# Technical Insights, Quick Reference Guide

*Taxation of Discretionary Trusts: 3. Inheritance Tax (IHT) exit charge*

**This guide will provide you with an understanding of when the exit 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/technical-insights/technical-insights-articles/discretionary-trust-tax-calculator/***

### Exit charges apply to 'relevant property' trusts

The definition of a relevant property trust can be complex. In general it covers; all discretionary trusts, other types of flexible trust created on or after 20 March 2006 and interest in possession (IIP) trusts created on or after 20 March 2006 unless as part of a Will. Flexible Trusts and IIPs created before that date may also become relevant property trusts if they have been altered.

The charge does not apply to bare/absolute trusts.

### Exit charges are calculated when capital leaves a relevant property trust

For example, where the trustees assign a bond to a discretionary beneficiary. The charge does not apply to payments of income such as interest or dividends.

### 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. An exit charge calculation is required for each of these settlements. Value of the distributions to the beneficiary is apportioned between the settlors in accordance to their contribution to the trust. Where the calculation requires historic information such as contributions to the trust, or gifting history, this means the history specific to that settlor.

For example, two settlors who made a combined gift of £200,000 to the trust are deemed to have separately given £100,000 each. If £10,000 is distributed to a beneficiary, the exit charge calculation is performed for each settlor for £5,000 each.

### There are two types of exit charge calculation

The method of calculation depends on whether the distribution to the beneficiary is made within the first 10 years after the trust date, or after the first 10 years.

### Payments of the settlor's carved out rights do not usually incur an exit charge

For example, payment of 'income' to the settlor of a Discounted Gift Trust, or payment of the settlor's entitlement under a flexible reversionary trust (such as Quilter's Lifestyle Trust) are not subject to the exit charge. However, the charge applies to capital payments to a settlor as a beneficiary of a settlor included trust.

### Loan repayments do not incur an exit charge

For example, repayment of a loan to the settlor of a Loan Trust.

## *Reporting*

### Exit charges must be reported to HMRC within 6 months

The trustees must complete HMRC's IHT100 and 100c forms along with applicable supplementary pages. For jointly settled trusts, separate forms are required for each settlor. Payment of tax owed should be made within 6 months of the end of the month in which the charge arises. If payment is made after this, interest is payable.

### A report to HMRC may be required even if there is no tax due

The trustees must still report to HMRC even if there is no tax due unless the trust is an 'excepted settlement'. A trust will be an excepted settlement where all the following apply.

- the settlor was domiciled in the UK at the time the settlement was set up and has remained so throughout the existence of the trust, and
- the trustees are resident in the UK throughout the existence of the trust, and
- there are no related settlements (other relevant property trusts by the same settlor on the same day), and
- the value of the trust fund, plus previous chargeable transfers in the 7 years prior to creating the trust, plus any distributions that gave rise to an exit charge (even if that charge was £0) in the past 10-year period, is equal to or less than 80% of the nil rate band.

> *Note*
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> Any outstanding loan owed by the trustees cannot be deducted from the trust value for the purpose of the '80%' rule.

### Trustees must also update the trust register

Since 1 September 2021, all UK resident express trusts are required to register with HMRC's trust registration service. The trust must update the register in each year in which it has a UK tax liability. This includes the periodic charge. The register must be updated by 31 January following the tax year in which the liability arose.

***For financial advisers only***

## *Exit charge calculation steps - for distributions within the first 10 years*

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| **Step 1 –** Calculate the nil-rate band available | |
| A. | Confirm the nil-rate band at the time of the distribution.<br>(The NRB is currently frozen at £325,000 until April 2026) |
| B. | Calculate the total value of chargeable transfers made by the settlor during the 7 years immediately before the trust started. This includes any Chargeable Lifetime Transfers (CLT) and failed Potentially Exempt Transfers (PET). A PET fails if the settlor died within 7 years of making the PET. |
| C. | A - B = Available NRB<br>If the outcome is a negative number, then Available NRB = £0 |

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| **Step 2 –** Total value of gifts to this trust | |
| A. | Calculate the total value of gifts made to this trust before the distribution to the beneficiary is made[1]<br>This is the value prior to any reliefs, such as the annual gift exemption. |
| If the value of Step 2 is less than the value of Step 1, then no exit charge will apply. Otherwise, continue to Step 3. | |

