



# Trust Referencer

Focused Report

*for*

A discretionary trust  
arising in a Will

*where*

the trust period is restricted to 2 years

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Report includes the following sections

Outline  
Inheritance Tax  
Capital Gains Tax  
Income Tax

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This Trust Referencer Report was created on 17th January, 2022.

Please note that:

Trust Referencer is constantly updated  
It assumes the relevant parties are domiciled and resident within the U.K.  
References to the masculine gender include the feminine  
The agreed Terms and Conditions apply to the reliance upon its content.

# Outline

- The trust is created with a view to flexibility with the intention that the trustees will distribute the trust funds within a 2 year period. Compare this to a full term discretionary, where the trust could last for up to 125 years
- This is therefore intended to control trust property on a short term basis and the trustees will be focused on the appointment of the capital of the fund.
- It will allow the trustees to act in the most appropriate manner, taking into account all circumstances existing at the death of the testator.
- The provisions of s.144 IHT Act 1984 relating to "reading-back" means that if within the period of 3 months to 2 years from the testator's death the trustees appoint all or part of the trust fund to individuals this will be treated as if this was a provision within the testator's Will. By the provisions of the Finance Act 2015, the 3 month waiting period will not apply where property is appointed to the surviving spouse or civil partner of the testator.
- S.144 might be used to change the nature of this relevant property trust so as to qualify for the additional residence nil rate band relief.
- Property is settled so that trustees may apply the capital at their discretion for the benefit of a defined class of beneficiaries.
- A person who is included as a possible beneficiary, has no legal entitlement unless and until the trustees make an appointment to them. Only then, will creditors or possible claimants be able to pursue any claim. The assets of the trust can therefore be protected.
- The trust is often used in IHT planning.
- The testator's wishes are often recorded in an informal memorandum of wishes. This has no binding legal force but is a useful guide to the trustees when exercising their discretion.
- It is important that trustees are seen to exercise discretion and that any decisions are formally recorded in terms of trust minutes.

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## Inheritance Tax

In respect of a 2 year discretionary trust and which came into being post 22 March 2006 :

- From commencement this will be treated as a relevant property trust.
- IHT is calculated in the normal way on the testator's estate. The value of the property passing to the trustees will be treated as the commencement value of the trust fund.
- The provisions of s.144 IHT Act 1984 relating to "reading-back" are highly relevant to this trust. If within the period of 3 months to 2 years from the testator's death the trustees appoint all or part of the trust fund to individuals this will be treated for IHT purposes as if this was a provision within the testator's Will.
- S.144 might be used to change the nature of this relevant property trust so as to qualify for the additional residence nil rate band relief.

- By the provisions of the Finance Act 2015, the 3 month waiting period will not apply where property is appointed to the surviving spouse or civil partner of the testator. There will be no exit charge.
- The following apply only if the trust extended beyond the 2 years.
- the trust fund is re-valued at 10 yearly intervals. With effect from 6 April 2014 this includes undistributed and unaccumulated income which has been held by the trust for more than five years prior to the valuation date.
- At each 10 year anniversary, a charge can arise, currently at a maximum rate of 6%
- The anniversary charge may be nil, or reduced, if the trust comprised property of no more than the available nil rate exemption of the testator.
- Upon each appointment of funds by the trustees and at the termination of the trust an exit charge may be payable.
- The rate of the exit charge will be a proportion of the anniversary charge calculated, by reference to the number of complete 3 month periods, either from the last 10 year anniversary or from the commencement of the trust, if no anniversary.
- The exit charge may be nil, or reduced, if the trust has available, all or part of, the nil rate exemption of the testator.
- Both anniversary and exit charges may be avoided or reduced if the trust fund comprises property which has its own IHT reliefs. e.g. APR, BPR.
- If exit charges apply during the first ten years of a discretionary trust's life then business and agricultural property relief may not always be available to reduce the exit charge.
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- For chargeable transfers made on or after 6 April 2014 both the filing date and payment dates are six months from the end of the month in which the tax event occurred.

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## Capital Gains Tax

In respect of a 2 year discretionary trust:

- The death of the testator does not create a charge for CGT.
- In respect of any disposals by the personal representatives (as opposed to the trustees) in the tax year when the testator died and/or in the following 2 tax years, they will be entitled to claim the individual's annual exemption (2020/21 being £12,300).
- The trustees are deemed to acquire the assets of the trust at the probate value.
- No CGT charge will arise upon the disposal of certain exempt trust assets. The most important would usually be a trust beneficiary's only or principal main residence.

