HOMS SOLICITORS

A PRACTICAL GUIDE TO

DISCRETIONARY TRUSTS

HOLMES O'MALLEY SEXTON SOLICITORS

HOMS Solicitors is a long established legal practice with offices in both Limerick and Dublin. We have significant experience in drafting wills, trusts, enduring powers of attorneys, advising on inheritance tax and administering estates. Our probate team are qualified members of the Society of Trust & Estate Practitioners (STEP) and qualified tax advisors.

WHAT IS A DISCRETIONARY TRUST?

In its simplest terms, a discretionary trust is a trust where trustees have a wide discretion to apply income and capital for the benefit of certain beneficiaries. The trustees decide when, how and to whom the trust fund is allocated, from the pool of beneficiaries, within the trust. A beneficiary of the trust does not have an automatic right to receive anything from the trust, if and until the trustees exercise a discretion in their favour. In addition, a discretionary trust can exist for tax purposes where trustees accumulate income and do not distribute that income. A discretionary trust can be created during a person's lifetime, or it can be created by will, taking effect after a person's death.

BENEFITS OF A DISCRETIONARY TRUST

Discretionary trusts are useful vehicles which can assist greatly in succession planning. They offer a great deal of flexibility in providing for young children, beneficiaries with disabilities, vulnerable adult beneficiaries and as asset protection measures.

1. Protects the social welfare entitlements of beneficiaries.
2. Allows a great deal of flexibility - the trust can respond to the changing circumstances of beneficiaries.
3. Prevents over reliance on state supports and intervention.
4. Can be used for efficient tax planning - creating a time lag to allow beneficiaries to qualify for certain valuable reliefs, such as dwelling-house relief, agricultural relief and business relief.
5. Assets can be protected from creditors as beneficiaries do not actually own the trust assets.
6. Can ensure that beneficiaries are sufficiently mature to handle a significant inheritance.
7. Can allow flexibility in the distribution of the assets on death to beneficiaries, particularly where it is difficult to anticipate their future needs and facilitates a wait and see approach.
8. It can be a mechanism to provide for adult beneficiaries who suffer from alcohol, drug or gambling addictions, without risk of the assets being depleted by reckless management.

TAXATION OF DISCRETIONARY TRUSTS

One key tax is discretionary trust tax. This tax was introduced in 1984 and consists of an initial levy and an annual levy. There is an exemption from this tax for trusts exclusively set up for incapacitated persons. Discretionary trust tax applies to the entire value of the trust subject to certain exceptions.
The initial levy is 6%. It will apply on the latest of the following dates:

a) The date the discretionary trust is set up.
b) The date of death of the settlor.
c) The date the youngest principal object reaches 21.
(A principal object is a spouse or children or minor children of a predeceased child).

Therefore if the answer to any of the following questions is YES, then no charge to discretionary trust tax arises:

a) is the settlor still alive? b) is there a principal object under 21?

If the initial levy arises, it must be accounted to the Revenue Commissioners within 4 months. The trustees can avoid discretionary trust tax, if they appoint assets to a beneficiary for their life, or for a minimum duration of 5 years so that the beneficiary is entitled to the income from those assets.

If the trust is wound up within 5 years of the initial levy, a refund of 3% is available, which must be claimed from the Revenue Commissioners - it will not issue automatically.

The annual levy is 1% and applies to the value of entire assets that are within the trust on the 31st of December each year. It commences the year after the year the initial levy arose. The annual levy will continue to apply for as long as the discretionary trust remains in being.

Therefore, trustees will face a difficult choice between distributing the assets to the beneficiaries before they reach 21 to avoid tax, or retaining the assets in the trust and suffering discretionary trust tax.

EXEMPTION FROM DISCRETIONARY TRUST TAX

The exemption applies where the trust is set up exclusively for an incapacitated beneficiary and no other person. If the trust includes other beneficiaries who are not incapacitated, then the exemption will not apply. Children under 18 are deemed to be incapacitated, but lose that designation once they reach 18. If there are other beneficiaries, it is recommended to set up separate trusts.

This exemption only applies to discretionary trust tax and not to other taxes such as Capital Gains Tax, Income Tax, and Capital Acquisitions Tax.

LETTER OF WISHES

We would recommend when setting up a discretionary trust to incorporate a letter of wishes. This is a very individual letter from the settlor to the trustees - essentially an operating guidance manual for the trust. It may include, for example, a direction on the manner of distribution of the trust fund and how the trust is managed. The letter of wishes is non-binding on the trustees, but nonetheless is a helpful instruction to the trustees of the intentions and views of the settlor. Only the trustees will have sight of this document.

CAPITAL ACQUISITIONS TAX (CAT)

No Capital Acquisitions Tax arises on the creation of a discretionary trust as the potential beneficiaries do not have any beneficial entitlement to any of the assets.

A charge to CAT may arise when the beneficiary receives a benefit from the trust. Each beneficiary has a CAT free threshold below which no tax will be charged. Where the current benefit and any previous gifts or inheritances arising within the same group (since December 5th 1991) exceed the threshold, CAT applies on the excess.

The Current (2016) thresholds are:

Group A - children and minor children of a predeceased child	€280,000
Group B - brothers, sisters, nieces, nephews and grandchildren	€30,150
Group C - everyone else	€15,075

However, under Section 84 of the Capital Acquisitions Tax Consolidation Act 2003, a benefit taken exclusively for the purpose of discharging qualifying medical expenses of an individual with a disability is exempt from CAT. Qualifying medical expenses are defined as expenses relating to medical care, including the costs of maintenance in connection with medical care. There are various reliefs from Capital Acquisitions Tax, the relevance of which will depend on individual circumstances.

TOP TIPS

Choose your trustees wisely so that the care and responsibility of the beneficiary can continue after your death. Trustees in the main should have business acumen, be trusted and independent and seek advice when necessary.

Ensure your trustees have sufficient resources and flexibility to react to the changes in circumstance of the trust beneficiary.

Ensure a proper procedure is put in place for the financial and physical care of any incapacitated beneficiary.

Ensure the trust is set up exclusively for an incapacitated beneficiary to qualify for exemption from discretionary trust tax.

Determine what will happen to any surplus funds from the trust on the death of the beneficiary.

HOMS WILLS WEBSITE

We operate a dedicated wills website where you can find a wealth of advice and tips.
Please log on to www.homswills.ie

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MEET THE HOMS SOLICITORS PRIVATE CLIENT TEAM

If you have any additional queries on the subject of Discretionary Trusts, please contact one of the members of our Private Client Team, who would be happy to assist you.

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