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| **Step 3 –** Calculate the effective rate of tax | |
| If Step 1 (available NRB) = £0, then the effective rate of tax is = 6%. Move on to Step 4. Else continue with Step 3. | |
| A. | Step 2 - Step 1 = *Excess* |
| B. | *Excess* x 20% = *Entry Tax* |
| C. | (*Entry Tax* / Step 2) x 100 = **The effective rate of tax** |

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| **Step 4 –** Calculate the actual rate of tax | |
| A. | The effective rate of tax x 30%<br>*Example: 6% x 30% = 1.8%* |
| B. | Calculate the number of complete quarter years between the start date of the trust and the date of the distribution to the beneficiary and divide this number by 40.<br>*Example: if the trust was established 3 years and 1 month ago, then the total is 12 quarters. 12/40 = 0.3* |
| C. | Multiply A by B to give you the Actual rate.<br>*Example: 1.8% x 0.3 = 0.54%* |

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| **Step 5 –** Calculate the tax payable on the distribution (the exit charge) | |
| The calculation differs depending on whether the tax is paid from the distribution to the beneficiary or whether the trustees pay it from the remaining trust fund. | |
| A. | **Paid from the distribution**<br>Amount distributed x Step 4 = Exit charge<br>*Example £80,000 x 0.54% = £432* |
| B. | **Paid from the remaining trust fund**<br>Gross up the amount distributed by the actual rate of tax calculated in Step 4.<br>Gross distribution x actual rate = Exit charge.<br>*Example: (£80,000 /(100 - 0.54)) x100= £80,434.35 Gross distribution*<br>*£80,434.35 x 0.54% = £434.35* |

[1] *It is also necessary to include the historic value of gifts to related settlements (relevant property trusts created the same day as this one, and any same-day additions (additions to relevant property trusts made on the same day as an addition to this one). However, this is beyond the scope of this guide. Refer to our discretionary trust tax calculator.*

## *Exit charge calculation steps - for distributions after 10 years*

The rate applicable to distributions made after the first 10 years is the same rate that is applied at the previous 10-year anniversary. However, the periodic charge rate should be recalculated if the rate of IHT or nil-rate band has changed between the anniversary and the distribution to the beneficiary.

### *Note*

A simplified version of the periodic charge calculation is given in Step 1 for demonstration purposes. For the complete calculation method, see Discretionary Trust Taxation Guide 2 - Periodic Charge or use our discretionary trust tax calculator.

| **Part A –** Calculate the 'Actual Rate' applicable at the previous periodic charge |
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| Use the steps outlined in our periodic charge guide<br>***quilter.com/siteassets/documents/platform/support/18976-quick-reference-guide---taxation-of-discretionary-trusts.pdf*** |

| **Part B –** Calculate the exit charge |
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| **Step 1 –** Calculate quarter years |
| Calculate the number of complete quarter years between the 10-year anniversary of the trust and the date of the distribution to the beneficiary. Divide this number by 40.<br>*Example: Previous anniversary 3 years and 1 month ago. Then total quarter years is 12.*<br>*12/40 = 0.3* |

| **Step 2 –** Calculate the exit rate |
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| Multiply the 'Actual Rate' from Part A by Step 1 above.<br>*Example: Actual rate of 6% and 12 Quarters since anniversary;*<br>*6x (12/40) = 1.8%* |

| **Step 3 –** Calculate the tax (use either A or B) | |
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| A. | **Exit charge deducted from the distribution.**<br>Amount distributed x exit rate = Exit charge (£)<br>*Example: £80,000 x 1.8% = £1,440* |

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| B. | **Paid from the remaining trust fund**<br>Amount distributed is grossed up by the exit rate.<br>Gross distribution x exit rate = Exit charge (£)<br>*Example: (£80,000 / (100 - 1.8)) x 1.8% = £1,466.40* |

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

It is based on Quilter's interpretation of the relevant law and is correct at the date shown. While we believe this interpretation to be correct, we cannot guarantee it. Quilter cannot accept any responsibility for any action taken or refrained from being taken as a result of the information contained in this article.




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