating investment in one or more of the single premium life assurance investment bonds (here called "Bonds") offered via Fidelity Adviser Solutions.

By using the Discretionary Loan Trust with Bonds and/or investment funds, the investor will be able to achieve a gradual reduction in his or her estate for inheritance tax purposes while retaining access to his or her original capital.

The investor using the Discretionary Loan Trust is called the Settlor.

The Discretionary Loan Trust anticipates that a potential investor in Bonds and/or investment funds who has these objectives could, instead of investing directly in his or her own name, lend a sum of money to Trustees to invest in Bonds and/or investment funds to hold on trust for the Beneficiaries indicated in the Trust Deed, subject to the right of the Settlor to repayment of his or her loan.

With the moneys lent to them by the Settlor, the Trustees will collectively apply for the intended investment. When the intended investment is Bonds, the Trustees will normally make an application for a policy on the lives of the Settlor and/or some of the Beneficiaries on a joint, or multiple, lives last survivor basis.

The Trust is "discretionary" which means that there is no need to decide at outset which Beneficiary is entitled to what. Instead there are several classes of Beneficiary and the Trustees have discretion as to which Beneficiary(ies) should receive benefits, how much and when.

To ensure that the Discretionary Loan Trust is effective for inheritance tax purposes, the Settlor cannot benefit from the Trust assets in any circumstances, although he or she is, of course, entitled to repayment of his or her outstanding loan at any time.

The more specific objectives of the Discretionary Loan Trust can be summarised as follows:

- to gradually reduce the value of the Settlor's taxable estate and to reduce the inheritance tax liability arising on his or her death;
- to allow the Settlor tax efficient access to the amount originally invested through capital (loan) repayments;
- to ensure that all capital growth on the investment accrues outside the estate of the Settlor and passes to the Beneficiaries free of inheritance tax; and
- to allow the Settlor, as one of the Trustees, to exercise an element of control over who will benefit from the Trust, by how much and when.

The investor for whom a Discretionary Loan Trust may be appropriate would normally:

- be of an age where IHT planning is relevant;
- have a net estate (either alone or with a spouse or registered civil partner) for inheritance tax purposes exceeding the IHT nil rate band;
- have capital to invest or realisable investments available for reinvestment without capital gains tax liabilities;
- require access to his or her capital, for example, to periodically supplement his or her income; and
- need to know that he or she can call upon the whole (or the remaining part) of the original capital (the loan) invested at any time should he or she need to.

The Settlor can choose whether to include his or her spouse, or registered civil partner, as one of the Beneficiaries. Although this would have no adverse inheritance tax implications, it has important income tax implications.

Further details of the UK tax implications of the Discretionary Loan Trust can be found in Section 6 of this guide.

As well as being able to secure important tax benefits, the Discretionary Loan Trust offers important probate avoidance advantages. The asset that is subject to the Discretionary Loan Trust will not be an asset of the Settlor's estate for probate purposes which means that in the event of the Settlor's death, the Trustees can carry on dealing with the investment without waiting for probate or letters of administration on the investor's estate. Of course, any outstanding loan will form part of the Settlor's estate for probate purposes.

To ensure that the investment can be dealt with without delay following the Settlor's death, the legal ownership of the investment must be with a person or persons other than just the Settlor. Therefore, this benefit will only be secured if there is at least one other Trustee who survives the Settlor. Under the Discretionary Loan Trust, the Settlor is automatically appointed as one of the Original Trustees and further Trustees are appointed in the Trust Deed. If any of the additional Trustees is removed, retires or dies before the Settlor, a further Trustee or Trustees should be appointed. The power of appointing Trustees vests in the Settlor, during his or her lifetime, and then the Trustees.

If no additional Trustees are appointed, or they have been appointed and retired, died or been removed, so that there is no surviving Trustee at the date of the Settlor's death (the Settlor therefore being the sole Trustee immediately before his or her death), the Trust will nevertheless continue to exist and 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 inheritance tax or probate purposes, securing probate or letters of administration to the Settlor's estate will still be necessary to establish who will act as Trustee under the Trust. Clearly, it is very important that additional Trustees are appointed who are likely to survive the Settlor so as to ensure that delays in being able to deal with the Trust investments are avoided.

The Discretionary Loan Trust is available only to individual investors i.e. it cannot be effected jointly. This is because a joint Loan Trust can become highly complex and cause adverse inheritance and inheritance tax problems.

