

Discretionary Trust



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What is a discretionary trust?

A discretionary trust is a trust created either in your lifetime or by your Will. They are sometimes referred to as pilot trusts or spousal bypass trusts.

The person setting up the trust is known as the settlor and they decide who can benefit from the trust. These can be named individuals or classes of people, for example 'my children'. They are known as beneficiaries.

The settlor would appoint people they trust (known as trustees) to manage the capital and income of the discretionary trust. It is at the discretion of the trustees to decide how much, when and which, if any, of the beneficiaries should benefit from the trust. The trustees can distribute income and capital separately to beneficiaries, as the trustees think fit. No beneficiary is absolutely entitled to either income or capital. Often the settlor will leave a 'letter of wishes' setting out how they would like the trustees to exercise their powers. This is not legally binding on the trustees.

The powers of the trustees will depend on the trust document.

What assets can the trust hold?

The trust can hold most assets including cash, investments, property or even vintage wine.

If establishing a trust in your lifetime, cash is often transferred to it due to tax considerations.

If established by your Will, you can choose how much to leave to the trust e.g. the entire estate, a specific amount of cash or a specific item such as a house.

Who can be a trustee?

You can appoint any number of trustees but we would recommend a maximum of four trustees and a minimum of two.

Careful consideration should be given before appointing anyone, as the trustees have wide powers at their discretion. Any potential conflict between a trustee and a beneficiary should also be considered.

The settlor can also act as a trustee.

Often a mixture of family members and professional trustees are appointed.

Tax treatment

The trustees are responsible for declaring and paying the tax generated by the trust.

Income tax

Income is taxed at special trust rates, with the exception of the first £1,000 of trust income. This is known as the 'standard rate band'. It is important to note that each settlor has only one of these allowances and it is divided equally between the number of trusts they have established. For example, if a settlor has four trusts, the standard rate band is £250 for each trust.

Income tax

The rates for the tax year 2018/2019 are as follows:

Up to £1,000 income

- Dividends are taxed at 7.5%
- Other income including rent, trading and savings are taxed at 20% (basic rate)

Over £1,000 income

- Dividends are taxed at 38.1% (dividend trust rate)
- Other income is taxed at 45% (trust rate)

Capital gains tax

A trust may have to pay capital gains tax if assets are sold, given away or exchanged and the value has increased since being put into the trust. The trustees have an annual exemption for capital gains tax purposes (£5850 for 2018/19). Gains that exceed this amount will be subject to capital gains tax at the rate of 20% (28% on certain gains e.g. disposal of residential property to which principal private residence relief does not apply).

Inheritance tax

There may be an inheritance tax charge :

- When assets are put into the trust (entry charge)
- On each ten year anniversary of the trust
- When assets are distributed to beneficiaries (exit charge)

How can Greenwoods GRM help?

The Private Client Team at Greenwoods GRM will be able to advise you as to whether this trust is suitable for your circumstances and will explain fully all of the options available to you. We are experienced in working in the role of a professional trustee or working behind the scenes advising the trustees as and when necessary.

Contact +44 (0)1733 887665 and ask to speak to a member of our Private Client Team.

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