

## Adviser Edge

# Taxation of UK trusts: an overview



CATEGORY: ESTATE AND TRUST PLANNING

## Key Takeaways

- Understanding the fundamentals of trust taxation
- How each type of trust is taxed differently
- How inheritance tax, capital gains tax and income tax apply to trusts

In this summary, we answer some common questions and outline how inheritance tax, capital gains tax and income tax apply to trusts

	Trust settled pre 22 March 2006	Trust settled on or after 22 March 2006
	<b>Inheritance tax</b>	
<b>Interest in possession trusts</b>	<ul style="list-style-type: none"> <li>■ Potentially exempt transfer (PET) when settled</li> <li>■ Life tenant(s) has value of trust in their estate</li> </ul> <p><b>Trusts transitional period 22.3.06 until 06.10.08</b></p> <ul style="list-style-type: none"> <li>■ Life tenant could be changed once before 06.10.08.</li> <li>■ After 06.10.08 trust will fall into "relevant property" regime if life tenant changed (subject to transitional serial interest provisions)</li> <li>■ Where the trust falls into the relevant property regime, there is a chargeable lifetime transfer (CLT) of the trust value at the time and possible future periodic and exit charges</li> </ul> <p><b>Transitional Serial Interest</b></p> <ul style="list-style-type: none"> <li>■ If life tenant dies and trust contains a policy of life assurance, a replacement can be appointed without trust falling into "relevant property" regime</li> <li>■ If life tenant dies after 06.10.08 and Interest in Possession (IIP) passes to surviving spouse/civil partner, trust will still form part of their estate</li> <li>■ Post 22 March 2006 additions to the trust will bring part of the trust into the "relevant property regime", except where trust holds pre-budget 2006 policy of life assurance with an option to increase the premiums</li> </ul>	<p><b>Lifetime settlement</b></p> <ul style="list-style-type: none"> <li>■ CLT</li> <li>■ Trust property does not form part of anybody's estate</li> <li>■ Periodic and exit charges may apply</li> <li>■ See discretionary trusts section below</li> </ul> <p><b>Created via will or intestacy*</b></p> <ul style="list-style-type: none"> <li>■ IIP trust created via settlor's will, giving life tenant an immediate post-death interest:</li> <li>■ Referred to as Immediate Post Death Interest (IPDI)</li> <li>■ "Qualifying" interest in possession:                             <ul style="list-style-type: none"> <li>- Trust forms part of life tenant's estate</li> <li>- No periodic or exit charges</li> </ul> </li> </ul>
		<small>* Intestacy may have resulted in an IPDI trust being created prior to 1 October 2014 and the coming into force of the Inheritance and Trustees' Powers Act 2014.</small>

	Trust settled pre 22 March 2006	Trust settled on or after 22 March 2006
	<b>Inheritance tax</b>	
<b>Accumulation and maintenance trusts</b>	<ul style="list-style-type: none"> <li>■ Trusts were in transition until 06.04.08</li> <li>■ PET when settled</li> <li>■ Trust property does not form part of anybody's estate</li> <li>■ To retain inheritance tax treatment, trust wording needed to be amended before 06.04.08 so that beneficiary receives benefit absolutely at age 18.</li> <li>■ If trust not amended, it fell into "relevant property" regime from 06.04.08 with periodic and exit charges potentially applying from the first 10-year anniversary from start of trust</li> </ul>	<ul style="list-style-type: none"> <li>■ Chargeable lifetime transfer (CLT)</li> <li>■ Trust property does not form part of anybody's estate</li> <li>■ Periodic and exit charges may apply</li> <li>■ See discretionary trust below</li> <li>■ 18-25 trusts can be created by parent via will trust/intestacy; maximum tax charge will be 4.2% of value of trust in excess of nil rate band</li> <li>■ The changes mean there will be little incentive for new accumulation and maintenance (A &amp; M) trusts; settlors may as well create full discretionary trusts</li> </ul>
<b>Discretionary trusts</b>	<ul style="list-style-type: none"> <li>■ Chargeable lifetime transfer (CLT)</li> <li>■ The excess above nil rate band (NRB)* taxable at 20% if trustees settle tax (effective rate is 25% if settlor pays)</li> <li>■ *Must take account of CLTs in previous seven years as they will count towards cumulative total</li> <li>■ Gift out of account for IHT in respect of settlor's estate after seven years</li> <li>■ Taper relief applies on death after three years</li> <li>■ Trust property does not form part of anybody's estate</li> <li>■ Periodic and exit charges may apply to trusts with value in excess of NRB at the time</li> <li>■ (N.B. any CLTs made by settlor in previous seven years will be set against NRB)</li> <li>■ HMRC reporting limits dependent upon:                             <ul style="list-style-type: none"> <li>- Assets transferred into the trust</li> <li>- Settlor's cumulative total</li> </ul> </li> </ul>	

