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Inheritance tax and discretionary trusts

Inheritance tax: a growing issue

It has been calculated that estates affected by inheritance tax (IHT) annually would rise from an estimated 21,000 in 2012-13 to 42,000 in 2016-17. In April 2014, the Institute for Fiscal Studies forecast that the number of deaths in which IHT would apply would rise from 2.6 per cent in 2009-10 to 9.9 per cent in 2018-19.

No solicitor wants to miss out on opportunities to assist clients to maximise IHT efficiency but inheritance tax planning is a complex issue that can cut across legal, accountancy and financial advice. As a result, there may be times when you would welcome additional, specialist input from IHT professionals.

At Haslers, we are experienced in working with legal professionals to enhance IHT planning services, delivered as and when needed, to help them offer more to their clients and generate additional fee income.

As a professional firm ourselves, we understand that the integrity of adviser-client relationships is crucial. Legal firms that work with us can do so in complete confidence that their client relationships are secure and that there are no conflicts of interest.

Inheritance tax and discretionary trusts

Traditional IHT planning tools include maximising use of annual IHT exemption, gifts out of income, business property relief (BPR) and agricultural property relief (APR).

One area of IHT planning that, as a result of changes to tax legislation, may often now be overlooked is the use of discretionary trusts. However, they do offer certain benefits, including the flexibility that comes with the level of discretion given to the trustees.

Discretionary trusts and tax

- Using available reliefs can make the transfer of assets into the trust IHT-free.
- The trust has its own nil rate band and taxing regime for IHT purposes (at a rate of six per cent on the market value of its assets in excess of £325,000 on each ten-year anniversary of the trust's creation).
- There will be no IHT charge on the death of a trust beneficiary.
- Transfer of assets into a trust is a disposal for capital gains tax (CGT) purposes but hold-over relief will be available. It may also be available when funds are distributed.
- In most cases, assets qualifying for 100 per cent BPR or APR can be settled on trust without a lifetime inheritance tax charge.

But be aware…

- Capital gains tax on trusts is charged, where payable, at 28 per cent with an annual exemption of 50 per cent of an individual's annual exempt amount.
- There may be problems with claiming CGT private residence relief – to qualify, the property must be owned by the trustees and also be the main residence of someone entitled to occupy it under the trust's terms.
- The trust will be liable to income tax of 37.5 per cent for dividend-type income and at 45 per cent for all other income, e.g. rents, savings.
- Trustees must keep a record of tax payments called the tax pool. Income payments to beneficiaries are treated as carrying tax credits, at the trust rate, the value of which are deducted from the pool. If the tax pool cannot cover the tax credits, the trustees will need to pay additional tax on the excess.

Contact Haslers

For a free, initial, no obligation discussion about discretionary trusts or any aspect of IHT, please contact a member of our team.

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