

Adviser guide

# Nucleus Discretionary Loan Trust

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## Introduction

This document consists of six sections:

1. The Nucleus Discretionary Loan Trust: an overview
2. Inheritance Tax (IHT) planning and the Nucleus Discretionary Loan Trust
3. The suitability of the Nucleus Discretionary Loan Trust
4. The Nucleus Discretionary Loan Trust – The trust and the loan agreement provisions in detail
5. The UK Tax implications of the Nucleus Discretionary Loan 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 Discretionary Loan Trust: an overview

## 1.1 The aim

The aim of the draft Nucleus Discretionary Loan Trust is to enable a person to undertake effective and flexible lifetime inheritance tax (IHT) planning whilst retaining access to funds used in the planning. It is essential that each client should confirm with their legal and professional advisers that the drafts are suitable for their purposes. The tax position of the trust is complex and depends on each individual's circumstances. Nucleus cannot provide legal, tax or investment advice and accepts no responsibility for any reliance placed on the contents of this guide, or for the use of the draft trust documentation.

## 1.2 What is it and who is it for?

The Discretionary Loan Trust is an estate planning tool which has three components:

- A trust
- A loan
- An investment in the Nucleus wrap.

The types of investor who may be interested in using the Nucleus Discretionary Loan Trust are those who:

- are contemplating an investment in collective investments in a Nucleus General account (referred to in this guide as collectives) or a Nucleus Onshore or Offshore Bond in the Nucleus wrap (referred to in this guide as bonds)
- wish to carry out estate planning
- cannot afford to give up all access to the funds to be invested but can give up access to any investment growth on the amount invested

This deed has been drafted for the use of a single Settlor only, not joint Settlor's. If your clients are wanting to be joint Settlor's, you should speak to them about this and their legal representatives before completing any paperwork.

## 1.3 Tax effectiveness and flexibility

The trust is 'discretionary' which means that there is no need to decide at outset which beneficiary is entitled to the trust assets or when they become entitled to them and to what extent. There are several classes of beneficiary. The appointer/ trustees has absolute discretion on who can benefit, when and by how much. When completing the trust deed the Settlor can add a class of beneficiary(ies) to the pre-designated list. Further beneficiaries (excluding the Settlor) can be added by the Settlor notifying the Trustees in writing at any time.

To ensure that the discretionary loan trust is effective for IHT purposes, the Settlor only has rights to the outstanding loan they made to the trustees, not other trust property.

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, which the Settlor should discuss with their tax adviser before proceeding.

## 1.4 Death of the Settlor

The trustees are the legal owners of the investments held in the discretionary loan trust and so should be able to continue to deal with the trust assets after the Settlor dies. However consideration needs to be given to any outstanding loan and any provisions the Settlor has made on how this should be dealt with in the event of their death. The trustees will need to liaise with the deceased Settlor's legal personal representatives to see if the outstanding loan amount needs to be repaid to the estate, or if this has been gifted or waived.

Under the Nucleus Discretionary Loan Trust the Settlor is automatically one of the Trustees. Further Trustees are appointed in the trust deed as the Settlor should not make a loan to themselves as sole trustee. If any of the additional Trustees retires or dies before the Settlor, a replacement Trustee should be appointed.

It is 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 with the Nucleus Discretionary Loan Trust

Trusts are commonly used in estate planning as they can allow a person to make a gift that will reduce their estate and so the potential IHT on it, but without having to decide immediately who should receive the gift, to what extent and when. However, to be effective for IHT, the settlor must normally give up all access to the gifted property.

The Nucleus Discretionary Loan Trust allows the Settlor (as a creditor) to have full access, at any time, to the amount of the loan outstanding which remains in their taxable estate. The remainder of the trust fund from outset (effectively the growth on the investment) is outside of the Settlor's taxable estate for IHT purposes and inaccessible to the Settlor.

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.

The Settlor's right to have the 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 set up – the trust is simply declared with the initial trust property being lent – not gifted.

The Nucleus Discretionary Loan 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 IHT purposes.

The Settlor's spouse may be included as a beneficiary. 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 the trust could be caught by the gift with reservation of benefit provisions thus making it ineffective for IHT purposes.