	Trust settled pre 22 March 2006	Trust settled on or after 22 March 2006
	<b>Income tax</b>	
<b>Interest in possession trusts</b>	<p><b>Trustee position</b></p> <p><b>Trustees liable to basic rate tax unless income is mandated directly to the life tenant</b></p> <ul style="list-style-type: none"> <li>■ Savings income taxed at 20%</li> <li>■ Rental income taxed at 20%</li> <li>■ UK dividend income taxed at 8.75%</li> </ul> <p><b>Chargeable gains under non-qualifying life assurance policies:</b></p> <ul style="list-style-type: none"> <li>■ Taxed on settlor during their lifetime</li> <li>■ In subsequent tax years, gains assessed on trustees at 45% (with 20% tax deemed to be paid within the life fund for UK policies)</li> </ul>	<p><b>Beneficiary position – following distribution</b></p> <p><b>Life tenant(s) assessed on income whether distributed or accumulated</b></p> <p><b>Taxed at life tenant's highest marginal rate:</b></p> <ul style="list-style-type: none"> <li>■ Non-taxpayers can reclaim basic rate paid by trustees</li> <li>■ Basic rate taxpayers have no further liability</li> <li>■ Higher rate taxpayers:                             <ul style="list-style-type: none"> <li>- additional 25% tax on dividends received*</li> <li>- additional 20% tax on other income received*</li> </ul> </li> <li>■ Additional rate taxpayers                             <ul style="list-style-type: none"> <li>- Additional 30.6% tax on dividends received*</li> <li>- Additional 25% tax on other income received*</li> </ul> </li> </ul> <p style="font-size: small; margin-top: 10px;">*as income from an IIP trust retains its character the beneficiaries can set their available dividend allowance against dividends and Personal Savings Allowance against savings income paid from the trust.</p>

	Trust settled pre 22 March 2006	Trust settled on or after 22 March 2006
	<b>Income tax</b>	
<b>Accumulation and maintenance trusts</b> <b>Discretionary trusts</b>	<p><b>Standard rate band</b></p> <p>If income is below £500 there is no tax to pay as it arises. The £500 is divisible by the number of settlements established by the settlor subject to a minimum of £100.</p> <p><b>Rate applicable to trusts</b></p> <ul style="list-style-type: none"> <li>Income in excess of this band is taxed at the Rate Applicable to Trusts (RAT) of 45% (39.5% for UK dividends), therefore;</li> </ul> <p><b>Chargeable gains under non-qualifying life assurance policies:</b></p> <ul style="list-style-type: none"> <li>taxed on settlor during their lifetime</li> <li>In subsequent tax years, gains assessed on trustees at 45% (with 20% tax deemed to be paid within the life fund for UK policies) on gains above the standard rate band</li> </ul>	<p><b>45% tax credit</b></p> <ul style="list-style-type: none"> <li>Beneficiaries receive trust income net of a 45% tax credit.</li> <li>Even though the aggregate rate of tax is unlikely to be 45% (different rates of tax may apply) the income distributed must be paid with a 45% tax credit).</li> </ul> <p><b>The tax pool</b></p> <ul style="list-style-type: none"> <li>This 45% tax credit must be supported by the tax pool which is a record of tax paid by the trustees</li> <li>The tax pool consists of:                             <ul style="list-style-type: none"> <li>Tax paid by the trustees minus,</li> <li>Tax credits previously issued to beneficiaries in respect of trust income previously paid</li> </ul> </li> <li>Beneficiaries in receipt of trust income can recover the difference between the tax paid and their own rate</li> </ul> <p><b>Trust income</b></p> <ul style="list-style-type: none"> <li>Income paid to a beneficiary from the trust is non-savings income for income tax purposes</li> </ul>
		<b>Capital gains tax</b>
<b>Interest in possession, accumulation and maintenance trusts</b> <b>Discretionary trusts</b>	<ul style="list-style-type: none"> <li>Gains taxable at 24%</li> <li>Annual exemption of £1,500* (2024/25 &amp; 2025/26) but divisible by the number of settlements established by the same settlor, subject to a minimum of £300 for trusts created since 06.06.1978</li> </ul> <p>*£3,000 in respect of disabled persons trusts (2024/25)</p>	

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