

Client guide

The Nucleus Discretionary Gift Trust

Edition 9

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1. Introduction

Welcome to the Nucleus Discretionary Gift Trust guide. This section explains how the document is structured and defines some of the terms we will be using.

This document consists of nine sections:

1. Introduction
2. What is the Nucleus Discretionary Gift Trust?
3. When should you use the Nucleus Discretionary Gift Trust?
4. When should the Nucleus Discretionary Gift Trust not be used?
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Where we refer to 'you' in this guide, we mean you as the settlor.

Note that settlor refers to both settlors where there are two settlors. This document is provided strictly for general consideration only.

Any action taken or refrained from in connection with the Nucleus

Draft Discretionary Gift Trust must be preceded by discussion with your 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 Gift Trust in any circumstances whatsoever except as provided by law.

Tax treatment depends on the individual circumstances of each client and may be subject to change in the future.

2. What is the Nucleus Discretionary Gift Trust?

A trust is an arrangement where a person or persons (called the trustee(s)) hold(s) property given to them by another person (called the settlor) for the benefit of yet another person or persons (called the beneficiary(ies)). The trustees have the control and legal ownership of the trust assets but must act as custodians of them and use them for the benefit of the beneficiaries.

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 inheritance tax (IHT) on it, but without having to decide immediately who should receive the gift.

The Nucleus Discretionary Gift Trust allows you, as an investor or prospective investor in the Nucleus wrap, to make a gift of your investments or the cash intended for the investment, for the benefit of other individuals, but without giving those individuals outright ownership and control. The trust can be used whether the current investment (or intended investment) is a Nucleus Onshore or Nucleus Offshore Bond (bond) or a holding of units or shares in a unit trust/ Oeic/investment trust (collectives) that are held in a general account on the Nucleus wrap.

When you create the trust you are the settlor of the trust and you cannot benefit from the investment in the trust in any way. There can be more than one settlor, for example where you and your spouse or civil partner jointly create a trust.

The beneficiaries are known as the beneficial (or equitable) owners of the trust property. In relation to trust assets that include investments, they will be able to benefit from the disposal proceeds when an investment is sold, surrendered or otherwise disposed of. Where the trust assets consist of certain collective investments that produce income, a beneficiary may receive such income if the trustees decide to distribute it. Under the Nucleus Discretionary Gift Trust, no beneficiary is entitled to any benefit (capital or income) until the appointor decides who from the classes of beneficiary specified in the trust should benefit from the trust assets and when. The appointor is initially you and, after your death, the trustees.

The trust assets can be distributed to beneficiaries when the appointer believes it is appropriate. However, in order for a trust to be legally effective, the benefits must be distributed out of the trust by the end of the trust period – 125 years. For this reason, you need to appoint a default beneficiary or default beneficiaries who will benefit if assets are still in the trust at the end of the trust period, i.e. have not been distributed in full by that time.

In the unlikely event that no appointments have been made and some assets remain in the trust at the end of the trust period (125 years), the individual or individuals named as default beneficiaries (or their estates if, by then, the default beneficiaries are dead) will benefit.

The main objectives of the Nucleus Discretionary Gift Trust are to make sure that the investment is held for the benefit of the beneficiaries outside of your (inheritance) taxable estate and to provide maximum flexibility as to who benefits and when.

3. When should you use the Nucleus Discretionary Gift Trust?

You should consider using the Nucleus Discretionary Gift Trust if:

- you wish to make an IHT effective lifetime gift of the investment(s) you currently hold in the Nucleus wrap or of a cash sum that is to be invested in the Nucleus wrap.
- you do not need to retain access to the funds for your own benefit in the future.
- you are not certain who is to benefit from your gift or when they are to benefit, i.e. you wish to retain flexibility over which of your beneficiaries ultimately benefit from the trust fund.
- you are prepared to accept that, in certain cases, you may need to report the trust to HMRC and, where the trust property has substantial value, there may be a periodic (every 10 years) IHT charge on the trust.

4. When should the Nucleus Discretionary Gift Trust not be used?

The Nucleus Discretionary Gift Trust should not be used if:

- you wish to retain access to all or a part of the investment for your own benefit.
- you wish to make an absolute gift to a specific beneficiary or beneficiaries (with nobody else benefiting or being capable of benefiting from this gift).

5. How is the Nucleus Discretionary Gift Trust established?

The discretionary gift trust can be used with either cash available for investment or with one or more existing investments held by the investor in the Nucleus wrap.