The inclusion of the Settlor's spouse as a beneficiary under the trust would also give rise to income tax implications, please seek professional tax advice as to what these implications might be.

## 3. The suitability of the Nucleus Discretionary Loan Trust

### 3.1 Suitability

The Nucleus Discretionary Loan Trust may be suitable for an investor who would:

- like to gradually reduce the value of their estate, which could be liable to IHT on their death.
- like to retain access to the amount originally invested (possibly to supplement their income) through repayment of their loan in whole or in part, at any time should they need to.
- like to ensure that all capital growth on the trust investments accrues outside of their estate and passes to the beneficiaries free of IHT.
- like to retain control and flexibility over who should ultimately benefit from the investments.

### 3.2 Matters to consider before establishing the trust

A discretionary loan trust is suitable only if there is cash available to lend to the Trustees/invest on their behalf, i.e. it cannot be set up with any existing investments. So, if existing investments in the Nucleus wrap are to be used to provide the cash for the loan, they will need to be realised. The tax implications of such a disposal should be fully considered before any such realisation takes place.

Before recommending the Nucleus Discretionary Loan 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.
- the practical objectives of the investor – namely, how much flexibility is required, who the potential beneficiaries should be and, in particular, whether the Settlor's spouse should be included amongst the beneficiaries.
- that the Settlor will not require access to the entire investment in the future, just the outstanding loan.
- the choice of the initial investment (i.e. onshore or offshore bond or collectives).
- if the investment is to be in collectives, whether the income from the collectives should be accumulated or distributed under the trust provisions.

The Nucleus Discretionary Loan Trust will not be suitable for an investor who requires access to their entire investment or wishes to make an outright gift.

## 4. The Nucleus Discretionary Loan Trust – The trust and the loan agreement provisions in detail

### 4a. The trust

The Nucleus Discretionary Loan Trust is a discretionary settlement, which gives the appointor power to appoint benefits under the trust among a wide class of beneficiaries. The Settlor is the first appointor. After the Settlor's death (or mental incapacity), the appointor will be the Trustees. No beneficiary is entitled to any benefit until the appointor so decides – the ultimate default beneficiaries named in the trust will benefit only if there are unappointed assets in the trust at the end of the trust period, which is 125 years.

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

#### Recital

The deed, if thought to be suitable and after taking advice, 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

No gift is made when the Settlor declares the trust. Instead, the Settlor makes a non-binding promise to make a loan to the Trustees. The trust will become completely constituted when the loan monies are paid to the Trustees. The Trustees then invest the loan monies and the investment is held as the trust asset. 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 and help the trustees and their legal advisers understand the terms within the trust deed.

#### Part 3 – The main trust terms

This part contains the main provisions of the trust. These should be read and understood by the trustees and their legal advisers.

As previously indicated, the power to appoint capital and 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.

The Trustees have power to accumulate any trust income.

If not all of the trust property has been appointed by the end of the 125 year trust period then the default beneficiaries will benefit.

There is also a special provision dealing with any potential conflict of interest. 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.

#### 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.

### 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 then 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.

After the death or loss of capacity of the Settlor, if any Trustee loses mental capacity, they can be dismissed by the majority of the other Trustees. In all other cases, Trustees under an English trust 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 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 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 discretionary beneficiary at outset).

### Part 7 – Proper law

The draft trust deed specifies that the trust will be governed by the laws of England and Wales. If the Settlor wishes to have the laws of Scotland or Northern Ireland applying then they should seek legal advice about getting a bespoke trust deed created to suit their circumstances and the implications of this.

The tax implications of the trust are the same throughout the UK.

### The schedule

The amount of the Intended loan is identified in the schedule.

### Part 8 - Signatures

The trust deed is executed by all the parties by signing and having their signatures witnessed.

## 4b. The loan agreement

Once the trust deed is executed 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 this loan in a bond or collectives in the Nucleus wrap and, with this in mind, the Settlor should draw a cheque in favour of (or make a BACS transfer to) Nucleus Financial Services and the Trustees will apply for the chosen investment(s) in the usual way. The Trustees acknowledge receipt of the loan using the form of 'Acknowledgment of receipt of loan by Trustees' available from Nucleus.

