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FINANCIAL PLANNING



TRUST INVESTMENT MADE SIMPLE

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0330 122 8618

www.deep-dive.co.uk



IS THIS YOU?

Has someone told you a trust is the answer to your Inheritance Tax problem, and someone else told you trusts are a nightmare to run? Or are you a trustee already, with a tax return nobody enjoys and a feeling the money is being taxed harder than it needs to be?

Perhaps you've been handed a trust deed by a solicitor and a tax return by an accountant, and nobody has ever sat down with you and explained what the money should be doing. This guide was written for you.

IN THIS GUIDE YOU WILL FIND

- Why a trust is worth having when Inheritance Tax is 40%, or 60% in the trap.
- What makes a trust easy or miserable to run: the trustees' investment decisions, and the rates a trust pays.
- What happens when a trust holds shares, funds, cash or a buy-to-let, and why an investment bond removes most of the annual tax work.
- Onshore or offshore, and assigning segments to a grandchild who pays no tax.
- A worked example: £650,000 into trust, around £340,000 of tax saved, and three degrees paid for.
- The trustees' duties, the two-hour annual meeting, what ongoing advice does, and what to do about a trust that already holds the wrong things.

Prefer a print version? For one that won't slurp up half your toner, email **info@deep-dive.co.uk** and we'll ping it through.

Reading time: about 10 minutes.

By the end of it you'll know why a trust is worth having, what makes one easy or miserable to run, what a trust should hold and why, how the trustees pass money to a grandchild who pays no tax, and what the annual meeting looks like. The last page lists the seven mistakes trustees make and the nine tactics they should know, so you can decide what the trust should hold.

WHAT IT IS

If your estate is heading for an Inheritance Tax bill, someone has probably told you a trust is the answer. Someone else has probably told you trusts are a nightmare to run. Whether yours turns out to be one or the other depends mostly on what the trustees put in it.

A trust is a legal arrangement in which trustees hold assets for the benefit of other people, usually your children and grandchildren, according to rules you set in a trust deed. For Inheritance Tax purposes it takes money out of your estate while you keep a say over who receives it, when, and on what terms. The money is also protected from a child's divorce, from a grandchild receiving a large sum too young, and from a surviving spouse's second marriage.

The trust is a separate taxpayer with its own tax return, and where profits are received by the trust, it can pay some of the highest rates of tax there are. Some investments generate those profits every year and some don't, which is why the choice of what to hold has such an effect on the trustees' workload and on the tax the family pays. This explainer covers that choice, and what an adviser does to keep a trust running properly.



THE QUESTIONS PEOPLE ASK

Why would I want a trust at all?

Because Inheritance Tax is 40%, and the effective rate for estates between £2 million and £2.7 million is 60%. Money given into a trust is outside your estate after seven years. Growth on money lent or given to a trust is outside the estate from the day of the transaction. And unlike money handed directly to your children, it stays subject to rules you wrote: for the grandchildren's education rather than a son-in-law's business; at the right age, not automatically at 18; protected if a marriage fails. For most families with a serious Inheritance Tax

liability, a trust of some kind forms part of the answer. Which kind, and how much goes into it, is where the advice comes in.

Isn't a trust a lot of hassle?

It can be. The reasons are these. A discretionary trust, the usual kind, where the trustees decide who gets what and when, pays 45% on income and 39.35% on dividends once its income passes £500 a year. Capital gains are taxed at 24% above an allowance of £1,500, half an individual's. The trustees must register the trust with HMRC, file a return for each year there is income or gains, keep records, and report an Inheritance Tax charge on every tenth anniversary of the trust being set up. How much of this machinery runs each year depends on what the trust holds.

What happens if the trust holds ordinary shares, funds and cash?

Every dividend, interest payment and fund distribution is trust income, taxed at 45% or 39.35% and reported on the return. Every sale, switch or rebalance is a capital gains calculation, and one modest switch can use up the allowance. If income is paid out to beneficiaries, the trustees issue a tax certificate for each payment and keep a running tally, known as the tax pool, of the tax they have paid. All of this is manageable, and plenty of trusts are run this way. It requires an accountant, a fee and a good deal of the trustees' time every year for as long as the trust lasts.

And a buy-to-let?

The trustees become landlords, with tenants, repairs, safety certificates, a deposit scheme and insurance to look after. Rent is trust income at 45%, with only a basic-rate credit for mortgage interest. A sale means capital gains tax at 24% and a report to HMRC within sixty days. Putting a mortgaged property into trust can trigger stamp duty, and taking a house out again is awkward because it can't be divided between three grandchildren. Property does sometimes belong in a trust, particularly where it was the family's main asset or the trust was set up to protect it. Trustees who choose it should expect the work of running a small business.

