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Taxation of Discretionary Trusts - the Rysaffe principle (multiple trusts)

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This guide will provide you with an understanding of how the Rysaffe principle can be used to reduce the periodic charge. The guide should be read along side our guide to the periodic charge (guide 2 in this series).

The periodic charge applies at the 10 year anniversary of the trust

At each 10-year anniversary of the trust, the periodic charge calculation looks at the value of the trust fund (among other factors) plus the historic value of any previous CLTs made by the settlor in the seven years before trust declaration. This figure is compared to the NRB at the time of the calculation, the excess over the NRB is taxed at a maximum of 6%.

Splitting a CLT across multiple trusts on separate days is known as the Rysaffe Principle

It refers to the case of Rysaffe Trustees v IRV (2003), where it was established that trusts declared on separate days are not 'related settlements'.

Using the Rysaffe principle means each trust will have its own nil-rate band (NRB)

As the trusts are not 'related', at the 10 year anniversary, each trust will have its own NRB for the periodic charge calculation. This effectively means less of the trust fund will be subject to the periodic charge.

Lower periodic charge means a lower exit charge

Exit charges after the first 10 years are based on the rate of tax applied at the time of the periodic charge. Lower periodic charge means lower exit charges.

Rysaffe principle does not avoid the entry charge

The entry charge is calculated by comparing the cumulative total chargeable lifetime transfers (CLT) against the settlor's available NRB. The excess is taxable at 20%. The Rysaffe principle does not increase the settlor's available NRB and therefore does not impact the total entry charge payable.

Example calculation (without Rysaffe)

Initial gift: £325,000
10-year value: £400,000

For simplicity this example assumes no distributions to the beneficiaries, related settlements, same day contributions or previous CLTs.

Step 1 - the 'Notional Transfer'
Value of the trust fund the day before the 10 year review
£400,000

Step 2 - Calculate the 'Available NRB'
The current nil rate band.
£325,000

Minus

Total Chargeable Lifetime Transfers made by the settlor in the 7 years immediately before the trust started.
£0

Equals the 'Available NRB'
£325,000

Step 3 - Calculate the Periodic Charge
£400,000 - £325,000 = £75,000
£75,000 x 20% = £15,000
£15,000 / £400,000 = 3.75%
3.75% x 0.3 = 1.13%

1.13% x Trust value =
£4,500 Periodic Charge

Example calculation (with Rysaffe)

Initial gifts: 3 x £108,333
10-year value of each trust: £133,333

For simplicity this example assumes no distributions to the beneficiaries, related settlements, or same day contributions, or previous CLTs.

Trust one

Step 1 - the 'Notional Transfer'
Value of the trust fund the day before the 10 year review   *£133,333*

Step 2 - Calculate the 'Available NRB'
The current nil rate band   *£325,000*
Minus
Total Chargeable Lifetime Transfers made by the settlor in the 7 years immediately before the trust started.   *£0*
Equals the 'Available NRB'   *£325,000*

Step 3 - Calculate the Periodic Charge
£133,333 - £325,000 = £0
£0 x 20% = £0
£0 / £400,000 = 0%
0% x 0.3 = 0%
0% x Trust value =   *£0 Periodic Charge*

Trust two

Step 1 - the 'Notional Transfer'
Value of the trust fund the day before the 10 year review   *£133,333*

Step 2 - Calculate the 'Available NRB'
The current nil rate band   *£325,000*
Minus
Total Chargeable Lifetime Transfers made by the settlor in the 7 years immediately before the trust started.   *£108,333*
Equals the 'Available NRB'   *£216,667*

Step 3 - Calculate the Periodic Charge
£133,333 - £216,667 = £0
£0 x 20% = £0
£0 / £400,000 = 0%
0% x 0.3 = 0%
0% x Trust value =   *£0 Periodic Charge*

Trust three

Step 1 - the 'Notional Transfer'
Value of the trust fund the day before the 10 year review   *£133,333*

Step 2 - Calculate the 'Available NRB'
The current nil rate band   *£325,000*
Minus
Total Chargeable Lifetime Transfers made by the settlor in the 7 years immediately before the trust started.   *£216,666*
Equals the 'Available NRB'   *£108,334*

Step 3 - Calculate the Periodic Charge
£133,333 - £108,334= £24,999
£24,999 x 20% = £4,999.80
£4,999.80/ £133,333 = 3.75%
3.75% x 0.3 = 1.12%
1.12% x Trust value =   *£1,500 Periodic charge*

Saving: £3,000

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