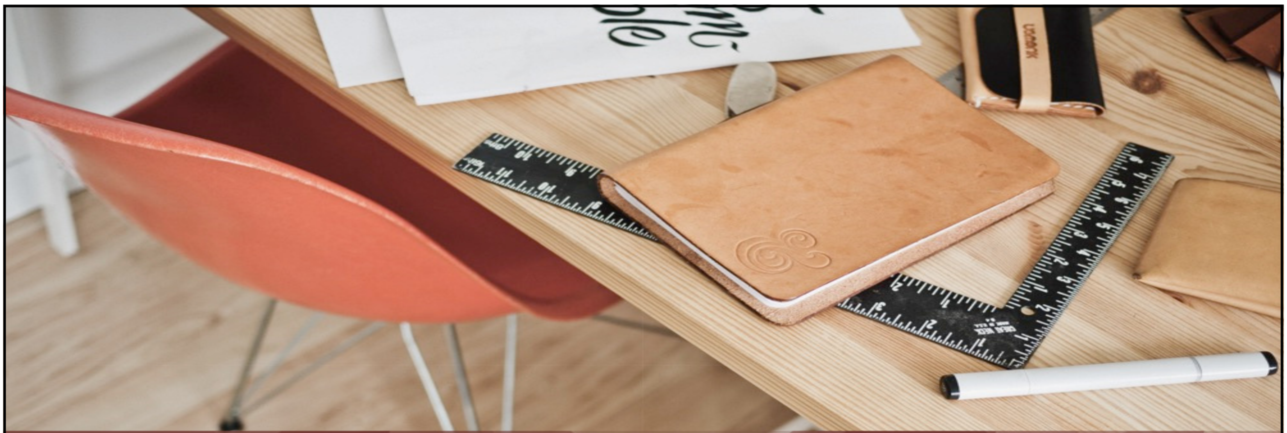

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Trust Taxation Professional Conferences

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BARE TRUSTS

- The beneficiary has an immediate and absolute right to both the trust capital and the income received by the trust from that capital.

- The trust assets are held in the name of a trustee, but the trustee has no discretion over what income or capital to pass on to the beneficiary or beneficiaries. Commonly used to transfer assets to minors.

- Example
- Jake leaves his sister Minnie some money in his Will. The money is to be held in trust. Minnie is the beneficiary and is entitled to the money and any income (such as interest) it earns. She also has a right to take possession of any of the money at any time.

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LIFE INTEREST TRUSTS

- Doesn't have to be property; can be set up for anything at all.
- Beneficiary known as life tenant, and the beneficiaries on their death are known as "remainder men", obtaining the capital as and when the life tenant dies.
- Issues with including these sorts of trusts within a will. Eg, does this provide adequate provision for the spouse or civil partner, who will only be entitled to income? This could be overcome by giving power to the trustees to make advances of capital (for example gifts or loans).
- Ability for the remainder men and life tenant to agree to wind up the trust, and divide the assets between them.

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INTER VIVOS LIFE INTEREST TRUSTS

- Commonly set up to provide a receptacle for property where the family home is passed into a trust, but the settlor continues to reside in the same. This creates a Gift with Reservation of Benefit.
- Done to protect assets from inheritance act claims on death, to prevent any delays or costs of probate on death, and to attempt to mitigate assets for care fees (be aware of deliberate deprivation of capital rules).
- Cannot be on means tested benefits or be diagnosed with any illness!!

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DISCRETIONARY TRUSTS

- Flexible trust where the trustees can make certain decisions about how to use the trust income and capital. Can hold almost anything (NOT ISAS)
- Depending on the trust deed, trustees can decide:
- what gets paid out (income or capital)
- which beneficiary to make payments to
- how often payments are made
- any conditions to impose on the beneficiaries

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DISCRETIONARY TRUSTS: DISADVANTAGES

- NO RNRB (Unless the property is appointed out to linear descendants within 2 years)

- A discretionary trust is a “Relevant Property Trust”; 6%tax charge at each 10-year anniversary of the trust, which applies to any excess over the nil rate band, plus an exit charge of up to 6%.

- Potentially income tax and capital gains tax charges, dependent upon what assets are in the trust and how they are invested.

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2 YEAR DISCRETIONARY TRUSTS ON DEATH

- Section 144 Inheritance Tax Act 1984; dispositions from a trust made by the trustees within 2 years are read back into the will.
- You can draft the trust to end automatically at the end of the two-year period…..
- The benefits;
- 1. gives the trustees that period to consider the needs of the beneficiaries set out in the trust.
- 2. Tax efficiency to calculate the best way to manage estate
- 3. NO TRS REQUIREMENT
- CONSIDER DUTY OF CARE…….!

