

# TAX TREATMENT

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The taxation of discretionary trusts is complex. Here are some of the main points:

- A standard discretionary will trust is treated as a non-exempt beneficiary, reducing the testator's nil rate band. Inheritance tax on the estate, if it is chargeable, is paid before assets are transferred into trust.
- Discretionary Trusts incur charges over £325,000, taxed up to 6% every 10 years, known as the principal or anniversary charge.
- Exit charges apply to capital sums withdrawn from trusts over the Nil Rate Band, based on factors like time elapsed and value transferred, with a maximum rate of 0.6% per annum.
- Trust income is taxed at the rate of 45% on annual income over £1,000; income below that is taxed at the basic rate.
- Capital Gains Tax will be charged on assets exiting the trust which have made a chargeable gain over the current allowance.
- No beneficiary is seen to own any of the trust assets for as long as they are held in the trust, so the trust value should not affect their individual taxable estates.
- Assets in a discretionary trust do not qualify for the Residential Nil Rate Band, even if beneficiaries are descendants of the settlor.

## CONTACT US

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0330 056 2181

PM House, 250 Shepcote Lane,  
Sheffield, S9 1TP

[enquiries@pm-law.co.uk](mailto:enquiries@pm-law.co.uk)

[www.pm-law.co.uk](http://www.pm-law.co.uk)

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# Discretionary Trust



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Discretionary Trust gives trustees absolute discretion over distributing trust property (capital, income, or both).

A standard discretionary will trust becomes active after the testator's death. Trustees can hold assets and distribute them to beneficiaries chosen by the testator. The beneficiaries have no guaranteed inheritance but may receive assets if trustees decide to distribute capital or income.

A letter of wishes is crucial to guide trustees on understanding the testator's intentions and the trust's operation due to their broad discretionary powers.



## IN WHAT CIRCUMSTANCES WOULD YOU CONSIDER A DISCRETIONARY TRUST?

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Owing to the wide-ranging powers conferred to trustees, discretionary trusts offer a great deal of flexibility to cater for changes in the circumstances of beneficiaries. Such circumstances cannot always be foreseen at the time of creating the will, making the discretionary trust a powerful planning tool should you have concerns about particular beneficiaries.

Examples of concerns that may lead you to include a discretionary trust in your Will:-

- Trustees can manage funds for beneficiaries who cannot handle large sums of money themselves to ensure proper and safe use.
- Transferring shares into a discretionary trust in divorce cases may protect them from financial settlements, but courts can overturn transfers if necessary.
- Upon the Testators death the Trustees can assess the lifetime gifts given by the deceased in his/her lifetime and ensure that the distribution to the potential beneficiaries is equally distributed.
- If the testator leaves young children, they can nominate funds to guardians for education, support, and maintenance.

## TRUSTEE SELECTION

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Careful selection of trustees is vital for all types of discretionary trust. The testator should take into account the following:

- The size and complexity of the trust: will trustees be capable of managing funds, completing tax returns, arranging and minuting trustee meetings, seeking legal advice etc.
- The likely duration of the trust needs to be considered in respect of the trustees' ages.
- The trustees should have good, fair relationships with all of the beneficiaries.
- The trustees honesty should be unimpeachable: are they loyal to the testator and likely to act in good faith while following the wishes of the deceased?
- Minimum of two Trustees, maximum of four. Replacement Trustees may also be appointed.
- Consideration should also be given to trustees relationships with one another.
- Careful consideration of the potential for a conflict of interest to arise should be given before a beneficiary is also appointed as a trustee.