- Additionally these include gilt-edged securities, shares in Venture Capital Trusts/Enterprise Investment schemes and moveable chattels sold for less than £6,000.
- The provisions of s.62 TCGA 1992 and s.142 IHT Act 1984 relating to "reading-back" are relevant to this trust. If within the period of 2 years from the testator's death the trustees appoint all or part of the trust fund to individuals this will be treated for CGT purposes as if this was a provision within the testator's Will. There will be no CGT charge.
- Otherwise, if during the trust the trustees sell any asset being part of the trust fund, this may cause CGT to be payable in respect of the difference between the sale price above the acquisition or deemed acquisition cost, deducting the costs of sale, any available exemptions and allowable losses. If the disposal, includes business assets, holdover relief may be available to the trustees.
- Any capital gain arising in the period(s) during the trust when any beneficiary occupied all or part of trust property as his principal main residence, will be exempt from CGT.
  - The exemption includes garden and grounds of up to 0.5 hectare and is available even though occupation, under the terms of the trust, was at the discretion of the trustees. If the garden and house are sold separately then for exemption to apply to the garden and grounds the garden and grounds must be sold before the main house.
  - Where the grounds exceed 0.5 hectare then the extra may qualify for relief if the land above 0.5 hectare is required for the reasonable enjoyment of the property on an objective test.
- Upon a disposal trustees pay CGT at 20% (whereas private individuals may pay at rates between 10% and 20%). If the disposal is of a residential property not qualifying for private residence relief trustees pay CGT at 28% (whereas private individuals may pay at rates between 18% and 28%). Therefore the executors should consider any opportunity to transfer the asset directly to the beneficiary, for him, to dispose of, if a lower rate of tax applies or a larger annual exemption applies.
- For UK property disposals made from 6 April 2020, the sale must be reported to HMRC within 30 days after the property's completion date and any Capital Gains Tax due paid. Failure to comply will result in tough penalties. These rules also apply where a property has been disposed of by trustees or personal representatives and will mainly affect buy-to-let properties, land or gifted property such as second homes. The rules will not apply where the property is treated as the main residence of the occupying beneficiary when principal main residence relief will apply.
- In respect of any disposals by the trustees after the 3rd tax year, following the death of the testator, trustees only have an annual exemption of half that of an individual (2020/21 being £6,150 ). The exemption would reduce if the settlor had created other settlements which should be pro-rated between the number of settlements created by the settlor but with a minimum of £1,230 for 2020/21.

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## Income Tax

In respect of a 2 year discretionary trust:

- Until the completion of the administration of the estate, the personal representatives pay income tax determined by the type of income received but without personal allowances. They do not pay higher rate tax.
- The trustees become responsible when the trust funds are transferred to them, by the personal representatives.
- This will be treated as a discretionary or accumulations trust and income is taxed at the following rates, which for the 2020/21 tax year are as set below.
- Trust income up to £1,000 (if there is more than one trust this standard rate £1,000 band is shared between the like trusts - subject to a minimum of £200):
  - 20% (basic rate) when the income is rent, trading and savings
  - 7.5% (dividend ordinary rate) for UK dividends such as income from stocks and shares (if the basic rate is not fully utilized).
- Trust income over £1,000:
  - 38.1% (dividend trust rate) when the income is dividends and distributions
  - 45% (trust rate) for other income.
- Various sums that are capital in trust law are deemed to be income for tax purposes and the above dividend trust (38.1%) and trust rate (45%) apply. These are:
  - company purchase of its own shares (dividend rate applies)
  - gains arising on contracts for life insurance
  - profits on the disposal of deeply discounted securities
  - disposals of futures and options
  - sales of foreign dividend coupons
  - chargeable events in respect of employee share ownership trusts
  - offshore income gains
  - lease premiums
  - transactions in deposit rights
  - transactions in land arising under the anti-avoidance provisions
  - accrued Income Scheme charges
- Any trust expenses, attributable to income, are first set off against dividend-type income. Capital expenses are not deductible against income.
- As this is a discretionary trust, to ensure that the trustees have paid sufficient income tax, the trustees are required by HMRC to maintain a 'tax pool' to regulate and record this. This will assist the trustees to make distributions to beneficiaries. Any tax shortfall has to be paid over to HMRC through the trust's tax return.

- When, during the trust, income payments are made to any beneficiary the trustees will supply them a certificate of tax deducted (form R185), showing a tax credit of 45%.
- If the beneficiary is not a taxpayer or pays tax at a rate below 45% he might be able to claim some or all of the tax back, other than on dividend-type income.