The bond or collectives invested in by the Trustees will represent the only asset of the trust.

The liability of the Trustees for the repayment of the loan is limited to the amount of the trust assets except where there has been a breach of trust or the Trustees have advanced capital to a beneficiary where there were insufficient funds in the trust after taking into account the outstanding loan.

From time to time the Settlor will, typically, request a part repayment of their loan. Nucleus provides standard forms of 'Request to Trustees for loan repayment' and 'Receipt of repayment'. It is important that all repayments are properly documented. To facilitate the repayment the Trustees will encash part of the bond or collectives.

As the loan is expressed to be repayable on demand the repayment of the whole of the outstanding loan can be demanded by the Settlor at any time, though there could be tax consequences for recalling the loan and these should be discussed with the tax adviser.

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.

## 5. The UK tax implications of the Discretionary Loan Trust

In what follows it is assumed that the donor, the beneficiary(ies) and the Trustees of the trust are all UK resident. Special rules apply where this is not the case. In all cases specialist advice must be sought.

### 5.1 Inheritance tax

#### 5.1.1 Establishing the trust

Since no gift is made by the Settlor when the trust is established, the creation of the trust should not give rise to a transfer of value by the Settlor for IHT 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/lender.

As the Settlor is entitled only to their loan repayments and is not a beneficiary of the trust, the arrangement should not be caught by the 'gift with reservation of benefit' provisions.

HMRC has confirmed (in their Inheritance Tax Manual at IHTM44113) that the pre-owned assets tax rules in Schedule 15 Finance Act 2004 should not apply either.

#### 5.1.2 Registering the trust with HMRC's online trust registration service

All UK express trusts unless excluded will need to be registered on HMRC's Trust Registration Service (TRS). The trustees have a responsibility to ensure the correct registration requirements are met, proof of registration is sent to Nucleus when requested and that the register is kept up to date.

#### 5.1.3 What are the IHT implications of the Settlor dying within seven years of establishing the discretionary loan trust?

On the death of the Settlor, any outstanding loan will be part of their estate and the trustees will have to work with their legal personal representatives as to what will happen to this. All growth will be outside the estate from day one.

A Settlor who is married or in a registered civil partnership may, in their will or a codicil to their will, leave the right to the repayment of the outstanding loan to their spouse or registered civil partner, which will benefit from the spousal exemption in relation to IHT.

#### 5.1.4 What are the IHT implications for the trust?

As the trust is a discretionary trust, this means that the relevant property rules apply. Under these rules there may be IHT charges:

- on every 10-year anniversary of the Trust – 'the Principal charge' – and/or
- whenever capital is distributed to the beneficiaries – 'the exit charge'.

As mentioned earlier, since no initial gift is made to the trust there should be no IHT considerations on the creation of the trust.

Trustees of discretionary trusts may have to submit special IHT returns on 10-year anniversaries and when distributions from the trust are made even though IHT charges may then not apply.

#### The principal charge

Principal charges at 10-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 10-year anniversary. Remember that under the discretionary loan trust the value of the trust assets will be determined after deducting the amount of the outstanding loan.

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 10-year anniversary and the value at commencement of any related trusts set up on the same day (the assumed transfer), and
- the Settlor's cumulative total of chargeable lifetime transfers (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 10 years prior to the anniversary (the cumulative total of the assumed transferor).
- the available nil rate band

The maximum liability will, in effect, be 6% of the value of the trust property above the nil rate band available to the trust. This means that, in many cases, the effective rate on the whole of the trust property will be much lower than 6%, possibly nil.

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.

## The exit charge

Exit charges will be based on the value of property leaving the trust.

Exit charges will not apply to loan repayments (or loans made to beneficiaries out of the trust by the Trustees).

Under a discretionary loan trust If trustees appoint capital out of the fund to beneficiaries then the the following rules will apply.

### (i) First 10 years

On the basis that no gift is made to the trust, there should be no exit charges within the first 10 years following the creation of the discretionary loan trust so long as the cumulative total of the Settlor's CLTs in the seven years immediately prior to creating the trust is below the nil rate band when the trust is created and no assets have been gifted to the trust.