The Discretionary Loan Trust will not be suitable where:

- an investor does not require any access to the funds (as loan repayments); or
- an investor is happy that his or her choice of Beneficiary is certain;

In these cases, although the Discretionary Loan Trust will not be suitable, a different type of trust may be. Offers a range of different trust wording for the consideration of professional advisers.

*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.

2 The Discretionary Loan Trust and inheritance tax planning

By establishing a trust under which the Settlor does not have any beneficial interest, the Settlor will, effectively, remove the Trust Fund (after deduction of any loan owing to the Settlor) from his or her taxable estate for inheritance tax purposes. The Settlor (as a creditor) has full access, at any time, to the amount of the outstanding loan. The amount of any outstanding loan remains in his or her taxable estate, but the remainder of the Trust Fund (effectively the accrued investment growth) is outside of the Settlor's taxable estate for inheritance tax purposes and inaccessible to the Settlor.

HM Revenue & Customs (HMRC) accepts that the loan itself, even though it is interest-free, does not involve any element of gift as long as it is repayable on demand.

To ensure that the Settlor makes an effective gift for inheritance tax purposes, the Settlor must not retain any benefit (actual or prospective) under the Trust. This is the case with the Discretionary Loan Trust. The Trust is expressed as being irrevocable and the only persons who can benefit are those individuals identified as Beneficiaries in the Trust Deed. The Trust is therefore effective for inheritance tax purposes.

The Settlor's right to have his or her loan repaid does not amount to a reservation of benefit. The argument against any gift with reservation arising in connection with the arrangement is also strengthened by the fact that the Settlor does not actually make any gift when the Trust is established.

The Settlor's spouse, or registered civil partner, may be included as a Beneficiary if the Settlor so desires by initialling the appropriate box in the Trust Deed. The inclusion of the Settlor's spouse, or registered civil partner, will by itself not have any adverse inheritance tax implications. However, great care should be exercised if any payments are to be made from the Trust to the Settlor's spouse or registered civil partner, during the Settlor's lifetime. If, in these circumstances, the Settlor enjoyed a direct or indirect benefit (for example if the funds were used for common family expenses) the whole Trust could fall within the gift with reservation of benefit provisions thus making the Trust ineffective for inheritance tax purposes.

3 The Discretionary Loan Trust – some practical issues

Choosing the Trustees

The Settlor and at least one other individual (preferably two or three) must be appointed as Original Trustees in the Trust Deed. The Settlor has the power to appoint and/or remove other Trustees. Trustees must be aged 18 or over, of sound mind and ready and willing to act as a Trustee.

It is important for the Settlor to choose his or her Trustees wisely. Even though the Settlor will be one of the Original Trustees and it is expected that he or she will remain as Trustee during his or her lifetime, the Trustees must act unanimously. In extreme circumstances of disagreement, the Settlor has the power under the Trust to dismiss a Trustee but only if at least one Trustee remains other than the Settlor or the Settlor's spouse or registered civil partner.

The Trustees must understand their responsibilities to the Beneficiaries and to the Settlor. Therefore, if the Trustees were considering paying a benefit to Beneficiaries, they should take account of the Settlor's outstanding loan. At the very least, it would be prudent for them not to deplete the value of the Trust Fund below the amount of the outstanding loan.

Making the loan

The Settlor, as Lender, and the Trustees execute the Loan Agreement.

A cheque for the amount of the loan should be made payable to the investment provider concerned (e.g. Fidelity) and handed over by the Settlor to the Trustees.

On the basis that the Settlor provides the Trustees with a cheque payable to, say, Fidelity, there will be no need for the Trustees to open a bank account at this stage. This would only be necessary if the Settlor wished to make the loan in cash or by cheque payable to the Trustees. In such a case, as it is generally no longer possible to simply endorse cheques, the Trustees would have to pay the cheque into their own bank account and subsequently draw a cheque from that account in favour of Fidelity. It may, however, become necessary for the Trustees to consider opening a bank account in due course should they start receiving investment income, requesting withdrawals from Bonds or selling investment funds.

It is important that the cheque should come from a bank or building society account held in the Settlor's sole name because it is only the Settlor who is establishing the Trust, i.e. the cheque should not be drawn on a joint account, for example, in the name of the Settlor and his or her spouse or registered civil partner. This is especially important if the Settlor's spouse, or registered civil partner, is a potential Beneficiary under the Trust, as otherwise the inheritance tax benefits of the Trust could be negated.

