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Trusts explained

Part of the UK legal landscape for hundreds of years, trusts are still very much in use today.

What's more, they are suddenly need to know information when it comes to tax. This briefing explains why.

What are trusts?

There are many different kinds of trust, but whatever the name, the underlying purpose is the same: the creation of a legal entity to manage specific assets. In a trust, assets are owned and administered by one or more people (the trustees), for the benefit of someone else (the beneficiary).

Trusts are separate persons for UK tax purposes. They have their own rules for each of the main taxes: income tax, inheritance tax, capital gains tax, and so on (see below), and anti-avoidance measures exist to prevent manipulation of these. Because, in law, trusts exist independently of both those who set the trust up, and those who benefit from them, they can provide significant flexibility in a family or business context. In terms of tax planning, or the ownership and control of family or business assets, they can be very valuable tools indeed.

Trusts can accommodate many different scenarios. They can be set up for under age children, or when someone lacks capacity to look after their own affairs. They can be used to pass on assets during someone's lifetime, in order to remove them from the estate at death. They can be used to transfer shares in a family company, either during someone's lifetime or on death, to take advantage of business property relief. They can also be used to provide income from an asset without giving away the asset itself.

Please note that trust law in Scotland is not the same as in England and Wales. Special rules can also apply in Northern Ireland. Do contact us for further advice.

Jargon buster

- **assets:** different types of asset can be put in a trust. These include land, property, shares and cash
- **beneficiary:** someone who gets income and/or capital from a trust
- **protector:** someone independent of the trustees, with powers of oversight over the trust. It is not a common arrangement in English trusts: the position is different in Scotland
- **settlor:** someone who puts particular assets into a trust: in Scotland, the term is truster
- **trust deed:** document setting out the terms of the trust, such as its assets and beneficiaries
- **trustee:** someone responsible for managing a trust. Legally, trustees own the assets held in a trust. Broadly, it's their job to see that the trust does what it was set up to do, to manage it on a day to day basis, and to report and pay any tax due on its behalf.

Types of trust

There are many different types of trust; each type has its own tax treatment. These include, for instance:

Bare trusts

Assets here are held in the name of a trustee. The beneficiary has the right to all the capital and income at any time, if aged 18 or over in England and Wales, or 16 or over in Scotland. Bare trusts are often used as a means of holding assets for children until they are of age to take responsibility themselves.

Interest in possession trusts

Often known as life interest or life tenant trusts, and in Scotland as life renter trusts. Here there is a nominated beneficiary, who is given an interest in income from the assets in the trust, or the use of trust assets. This right will be given for a specified period, say for life, or until the recipient reaches a certain age. The beneficiary doesn't, however,

control the assets which provide the income. The capital may then pass to another beneficiary or beneficiaries. A typical example would be a widow left income for her life, with capital passing on her death to the children.

Discretionary trusts

Here trustees control both assets and income. No beneficiary is entitled to income as of right: it can be retained by the trustees or paid at their discretion to one, some or all of a nominated class of possible beneficiaries. They are also given discretion to gift capital to nominated individuals or a class of beneficiaries.

Trusts for vulnerable beneficiaries

A vulnerable beneficiary is defined as someone under 18, whose parent has died; or someone eligible for particular benefits (even if they do not receive them), such as Personal Independence Payment or Adult Disability Payment; or someone unable to manage their own affairs because of a mental health condition. Special tax treatment applies to these trusts.

Trusts and tax

Personal and capital taxes both have the potential to apply for trusts. The income tax position is complex, and the rules both as regards the trust and its beneficiaries need attention. In some circumstances, beneficiaries may be able to reclaim a refund or credit of tax paid.

Capital gains tax (CGT) is another area to take into account. A disposal at market value for CGT purposes is considered to take place when assets are transferred to trustees. In many cases, however, any capital gain arising can be deferred and passed on to the trustees.

Gains made by trustees are chargeable at 20%, and residential property gains at 28%. Certain CGT reliefs may apply in specific circumstances, such as private residence relief, business asset disposal relief (formerly known as Entrepreneurs' Relief) and hold-over relief.