### (ii) After the first 10-year anniversary

The amount of any exit charge occurring after the first 10 years will depend on the rate of tax charged at the last 10-year anniversary (if any) the value of the distribution and the length of time (in quarters) that the property has been in the trust since the last principal charge.

## 5.2 Income tax

The income tax implications of the discretionary loan trust depend on whether the asset held by the Trustees is an onshore or offshore bond (see 5.2.2.1 (a) below) or collectives in the general account (see 5.2.2.1 (b) below).

### 5.2.1 Creation of the trust

As the discretionary loan trust can only be set up with cash, there will be no income tax implications at this stage.

### 5.2.2 During the trust's existence

#### 5.2.2.1 Income tax implications of loan repayments

(a) Where the investment is an onshore or offshore bond

Under current legislation, the Trustees can make a withdrawal from the bond of up to 5% of the amount invested, each year for 20 years, without an immediate tax charge. Any allowable amount not withdrawn in a year can be carried forward to the next year and so on. Therefore, a convenient level of capital (e.g 5% per year of the original investment) can be tax effectively accessed by the Trustees to facilitate loan repayments.

If more than 5% of the initial capital is withdrawn by the Trustees each year to finance loan repayments, this will mean that:

- the loan will be repaid quicker and therefore the Settlor/lender 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 be a chargeable event and, during the Settlor's lifetime (if he/she is UK resident), be assessed on the Settlor for income tax purposes.

In determining the level of loan repayments and ensuring that the withdrawals made by the Trustees do not trigger a chargeable event, account should be taken of any additional amounts withdrawn by the Trustees to pay adviser charges.

(b) Where the investment is in collectives

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

### 5.2.2.2 The taxation of chargeable event gains under a bond (onshore or offshore)

When a bond held subject to a discretionary loan trust is encashed (fully or partially in excess of the tax deferred allowance) 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 alive or not, and whether they are UK resident.

(i) Where the Settlor is UK resident and the encashment occurs during their lifetime (or in the tax year of their death).

For income tax purposes, any chargeable event gains arising under the bond will be assessed on the Settlor upon a chargeable event gain. A basic rate 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 or additional rate taxpayer. This credit will not be available for gains made under offshore bonds. The Settlor would have the statutory right to reclaim any such liability from the trust and any failure to do so would amount to a gift to the trust which is to be avoided.

(ii) After the end of the tax year in which the Settlor's death occurs or in a year in which the Settlor is non-UK resident.

Any chargeable event gains arising in a tax year after that in which the Settlor died (or in a year in which the Settlor is non-UK resident) will be assessed on the Trustees if they are UK resident. If total income is less than £500, it will be taxed at 0%, though the £500 is split between the number of discretionary trusts created by the Settlor.

If the gain is over £501, then the whole amount will be taxed at trustees rates, accounting for any tax credit for onshore bonds only.

If the Trustees are not UK resident there are special rules and specialist advice should be sought if this is the case.

### 5.2.2.3 Income arising to the Trustees from investments in collectives.

The income tax position will depend on whether the Settlor's loan is still outstanding, the type of collective in question and whether the Settlor's spouse is included as a discretionary beneficiary.

(i) UK funds and offshore reporting funds

(a) If the Settlor's spouse is excluded from benefit under the trust and the loan has been repaid

If the spouse of the Settlor is excluded from benefit under the trust (the Settlor will always be excluded), and the loan has been repaid in full then, for income tax purposes, the Trustees are taxed as the owners of the trust investments and are assessed to income tax on any trust income (e.g. dividends).

The level of income and the source of that income will determine whether income tax is payable and at what rates. The trustees should seek advice on this.

Where income is to be distributed to a beneficiary, the Trustees must first have paid 45% income tax on the income they have actually received regardless of its source.

The beneficiary will then be taxed on the income received from the trust grossed-up to take account of the tax credit in respect of the tax paid by the Trustees. Where the beneficiary is not an additional 45% rate taxpayer, a tax reclaim may be made. However, as this income is classed as 'trust income' neither the personal savings allowance nor the dividend allowances will be available.