Loan repayments

Loan repayments may be requested by the Settlor from time to time when he or she requires capital and the Trustees will have to make part encashments from the Bonds and/or investment funds to facilitate repayments. Although, in theory, it is possible for the Trustees to set up a regular withdrawal facility from a Bond, caution should be applied.

It is important to understand that the loan must operate as an interest free loan that is repayable on demand (in accord with the loan agreement). Where a loan is made that is both interest free and repayable on demand, the making of that loan should not constitute a transfer of value for inheritance tax purposes. Where a loan is made that is either repayable at the end of a fixed term or by instalments over a fixed term, rather than on demand, it is likely to constitute a transfer of value and have adverse inheritance tax consequences.

Where the Settlor demands repayment by way of a single sum or irregular ad hoc sums, it can be seen that there is no pattern of repayment to suggest that the loan is repayable by fixed instalments over a term. Where the loan is repaid by way of a specified regular fixed withdrawal (e.g. 5%) from a bond set up in advance, it may be seen that there is a possible argument that the loan is, in reality, a term loan repayable in instalments over 20 years. Ideally, the demand for loan repayments should operate in such a way to avoid any possibility of argument that it is a fixed term loan of whatever nature.

It is, of course, possible that the Settlor will request a significant loan repayment during the course of a year, so the ability to access any investments and any consequent tax charges must always be considered.

Type of investment

The Trustees can invest in Bonds and/or investment funds.

Planning for spouses

It is not recommended that each of a couple sets up their own Discretionary Loan Trust arrangement if the spouse, or registered civil partner, of the respective Settlor is to be included as a Beneficiary (i.e. one spouse establishes a trust with the other spouse as a potential Beneficiary on condition that his or her spouse establishes a trust with the other spouse as a potential Beneficiary).

The reason for this is that, in such a case, HMRC may argue that the two arrangements are effected simultaneously, or in contemplation of each other, and are therefore associated and effectively, if merged, would constitute a gift with reservation. Although some reassurance on this point may exist because the arrangement involves no gift, the investor should consult with his or her advisers on this issue if such an approach is contemplated.

Further investments by the Settlor
The Settlor can add to his or her investment provided no gift is made into the Trust. If further sums are to be made available then these should be solely by way of further interest-free loans by the Settlor to the Trustees. If the Settlor wishes to make outright gifts, these should either be made directly to the donee(s) or to another trust. It is important to maintain the inheritance tax effectiveness of the Discretionary Loan Trust by making no gifts to it.

Writing the loan off
If the Settlor decides that he or she no longer needs access to his or her capital, he or she can by Deed write off the loan. This would, however, constitute a gift to the Trust by the Settlor and it is important not to mix gifted sums and lent sums in a single trust, which is why any loan write-off should only occur in respect of the whole amount outstanding under the loan. As the Trust is a Discretionary Trust, the gift would be a chargeable lifetime transfer for inheritance tax purposes and it could result in an inheritance tax liability, potentially at 20%, if the value of the gift, together with the cumulative total of other chargeable lifetime transfers made by the Settlor in the preceding seven years, exceeds the then IHT nil rate band.

4 The Discretionary Loan Trust and income tax and capital gains tax planning

As the income tax and CGT rules for Discretionary Trusts are quite complex and depend on who the Beneficiaries of the Trust are, it is important that the Settlor is aware of the potential implications before he or she creates the Trust and chooses his or her Beneficiaries accordingly. Further details of the tax rules are given in Section 6 but the following key principles should be noted.

Income Tax

For income tax purposes, if any of the Settlor's loan is outstanding or the Settlor's spouse or registered civil partner is included as a Beneficiary, then all trust income is assessed on the Settlor as it arises. Income may also be assessed on the Settlor if, in some circumstances, trust income received is accumulated in the Trust and not paid out.

The fact that the Settlor is assessed does not absolve the Trustees from being assessed on the same income in the first place. If the Settlor pays tax at a rate lower than the Trustees, he or she can recover the overpaid tax from HMRC. However, the Settlor must pay to the Trustees any tax repayment obtained.

Capital Gains Tax (CGT)

Investment funds
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.

Insurance Bonds
The above will not be relevant if the sole underlying asset of the Trust is a Bond – the special tax rules applying to Bonds in trust are explained in Section 6.