# Tax Rates

## Inheritance Tax

Category	2021 / 2022	2020 / 2021	2019 / 2020
Rates of Inheritance tax on death	40%	40%	40%
Lifetime Rates of Inheritance tax	20%	20%	20%
Threshold/nil rate band	£325,000	£325,000	£325,000
Residence Nil Rate Band	£175,000	£175,000	£150,000
Annual Exemption	£3,000	£3,000	£3,000
Small Gifts Exemption	£250	£250	£250
Wedding Gifts Exemption	2019 / 2020 to 2021 / 2022		
by parent of party to marriage		£5,000	
by remoter issue		£2,500	
by other party to marriage		£2,500	
by other individuals		£1,000	

## Capital Gains Tax

Category	2021 / 2022	2020 / 2021	2019 / 2020
Rates of capital gains tax			
Individual standard rate:			
Residential Property Gains & Carried Interest	18%	18%	18%
Other Gains	10%	10%	10%
Individual higher rate:			
Residential Property Gains & Carried Interest	28%	28%	28%
Other Gains	20%	20%	20%
Trust & Estate Rate:			
Residential Property Gains & Carried Interest	28%	28%	28%
Other Gains	20%	20%	20%
Exemption - Individuals, personal reps and Trustees for disabled people	£12,300	£12,300	£12,000
Exemption - Trusts	£6,150	£6,150	£6,000
Disposal of Chatel Not Exceeding	£6,000	£6,000	£6,000
Entrepreneurs relief			
Amount of qualifying gain on disposal of business assets	£10m	£10m	£10m
Rate of CGT charged on qualifying amount	10%	10%	10%

Note: Gains in excess of the qualifying amount are charged at the rates detailed above

## Income Tax

### Rates of Income Tax for 2021 / 2022

Band	Detail
£0 - £2,000	Tax free dividend allowance. (Dividends within the allowance will still count towards basic or higher rate bands.)
£0 - £37,700	20% (Except dividends, taxed at 7.5%)
£37,701 - £150,000	40% (Except dividends, taxed at 32.5%)
Over £150,000	45% (Except dividends, taxed at 38.1%)

Other income taxed first, then savings income and finally dividends. Personal savings allowance means that basic rate will not have to pay tax on the first £1,000 of savings income and higher rate tax payers on first £500.

### Rates of Income Tax for 2020 / 2021

Band	Detail
£0 - £2,000	Tax free dividend allowance. (Dividends within the allowance will still count towards basic or higher rate bands.)
£0 - £37,500	20% (Except dividends, taxed at 7.5%)
£37,501 - £150,000	40% (Except dividends, taxed at 32.5%)
Over £150,000	45% (Except dividends, taxed at 38.1%)

Other income taxed first, then savings income and finally dividends. Personal savings allowance means that basic rate will not have to pay tax on the first £1,000 of savings income and higher rate tax payers on first £500.

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£0 - £37,500	20% (Except dividends, taxed at 7.5%)
£37,501 - £150,000	40% (Except dividends, taxed at 32.5%)
Over £150,000	45% (Except dividends, taxed at 38.1%)

Other income taxed first, then savings income and finally dividends. Personal savings allowance means that basic rate will not have to pay tax on the first £1,000 of savings income and higher rate tax payers on first £500.

## Income Tax

### Special Rate for Trustee's income 2021/2022

Standard rate on first £1,000 of income which would otherwise be taxable at the special rates for trustees.

Up to 20%, depends on type of income

Trust Rate

45%

Dividend Trust Rate

38.1%

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Dividend Trust Rate

38.1%

## Personal Allowance for 2021 / 2022

Age Group	Allowance
under 65 years (subject to adjustment see Note 1 below)	£12,570
65 - 74 years (subject to adjustment see Note 1 & 2 below)	£12,570
75 years and over (subject to adjustment see Note 1 & 2 below)	£12,570

## Personal Allowance for 2020 / 2021

Age Group	Allowance
under 65 years (subject to adjustment see Note 1 below)	£12,500
65 - 74 years (subject to adjustment see Note 1 & 2 below)	£12,500
75 years and over (subject to adjustment see Note 1 & 2 below)	£12,500

## Personal Allowance for 2019 / 2020

Age Group	Allowance
under 65 years (subject to adjustment see Note 1 below)	£12,500
65 - 74 years (subject to adjustment see Note 1 & 2 below)	£12,500
75 years and over (subject to adjustment see Note 1 & 2 below)	£12,500

## Married Couples Allowance (where one party to the marriage was born before 6 April 1935)

Year	Allowance
2021 / 2022	£9,125 (Minimum amount £3,530)
2020 / 2021	£9,075 (Minimum amount £3,510)
2019 / 2020	£8,915 (Minimum amount £3,450)

## Blind Person's Allowance

Year	Allowance
2021 / 2022	£2,520
2020 / 2021	£2,500
2019 / 2020	£2,450

## Notes

### Note 1 (Personal Allowance Adjustment)

For all ages, the personal allowance reduces where the taxable income is above £100,000, by £1 for every £2 income above this limit.

### Note 2 (Age Allowance Adjustment)

For those 65 years and over, reduce Age Allowance by £1 for every £2 income is over the following limit:

2021 / 2022	£30,400
2020 / 2021	£30,200
2019 / 2020	£29,600