If the beneficiaries include the Settlor's minor children and income is paid to those children, parental settlement rules apply and tax is assessed on the Settlor if gross income is over £100. In such cases the Settlor will be entitled to use his personal savings allowance and/or dividend allowance.

(b) If the loan remains outstanding or the Settlor's spouse is included as a beneficiary under the trust

If any amount of the loan remains outstanding, or if the spouse of the Settlor is included as a discretionary beneficiary under the trust, all trust income will be treated as income of the Settlor. However, the Trustees will still be liable to income tax at the trust rates depending on the source. If the Settlor's marginal rate of income tax is lower than that paid by the Trustees, the tax overpaid by the Trustees can be reclaimed from HMRC. Any such reclaimed tax must be paid back to the trust.

In such cases the Settlor will be entitled to use his personal savings allowance and/or dividend allowance.

(ii) Offshore non-reporting funds

Where the collective is an offshore non-reporting fund there will normally not be any real income distributions from the fund. Instead, when units/shares 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 exemption from capital gains tax. This means that any income that arises to the fund effectively suffers income tax when an offshore income gain is made by the investor (the Trustees).

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 and whether the loan has been repaid in full.

Tax could be due on the trustees or Settlor. All parties should discuss with their regulated tax adviser the implications of holding these assets in this trust and any reporting requirements for HMRC.

## 5.3 Capital gains tax (CGT)

### 5.3.1 Creation of the trust

There are no CGT implications when the trust is created. There may be the usual CGT implications if the Settlor has to sell investments that they own in order to raise the cash for the loan.

### 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 above the available exemption when they sell the shares/units held as Trustee investments in the Nucleus General account or transfer those shares/units to a beneficiary. However, where the fund is an offshore non-reporting fund the offshore income gain will be subject to income tax – see section 5.2.2.3(ii) above.

Unless the Settlor has created more than one settlement the Trustees are entitled to an annual CGT exemption equal to £1,500 (i.e. equal to half of the exemption available to individuals) before any tax is actually payable. The Trustees will pay tax at a special Trustee rate which is 24% on capital gains that exceed their available annual exemption. If the Settlor has created more than one settlement, then the annual exempt amount is split up to a maximum of 5 and so could be as little as £300.

If loan repayments are funded from the proceeds of the sale of units or shares any capital gains will be assessed on the Trustees and not the Settlor.

In determining whether any gains from encashment will give rise to any liability to CGT for the Trustees, account should be taken of any disposals made to pay adviser charges.

## 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 legal ownership to the beneficiary. Please note that this route cannot be used for loan repayments, which must be made in cash.

The tax effect of this would depend on the asset advanced.

### (i) Onshore or offshore bond

The assignment of bond policies to an appointed beneficiary would not give rise to a chargeable event and so there should be no income tax liability at the time of the advancement.

Any gains arising on subsequent encashment by the 'receiving' beneficiary would be subject to tax at the rate of tax relevant to that beneficiary.

### (ii) 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 discretionary 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.

## 5.5 Tax advice

The tax position relating to trusts and the investments held in them is highly complex. Specialist tax advice should be sought at outset and throughout the trust period.

## 6. Frequently asked questions

### Who can be a Trustee of the discretionary loan 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.

### Why is it necessary to name a default beneficiary?

The Settlor must name (as 'default beneficiaries') the individual or individuals who the Settlor would like to benefit from the trust fund if no other appointment is made during the trust period. As this is 125 years from the date the trust is created, this is an unlikely outcome. Nevertheless, this is necessary, not just to ensure that there is certainty as to who is a beneficiary at all times, but also to avoid potential unwanted tax implications. If there is no certain default beneficiary under a trust, there can be a 'resulting trust' in favour of the Settlor. Although this will not upset the IHT treatment of the trust, for income tax purposes the trust may then be treated as a 'Settlor-interested' trust, even if the spouse of the Settlor is excluded from all benefit.

This means that there may be a risk that the POAT (pre-owned assets tax) income tax charge could arise.

### What investments can be held in the discretionary loan trust?

The draft discretionary loan trust is intended for use with investments held in a Nucleus wrap: collectives in a general account or a Nucleus Onshore or Offshore Bond.