5 The Discretionary Loan Trust provisions in detail

For tax purposes the Discretionary Loan Trust is a Discretionary Trust. The Trust gives the Trustees power to appoint benefits under the Trust among a wide class of Beneficiaries. No Beneficiary is entitled to any benefit until the Trustees so decide – the ultimate Default Beneficiaries named in the Trust will benefit only if no other appointment has been made by, or assets remain in the Trust at, the end of the Trust period which is 125 years.

Execution of the deed and trust declaration
The Trust Deed is executed by the Settlor and the named additional Trustees. No gift takes place at this time.

The Loan Agreement
Once the Trust is established, the Settlor makes an interest-free loan, repayable on demand, to the Trustees. The Settlor, as Lender, and the Trustees together execute a formal Loan Agreement to this effect. It is envisaged that the Trustees invest the loan moneys in Bonds and/or investment funds and with this in mind the Settlor should draw the cheque in favour of the appropriate investment provider (e.g. Fidelity). The Bonds and/or investment funds will represent the only assets of the Trust.

From time to time, the Settlor may request repayments of his or her loan. The Trustees will encash part of the Bonds and/or investment funds to make the repayment – see Section 6 for the tax implications of encashment. The part repayment of the loan to the Settlor will be tax-free in the hands of the Settlor as a capital repayment (although there may be some income tax and capital gains tax implications if the underlying investment is in income-producing investment funds – see Section 6 for further details).

Caution should be applied with loan repayments that are made on a regular basis and for the same amounts, so as to avoid any possibility of the inference that the loan is in fact repayable by instalments and therefore payable within a fixed time frame (which may give rise to adverse inheritance tax implications).

It is important that the loan is expressed to be interest-free and repayable on demand as loans repayable by instalments have different (less favourable) tax consequences.

The investment
The Original Trustees (of whom the Settlor is one) make an application for Bonds and/or investment funds, as appropriate, using the cheque given to them by the Settlor. In the case of a Bond (a life assurance policy), the Trustees must indicate on whose lives the policy should be issued. Normally this should be on a joint, or multiple, lives last survivor basis on the lives of the Settlor and/or some of the Default Beneficiaries with the Trustees as the policyholder.

If the Settlor were the sole life assured under the Bond, the Bond would automatically encash on his or her death. Effecting the Bond on the lives of two or more persons, as indicated above, will avoid this automatic encashment assuming the Settlor dies first. It could therefore provide greater flexibility as to the time of the final encashment of the Bond and could avoid an encashment at a time that is unsuitable for either investment or tax reasons.

The Trustees can exercise all the powers and options under the policy including taking withdrawals from the Bond. When the Settlor requests repayment of the loan at any time the Trustees will have to encash an appropriate part of the Bond or sell a number of units or shares from the investment funds in order to fund the repayment.

The Draft Discretionary Loan Trust Deed

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

Part 2 – Definitions
In this part of the Trust the terms used throughout the Trust are defined to avoid repetition. The most important definitions are those of the Discretionary Beneficiaries and the Default Beneficiaries.

The **Discretionary Beneficiaries** are those in favour of whom the Trustees may make appointments of benefits. They include the widow, widower or surviving registered civil partner 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 as well as any charity. The Settlor can add any other individual not covered by the standard wording.

The Settlor can choose whether to include his or her spouse, or registered civil partner, which may have important income tax implications if the investments of the Trust are investment funds – see Section 4 for further details.

The class of Discretionary Beneficiaries is very wide and can be added to by the Settlor – all that is necessary is a written notification to the Trustees. However, the Settlor cannot be added to the class at any time.

The **Default Beneficiaries** are the individuals who will benefit in the unlikely event that the power of appointment is not exercised by the Trustees 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 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 from equal shares. This is necessary to ensure the Trust is valid.

Part 3 – Principal trust terms

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

As previously indicated, the power to appoint capital and income under the Trust is vested in the Trustees. The power is exercisable at the Trustees' discretion and includes the power to appoint further trusts in favour of Beneficiaries.

The Trustees have power to accumulate any trust income throughout the duration of the Trust period of 125 years.

In default of appointment by the end of the trust period the Default Beneficiaries will benefit.

There is also a special provision dealing with any potential conflict of interest. In many cases the Trustees of the Trust would be family members who would also be Beneficiaries under the Trust. If an appointment of benefits were to be exercised in favour of a Beneficiary who is also a Trustee, then a suspicion of conflict of interest could arise. For this reason, there is a provision in this Trust which states that, if a Beneficiary is also one of the Trustees, the Trustees 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 Beneficiaries and to make loans to Beneficiaries.

Part 4 – 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.

