



# Trusts and Estates Toolkit

2011-12 Trust and Estate Tax Returns

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## Introduction

Tax agents and advisers play an important role in helping their clients to get their tax returns correct. As a specialised tax area, many agents do not complete a large number of Trust and Estate returns. This toolkit is aimed primarily at helping and supporting tax agents and advisers for whom trusts and estates is not a significant element of their practice's work. Other agents may still find the toolkit helpful in validating their approach to this work and anyone, including businesses, trustees, and personal representatives may also find the toolkit useful if they are completing a Trust and Estate Tax Return.

This toolkit is applicable for 2011-12 Trust and Estate Tax Returns. Its use is entirely voluntary.

There is also a **supplementary toolkit** addressing the areas of possible error that we identify as key Capital Gains Tax risks for trusts and estates if you need to complete form **SA905 Trust and Estate Capital Gains** supplementary pages. If there has been a chargeable gain in the period the return covers, or you are not sure whether Capital Gains Tax applies, use both toolkits.

The content of this toolkit is based on our view of how tax law should be applied. Its application to specific cases will depend on the law at the relevant time and on the precise facts.

For further information on using this toolkit and reasonable care under our penalty system see **Toolkits to help reduce errors - essential information**.

For guidance on matters not dealt with in this toolkit you should refer to **Trusts forms, manuals and detailed guidance**.

## Areas of risk when completing returns for trusts and estates

Trusts and estates are complex areas that draw on a mixture of general and tax law. Many of the identified risks can lead to an incorrect tax charge and sometimes to the incorrect person being charged or a charge being overlooked.

Where we have referred to 'an estate' this means a deceased person's estate while it is being administered.

Areas of risk for trusts and estates fall broadly into four categories:

### Establishing whether this is a trust or estate, and/or the type of trust

Different rules apply to estates in administration and trusts and this affects the way the personal representatives and trustees are taxed. It is important that the status, ie whether it is an estate in administration or a trust, and if a trust the type of trust, is established first and any changes since the previous year are noted as this determines a number of issues. Preliminary work includes a thorough examination and verification of original documents, such as the will or deed setting up the trust, together with any later or supplementary documents, such as deeds of variation. This is essential in order to establish the capacity in which your client is acting, for example as trustee or personal representative or both.

### Applying the correct legislation, rules and practice

Every year we receive a number of returns where it is clear the information sent does not meet the requirements of current practice. Keeping up to date with legislative changes is not easy and searching through guidance is time consuming. We appreciate that applying the rules correctly is difficult, particularly where they are complex or unfamiliar. However it is important that the rules are applied as they should be.

## Incomplete information

It is important, subject to proportionality, to look beyond the information provided by the trustees or personal representatives and check the basic details. People outside the professional agent community often do not always understand the terms we use or recognise the significance for tax purposes of specific events or transactions. A good example is that some people are unaware that payments from life insurance policies may be chargeable to Income Tax but not necessarily on the person receiving the payment.

## Capital Gains

Capital Gains Tax is sometimes overlooked as many people are not aware when it applies. For instance some people are unaware that Capital Gains Tax applies to assets located outside the UK. Terms we use can also be confusing, for example the word 'disposal' - the meaning is not intuitive so a deemed disposal or an asset vesting in a beneficiary is easily overlooked. It is therefore important to ask the right questions - not simply 'have there been any disposals? For further information see the **[Capital Gains Tax for Trusts and Estates Supplementary Toolkit](#)**.

## Using links within this document

[Blue underlined text](#) are links within this document.

**Green bold text** are hyperlinks to external documents on the internet (access to the internet is necessary to view these).

We have a range of services for people with disabilities, including guidance in Braille, audio and large print. Most of our forms are also available in large print. Please contact any of our helplines if you need these services.