So what should a trust hold?

A trust can hold any asset. If the trustees want to make their lives easy and avoid bothering their accountant every year, they could consider an investment bond. A bond is a life insurance policy wrapped around a portfolio of funds, and it produces no income. Nothing inside it is taxed in the trustees' hands as it grows: there are no dividends to report, no interest, no capital gains when funds are switched, and no tax return while nothing is withdrawn. The trustees can draw up to 5% of the original investment each year with no tax to pay at the time, which is how a loan trust, where you have lent money to the trust, repays you, and how a discounted gift trust, where you have given money away but kept an income, pays that income. Tax arises only when the bond, or part of it, is cashed in, and even then there is a choice about who pays it. Where a bond suits the trust, it removes nearly all of the annual tax work.

Onshore or offshore?

An onshore bond is issued by a UK insurer, which pays tax inside the fund as it goes, so gains carry a 20% credit. An offshore bond, issued from somewhere like the Isle of Man, Dublin or Guernsey, grows with no tax inside it, and the whole gain is taxed when it comes out at the rate of whoever is liable. While you are alive and living in the UK, gains on a bond in your trust are taxed on you. After that they fall on the trustees at 45%, less the credit for an onshore bond, unless the trustees have been advised on the alternative.

What is the alternative?

One piece of planning some trustees consider is to let the gains build up within the trust and then, when a beneficiary needs the money, assign the profitable investments to a beneficiary in a lower tax band. Bonds are issued in segments, a cluster of identical smaller policies, and the trustees can give segments to a beneficiary without any tax arising at that point. The beneficiary then cashes them in at their own rate. A grandchild at university with no other income can take more than £18,000 of gain from an offshore bond in a year and pay nothing, because their personal allowance, their starting rate for savings and their savings allowance all apply. The same gain cashed in by the trustees would be taxed at 45%. It depends on somebody keeping track of who the beneficiaries are and what they earn each year.

What does it look like in practice?

A married couple with an estate of £2.4 million, inside the 60% band, put £650,000 into a discretionary trust: £325,000 each, within the amount each of them can give away without an immediate tax charge, so nothing is due on the way in. The trustees hold it in an offshore bond, so there is no annual tax return. After seven years the £650,000 is outside the estate, and because the estate is now under £2 million the extra tax-free allowance for the family home is restored as well. The tax saved is around £340,000. Over the same period the trustees give segments to three grandchildren through their university years, each cashing in within their own allowances and paying nothing, so the trust pays for three degrees free of tax. The tax paperwork for the year is a short appendix to the trustees' minutes.

What do the trustees have to do?

Follow the deed. Act in the beneficiaries' interests and fairly between them, including beneficiaries not yet born. Take reasonable care. Invest as the Trustee Act 2000 requires: consider whether each investment suits the trust and whether the whole is diversified, take proper advice before investing and when reviewing, and review regularly. Keep accounts. Act together rather than individually. Register the trust, file the returns and pay the tax on time. Never benefit personally unless the deed permits it. Most of this is routine once the trust is set up properly, and much of it is work the adviser does for the trustees.

What does the annual meeting look like?

Once a year, with minutes, and ours take about two hours. The administrative part is the shorter half: read the deed and the letter of wishes, your note to the trustees about how you'd like them to use their discretion, again; review the investments against the written investment policy; decide on payments out, gifts of segments and loans, and record the reasons; check the tax, the 5% allowances and the date of the next ten-year anniversary; confirm HMRC's trust register is current, since changes must be reported within ninety days; note the written advice the Trustee Act requires and who gave it; sign the minutes and file them with the deed.

The longer half is about the family. Who the beneficiaries are now, what each of them needs, what they earn, who has married or divorced or had a child, who is about to start university or buy a flat or retire. A trust is meant to run for decades, and the trustees can only act as custodians of the family's wealth across the generations if they understand how the family works. Getting to know the whole family, parents, children and grandchildren, is a large part of what we do, and the annual meeting is where the dots between the generations get joined.

What does ongoing advice do?