Part 5 – Appointment, dismissal, retirement and remuneration of Trustees

The Trust contains comprehensive provisions applying to the Trustees.

The power to appoint new or additional Trustees is vested in the Settlor during his or her lifetime and after his or her death in the Trustees. The Settlor also has power to dismiss any Trustee provided at least one Trustee other than the Settlor and/or the Settlor's spouse or registered civil partner remains after such a dismissal.

There is no power to dismiss a Trustee after the death of the Settlor and it must be remembered that Trustees under a trust governed by the law of England must act unanimously.

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

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

Part 6 – Further trust provisions

These mainly deal with the Trustees' liability in relation to the Trust.

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.

Part 7 – The Governing Law

The Trust is governed by the law of England.

6 The UK tax implications of the Discretionary Loan Trust

The following assumes that the Settlor, the Beneficiaries and the Trustees of the Trust are UK resident and domiciled. Special rules apply where this is not the case and relevant professional advice should be sought. 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

- Since no gift is made by the Settlor when the Trust is established, the creation of the Trust will not give rise to a transfer of value by the Settlor for inheritance tax purposes, as long as the correct procedures are followed.
- As long as the loan is expressed to be interest-free and repayable on demand, the granting of the loan should have no immediate tax implications for the Settlor.
- As the Settlor is entitled only to his or her loan repayments and is not a Beneficiary of the Trust, the arrangement is not caught by the "gift with reservation of benefit" provisions. Furthermore, HMRC has confirmed that the income tax pre-owned assets tax (POAT) rules in Schedule 15 Finance Act 2004 should not apply.
- There will be no capital gains tax or income tax implications at the time the Trust is established although, of course, a capital gains tax charge may arise if the Settlor realises investments to generate the cash used to make the loan.

IHT whilst the Trust is in existence

As this is a Discretionary Trust, this means that special IHT charging rules apply. Under these rules there may be IHT charges:

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

The Periodic Charge

Periodic charges at ten-yearly intervals may be applied to the value of the assets in the Trust. It is important that under the Discretionary Loan Trust the value of the Trust assets will be determined after deducting the amount of any outstanding loan.

The rate of inheritance tax charged will be determined based on an assumed transfer by an assumed transferor. This will mean that it will be necessary to take account of:

- the value of the property in the Trust on the ten-year anniversary, any added property and any sums paid out of the Trust in the 10 years immediately prior to the anniversary (the assumed transfer); and
- the Settlor's seven year cumulative total immediately before he or she created the Trust including any transfers to related settlements and 'same-day' additions (the cumulative total of the assumed transferor).

Any excess over the then IHT nil rate band applicable to the Trust will suffer inheritance tax at an effective rate of 6%.

Example

Nick creates a Discretionary Loan Trust in November 2016. The loan of £200,000 is invested by the Trustees in OEICs held with Fidelity Adviser Solutions (although for inheritance tax purposes the nature of the underlying investment is not relevant, i.e. the consequences will be the same for a Bond). He has made no chargeable transfers in the previous seven years. No payments are made out of the Trust in the first 10 years and no property is added to the Trust.

After 10 years, in November 2026, loan repayments of £100,000 in total have been made. As an example, assume that the remaining Trust Fund is now worth £200,000. The value of the relevant property will be £100,000 (i.e. £200,000 less the £100,000 outstanding loan). If the IHT nil rate band applicable to the Trust in November 2026 is £400,000, there will be no inheritance tax charge.

If, on the other hand, Nick's trust is worth £550,000 on the ten-year anniversary in November 2016, the value of the Trust for the purposes of the periodic charge will be £450,000 after the outstanding loan is deducted. Based on a then IHT nil rate band applicable to the Trust of £400,000, the inheritance tax charge will be £3,000 (£50,000 @ 6%).

It should be remembered that for the purpose of calculating the value of the Trust Fund at any time the amount of the outstanding loan must be deducted from the total in order to arrive at the value for inheritance tax purposes.

The Exit Charge

Exit charges will be based on the value of property leaving the Trust or being appointed absolutely to a Beneficiary. No exit charge will arise on loan repayments to the Settlor. The calculation process can be complex and in addition to taking account of the actual values within and exiting the Trust may also need to take account of related settlements and same-day additions. The maximum rate of charge is currently 6% (as for the periodic charge) but will often be lower or nil.