### Is the discretionary loan trust available for joint Settlers?

No. First, if there were joint lenders/Settlers, the arrangement would become very complicated. For example:

- One would need to consider if each Settlor had contributed to the loan equally.
- It would be necessary to ascertain whether each loan repayment was being made equally between the two Settlers or on some other basis.
- It would be necessary to be able to deal with independent loan repayments since any one lender could not be precluded from requesting a repayment of their part of the loan only as this would be against the 'repayable on demand' principle. This would put a considerable administrative burden on the Trustees.
- Special provisions would be needed in the loan agreement to determine what the position is on death and this is difficult to provide for in a 'standard' draft as it would depend on the individual circumstances.

Second, if the joint lenders were both Settlers then neither could be beneficiary under the trust. On the other hand, by having one Settlor, the partner or spouse of the Settlor could be a beneficiary under the loan trust and potentially benefit from the trust after the Settlor's/lender's death.

### Do the Trustees need to open a bank account?

On the basis that the lender provides the Trustees with a cheque payable to Nucleus Financial Services (NFS) (or arranges for a BACs transfer to NFS) when the trust is created, in satisfaction of the commitment to make an interest free loan to the Trustees, there will be no need for the Trustees to open a bank account at the outset. This would only be necessary if the lender wished to make the loan in cash or by cheque payable to the Trustees. In the case of a cheque, 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 NFS. However, it may be necessary for the Trustees to open a bank account in due course when they start requesting withdrawals from the bond or selling collectives.

## How are loan repayments made?

Loan repayments will be requested by the Settlor from time to time when they require capital and the Trustees will have to make part encashments from the bond or collectives to facilitate repayments.

In the case of an investment in a bond, it is of course possible that the Settlor will request a repayment of more than 5% in a policy year and the Trustees will have to encash more than 5% of the original investment. Where the withdrawal from a bond exceeds the cumulative annual allowances (5% p.a. of the original premium for 20 years), a chargeable event gain will arise – see section 5.2.2.2.

This needs to be considered if it is anticipated that the Trustees will need to make withdrawals from a bond to meet adviser charges.

## Can the Settlor make further investments into the discretionary loan trust?

The Settlor can add to their investment provided no gift into the trust is made. If further sums are to be made available then this should be solely by way of a further interest-free loan by the Settlor to the Trustees with the Trustees effecting a further investment. A new loan agreement should be completed for any new loan to the trustees.

## Can the loan be written off?

If the Settlor decides that access to the capital lent is no longer needed, the outstanding loan could be written off. 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. Therefore, any loan write-off should only occur in respect of the whole outstanding amount. As the trust is a discretionary trust, the gift would be a chargeable lifetime transfer (CLT) for IHT purposes and it could result in an IHT liability, if the value of the gift, together with the cumulative total of other CLTs made by the Settlor in the preceding seven years, exceeds the then nil rate band.

## 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. In practice no advancements should be made to a beneficiary as long as there is any loan outstanding.

## 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 cheque (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. The Settlor is free to request the repayment of their loan at any time.

## What are the charges associated with an investment in the discretionary loan trust?

There is no charge for setting up the trust. Professional Trustees may charge. The charges relating to the Nucleus General account and the Nucleus Onshore and Offshore Bonds are covered in the relevant product literature. The financial and any other legal, tax or professional adviser is, however, likely to make a separate charge for advice given in relation to the establishment of the trust.

## How do the Trustees find cash to pay the fees of their advisers and tax liabilities?

The fee for the initial advice (leading to the investment and the trust creation) will be the responsibility of, and will be invoiced to and paid by, the Settlor. The responsibility for adviser charges made in relation to the trust and Trustee investments after its creation ('ongoing charges') 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 available uninvested cash (that is not trust income) in the general account then the adviser charges and tax liabilities 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 and tax liabilities. As explained earlier in this guide there will be the usual potential income tax implications (for bonds and non-reporting offshore funds) or CGT (for collectives other than non reporting offshore funds in the general account).

## Important note

Tax treatment depends on the individual circumstances of each client and may be subject to change in the future. The information in this guide is based on our understanding of current law and HMRC practices. 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.

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