Client guide

The Nucleus Discretionary Loan Trust

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1. Introduction

Welcome to the Nucleus Discretionary Loan 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
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Where we refer to 'you' in this guide, we mean you as both the settlor and the lender. A Nucleus Discretionary Loan Trust may only be set up by one person, i.e. it may not be set up jointly by two people.

The expression 'spouse' applies to husbands, wives and civil partners.

This document is provided strictly for general consideration only and is based on our current understanding of the law. Any action taken or refrained from in connection with the Nucleus Draft Discretionary Loan 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 Loan Trust in any circumstances whatsoever.

2. What is the Nucleus Discretionary Loan Trust?

A trust is an arrangement where a person or persons (called the trustees(s)) hold 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.

The Nucleus Discretionary Loan Trust has been designed for investors who wish to carry out estate planning and, while they cannot afford to give up all access to the funds intended to be used in the planning, they can give up access to any investment growth on these assets.

The Nucleus Discretionary Loan Trust has three components:

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

Under the Nucleus Discretionary Loan Trust you will first create a trust for the specific purpose of lending a sum of money to the trustees of that trust which is then invested by the trustees in investments held in the Nucleus wrap. After the trust is set up, you and the trustees enter into a loan agreement. You are both the settlor and the lender. The trustees jointly make the application for the investment. The underlying investment can be a Nucleus Onshore Bond, a Nucleus Offshore Bond or collective investments (collectives) in the Nucleus General Account.

The trustees hold the trust asset for the beneficiaries. However, you as the lender retain the right to have your loan repaid to you at any time.

There is no initial gift and so no immediate reduction in your estate for IHT purposes but, as the trust investment grows in value, all the investment growth will be outside your estate for IHT purposes and held for the beneficiaries of the trust. You can request the repayment of the whole or part of your outstanding loan at any time. Any loan repayments made by the trustees, and spent by you will reduce the value of your estate for IHT purposes.

Under the Nucleus Discretionary Loan 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 appointor 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. the assets haven't been distributed in full by that time.

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

You should consider using the Nucleus Discretionary Loan Trust if:

- you wish to make an investment in the Nucleus wrap but do not wish to make a gift of your investment;
- you have established with your advisers that there may be IHT payable in respect of your estate on your death and wish to take some action to mitigate this;
- you need to retain access to the capital you intend to invest for your own benefit, but you can afford to give away the growth on the capital invested; and
- you are not certain who you wish to benefit from the trust fund.

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

The Nucleus Discretionary Loan Trust should not be used if:

- you are not interested in estate planning; or
- you can afford to make a gift of the entire sum intended for investment without retaining any access; or
- you wish to retain total control over and access to the whole investment, not just the original capital.

5. How is the Discretionary Loan Trust established?

The Discretionary Loan Trust can be used only with cash available for investment. 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.

As explained earlier, the Nucleus Discretionary Loan Trust has three components.

First, the trust is established by you, as the settlor, and your chosen additional trustees by completing the Discretionary Loan Trust Deed having, of course, first agreed with your legal advisers that the draft trust provided is suitable for you. You do not make a gift at that time but make a promise to make an interest-free loan, to the trustees.

Second, once the trust is established you enter into a formal agreement with the trustees to make an interest-free loan repayable on demand. The intention is that the trustees will invest the loaned money in the Nucleus wrap. The loan is satisfied by you handing over to the trustees your cheque payable to, or making a BACS transfer to, Nucleus Financial Services. The trustees acknowledge receipt of the loan using a special form which you should keep together with your copy of the loan agreement.

Third, the trustees collectively make the application to invest. This is done with the help of your financial adviser.

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

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

6. Key provisions of the Nucleus Discretionary Loan Trust

During the trust period the appointor (initially you and then the trustees) may appoint the trust benefits (capital or income) to any of the discretionary beneficiaries. However before doing so, this should be discussed with your advisers as your entitlement to any outstanding loan, unless you are giving this up should take precedent and the trustees need to ensure there is enough in the trust fund to satisfy the loan.

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 among the beneficiaries by initialling the appropriate box in the trust deed. This can have income tax consequences, and you should discuss this with your adviser.

As the trust is a discretionary trust, no beneficiary is entitled to anything 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 ie. reinvest it. If the only investment of the trust is an onshore or offshore bond, no actual income will arise to the trustees.

You cannot benefit from the trust fund, you are only entitled to have your loan repaid to you. This loan can be repaid to you at any time though you should seek advice before doing so and there could be tax consequences depending on the circumstances at the time.

You must name (as default beneficiaries) 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.

To be IHT effective the loan must be repayable on demand and interest free. If, as expected, you spend these loan repayments without bringing into existence an asset of equivalent value, your taxable estate would reduce at that time.

Nucleus provides standard forms to make requests for loan repayments to make the running of the scheme easier. The trustees must keep a record of all repayments and ensure that no more than the original loan is ever repaid to you.

7. The law of the trust

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.

8. The trustees

You are automatically included as an original trustee. At least one additional trustee should be appointed at outset.

You and the additional trustee(s) together execute the trust deed.

Anyone over the age of 18 and of sound mind can be a trustee. Obviously 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 change a trustee provided at least one trustee other than you or your spouse remains.

The trustees of an English trust must act unanimously.

9. The tax implications of the Nucleus Discretionary Loan Trust

In all cases, it is assumed that the settlor and the trustees and the beneficiaries are UK resident – special rules apply where this is not so and specialist advice must be taken. The following is an outline of the key tax implications. Full details of the tax implications of the Nucleus Discretionary Loan Trust are included in the adviser guide.