The trust is established by you, as the settlor, and your chosen additional trustees completing the discretionary gift trust deed, having first agreed with your legal advisers that the draft trust provided is suitable for you.

When you are making a new investment, you would normally provide the trustees with a cheque made payable to Nucleus Financial Services and the trustees will then collectively make the application to invest. This is done with the help of your financial adviser.

For existing general accounts holding collectives in the Nucleus wrap, you would assign your beneficial title to the investments to the trustees (the legal ownership of the shares or units are vested with NFS (Nominees) Limited. You must also instruct NFS (Nominees) Limited to amend their register to show the trustees as the new owners. Special wording is included in the trust deed to facilitate this.

In the case of an existing onshore or offshore bond held in the wrap, the trust deed incorporates an assignment of the bond to all the trustees. A notice of assignment will have to be given to the relevant life assurance company, i.e. CASLP Ltd, Scottish Friendly Assurance or RL360. Again, the necessary wording is included in the trust deed.

The draft Nucleus Discretionary Gift Trust provides for a maximum of four trustees (including the settlor(s)).

Once the investment is made subject to trust, any subsequent dealings with the investment will be by the trustees rather than you personally.

6. Key provisions of the Nucleus Discretionary Gift Trust

- During the trust period (up to 125 years) the appointor (initially you and then the trustees) may appoint the trust benefits (capital or income) to any of the discretionary beneficiaries. These beneficiaries include your widow/er, children and grandchildren, brothers and sisters and their issue.
- You can also specify other beneficiaries at the time the trust is established. If after the trust has been established you want to include a person as a beneficiary who is not listed as a discretionary beneficiary, you can nominate that person to the trustees in writing.

You can choose whether to include your spouse or civil partner amongst the beneficiaries by initialling the appropriate box in the trust deed. This can have income tax consequences, as follows.

- As the trust is a discretionary trust, no beneficiary is entitled to anything unless and until the appointor makes an appointment in their favour. If any income arises to the trustees from the trust investments, the trustees can distribute it to or for the benefit of any of the beneficiaries. Alternatively, they can accumulate the income, i.e. reinvest it. If the trust is governed by the law of Scotland, the income can be accumulated for a maximum of 21 years. No such restriction applies in England. If the only trustee investment is an onshore or offshore bond, no actual income will arise to the trustees.
- You cannot benefit from the trust under any circumstance.
- You must name (as default beneficiary(ies)) the individual or individuals who are to benefit from the trust fund at the end of the 125-year trust period, in the unlikely event that no appointment has been made before then.
- The trustees have wide powers to invest, including reinvestment in other assets and generally dealing with the trust property.

7. The law of the trust

The trust gives you the choice of law to govern it, either the law of England or the law of Scotland. If you are domiciled in Scotland you would usually choose Scots law to apply to your trusts but there is no requirement to choose the law of your domicile.

Tax implications of the trust are the same throughout the UK.

8. The trustees

You (or both of you in the case of joint settlors) are automatically included as original trustees. At least one additional trustee should be appointed at outset. You and the additional trustee(s) execute the trust deed together.

Anyone over the age of 18 and of sound mind can be a trustee. You should choose your trustees with care.

You may wish to appoint a professional person, such as a solicitor, to be a trustee. Bear in mind that such professionals will normally charge fees to act as a trustee.

You can appoint further trustees later on and you may also dismiss a trustee provided at least one trustee other than you or your spouse/civil partner remains.

In all other cases the trustees of an English trust must act unanimously. In Scotland trustees may act by majority. After your death, if any trustee loses mental capacity, they can be dismissed by the majority of the other trustees.

9. The tax implications of the Nucleus Discretionary Gift Trust

9.1 Inheritance tax (IHT)

9.1.1 Establishment of the trust

- For IHT purposes a transfer of value (a gift) takes place at the time the trust is created.
- Where there are two settlors, each is treated as making a gift of one half of the value transferred.
- When a new investment is to be made subject to trust with cash given to the trustees, the value transferred will be the cash gift.
- When an existing onshore or offshore bond is made subject to trust, the value of the gift will be the value of the bond or the amount of the premium originally paid if greater.
- When collectives in an existing investment account are made subject to trust, the value of the gift will be the value of the shares or units at the time of the gift. The IHT implications will be as set out above.
- If the amount of the transfer exceeds the settlor's available annual exemption, currently £3,000 for each settlor (£6,000 maximum for each settlor if the annual exemption for the previous tax year has not been used), it will be a chargeable lifetime transfer. This means that a liability to IHT at 20% will immediately arise if the value of the gift plus the value of all other chargeable transfers made by you in the previous seven years exceeds the nil rate band at the time the gift is made (the nil rate band in the tax year 2022/23 being £325,000). A further tax liability could arise if you die within seven years of making the gifts (see section 9.1.4 for further information).
- In general, provided the amount of the gift does not cause the cumulative chargeable lifetime transfers made by you to exceed 80% of the nil rate band (£260,000 in the tax year 2022/23) the gift need not be reported to HMRC.

