



Discretionary Trusts – Tax

Legal services for life and for business

Discretionary trusts are subject to their own tax regime. This factsheet provides you with an overview of the key points.

Trusts can be established during your lifetime or under the terms of your Will. They are subject to inheritance tax (IHT), capital gains tax (CGT) and income tax.

INHERITANCE TAX (IHT)

The maximum possible rate of IHT is 6% above the trust's own IHT allowance (presently £325,000). Very broadly, the IHT treatment of discretionary trusts is as follows:

a) If assets are distributed within two years of death these are treated as if they had been distributed under the Will and are therefore not subject to the trust IHT regime.

b) Subject to the above, a trust IHT charge may arise when assets leave the trust and/or on any ten year anniversary of the creation of the trust.

CAPITAL GAINS TAX (CGT)

CGT is payable when property is distributed from a trust (subject to certain exemptions). The current rules applicable to discretionary trusts in relation to CGT are as follows:

a) Capital gains produced by invested trust funds are charged at the highest rate of CGT (currently 20% for investments and 28% for residential property).

b) Trustees are able to utilise their CGT allowance (currently £3000 for 2023/24 tax year and £1500 for 2024/25 tax year) to reduce any tax payable.

INCOME TAX

Trusts are their own entity for income tax purposes and trustees are liable to pay income tax as follows:

a) The first £1,000 of income produced by discretionary trusts is taxed at basic rate (20% for savings income and 8.75% for dividend income) and any income over £1,000 at the trust rate which is currently 45% for savings income and 39.35% for dividend income.

This is based on a full standard rate band allowance. This is reduced if a settlor creates more than one trust.

b) Beneficiaries will be entitled to a credit for the tax paid by the trustees on the income distributed to them and this can be offset in the beneficiaries' personal tax returns.

Please note that not all of these rules apply to interest in possession trusts (i.e. life interest trusts for married couples).

This factsheet is not intended to be an exhaustive summary of the rules applicable to trusts but general guidance. For more specific advice about discretionary trusts and the tax consequences, please contact a member of our Private Client team.

“Considerate and polite. I felt they were “on my side” so to speak, protecting my interests. Clearly very knowledgeable but in no way intimidating, a very good balance.”

CLIENT COMMENT

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