**[hmrc.gov.uk/contactus/particular-needs.htm](http://hmrc.gov.uk/contactus/particular-needs.htm)**

# Checklist for trusts and estates

		Yes	No	N/A
<b>Status</b>				
1	Has it been established whether you are dealing with an <a href="#">estate or a trust</a> ?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2	If you are dealing with a trust, has the <a href="#">type of trust</a> been properly identified?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3	If the trust is said to be a <a href="#">bare trust</a> , have you established with certainty that it is bare?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4	If the trust is an <a href="#">accumulation or discretionary trust</a> , have you shown in the return that it is taxable at the special trust rates?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5	Have you established whether the settlor, settlor's spouse or civil partner has an <a href="#">interest in the trust</a> ?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
6	If the trust is settlor-interested, have you checked if the trustees are taxable at the <a href="#">special trust rates</a> ?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
7	If you are completing only <a href="#">Step 1 of the return</a> and not the full return, have you checked whether it is appropriate for this estate or trust?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<b>Capital Gains Tax</b>				
8	Have you checked whether there has been a <a href="#">disposal for Capital Gains Tax purposes</a> and, if so, used the <b>Capital Gains Tax for Trusts and Estates Supplementary Toolkit</b> ?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<b>UK Investment Income</b>				
9	Have you checked if there have been <a href="#">any gains</a> on life insurance policies, life annuities or capital redemption policies and whether they have been attributed to the correct person?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
10	Have you checked if <a href="#">interest bearing securities</a> have been sold, transferred or purchased, and if so the accruals basis has been applied and any loss been claimed at the correct time?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
11	In the case of an estate or interest in possession trust, have you considered whether all <a href="#">taxed UK investment income</a> should be shown in question 9 on form SA900?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
12	Have you checked that <a href="#">UK investment income</a> has been entered in the correct boxes on form SA900?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<b>Foreign Income</b>				
13	Have you checked that any <a href="#">foreign dividend</a> qualifies for a UK tax credit?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Yes No N/A

### Foreign Income continued

- |    |  |                          |                          |                          |
|----|--|--------------------------|--------------------------|--------------------------|
| 14 | If <a href="#">Foreign Tax Credit Relief</a> has been claimed, have you identified each separate source of income in the relevant boxes on form SA904?                                       | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 15 | Have you checked that Foreign Tax Credit Relief has been <a href="#">properly calculated</a> ?   | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 16 | Have you checked that any withholding tax shown in column D on form SA904 Trust and Estate Foreign supplementary pages is actually <a href="#">Special Withholding Tax</a> ?                 | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 17 | Where trust income is <a href="#">partly chargeable</a> at the special trust rates and partly at the standard rates, have you checked that Foreign Tax Credit Relief is properly attributed? | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

### Business (trade and rental) losses

- |    |  |                          |                          |                          |
|----|--|--------------------------|--------------------------|--------------------------|
| 18 | If <a href="#">relief for business losses</a> has been claimed, have you identified the nature of the business from which the losses arise and the year in which the losses arise? | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
|----|--|--------------------------|--------------------------|--------------------------|

### Trust management expenses

- |    |  |                          |                          |                          |
|----|--|--------------------------|--------------------------|--------------------------|
| 19 | If the trustees are claiming trust management expenses, have you checked they are all <a href="#">allowable</a> ?  | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 20 | If the trustees are chargeable at the special trust rates, has the <a href="#">correct amount</a> of trust management expenses been entered on the return? | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 21 | Has a check been made to see whether trust management expenses should be <a href="#">restricted</a> and if so that they have been restricted correctly?    | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

### Tax pool

- |    |   |                          |                          |                          |
|----|---|--------------------------|--------------------------|--------------------------|
| 22 | Have you established whether the trustees have made any <a href="#">discretionary payments out of income</a> ?  | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 23 | If discretionary payments out of income have been made, have you checked the correct amounts have been <a href="#">entered in the correct part</a> of the return? | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 24 | If you are <a href="#">self calculating</a> , have you checked that the amount of tax going into the tax pool is correct?   | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

### General

- |    |   |                          |                          |                          |
|----|---|--------------------------|--------------------------|--------------------------|
| 25 | Have you checked the appropriate amount of <a href="#">standard rate band</a> has been claimed?   | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 26 | If you are completing <a href="#">a paper return</a> , have you checked that it is the correct return for both the client and the year? | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 27 | Have figures on the return been <a href="#">rounded up or down</a> as appropriate?  | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 28 | If a <a href="#">repayment</a> is requested, have you checked whether any charges are due?  | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

General continued

	Yes	No	N/A
29 Have you checked whether the <a href="#">details</a> of the trustees or personal representatives have changed?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
30 Have you let the beneficiaries and/or settlor <a href="#">know the amount</a> of their taxable income?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

# Explanation and mitigation of risks

## Status

### 1. Has it been established whether you are dealing with an estate or a trust?

#### Risk

Different rules apply to estates in administration and trusts and this affects the way the personal representatives and trustees are taxed. If you do not establish or recognise the correct status then the tax charge may be wrong. Also, where an estate and trust exist side by side (where someone dies and a trust is established under the terms of the will or the rules of intestacy for example), the assets and income they generate are not always correctly attributed - which may lead to an incorrect tax charge.