9.1.2 Registering the trust with HMRC

Almost all trusts set up during lifetime (with some exceptions, for example, trusts set up before 6 October 2020 and holding total assets of not more than £100 and trusts holding pure protection life insurance) will have to be registered by the later of 90 days from the date the trust was created or 1 September 2022.

Before Nucleus can accept an application or monies for new registrable trust cases, we will need sight of a 'proof of registration' document issued to the lead trustee by HMRC.

9.1.3 Additions to the trust by the settlor

- Any additional investment will be a further gift and the tax implications will be as described for the initial gift. If regular gifts

are made out of income and do not reduce the settlor's normal standard of living, such gifts are likely to be exempt under the normal expenditure out of income exemption.

- Additional investments into the trust can also have an impact on the IHT periodic and exit charges that can apply to the trust (see sections 9.1.6. and 9.1.7. for further information).

9.1.4 Death of a beneficiary

- As no beneficiary is entitled to anything unless and until the appointor makes an appointment in their favour, the death of a beneficiary who is capable of benefiting under the trust has no IHT implications for this trust.

9.1.5 Death of the settlor

- On your death, the value of the trust investments will be outside of your estate for IHT purposes. However, there may be IHT implications as regards the gift made to the trust.
- IHT could become payable where the value of the original gift to the trust (net of any available exemptions) exceeded the nil rate band (so that there was a 20% lifetime charge on that excess) and you die within seven years of creating the trust. This further tax liability (up to 20%) could be reduced by taper relief if you survive for at least three years. If the value of the original gift is within the available nil rate band no liability will arise on the gift itself, either when made or on death within seven years.

For non-exempt lifetime transfers to the discretionary gift trust, the nil rate band available to determine the liability to IHT arising on your estate upon your death within seven years of the gift to the trust, will be correspondingly reduced by so much of the gift that fell within the nil rate band.

These provisions will apply to each settlor independently where there are joint settlors.

9.1.6 IHT while the trust is in existence

As this is a discretionary trust, it is subject to special IHT rules called the 'relevant property regime'. Under these rules there may be IHT charges on every 10-year anniversary of the trust – 'the periodic charge' or whenever property leaves the discretionary trust environment (e.g. when capital is advanced to a beneficiary) – 'the exit charge'.

9.1.7 The periodic charge

Periodic charges may be applied to the value of the assets in the trust on every 10-year anniversary of the trust. The rate of IHT charged will be determined by calculating the IHT liability on an assumed transfer by an assumed transferor. Broadly speaking, it will be necessary to take account of:

- the value of the property in the trust on the 10-year anniversary.
- the settlor's cumulative total of chargeable transfers made in the seven years immediately before the trust was created and any sums paid out of the trust in the 10 years prior to the anniversary.

If 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 rate that applies to this capital to take account of the time before the accumulated income was added to the capital.

The maximum IHT liability will be 6% of the amount by which the value of the trust property exceeds the nil rate band available to the trust, but frequently it will be much less or even nil. How much, if any, of a nil rate band will be available to the trust will largely depend on the history of gifts made by the settlor before they created the trust and any trusts created on the same day.

In cases where the settlor has not made any chargeable transfers in the seven years before the trust is created, no payments have been made out of the trust in the previous 10 years and there has been no added property, there will be no liability provided the value of the trust fund at the time of the periodic charge does not exceed the nil rate band applicable at that time. Any excess over the nil rate band at that time will suffer IHT at an effective rate of 6%.

Example

Alan creates a discretionary gift trust on 10 October 2022 by investing £285,000 in a Nucleus General account on the Nucleus wrap. He has made no chargeable transfers in the previous seven years. No payments are made out of the trust in the first 10 years.

On 10 October 2032 the trust fund (i.e. the value of the shares in the account) is worth £500,000 and the nil rate band is £450,000. The IHT charge will be calculated as £50,000 at 6% = £3,000. This equates to 0.6% of the total value of the trust fund.

Should all of the trust fund be distributed before the tenth anniversary then, provided there was no entry charge, it is likely that no tax charge will arise (see section 9.1.7 for further information). If assets remain in the trust after the distribution, or if further assets are added to the trust, the trustees will need to obtain specialist tax advice.