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INCOME TAX RATES: STANDARD RATES

- The beneficiary of a bare trust is responsible for paying tax on income from it at their own rates. If they do not usually send a tax return, They need to register for self-assessment by 5 October following the tax year in which they first received the income.
- Standard Trust Rates
- Dividend-type income 8.75%
- All other income 20%
- Sometimes the trustees 'mandate' income to the beneficiary. They pay at their rate!

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RELEVANT PROPERTY TRUST RATES

- The first £1,000 is taxed at the standard rate.

- Trust income up to £1,000 / Trust income over £1,000

Trust income up to £1,000		Trust income over £1,000	
Dividend-type income	8.75%	Dividend-type income	39.35%
All other income	20%	All other income	45%

- Trustees do not qualify for any dividend allowance. All are taxed…

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CAPITAL GAINS TAX RATES

- 20% generally unless residential property (24%) or within reliefs.

- Trustees can deduct allowable costs to reduce gains, including:
- the cost of the property (including any administration fees) and professional fees, for example for a solicitor or stockbroker
- the cost of improving property or land to increase its value, for example , building a conservatory (but not repairs or regular maintenance)

CAPITAL GAINS TAX RATES

- Private Residence Relief
- Business Asset Disposal Relief: Trustees pay 10% Capital Gains Tax on qualifying gains if they sell assets used in a beneficiary's business, which has now ended.
- Hold-Over Relief: Trustees pay no tax if they transfer assets to beneficiaries. The recipient pays tax when they sell or dispose of the assets, unless they also claim relief.
- Tax-free allowance: The tax-free allowance for trusts is CURRENTLY £1500, or £3000 if the beneficiary vulnerable .

RELEVANT PROPERTY TRUSTS AND CHARGES

- An exit charge is a charge to IHT which can occur in a range of circumstances, including when trustees decide to distribute trust capital to one of a trust's beneficiaries.
- Examples:
- 1. trustees pay an ad hoc withdrawal to a beneficiary
- 2. trustees pay regular withdrawals to a beneficiary – on each occasion the beneficiary receives a payment
- 3. trustees assign assets to a beneficiary

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WILL AND EXIT CHARGE ALWAYS APPLY?

- Instances where an exit charge won't arise include those where:
- 1. The trustees make capital distributions within three months of setting up the trust, or within three months following a ten yearly anniversary
- 2. The trustees make an income payment to a beneficiary
- 3. The trustees pay costs and expenses
- 4. Distributions are made from a discretionary will trust within two years of the settlor's death.

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HOW IS AN EXIT CHARGE CALCULATED?

- The initial value of property held in the trust (the value that the trustees actually receive) – relevant property and non-relevant property subsequently becoming relevant property (A)
- Initial value of relevant property comprised in any other trust created by the same settlor on the same date
- Initial value of any property added to the trust after it was set up but before any distribution
- Nil rate band at the time of exit Less the value of any chargeable transfers made by the settlor in the 7 years before the trust was set up- B

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THE CALCULATION

- B x current IHT lifetime rate of 20% = C
- Effective rate = C/A x 100
- Exit rate = effective rate x 30% x n (the number of complete quarters between trust commencement and distribution)/40
- IHT payable = Distribution made x exit rate
- Anti-avoidance provisions now apply where same day additions are made to more than one settlement established by the same settlor.

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EXAMPLE 1

- Thor invested cash of £346,200 into an investment bond held in a discretionary gift trust on 30th March 2016, having made no previous chargeable lifetime transfers. He had no unused annual exemptions available covering the current and previous tax years.
- On 1st July 2019 the trustees decide to make a capital appointment of £75,000 to Iron Man, a discretionary beneficiary under the trust. Iron Man agrees to pay any IHT due

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EXAMPLE 1

- Initial value of property held in trust £346,200
- Initial value of relevant property comprised in any other trust created by the same settlor on the same date NIL
- Initial value of any property added to the trust after it was set up but before any distribution NIL
- TOTAL IN TRUST £346,200
- Nil rate band at the time of exit £325,000 Less:

  Value of any chargeable transfers made by the settlor in the 7 years before the trust was set up NIL

  Balance after deduction of NRB : £21,200

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EXAMPLE 1

The Calculation:-

21,200 x 20% = 4,240

Effective rate = 4,240/346,200 x 100 = 1.225%

Exit rate = 1.225% x 30% x 13/40 = 0.119% **(30% is the ACTUAL RATE as it is 6% charge instead of the lifetime rate of 20%- 6/20 = 0.3**

IHT payable by Iron Man = £75,000 x 0.119% =£89.25

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GIFTS WITH RESERVATION OF BENEFIT

- Where an individual disposes of any property by way of gift on or after 18 March 1986 a reservation of benefit will arise where either;
- 1. the donee does not assume bona fide possession and enjoyment of the property at or before the beginning of the relevant period; or
- 2. at any time during the relevant period the gifted property is not enjoyed to the entire exclusion, or virtually to the entire exclusion, of the donor.
- The relevant period is the time ending at the donor’s death and beginning seven years before the death, or, if later, the date of gift.