9.1 Inheritance tax (IHT)

9.1.1 Establishment of the trust

Neither the declaration of trust nor the making of the interest-free, repayable on demand loan to the trustees gives rise to a gift for IHT purposes.

9.1.2 Registering the trust with HMRC

All UK express trusts, unless they are specifically excluded will need to register on HMRC's trust registration service (TRS). It is the responsibility of the trustees to ensure that the trust is correctly registered, the record is kept up to date and proof of registration or confirmation of exclusion is sent. If the trustees need assistance with this they will need to seek professional advice, Nucleus cannot assist with this.

9.1.3 Death of a beneficiary

As no beneficiary is entitled to the trust fund or it's income, until an appointment is made, the death of a beneficiary who is capable of benefiting under the trust has no IHT implications for this trust.

9.1.4 Death of the settlor

On your death the amount of the outstanding loan will be an asset in your estate for IHT purposes. However, the value of the trust fund will be outside your estate for IHT purposes.

If you are married you may, in your will, leave the right to the repayment of the outstanding loan to your surviving spouse. In such a case, no IHT will be due on the outstanding loan entitlement on death due to the spousal exemption and loan repayments can continue to your spouse.

9.1.5 IHT while the trust is in existence

The Discretionary Loan Trust subject to special IHT rules under the 'relevant property regime'. Under these rules there may be IHT charges on every 10-year anniversary of the trust ('the principal charge'), or whenever property leaves the discretionary trust environment, for example when capital is advanced to a beneficiary ('the exit charge').

9.1.6 The principal charge

Principal charges may be applied to the value of the assets in the trust on every 10-year anniversary of the trust. Under the Discretionary Loan Trust the value of the trust assets will be determined after deducting the amount of the outstanding loan.

For further information about the principal charge and how this might apply to the trust fund, please speak with your financial and tax adviser.

9.1.7 The exit charge

Exit charges apply when distributions are made from the trust to the beneficiaries, and when the trust is being wound up. This will be based on the value of property leaving the trust and the timing of the distribution.

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

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 professional adviser if you think they may apply in your situation.

9.2 Income tax

9.2.1 Creation of the trust

There are no income tax implications when the loan is made to the trustees. As explained earlier the loan must be made in cash.

9.2.2 During the trust's existence

When a bond is encashed (wholly or partially), 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 and a UK resident in the tax year when this occurs.

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 UK tax resident. 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. Please speak to your adviser regarding full details of the relevant bond taxation.

If the settlor is non-UK resident and the trustees are UK resident then the trustees are assessed to tax.

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.

Income within the £500 de minimus, is taxed at 0%. However please note the £500 can be split depending on the number of discretionary trusts the settlor has created and could be as little as £100. If the gain is over £501, then this will be taxed at 45%. A basic rate 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 ordinarily resident beneficiaries when and to the extent that they receive benefits – specialist advice should be sought if this situation applies.

Income arising to the trustees from investments in collectives

The income tax position will depend on whether the loan is still outstanding or has been repaid in full, and whether the settlor's spouse is included as a discretionary beneficiary.

Those previously in the remittance taxation basis for their foreign income and gains, are now subject to new rules and tax advice should be sought.

UK funds and offshore reporting funds

(a) Where the loan has been repaid and the settlor's spouse 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.

Trusts with income within the £500 de minimus, is taxed at 0%. If income is £501 or more then all income will be taxed at the appropriate trust rate depending on the income source.

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, they may have to pay more tax.

If the beneficiary is a non, basic or higher rate taxpayer, they may be able to claim some or all of the tax back. If they pay tax at the 45% rate they will have no more tax to pay on the trust income.

Special rules also apply if the income distribution is made to a beneficiary who is the settlor's minor child. In such a case the settlor will be taxed on that income if, it exceeds £100 gross in a tax year.

(b) Where the loan remains outstanding or the spouse of the settlor may benefit under the trust

If any amount of the loan remains outstanding, all trust income will be taxed on you at your personal rates of income tax. The same applies if you choose to include your spouse (not widow or widower) as a beneficiary under the Nucleus Discretionary Loan Trust.

However, despite this, the trustees will still be liable at the trust rates. You will receive a credit for the tax paid by the trustees and you may be able to reclaim any excess tax paid. Please speak to your financial and tax adviser about if this applies to you.

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 the gain will be taxed as income.

Please speak to your financial and tax adviser if you are investing in this type of fund about which taxes will apply and who is assessable for these.

a) Where the loan has been repaid and the settlor's spouse is excluded from all benefit under the trust

The trustees are liable to tax at the special rate of 45% on offshore income gains.

(b) Where the loan remains outstanding or the spouse of the settlor may benefit under the trust

If any amount of the loan remains outstanding, all trust income, including offshore income gains will be taxed at your personal rates of income tax. The same applies if you choose to include your spouse (not widow or widower) as a beneficiary under the Nucleus Discretionary Loan trust.

However, 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 and you may be able to reclaim any excess tax paid. Please speak to your financial and tax adviser about if this applies to you.

9.3 Capital Gains Tax (CGT)

9.3.1 Creation of the trust

There are no CGT implications when the trust is set up. There may be the usual CGT implications if you have to sell investments that you own in order to raise the cash for the loan.

9.3.2 trust capital gains (only relevant to collectives held in the General Account)

The trustees are assessed to CGT on any capital gains arising 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.

Unless the settlor has created more than one settlement the trustees are normally entitled to an annual CGT exemption, currently £1,500, before any tax is actually payable. The trustees pay tax at a special trustee rate, which is 24% on capital gains arising from investments that exceed their available annual exemption.

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