9.1.8 The exit charge

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

Exit charges within the first 10 years of the trust's existence will be nil if the value of the initial transfer going into the trust (including the cumulative total of the settlor's chargeable transfers in the previous seven years and the value of any added property) is below the available nil rate band when the exit occurs. If an exit charge does arise, it will increase according to the number of quarters that have expired since the trust was created.

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

Exit charges should not arise on loans made by the trustees to beneficiaries.

Certain transactions, such as capital payments to the beneficiaries, may also have to be reported to HMRC, even if no actual tax liability arises.

If there are joint settlors for IHT purposes, the trust is effectively treated as two separate trusts, each created by one settlor.

The IHT rules on the taxation of discretionary trusts are quite complex and may change in the future. You should discuss them in more detail with your adviser if you think they may apply in your situation. The IHT rules are explained fully in the guide for this trust which is available to your adviser.

9.2 Income tax

The income tax implications depend on whether the asset held by the trustees is an onshore or offshore bond (see UK funds and offshore reporting funds in section 9.2.2.2. below for further information) or collectives in the general account (see offshore non-reporting funds in section 9.2.2.2. below for further information).

9.2.1 Creation of the trust

The transfer of an existing onshore or offshore bond into a trust does not give rise to a chargeable event and so there are no income tax implications.

There are no income tax implications on the transfer of a collective into trust except in the case of offshore non-reporting funds, in which case the gain (based on the market value of the investment at the date of transfer, less the acquisition price but without the benefit of the annual exemption) will be taxed as your income.

9.2.2 During the trust's existence

9.2.2.1 Chargeable event gains under a bond

When a bond is encashed, 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 resident in the UK and, if so, whether the settlor is still alive.

(a) During the settlor's lifetime and in the tax year in which the settlor's death occurs

For income tax purposes, any chargeable event gains arising under the bond will be assessed on the settlor provided the settlor is alive and a UK tax resident. If there are joint settlors, each will be assessed on one half of the gain. A 20% 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 (40%) or additional rate (45%) taxpayer. This credit will not be available for gains made under offshore bonds. For full details of the relevant bond taxation please refer to the relevant Nucleus Onshore and Offshore Bond literature.

If the settlor is non-UK resident and the trustees are UK resident then the trustees will be assessed to tax as explained in (b) below.

(b) 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 trustees if they are UK resident. The first £1,000 of gain (assuming the settlor has not created any other trusts) is taxed at the standard rate, which is 20%, and the rest at the special rate of 45%. A 20% tax credit will apply if the bond is an onshore bond but this is not available for offshore bonds.

If the trustees are not UK resident there are special rules to tax UK beneficiaries when and to the extent that they receive benefits; specialist advice should be sought if this applies.

9.2.2.2 Income arising to the trustees from investments in collectives

The income tax position will depend on whether the settlor's spouse or civil partner is included as a discretionary beneficiary.

UK funds and offshore reporting funds

(a) Where the settlor's spouse or civil partner is excluded from all benefit under the trust

Under a discretionary trust there is no beneficiary who is entitled to income when it arises to the trustees. The trustees themselves are taxed on any income arising from the funds at the special trust rates.

Tax rates depend on whether income is treated as dividend income or interest income.

Dividends have been paid gross, with no associated tax credit, since 6 April 2016. Interest distributions from unit trusts, open-ended investment companies and investment trust companies have been paid gross since 6 April 2017.

There is a standard rate which applies to income received by the trustees up to £1,000 (gross) in a tax year. The tax rates on income falling within the standard rate band are 8.75% for dividends and 20% for savings income. The rates above the standard rate are 39.35% for dividends and 45% for other income (The £1,000 limit is scaled down if the settlor has created more than one trust).

Where trust income is paid to a beneficiary it is treated as having already been taxed at the trust rate of 45%. Where the trustees have paid insufficient tax on the income (perhaps because the income fell within their standard rate band or was taxed at the dividend rate in the hands of the trustees), they may have to pay more tax to cover the beneficiary's tax credit.

If the beneficiary is a non-taxpayer, or they pay tax at the 20% or 40% rate, they may be able to claim some or all of the tax back.

If they pay tax at 45% they will have no more tax to pay on the trust income. However, as this income is classed as "trust income" neither the personal savings allowance or the dividend allowances will be available.