We sit in the annual meeting, keep the written investment policy, give the written advice the Trustee Act asks for, run the annual review and draft the minutes, track the 5% allowances, flag the ten-year anniversary a year ahead, and keep the trust register current. The most valuable part is the beneficiary work: knowing which grandchild is a non-taxpayer this year, which child has an allowance going spare, and whether a segment of the bond should go to them now rather than being taxed at 45% later. A trust reviewed every year with the beneficiaries' tax positions in mind can pay considerably less tax than one left to run itself.

We already have a trust, and it holds the wrong things. What now?

This is common: a trust set up years ago with shares and cash, a return nobody enjoys and a tax bill that could have been avoided. Moving the assets into a bond is usually possible, though it means selling, and any gain has to be managed across tax years. We would look at what is held, what it costs in tax and fees, and who the beneficiaries are, and set out the options in writing before anything moves.

Who sets this up?

We do, in one place. Deep Dive Estate Planning drafts the trust, with STEP qualifications in trusts and estate taxation behind it. Deep Dive Financial Planning advises on what goes inside it, independently, with no funds of our own. Many firms do one or the other, and problems tend to arise at the point where the two meet: a well-drafted trust holding the wrong investments, or the right bond inside a deed that doesn't allow what the family wants. Our founder is a Chartered Financial Planner and a Fellow of the Personal Finance Society, and holds STEP's Advanced Certificates in Will Preparation and in Trusts and Estates Taxation.

What does advice involve?

We begin with your estate: what it is worth, what the bill will be on the second death, and which of the ways of reducing it fit your family. If a trust is part of the answer, we design it, choose what it holds, and set the whole thing out in writing before anything is signed or invested. We then attend the annual trustees' meeting each year for as long as the trust runs.

WHAT TO DO NEXT

Email **info@deep-dive.co.uk** and tell us how we can help, or book a free 20-minute call at trustsadvice.co.uk/mattbriefingddfp.

Further reading

If you're married and your joint estate is between £2 million and £4 million, you can cut the impact of the 60% Inheritance Tax trap with a change to your wills. Book a call with one of our team at trustsadvice.co.uk/mattbriefingddfp and we'll show you the secret sauce.

For the full picture, our one-hour technical webinar takes sophisticated trust planning and breaks it down step by step: deep-dive-trusts.co.uk/resources/videos/technical-inheritance-tax-and-trusts

