



TAX FREE GIFTS – USING A DISCRETIONARY TRUST TO GIFT ASSETS

In most cases if a person sells an asset and makes a gain over and above the cost of that asset, they will be liable to Capital Gains Tax (CGT) on that gain.

In the case of a gift to a spouse, the transaction is deemed to take place at 'no gain/no loss', but this only applies to spouses and civil partners. In the case of a gift to anyone else, a gain will be calculated on the assumption that the asset was sold at its market value.

Business Assets

If the subject of the gift falls within the definition of a 'business asset', or of "agricultural property", then it is possible to make a claim to 'hold over' the capital gain arising on the gift.

When a gain is "held over", the recipient of the gift is treated as acquiring the asset at its market value minus the amount of the gain that the donor would have made. In other words, the donor pays no capital gains tax and the recipient of the gift is treated as having acquired the asset at the same original cost (the "base cost") that applies to the donor, rather than acquiring it at its market value.

In the case of assets which do not qualify as 'business assets' or as "agricultural property" a different technique must be used in order to avoid an immediate charge to capital gains tax based on the market value of the asset gifted:

Discretionary Trust

A transfer of an asset from an individual to a discretionary trust is a 'chargeable transfer' for the purposes of inheritance tax (IHT). This means that it is chargeable to inheritance tax at the 'lifetime rate' (currently 20%), but only on so much of the transfer as exceeds the transferor's nil rate band (currently £325,000).

Assuming that the transferor has made no other chargeable transfers in the 7 years preceding the gift, therefore, they can transfer assets with a value up to £325,000 into a discretionary trust and although technically there will be a charge to inheritance tax it will be calculated at 0%. In the case of a married couple each has their own nil rate band and so the maximum transfer would be £650,000 between them.

The significance of this is that where a transfer is chargeable to inheritance tax it is possible to make a claim to hold over any capital gain that arises, much as if the asset concerned were a business asset.

Once the asset has been transferred to the discretionary trust it can either remain there if this is what is desired, or (subject to remaining in the trust for a minimum of 3 months) it can then be transferred out to an individual who is named as a beneficiary of the trust, and because this transfer too will be chargeable to IHT (again at 0%), the trustees can make a similar claim for hold over to the one made by the individual on the transfer into trust.

The net effect is that a gain arising on a gift of a non-business asset has been held over in much the same way as it can be on a business asset.

Although the process described above may seem rather artificial it is a well recognised and accepted part of tax planning and will not be challenged by HMRC provided that the various steps are followed and documented correctly.

The above is a very brief summary of a quite complex process which requires careful documentation, and detailed advice should be taken before it is put into effect.

This article by James Bailey first appeared in Tax Insider magazine (www.taxinsider.co.uk)