

## Discretionary Trusts

### The Format of Accounts

The best way to explain the layout of a discretionary trust set of accounts is by an example.

A discretionary trust is generally formed as a result of monies being left in a deceased person's "Will" for their beneficiaries. This can be to utilise inheritance tax thresholds for each spouse. The beneficiaries then become "owners" of the trust fund, similar to shareholders in a company. The fund is administered by Discretionary Trustee/s, similar to a board of directors, and the board must operate the fund according to the terms set out in the Will and Trust Deed. Confirmation of the 2006 budget changes to the way that trusts are treated by the government and therefore taxed are still to be published at the time of writing.

In general, the normal business and accounting principles apply to the interpretation and validation of income and expenses. The main consideration being, that the trustees must be careful to ensure that they are not receiving income, or charging expenses that are of a personal nature

An Example: -

- The Income and Expenditure Account is prepared on normal accounting principles, of income less expenses and taxes paid by the trust (2004/05 40%), but not the payments to beneficiaries.
- The Income Distribution Account is the net income brought forward plus the period income from the Income and Expenditure Account above, less net payments to beneficiaries, leaving a net balance carried forward.
- The Capital Distribution Account is similar to "fixed assets" and is generally the assets transferred into the trust by the deceased person in their will. These assets may be in the form of land and buildings or an investment portfolio. All movements into and out of these assets are shown in this account.
- The Balance Sheet is prepared using standard accounting principles, with the investment in the fund being the balances on the Income Distribution Account and Capital Distribution Account.

Balance Sheet for Discretionary Trusts: -

Assets	Freehold Property	xxx			
	Shares Portfolio	<u>xxx</u>	xxx		
	Cash at Bank	xxx			
	Debtors	<u>xxx</u>	xxx		
Liabilities	Creditors	xxx			
	Accruals	<u>xxx</u>	<u>xxx</u>	<u>xxx</u>	<span style="border: 1px solid black; padding: 2px;">yyy</span>

Represented by

Capital Account	xxx	
Income Account	xxx	<span style="border: 1px solid black; padding: 2px;">yyy</span>

The Taxes paid of 40%, by the Trust Fund are accumulated in a Tax Pool in the Tax Computation of the Trust Fund. It is reclaimable by each beneficiary in their personal Tax Returns.

The Discretionary Trustees complete a Form R185 each year, which shows the discretionary payments to the beneficiary and the amount of tax deducted and paid by the trust fund.

This can be found at: -

[http://www.hmrc.gov.uk/pdfs/r185\\_ti.pdf](http://www.hmrc.gov.uk/pdfs/r185_ti.pdf)

This form is treated similar to a P60 given by an employer to an employee, with Gross Income being added to the beneficiaries other income to establish income tax to be assessed. The tax is then deducted at the full 34% or 40% as an offset and is reclaimable.

More Details can be found at: -

[http://www.hmrc.gov.uk/manuals/rmmanual/html/RM4146/16\\_0002\\_RM4150.htm](http://www.hmrc.gov.uk/manuals/rmmanual/html/RM4146/16_0002_RM4150.htm)

There is also a tax bulletin with details of all the new forms issued: -

<http://www.hmrc.gov.uk/bulletins/tb64.htm>

Trusts have their own Self Assessment Returns with all the supplementary schedules.