Inheritance tax (IHT) is an important – and complex - area. Relevant property trusts, such as discretionary trusts and many life interest trusts, when set up in the settlor's lifetime, are likely to incur an immediate IHT charge 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, no tax is payable. Such trusts also have an ongoing charge arising on every tenth anniversary of the trust's being set up, as well as an exit charge when assets are taken out of the trust, or when the trust ends.

The taxation of trusts is a subject in its own right, and if this is an area of interest, we should be pleased to discuss it with you more fully.

News now

Low income trusts

There are new rules on the way for trusts and estates which have only a minimal income tax liability. An easement (technically known as a non-statutory concession) has applied for some time for trusts and estates with an annual income tax liability of less than £100 from receipt of interest: this means that there is no need for a tax return.

The concession has run on a year to year basis in the past. In a move providing welcome certainty, HMRC now intends to put the concession on a permanent footing. It will also be widened to cover all types of income, not just savings interest, though this is not expected to apply until the tax year 2023/24 at the earliest.

Trust Registration Service

There is a new requirement to register a wide range of trusts online with HMRC as part of Europe's efforts to combat money laundering and the financing of terrorist activity.

The Trust Registration Service (TRS), which commenced in 2017, initially only required certain taxable trusts to register. Now, however, its scope has been extended so that all UK express trusts need to register, whether they have a UK tax liability or not. HMRC defines an express trust as a trust deliberately (expressly) created by a settlor, usually

in the form of a document, such as a written trust deed or declaration of trust, rather than one created by an act of law. There are also provisions for certain non-UK trusts. The definition of UK and non-UK trusts for the purposes of the TRS depends on the residence status of the trustees and settlor of the trust: please talk to us for more details.

Exclusions

Exclusions cover express trusts considered lower risk by HMRC, though it should be stressed that even excluded trusts need to register if there is a liability to UK taxation. Exclusions include:

- trusts created by will holding only property from the estate of the deceased: these are excluded from registration for a period of two years from the date of death, to allow time to deal with the estate
- trusts set up for bereaved minors, and age 18 -to- 25 trusts subject to specific conditions
- trusts holding life insurance policies during the lifetime of the person assured
- trusts arising from employee share schemes
- co-ownership trusts set up to hold shares of property, or other assets, jointly owned by two or more people for themselves as tenants in common (in England and Wales). The joint legal and beneficial owners must be the same persons
- trusts registered as a charity in the UK, and certain charitable trusts not required to register in England and Wales under the Charities Act 2011. This includes, for example, smaller Parochial Church Councils and Scout and Guide groups
- trusts where a disabled person is the beneficiary
- bank accounts for children under the age of 16, or someone over 16 lacking mental capacity, where the account is in the name of, say, a parent or guardian: this arrangement creates a bare trust. The exclusion, however, applies only to *cash* deposit accounts. Where *investments*, such as stocks and shares, are held on trust for the benefit of a minor, registration with the TRS is needed. Child Trust Funds and Junior ISAs are not trusts, so the issue of registration does not arise.

The list is not exhaustive, and important conditions apply in some instances.

Registration: ongoing duties, deadlines and penalties

As well as a requirement to register, it is necessary to appoint one trustee as lead trustee, to be the main point of contact with HMRC. Trustees are required to keep information held on the TRS up to date; there is a 90-day action deadline here.

Non-taxable trusts created on or before 6 October 2020 should have registered by 1 September 2022. Non-taxable trusts created after 6 October 2020 must register within 90 days of creation, or by 1 September 2022, whichever is later. Taxable trusts created on or after 6 April 2021 should register within 90 days of becoming liable for tax or on or before 1 September 2022, whichever is later.

Working with you

Please do contact us if you have inadvertently missed the September deadline. Though penalties can apply to the regime, they should not attach to failure to register or late registration unless deliberate behaviour is involved.

This briefing has given a broad introduction to some of the main types of trust, outlining some of the tax planning potential and compliance involved. Bespoke advice is needed, however, and if trusts are of interest to you, we should recommend an in-depth discussion to explore the subject further. Please don't hesitate to get in touch.

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