



REMAINING A BENEFICIARY OF THE LIFETIME DISCRETIONARY TRUST

The IHT savings set out above only apply if the client is not a beneficiary of the trust. Otherwise the client will have "reserved a benefit". That means the trust assets will be fully taxable on the client's death at 40%, as if he or she had personally owned them, and the trust will have achieved nothing for IHT purposes. So why might the client remain a beneficiary?

It may be because the client is not yet sure he or she can afford to give away the assets outright and the client feels he or she may need to access the trust fund in the future. Only later might the client decide to exclude himself or herself as a beneficiary once he or she is certain that other personal assets will be enough for his or her future needs.

The act of ceasing to be a beneficiary would result in the client making a "potentially exempt transfer". Provided the client survives seven years, there would be no IHT to pay on his or her death and the value of the trust assets would fall outside the client's taxable estate.

This is far more tax efficient than doing nothing now and later transferring the same assets to a new trust from which the client is excluded as a beneficiary. A transfer to a new trust at that time would automatically trigger the initial 20% IHT charge. On the contrary, a potentially exempt transfer only triggers a tax liability if the client dies within seven years, and the client may be able to insure against this risk.

CAPITAL GAINS TAX ISSUES

Your clients need to think about Capital Gains Tax ("CGT") when considering lifetime discretionary trusts. A lifetime gift of assets (other than cash) into a discretionary trust will be treated for CGT purposes as if the client had sold the assets at their market value. That could trigger a large taxable gain, but with no actual cash proceeds to pay the tax.

The client may, however, be able to defer the CGT charge by claiming "holdover relief" on the transfer to the trust. The trustees would then take over the client's own base cost and the tax will have been deferred. The gain would only be taxed when the trustees eventually sell the assets.

Unfortunately holdover relief is not available if the client, or his or her spouse or minor children are beneficiaries of the trust. In that case, the client would have to pay the CGT on the transfer into trust, which is clearly a major deterrent. However, in the case of a gift of valuable shares that qualify for 100% BPR for IHT purposes, the CGT may be a price worth paying, especially if the CGT rate is only 10% as a result of "business assets taper relief", and particularly if a sale of the business is on the horizon, thereby freeing up cash to pay the CGT bill.

THE OUTLOOK FOR TRUSTS?

Trusts are not dead and buried. They remain an important weapon in the tax-planner's armoury and in the right circumstances they can be an ideal tax-efficient solution to a family's estate planning needs.