#### Mitigation

Check if your client is acting as personal representative or trustee (or both) and examine the will or trust deed, where they exist, together with any deeds of variation. A trust may also be established under the rules of intestacy that apply in England and Wales. Where an estate and trust exist side by side, particularly where the personal representatives are also acting as trustees, establish:

- the current position of the administration of the estate
- when the trust commenced
- whether the residue of the estate has been ascertained
- whether assets have been transferred from the estate to the trust
- when any assets were transferred

#### Explanation

Where the same people act as personal representatives and trustees they may not be aware of the significance of identifying in which capacity they hold the assets and this may lead to an incorrect tax charge. Personal representatives of estates are taxable at the standard rates. Trustees' taxation will depend on the type of trust.

In the circumstances where both an estate and a trust exist at the same time, two separate returns with separate reference numbers will be required, and the appropriate income arising to each will need to be properly identified.

For further information on estates see [Frequently Asked Questions about a deceased person's estate](#).

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### 2. If you are dealing with a trust, has the type of trust been properly identified?

#### Risk

Different rules apply to the different types of trust, which can make a significant difference to the tax charge. Where the type of trust is not properly recorded in question 8 on the [SA900 Trust and Estate Tax Return](#), the tax charge may be incorrect.

#### Mitigation

Check the trust deed and any subsequent variations to it. Liaise with the trustees to establish whether:

- the trust or any part of it is an accumulation or discretionary trust
- any part of it is an interest in possession trust

- any part of it is settlor-interested
- it is a trust for a particular purpose (for example an employment related trust, Heritage Maintenance Fund, Employer Finance Retirement Benefit Scheme, or an unauthorised unit trust)

It is also important:

- to establish if there has been any change in the nature of the trust since the previous year
- that either the 'No' or 'Yes' box is completed in respect of each part of question 8 on form SA900

### **Explanation**

The different rules that apply to the different types of trust affect the way trustees, beneficiaries and sometimes settlors are taxed. HMRC does not provide rulings on deeds.

For further information see our guide [Types of Trust and the Tax Implications](#).

It is important to check whether there has been a change in status since the previous year, for example one beneficiary's discretionary interest may have become an interest in possession.

It is also important to check if any settlor has an interest in the property or income of the trust because this potentially affects the tax treatment of discretionary payments and the liability of the settlor.

For further general guidance see [Settlor-interested trusts](#).

For more detailed guidance see [TSEM4005+](#).

For further guidance on unauthorised unit trusts see [Savings and Investment Manual \(SAIM\) SAIM6060+](#) and on other special purpose trusts see [TSEM5000+](#).

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### **3. If the trust is said to be a bare trust, have you established with certainty that it is bare?**

#### **Risk**

We often see trusts incorrectly returned as bare. Where this happens the wrong person may be charged to tax and the trustees' liability may be overlooked. The wrong rate of tax may also be applied.

#### **Mitigation**

Check the trust deed and speak to the trustees to establish whether the beneficiaries really have an absolute and immediate title to both the income and capital - only if this is the case will it be a bare trust.

#### **Explanation**

Beneficiaries of a bare trust should return any income and gains arising on their own personal tax returns. Trustees may choose to complete a tax return but are not required to do so unless we have issued a notice to file. When a return is made you need complete only Step 1, box 1 (on page 2 of form SA900) and any information required from question 19 on form SA900.

For further guidance see [TSEM1563](#).

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#### 4. If the trust is an accumulation or discretionary trust, have you shown in the return that it is taxable at the special trust rates?

##### **Risk**

We find in a significant number of cases that box 8.16 is not ticked even though the special trust rates apply. This leads to an incorrect tax charge.

##### **Mitigation**

If any part of the trust is an accumulation or discretionary trust, tick box 8.16.

##### **Explanation**

If any part of the trust is an accumulation or discretionary trust, the trustees are chargeable at the special trust rates, even if the trust is settlor-interested. Where there is also an interest in possession, the trust remains taxable at the special trust rates (income arising under the interest in possession is then shown in question 13 on form SA900 to avoid the charge at the special trust rates).

If you have self-calculated and shown the correct liability but not ticked box 8.16 on form SA900 there will be a discrepancy with our calculation.

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#### 5. Have you established whether the settlor, the settlor's spouse or civil partner has an interest in the trust?

##### **Risk**

If such an interest is not properly identified the tax treatment of discretionary payments may be wrong. Income Tax paid on income treated as that of the settlor does not enter the tax pool and discretionary payments made out of that income are not grossed up to include a tax credit. Failure to identify a trust as settlor-interested may lead to a charge on the trustees and the incorrect tax treatment of the settlor and beneficiaries.