Simplistically, exit charges within the first 10 years will be nil if the value of the initial chargeable lifetime transfer (before applying any inheritance tax exemptions or reliefs) going into the Trust (including the cumulative total of the Settlor's chargeable transfers in the seven years prior to creating the Trust and the value of any added property) is below the IHT nil rate band available to the Trust at the time of the property leaving 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. Generally, the amount of the initial gift (chargeable lifetime transfer) under a Loan Trust will be nil.

The amount of any exit charge occurring after the first 10 years will depend on the rate of tax charged at the last ten-year anniversary periodic charge (if any) and the length of time (in quarters) that the property has been in the Trust since the last periodic charge. Simplistically, if there was no charge at the previous ten-year anniversary, (and there has been no added property) there will be no exit charge.

Death of a Beneficiary

As no Beneficiary is actually entitled, or deemed to be entitled, to receive anything 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 value of the Trust investments will be outside the Settlor's estate for inheritance tax purposes, although the value of any outstanding loan at the date of death will form part of his or her estate.

The Income Tax Implications Of Loan Repayments

- **Where the investment is a Bond**

  Under current legislation, the Trustees can withdraw up to 5% p.a. of the amount invested from the Bond. without an immediate tax charge. This withdrawal limit is cumulative and any allowable amount not withdrawn in a year can be carried forward to the next year and so on, subject to total cumulative withdrawals not exceeding 100% of the amount invested in the Bond. Therefore, a convenient level of capital (up to 5% per year of the original investment) can be tax effectively accessed by the Trustees to facilitate loan repayments. Of course, the level of repayment depends entirely on the circumstances and the wishes of the Settlor.

  Repayments in excess of 5% of the initial capital may be withdrawn by the Trustees each year to finance loan repayments, but this will mean that:-

  - If such a level of repayment continues, the loan will be repaid quicker and therefore the Settlor will have no further rights under the Trust; and
  - any amounts withdrawn over and above the cumulative unused 5% annual allowances in any policy year will amount to chargeable event gains and will, during the Settlor's lifetime, and while he or she is UK resident, be assessed on the Settlor for income tax purposes under the usual rules governing chargeable events.

- **Where the investment is in investment funds**

  Even if the spouse or registered civil partner of the Settlor is not a Beneficiary under the Trust, the Settlor will be assessed on trust income because he or she is entitled to receive capital from the Trust – the entitlement to loan repayments counts in this respect.

  Thus, to the extent that the Trustees have received any income, this will be assessed on the Settlor as it arises. There will be no income tax on the capital (loan) payments received by the Settlor.

  If loan repayments are funded from the proceeds of the sale of units or shares in investment funds, any capital gains will be taxed as explained below.

Capital Gains Tax

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. A liability could 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 of the Trust depend on whether the asset held by the Trustees is a Bond or investment funds.

- **Chargeable event gains under a Bond**

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

  For income tax purposes, provided the Settlor is resident in the UK, any chargeable event gains arising under the Bond will be assessed to income tax 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 applicable to trusts less a 20% tax credit if the Bond is issued by a UK insurance company. 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 applicable to trusts. A 20% tax credit will apply if the Bond is issued by a UK insurance company. If there are no UK resident Trustees, special rules to tax UK ordinarily Beneficiaries when they receive benefits from the Trust – specialist advice should be sought if this applies.

- **Income arising to the Trustees from investments in investment funds.**
  - As long as the loan remains outstanding, all trust income 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 ten years after the loan has been repaid up to the amount of the loan.

    The income tax implications of loan repayments were considered earlier on.
  - Subject to the above, once the loan has been repaid the following will apply:

    If the spouse, or registered civil partner, of the Settlor is excluded from benefit under the Trust (if they are not - see below), then, for income tax purposes, the Trustees are assessed to income tax on any trust income at the relevant rates of tax applicable to trusts according to the type of income.

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

    The Beneficiary will be taxed on the income received from the Trust grossed-up to take account of any tax credit in respect of tax paid by the Trustees. 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 income from the shares or units in investment funds held in trust is actually paid to such a child or for his or her benefit, it will be assessed to tax on the Settlor if this income, and income from all other gifts the Settlor has made to, or for the benefit of, that child exceeds £100 gross in a tax year.

    If the spouse, or registered civil partner, of the Settlor is included as a Discretionary Beneficiary and at all times when any part of the loan is outstanding, all trust income will be treated as income of the Settlor. However, the Trustees must still submit relevant tax returns and 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.

7 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 intital transfer in or periodic valuations or exit amounts 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.

8 Further information

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

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

Adviser Solutions

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