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GIFTS WITH RESERVATION OF BENEFIT CHARGES

- GROB at the transferor’s death: deemed to be property to which they were beneficially entitled immediately before their death (Section 102(3) Finance Act 1986).

- GROB ceasing in the transferor’s lifetime
- If the reservation ceases during the transferor’s lifetime, the transferor is treated as making a PET of the gifted property, on the date the reservation ceased (Section 102(4) Finance Act 1986).

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PRE-OWNED ASSET TAX

- Schedule 15 Finance Act 2004 introduced an income tax charge on POATS. The POAT charge applies where the chargeable person occupies any land either alone or with other persons, and either the disposal condition or contribution condition is met.
- 1. The Disposal Condition
- The chargeable person, owned an interest which was disposed of where the proceeds were (either directly or indirectly) applied by another person towards the cost of acquiring the relevant land, otherwise than by an excluded transaction.
- Example: Bob gives Four Winds to Greg. Greg then sells Four Winds and buys West Point with the proceeds. Bob then occupies West Point. The disposal condition is met.

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PRE-OWNED ASSET TAX

- 2. The Contribution Condition
- the chargeable person has provided directly or indirectly any of the consideration given by another person for the acquisition of an interest in the relevant land; or any other property the proceeds of the disposal of which were directly or indirectly applied by another person towards an acquisition of an interest in the relevant land.
- The Charge
- For any taxable period, the chargeable amount is the appropriate rental value, less the amount of any payments which the chargeable person makes in the period which they are legally obliged to make to the owner of the relevant land in respect of their occupation.

ELECTION

- You can avoid the charge by electing that Sections 53(3) and (4) IHTA1984 and 54 are not to apply to the property.
- The election applies to each person individually, so in the case of a married couple or civil partners, both must elect if they both wish to avoid the POAT charge and have the property treated as subject to a reservation.
- In order to avoid the POAT charge, a person must elect using IHT500 by the next 31 January.

NOTE: Where a chargeable person has failed to make an election before they died, their personal representatives are not able to make an election on their behalf.

- See notes on how to calculate POAT charges

EXCLUSIONS

- Exclusions apply only to charges arising on land and chattels.
- 1. The Disposal Condition Exemption
- The disposal of any property is an excluded transaction if it was a disposal of their whole interest in the property, either by a transaction made at arm's length with a person not connected with them, (Para 10(1)(a)(i) Schedule 15), or by a transaction such as might be expected to be made at arm's length between persons not connected with each other, (Para 10(1)(a)(ii) Schedule 15).
- The exclusion only applies to sales of the entire interest in the property at full market value.

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EXCLUSIONS

- 2. The Contribution Condition Exemption
- The contribution by a person to the acquisition of any property is an excluded transaction in relation to the chargeable person if it was an outright gift of money to the other person **and was made at least 7 years** before the chargeable person occupied the land, or had possession or use of the chattel (Para 10(2)(c)).

- NOTE As the earliest date a POAT charge can arise is 6 April 2005, any contribution by way of an outright gift of cash made before 6 April 1998 will be an excluded transaction, irrespective of when the person subsequently went into occupation

ANY QUESTIONS?

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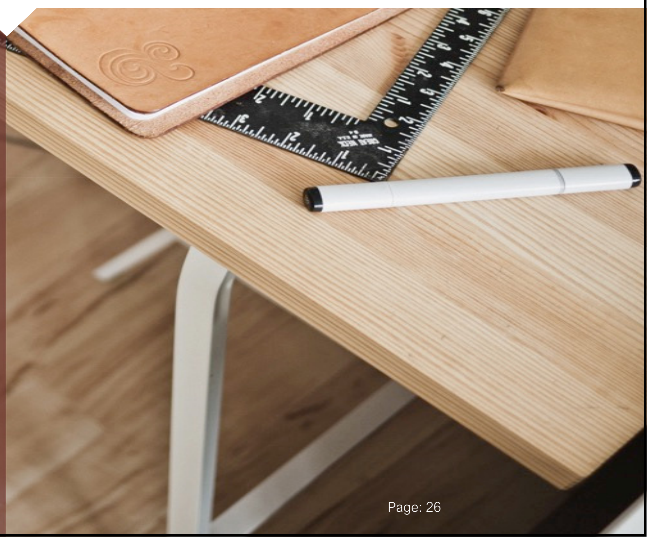

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