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A fresh approach to accounting

UK TRUSTS

What are trusts?

Trusts are a long established mechanism which allow individuals to benefit from the assets whilst others (the trustees) have the legal ownership and day to day control over the assets. A trust can be extremely flexible and have an existence totally independent of the person who established it and those who benefit from it.

A person who transfers property into a trust is called a settlor (or truster in Scotland). Persons who enjoy income or capital from a trust are called beneficiaries. Though not very common with English trusts, it is possible for the settlor to appoint a protector, an independent person who oversees the administration of the trust.

Trusts are separate persons for UK tax purposes and have specific rules for all the main taxes. There are also a range of anti-avoidance measures aimed at preventing exploitation of potential tax benefits.

Types of trusts

There are two basic types of trust in regular use for individual beneficiaries:

- life interest trusts (often referred to as interest in possession trusts and in Scotland known as life renter trusts)
- discretionary trusts.

Life interest trusts

A life interest trust has the following features:

- a nominated beneficiary (the life tenant or life renter in Scotland) has an interest in the income from the assets in the trust or has the use of trust assets. This right may be for life or some shorter period (perhaps to a certain age).
- the capital may pass onto another beneficiary or beneficiaries.

A typical example is where a widow is left the income for life and on her death the capital passes to the children.

Discretionary trusts

A discretionary trust has the following features:

- no beneficiary is entitled to the income as of right
- the settlor gives the trustees discretion to pay the income to one, some or all of a nominated class of possible beneficiaries
- income can be retained by the trustees
- capital can be gifted to nominated individuals or to a class of beneficiaries at the discretion of the trustees.

Inheritance tax consequences

Importance of 22 March 2006

Major changes were made in the IHT regime for trusts with effect from 22 March 2006. The old distinction between the tax treatment of discretionary and life interest trusts was swept away. The approach now is to identify trusts which fall in the so-called 'relevant property' regime and those which do not.

Relevant property trusts

Trusts which fall in the relevant property regime are:

- all discretionary trusts whenever created
- all life interest trusts created in the settlor's lifetime after 22 March 2006
- any life interest trust created before 22 March 2006 where a beneficiary changes after 6 October 2008. A key exception exists where a change occurs after 6 October 2008 on the death of a life tenant but the new life tenant is their spouse.

If a relevant property trust is set up in the settlor's lifetime, this may give rise to an immediate charge to inheritance tax at the lifetime rate of 20%. If the value of the gift (and certain earlier gifts) is below £325,000 or is covered by an IHT relief then no tax is payable. Trusts set up under a will attract the normal inheritance tax charge at the death rate of 40% (after reliefs and the nil rate band where available).

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Relevant property trusts are charged to tax every ten years (known as the periodic charge) at a maximum rate of 6% of the value of the assets on each tenth anniversary of the setting up of the trust. A fair prorate charge of less than 6% (and often much lower) is also made if assets are appointed out of the trust known as an 'exit charge'.

Benefits of a relevant property trust

Whilst the inheritance tax charges may not appear attractive, the relevant property trust has a significant benefit in that no tax charge will arise when a beneficiary dies because the assets in the trust do not form part of a beneficiary's estate for IHT purposes. There can be significant long-term IHT advantages in using such trusts.

Trusts which are not relevant property

Within this group are:

- life interest trusts created before 22 March 2006 where the pre-2006 beneficiaries remain in place or were changed before 6 October 2008 or where a second spouse has taken over the life interest on the death of the first spouse
- the trust was created after 22 March 2006 under the terms of a will and gives an immediate interest (cannot be replaced by another) in the income to a beneficiary and the trust is neither a bereaved minor's nor a disabled person's trust; or
- the trust is created in the settlor's lifetime or on death for a disabled person.

For pre-22 March 2006, lifetime transfers into a life interest trust, the gift would have been a potentially exempt transfer (PET) and no inheritance tax would have been payable if the settlor survived for seven years. Transfers into a trust on death would be chargeable unless the life tenant was the spouse of the settlor. There is no periodic charge on such trusts. There will be a charge when the life tenant dies because the value of the assets in the trust in which they have an interest has to be included in the value of their own 'settled estate' for IHT purposes.

Capital gains tax consequences

If assets are transferred to trustees, this is considered a disposal for capital gains tax purposes at market value but in many situations any capital gain arising can be deferred and passed on to the trustees.

Gains made by trustees on the disposal of trust assets are chargeable at 24% (20% for disposals before 30 October 2024). Residential property gains are charged at 24% throughout the tax year.

Where assets leave the trust on transfer to a beneficiary who becomes legally entitled to them, there will be a CGT charge by reference to the then market value. Again it may be possible to defer that charge.

Income tax consequences

Life interest trusts are taxed on their income at 8.75% on dividends and 20% on other income. Discretionary trusts pay tax at 39.35% (dividends) and 45% (other income).

Income paid to life interest beneficiaries has an appropriate tax credit available with the effect that the beneficiaries are treated as if they receive the income as the owners of the assets.

If income is distributed at trustee discretion from discretionary trusts, the beneficiaries will receive the income net of 45% tax. They are generally able to obtain refunds of any overpaid tax and if they pay tax at 45%, they will get credit for the tax paid. Refund exceptions may apply in certain settlor trust situations.

Could I use a trust?

Trusts can be used in a variety of situations both to save tax and also to achieve other benefits for the family. Particular benefits are as follows:

- If you transfer assets into a trust in your lifetime you can remove the assets from your estate but could act as trustee so that you retain control over the assets (always remembering that they must be used for the beneficiaries).
- A transfer of family company shares into a trust in lifetime (or on death) can be a way of ensuring that the valuable business property relief is utilised.
- By putting assets into a trust you can give the beneficiary the income from the asset without actually giving them the asset which could be important if the beneficiary is likely to spend the capital or the capital could be at risk from predators such as a divorced spouse.
- Trusts (particularly discretionary trusts) can give great flexibility in directing benefit for different members of the family without incurring significant tax charges.

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- If you want to make some IHT transfers in your lifetime but are not sure who you would like to benefit from them, a transfer to a discretionary trust can enable you to reduce your estate and leave the trustees to decide how to make the transfers in later years. It also means that the assets transferred do not now hit the estates of the beneficiaries.

Trust Registration Service

This is an important recent digital administration development, which came about due to Money Laundering Regulations which require countries to have a national register of certain information to fight against money laundering and terrorist financing.

Since 2020, The Trust Registration Service ('TRS') requires all UK non - taxable 'express' trusts (and certain additional non-UK trusts - not considered further here) to register. An express trust is one which is created deliberately by an individual in writing for specific purposes rather than being created by an act of law which is a non express trust. Common examples include but are not restricted to interest in possession and discretionary trusts. Non express trusts include trusts established by a Court or by legislation and provided there is no tax liability are not required to register.

The deadline for registration of new trusts or where changes determine that a trust needs to register is 90 days from creation.

Trusts on the register have to be updated whenever there are certain changes, such as a change in the lead trustee. These changes will also have a 90 day action deadline.

HMRC have published a manual to assist taxpayers - the **Trust Registration Service Manual - HMRC internal manual - GOV.UK**

How we can help

This factsheet briefly covers some aspects of trusts. If you are interested in providing for your family through the use of trusts or are concerned about whether there are any registration requirements under the TRS please contact us.

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