Special rules also apply if the income distribution is made to a beneficiary who is the settlor's minor child (if unmarried and not in a civil partnership). In such a case the settlor will be taxed on that income if, in general terms, it (together with other income arising from gifts made by the parents) exceeds £100 in a tax year.

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

(b) Where the spouse or civil partner of the settlor may benefit under the trust

If you choose to include your spouse or civil partner as a beneficiary under the Nucleus Discretionary Gift Trust, you will be taxed on all trust income at your personal rates of income tax. This rule does not apply if only your widow or widower can benefit.

Despite this, the trustees will still be liable at the trust rates described above, effectively paying tax on your behalf. You will receive a credit for the tax paid by the trustees. If you are not a higher rate or additional rate taxpayer and the trustees have paid income tax on the income at 45% or 39.35%, you can reclaim any excess tax paid by the trustees from HMRC. Even if you are a higher rate (40%) taxpayer, but not a 45% taxpayer (i.e. your taxable income is less than £150,000), you will be able to recover the 5% tax difference. Any tax recovered must be paid to the trustees. In such cases the settlor will be entitled to use their personal savings allowance and /or dividend allowance.

Special rules apply if you are non-UK domiciled and trust income arises on overseas investments but this is not something contemplated with investments in a Nucleus wrap.

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.

Who is assessed to tax on an offshore income gain made by the trustees depends on whether the settlor's spouse or civil partner can benefit under the trust or not.

(a) Where the settlor's spouse or civil partner is excluded from all benefit under the trust

The trustees are liable to tax at the special rate of 45% on offshore income gains. Any amount of the offshore income gain that falls within the £1,000 standard rate band (scaled down if the settlor has created more than one trust) will be taxed at 20%, with income in excess of £1,000 being taxed at 45%.

Where a payment is made out of the trust by the trustees to a beneficiary it is treated as capital without any liability to tax.

(b) Where the spouse or civil partner of the settlor may benefit under the trust

If you choose to include your spouse or civil partner as a beneficiary under the Nucleus Discretionary Gift Trust, you will be taxed on all trust income (including offshore income gains) at your personal rate of income tax. This rule does not apply if only your widow or widower can benefit.

Despite this, the trustees will still be liable at the 45% trust rate described above, effectively paying tax on your behalf. You will receive a credit for the tax paid by the trustees. If you are not a higher rate or additional rate taxpayer and the trustees have paid income tax on the income at 45%, you can reclaim any excess tax paid by the trustees from HMRC. Even if you are a higher rate (40%) taxpayer, but not a 45% taxpayer (i.e. your taxable income is less than £150,000), you will be able to recover the 5% tax difference. Any tax recovered must be paid to the trustees.

Where a payment is made out the trust by the trustees to a beneficiary it is treated as capital without any liability to tax.

Special rules apply if you are non-UK domiciled and offshore income gains arise but this is not something contemplated with investments in a Nucleus wrap.

9.2.3 Capital gains tax (CGT)

9.2.3.1 Creation of the trust

There are no CGT implications if cash is transferred to the Nucleus wrap to buy new collectives or bonds to be held in the trust or if an onshore or offshore bond is transferred to a trust, unless the bond had previously been bought from another investor.

When an existing general account holding collectives (or some of the collectives in the account, but excluding any offshore non-reporting funds) is transferred to the Nucleus Discretionary Gift Trust, this will be a disposal for CGT purposes. The gain will be calculated in the usual way and, after deduction of your available annual exemption, will be taxed at 10% and/or 20% depending on your marginal rate of income tax. However, if the collective is an offshore non-reporting fund the gain, without the benefit of the annual exemption, will be taxed as your income (as described in section 9.2.1). There will be no CGT implications.

As the transfer to a discretionary trust is also a chargeable transfer for IHT purposes, it might be possible for any chargeable gain to be held-over, i.e. deferred until a subsequent disposal by the trustees.

This relief will not be available if your spouse/civil partner or minor children can benefit under the trust or where the collective is an offshore non-reporting fund.

9.2.3.2 Trust capital gains (only relevant to collectives held in the general account)

- The trustees are assessed on CGT for any capital gains arising when they sell the shares/units in a collective unless it is an offshore non-reporting fund, when the gain will be subject to income tax (see offshore non-reporting funds in section 9.2.2.2. for further information).
- Unless the settlor has created more than one settlement the trustees are normally entitled to an annual CGT exemption equal to £6,150 in 2022/23 before any tax is actually payable. The trustees pay tax at a special trustee rate which is 20% on capital gains that exceed their available annual exemption. There is a higher rate, 28% where the asset disposed of is an interest in residential property.



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