

## Technical Insights, Quick Reference Guide

### *Taxation of Discretionary Trusts: 1. Inheritance Tax (IHT) Entry charge*

This guide will provide you with an understanding of when an entry charge applies and how to calculate it.

We have a calculator which can perform the calculation described within this guide. The calculator can be found on our website; [quilter.com/help-and-support/tools/discretionary-trust-tax-calculator/](https://quilter.com/help-and-support/tools/discretionary-trust-tax-calculator/)

#### **Entry charges apply to chargeable lifetime transfers (CLT) made to 'relevant property trusts'**

Generally, these are gifts to discretionary trusts or other flexible trusts created on or after 22 March 2006. The charge does not apply to bare / absolute trusts.

#### **The value of the CLT is the value of the gift after any reliefs or exemptions**

This includes the annual gifting exemption (£3,000 per person, per year) and any amount which falls under the gifts out of normal income exemption. Discounted gift trusts (DGT) may also have a reduced value CLT, depending on the age and health of the settlor at the time of the gift.

#### **The entry charge calculation checks if the CLT exceeds the available nil-rate band (NRB)**

The NRB is currently £325,000 (frozen until April 2028). The available NRB is reduced by any other CLTs made in the seven years preceding the new gift. The settlor cannot utilise NRB from a deceased spouse / civil partner, or any residence nil-rate band when calculating the entry charge.

#### **For jointly settled trusts a separate calculation is required for each settlor**

For calculation and reporting purposes, a jointly settled trust is treated as separate settlements for IHT purposes. An entry charge calculation is required for each of these settlements. Each settlor is assessed on their own contribution to the trust and gifting history.

#### *Reporting*

The settlor is primarily responsible for reporting to HMRC. The settlor (or their tax adviser) reports and pays any entry charge for the gift into the trust. However, the trustees may take on this responsibility if preferred. Where the settlor pays the charge the amount payable is grossed up as paying the charge is seen as a gift (loss to the estate). See below example as to how this is calculated.

#### **Reports must be submitted within six months**

The settlor or trustees must first apply for an IHT reference number using form HMRC's IHT122 form. Then they completed HMRC forms IHT100 and 100a along with any supplementary pages. Payment of any tax due should be made within six months of the end of the month in which the charge arises. If payment is made after this interest is payable.

#### **Some CLTs need to be reported, even if there is no entry charge due**

A CLT must be reported to HMRC unless it passes one of the two excepted transfers tests:

##### **Excepted transfers - Test 1**

- a. The asset transferred is cash or quoted shares or securities, **and**
- b. The value transferred by the chargeable transfer, together with the values transferred by any previous chargeable transfers made by the transferor during the seven years preceding the transfer, does not exceed the available IHT threshold\*.

This means that CLTs of cash, quoted shares or securities will not be required to be reported where all CLTs made by the client in the previous seven years (including the CLT now being made) do not exceed the value of the individual's available nil-rate band (NRB). In principle this means that reports in these circumstances will only be required where IHT is due.

##### **Excepted transfers - Test 2**

- a. The value transferred by the chargeable transfer, together with the values transferred by any previous chargeable transfers made by the transferor during the seven years preceding the transfer, does not exceed 80% of the IHT threshold\*, **and**
- b. The value transferred by the transfer of value giving rise to the chargeable transfer does not exceed the available IHT threshold\*.

\* Available IHT threshold means nil-rate band at the time of the gift (currently frozen at £325,000 until April 2028) less any other CLTs made by the settlor in the 7 years immediately before the new gift

#### **Trustees must also register the trust**

Since 1 September 2021 all UK resident express trusts are required to register with HMRC's trust registration service.

## Entry charge calculation steps

### Step 1 – Establish available nil rate band (NRB)

The NRB is currently £325,000. Subtract the value of any chargeable lifetime transfers (CLT) made in the last seven years.



### Step 2 – Check if the new CLT exceeds the available NRB (step 1) and calculate the excess

Subtract the available NRB from the value of the new gift. If the resulting value is £0 or a negative value, then there is no entry charge. Else, the resulting number is the 'excess', go to step 3



### Step 3 – Calculate the tax payable

The tax payable depends on who will be paying the tax.



#### Step 3a – The settlor pays the tax

Gross up the excess from step 2

Gross excess x 20% = Tax due

Example: £75,000 excess / 0.8 = £93,750

£93,750 x 20% = £18,750 tax due

or

#### Step 3b – The settlor pays the tax

Excess from step 2 x 20% = Tax due

Example: £75,000 excess x 20% = £15,000 tax due

### The information provided in this article is not intended to offer advice.

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