IN SUMMARY

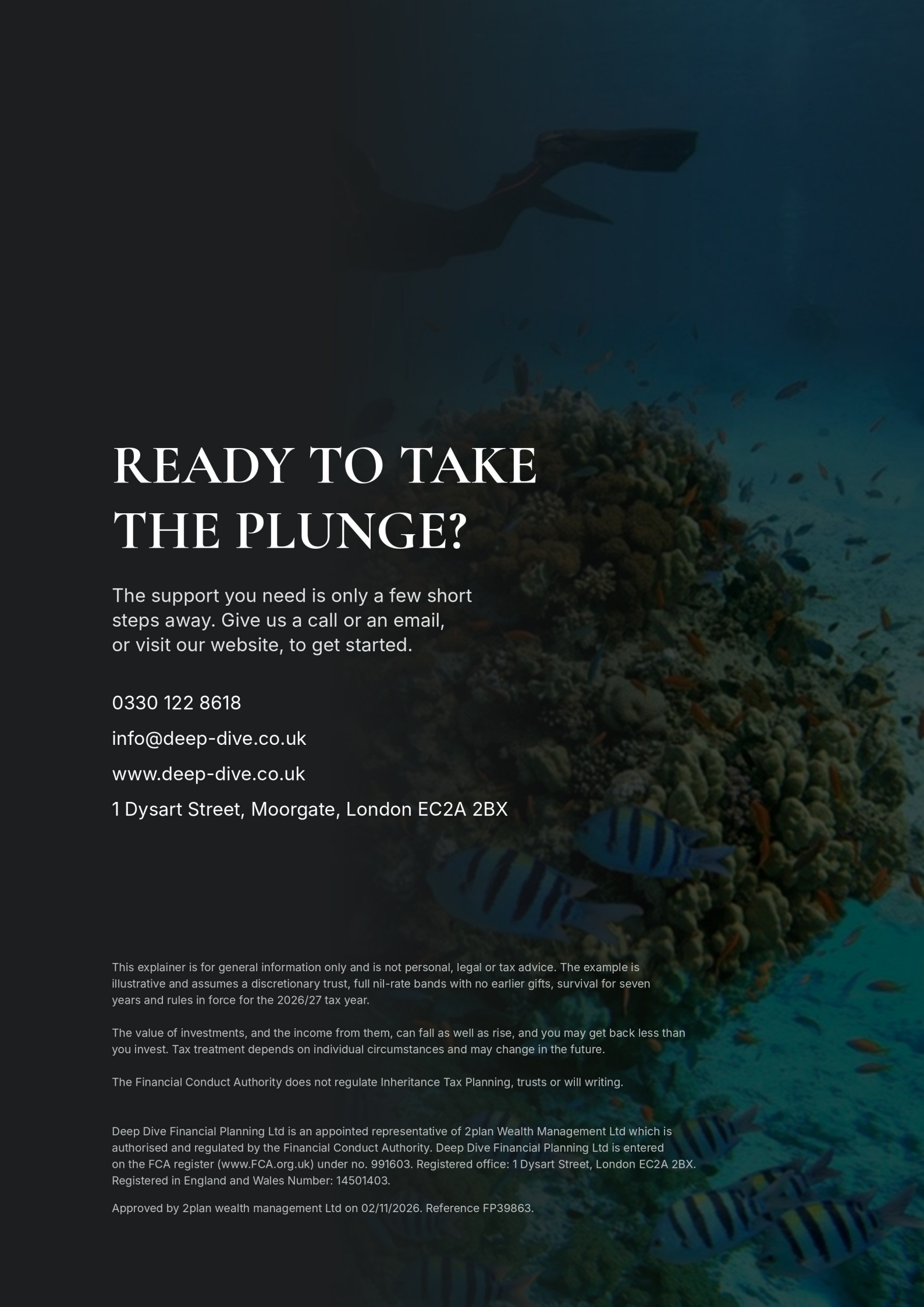
Seven mistakes trustees make

1. Holding shares, funds and cash without asking whether a bond would do the same job with less tax and less work. Where it would, the trust is paying 45% on income over £500, 39.35% on dividends, a capital gains sum on every switch, and an accountant every year for nothing.
2. Holding a buy-to-let by default rather than by decision. The trustees become landlords, the rent is taxed at 45%, and a house can't be divided between three grandchildren.
3. Cashing in gains at 45% when a grandchild at university could have taken over £18,000 of gain and paid nothing.
4. Nobody keeping track of who the beneficiaries are and what each of them earns this year.
5. Investing without the written advice the Trustee Act 2000 requires, or without a written investment policy to review it against.
6. Choosing the investment without reading the deed: the right bond inside a deed that doesn't allow what the family wants.
7. Leaving the trust to run itself. It pays considerably more tax than one reviewed every year.

Nine tactics trustees should know

1. Consider holding the trust's money in an investment bond: no income, no capital gains on switches, and no tax return while nothing is withdrawn.
2. Offshore where segments will go to beneficiaries in lower tax bands; onshore where the 20% credit inside the fund is worth having.
3. Give segments of the bond to a grandchild at university. They cash in within their own allowances, over £18,000 of gain a year, and pay nothing.
4. Use the 5% withdrawals to repay a loan trust or pay the income on a discounted gift trust, with nothing to pay at the time.
5. Growth on money given or lent to a trust is outside the estate from the day of the transaction, before the seven years are up.
6. Keep a written investment policy, record the advice taken, and review both at the annual meeting with minutes.
7. Make the annual meeting two hours: the short half is admin, the long half is who in the family needs what this year, so a segment goes to this year's non-taxpayer rather than being taxed at 45% later.
8. Flag the ten-year anniversary a year ahead, and update HMRC's trust register within 90 days of any change.
9. A trust that already holds the wrong things can usually be moved into a bond, with the gains managed across tax years.

Email **info@deep-dive.co.uk** and tell us how we can help, or book a free 20-minute call at **trustsadvice.co.uk/mattbriefingddfp**.



READY TO TAKE THE PLUNGE?

The support you need is only a few short steps away. Give us a call or an email, or visit our website, to get started.

0330 122 8618

info@deep-dive.co.uk

www.deep-dive.co.uk

1 Dysart Street, Moorgate, London EC2A 2BX

This explainer is for general information only and is not personal, legal or tax advice. The example is illustrative and assumes a discretionary trust, full nil-rate bands with no earlier gifts, survival for seven years and rules in force for the 2026/27 tax year.

The value of investments, and the income from them, can fall as well as rise, and you may get back less than you invest. Tax treatment depends on individual circumstances and may change in the future.

The Financial Conduct Authority does not regulate Inheritance Tax Planning, trusts or will writing.

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Approved by 2plan wealth management Ltd on 02/11/2026. Reference FP39863.