For financial advisers only

Quilter

Technical Insights – Discretionary trusts: Investment bonds as a trustee investment

This guide explains why a bond could be a suitable investment wrapper for a discretionary trust. Throughout this document we refer to our Chargeable Event Hub which includes calculators for bond gains and top slicing relief as well as a series of quick reference guides. Access the Chargeable Event Hub at *quilter.com/cehub*

Discretionary trusts, a quick refresher:

Features	*Taxation*
Flexibility over which beneficiary benefits and when benefits are distributed	Income tax at trustee rate of 45% and 39.35% (dividends)
Can protect the trust fund from divorce or bankruptcy of a beneficiary	If total net income is below £500 (reduced if more than one trust created, min £100) then no Income Tax is payable
Used for IHT planning	Capital gains tax at the trustee rate of 20% (24% on property)
	Ongoing 10 yearly (periodic) and exit charges to IHT

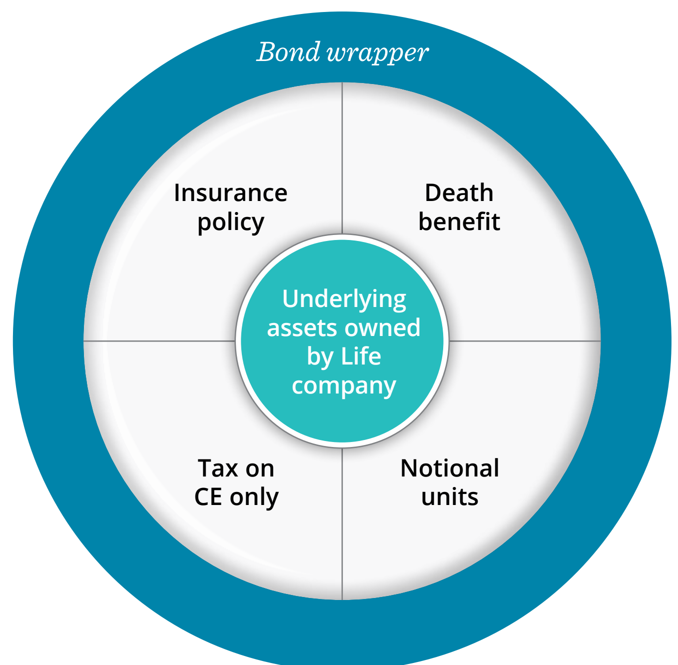
Simplified reporting

As a direct comparison to a general investment account, share account or an unwrapped investment solution, investment bonds can help trustees to avoid paying Income Tax on investment yields whilst avoiding capital gains on unit/share sales. This is only possible because of the bond structure:

- An investment bond (the bond) is a unit linked 'insurance wrapper' usually offering a death benefit. Usually written as a number of identical policy segments
- The trustees would own the 'insurance wrapper' – the bond
- The assets or units linked to provide a value for the bond, are actually legally and beneficially owned by the insurer
- Any income and gains made on the linked assets are taxable on the insurer
- This structure allows the trustees to hold a capital asset

If no withdrawals are made, then any income or gains within the wrapper do not require trustee tax or the associated reporting obligations.

Tax is only due when one or more chargeable events occur in a tax year. More information on chargeable events can be found on our Chargeable Events Hub.



Access to tax deferred withdrawals

Chargeable event rules apply to investment bonds making them liable to Income Tax on gains made on them. Within these tax rules, an allowance is provided to the bond holder of 5% of premiums paid per annum which can be withdrawn as capital for 20 years. The allowance can be carried forward in full or part if unused in any one year.

This allowance can provide the trustees with a way to:

- cover trustee expenses including advice fees and discretionary management fees
- provide an 'income' through regular capital payments to a beneficiary
- provide single larger payments, where the allowance has built up over numerous years, to a beneficiary

For all of the above, if the 5% allowance is not exceeded there is no taxable event on trustees and therefore no reporting obligation. Where the 5% allowance is exceeded, the excess at the end of the bond year is considered income in the relevant tax year.

Even when the allowance is exceeded the gain or excess isn't necessarily taxable at trustee rate. Chargeable events are initially assessable on UK resident settlors at their marginal rate of income tax. Only where the settlor is non-resident or has died in an earlier tax year might trustee rate apply.

Flexible beneficiary distribution options

As an alternative to regular or single withdrawals being taken from the bond - assessable against the available 5% allowance, the bond can provide two further options which can provide preferential tax outcomes for the trustees:

1. Surrender of one or more policy segments

For any policy segment surrendered the withdrawal amount plus any previous withdrawals from the segment is compared to the premium paid into it to arrive at a gain figure. In addition, a further deduction is allowed where a previous excess event (above 5%) has occurred to allow for any tax previously assessable against the segment.

For larger sums, particularly in the early years, this can provide a much lower gain when compared with a withdrawal assessed against the available 5% allowance. Of course, any gain on the surrender of policy segments is assessable in the same order as an excess event (covered above), settlor initially, else trustees.

2. Assign one or more policy segments to a beneficiary

Where a beneficiary has a marginal rate of income tax lower than the settlor or trustees (where the settlor is non-resident or deceased), an assignment of one or more policy segments can provide an efficient distribution option. Instead of the trustees surrendering the policies they transfer the ownership of them to an adult beneficiary. This assignment is not taxable under chargeable event rules and passes any gain on the policy to the beneficiary. If the beneficiary surrenders a policy segment(s) following assignment any gain is assessable at their marginal rate. This can provide significant savings particularly compared to trustee rate.

Where a gain is assessable on the settlor or a beneficiary they may also benefit from an income tax relief known as 'Top Slicing Relief'. More information can be found on our Chargeable Events Hub.

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

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