

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 six sections:

1. Introduction
2. What is the Nucleus Discretionary Loan Trust?
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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 understanding of the law as at April 2023. 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 except as provided by law.

## 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.

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, how much and when. However, to be effective for IHT, the donor must normally give up all access to the gifted property. For some, this can represent a serious obstacle that needs to be overcome if effective estate planning is to be possible.

The Nucleus Discretionary Loan Trust is designed to overcome this objection. It is an estate planning scheme which has three components:

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

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.

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 (without bringing an equivalent value asset into being), will reduce the value of your estate for IHT purposes.

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 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.

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

### 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; but
- you need to retain access to the capital you intend to invest for your own benefit, although you can afford to give away the growth on the capital to be invested; and
- 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 will ultimately 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 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, repayable on demand, 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 loan moneys 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 (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 among the beneficiaries by initialling the appropriate box in the trust deed. This can have income tax consequences, as explained below.
- 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 investment of the trust is an onshore or offshore bond, no actual income will arise to the trustees.
- You cannot benefit from the trust in any circumstances except that you are, of course, entitled to have your loan repaid to you.
- 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 – see above for an explanation of why this is necessary.
- The trustees have wide powers to invest, including reinvestment in other assets and generally dealing with the trust property.
- The value of the trust fund available for the beneficiaries will increase as the value of the investment grows.
- You remain entitled to have your loan repaid at any time and the amount of the outstanding loan remains in your estate for IHT purposes.
- To be IHT effective the loan must be repayable on demand and interest free. You can request repayments of part or the whole of your loan at any time. A repayment will be made by the trustees after making withdrawals of capital from the bond or collectives. 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 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's no requirement to choose the law of your domicile.

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. This is particularly important if you are domiciled in Scotland as, without an additional trustee, a trust may not be validly created under Scots law.

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 dismiss a trustee provided at least one trustee other than you or your spouse remains.

The trustees of an English trust must act unanimously. In Scotland trustees may act by majority.

## 9. The tax implications of the Nucleus Discretionary Loan Trust

In what follows, 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 Death of a beneficiary

As no beneficiary is actually entitled to any benefit under the trust unless and until the appointor makes an appointment in their favour, the death of a beneficiary who is merely capable of benefiting under the trust has no IHT implications.

#### 9.1.3 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 balance value of the trust fund (represented by the bond and/or collectives) will be outside your estate and subject to its own tax rules.
- If you are married you may, in your will, leave the right to the repayment of the outstanding loan to your spouse. In such a case, if your spouse survives you, no IHT will be due on the outstanding loan entitlement on death and loan repayments can continue to your spouse.

#### 9.1.4 IHT while the trust is in existence

As the Discretionary Loan Trust is founded on 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'

#### 9.1.5 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. 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 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 period of 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 (net of the outstanding loan) exceeds the nil rate band available to the trust but frequently it will be much less or even nil. How much, if any, of the 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 then nil rate band will suffer IHT at an effective rate of 6%.

#### Example

Alan creates a Discretionary Loan Trust on 10 May 2023. The loan of £300,000 is invested in a General Account in 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 except for loan repayments of £150,000 in total. No property is added to the trust.

On 10 May 2033 the value of the shares in the account is £450,000 which means that the value of the trust fund (i.e. after deducting the outstanding loan) is £300,000. This will be within the nil rate band and so there will be no IHT charge. For comparison, if the trust fund was worth £500,000 and the nil rate band was £450,000, the IHT periodic charge would be calculated as  $£50,000 @ 6\% = £3,000$ . 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 it is likely that no tax charge will arise (see the next section). If assets remain in the trust after the distribution, or if further assets are added to the trust, the trustees will need to seek specialist tax advice.

### 9.1.6 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 it is highly unlikely that there would be any 'exits' other than 'inoffensive' loan repayments. However, if capital were to be appointed to a beneficiary, the following rules will apply.

Given that there is no initial gift to this trust, exit charges within the first 10 years of the trust's existence will be nil if the cumulative total of the settlor's chargeable transfers in the seven years preceding the creation of the trust and the value of any property added to the trust (not recommended) 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 ten-year anniversary. In most cases with a Discretionary Loan Trust there will have been no periodic charge (see above) so no exit charge would arise.

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

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. The IHT rules are explained fully in the adviser guide to this trust which is available to your adviser.

## 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 UK resident and, if so, whether the settlor is still alive.

- 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 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. Please refer to the relevant Nucleus Onshore and Offshore Bond literature for 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.

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 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:

#### (i) 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.

First, there is a 'standard' rate which applies to income received by the trustees up to £1,000 (gross) in a tax year. The income falling within the standard rate band (SRB) is taxed at the rate of 20% for savings income and 8.75% for dividends. The SRB is reduced if you have created more than one settlement.



In respect of income in excess of £1,000, the trustees are taxed at a special rate which is 45% for interest and 39.35% for dividends.

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 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 (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 that parental settlor) 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 as a beneficiary under the Nucleus Discretionary Loan Trust. This last rule, though, does not apply if only your widow or widower can benefit.

However, 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 an additional (45%) rate taxpayer and the trustees have paid income tax on the income at 45%/39.35%, you can reclaim any excess tax paid by the trustees from HMRC. Even if you are a higher rate (i.e. 40%) taxpayer, but not a 45% taxpayer (i.e. your taxable income is less than £125,140), you will be able to recover the 5% tax difference. Any tax recovered must be paid to the trustees.

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.

**(iii) 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.

In addition to the income tax calculation, a capital gains tax calculation also has to be performed. Any offshore income gain subject to income tax is deducted from the proceeds for capital gains tax purposes which means, in most cases, that there will be no capital gain subject to tax. However, in certain circumstances, this may result in a CGT loss being available.

Who is assessed to tax on an offshore income gain made by the trustees depends 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.

**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. Any amount of the offshore income gain that falls within the £1,000 standard rate band will be taxed at 20%, within 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 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 as a beneficiary under the Nucleus Discretionary Loan trust. This last rule, though, does not apply if only your widow or widower can benefit.

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. If you are not an additional (45%) 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 (i.e. 40%) taxpayer, but not a 45% taxpayer (i.e. your taxable income is less than £125,140), 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 of 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 the Nucleus wrap.

## 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 (e.g. in order to repay your loan) unless it is an offshore non-reporting fund when the gain will be subject to income tax – see ii (B) above.
- Unless the settlor has created more than one settlement the trustees are normally entitled to an annual CGT exemption equal to £3,000 in 2023/24 before any tax is actually payable. The trustees pay tax at a special trustee rate, which is 20% on capital gains arising from investments that exceed their available annual exemption.
- The fact that your loan may be outstanding or that your spouse may be a beneficiary under the trust is of no consequence for CGT purposes.

## 9.4 Registering the trust with HMRC

Almost all trusts set up during lifetime (with some exceptions, such as trusts holding protection life insurance or trusts holding sums of money in a bank or building society for a minor or a vulnerable person ) have to register with the Trust Registration Service (TRS). This includes Discretionary Loan trusts. Registration must be done within 90 days of the trust being created.



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