##### **Mitigation**

Check the trust deed to identify who has, may, or could have, an interest and, where possible, their relationship to any settlor. If the trust is settlor-interested tick box 8.12 on form SA900.

##### **Explanation**

A settlor has an interest in a trust if he or she (or his or her spouse or civil partner) can benefit in any way from the income or property in the trust. The interest of a spouse or civil partner of a settlor is often overlooked as it can be difficult to establish. A trust may become settlor-interested where, for example, a beneficiary marries the settlor.

For further information on income treated as the settlor's see [Helpsheet 270](#).

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#### 6. If the trust is settlor-interested, have you checked if the trustees are taxable at the special trust rates?

##### **Risk**

We still see accumulation or discretionary trusts, which are settlor-interested, shown as not taxable at the special trust rates. If box 8.16 in question 8 on form SA900 has not been ticked, the incorrect rate of tax will be charged on the trustees.

##### **Mitigation**

Confirm whether or not the trust is an accumulation or discretionary trust. If it is, tick both boxes 8.12 and 8.16 on form SA900 to show that the trustees are chargeable at the special trust rates.

## Explanation

The rules regarding the rate at which trustees of settlor-interested trusts are chargeable changed in 2006. They are no longer exempt from the special trust rates.

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## 7. If you are completing Step 1 of the return and not the full return, have you checked whether it is appropriate for this estate or trust?

### Risk

In certain circumstances it is sufficient to only complete Step 1 (on page 2 of form SA900) and questions 17-22, instead of the full return. If you tick the boxes in Step 1 where it is not appropriate, it may lead to unnecessary correspondence and/or the wrong person being charged.

### Mitigation

Read the notes on page 2 on form SA900 to see if it is appropriate for your client to complete Step 1 and questions 17-22 only. If it is not appropriate, do not tick any boxes.

### Explanation

If you are dealing with an accumulation, discretionary or mixed trust, or an unauthorised unit trust you must always complete the return in full.

Step 1 is appropriate for:

- bare trusts - for further information see **Bare trusts**
- certain estates (broadly with UK income only - but not deemed income that has had tax deducted at source or carries a tax credit) - for further information see **Completing the Trust and Estate Return following a death**
- certain interest in possession trusts (broadly with UK income only - but not deemed income that has had tax deducted at source or carries a tax credit and which has been mandated to the beneficiary) - for further information see **Interest in possession trusts**
- certain settlor-interested trusts (where all the income is mandated to an interest in possession beneficiary) - for further information see **Settlor-interested trusts**

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## Capital Gains Tax

### 8. Have you checked whether there has been a disposal for Capital Gains Tax purposes and, if so, used the Capital Gains Tax for Trusts and Estates Supplementary Toolkit?

#### Risk

It is not always obvious when a disposal has occurred for Capital Gains Tax purposes and therefore when the form **SA905 Trust and Estate Capital Gains** supplementary pages should be completed. If a chargeable gain is not returned correctly it can affect the tax charge.

#### Mitigation

Check whether there has been a disposal in the period the return covers. If there has, or you are not sure whether Capital Gains Tax applies, use the **Capital Gains Tax for Trusts and Estates Supplementary Toolkit**.

## Explanation

Capital Gains Tax can be a complex subject with its own risks. These are addressed in the supplementary toolkit.

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## UK Investment Income

9. Have you checked if there have been any gains on life insurance policies, life annuities or capital redemption policies, and whether they have been attributed to the correct person?

### Risk

The tax charge will be incorrect if a gain is not identified and if it is not treated as income. However, gains are not always chargeable on trustees or personal representatives so if the circumstances are not correctly identified then the wrong person may be charged.

### Mitigation

- Establish if a gain has arisen - usually there will be a certificate but not in all cases.
- Establish who is chargeable on the gain.
- Where it is the trustees or personal representatives, check whether basic rate tax is treated as paid. This is usually shown on the certificate, where held, otherwise contact the insurer - see the notes on page 16 of the **SA950 Trust and Estate Return Guide**.
- Enter gains on UK policies, chargeable on trustees or personal representatives, in box 9.29 (where no tax is treated as paid) or 9.31 (and the tax treated as paid in box 9.30) on form SA900.
- Enter gains on foreign policies, chargeable on trustees or personal representatives, in box 4.6 (where no tax is treated as paid) or 4.8 (and the tax treated as paid in box 4.7) on form **SA904 Trust and Estate Foreign** supplementary pages.

### Explanation

Chargeable event gains relating to life insurance policies (often known as life insurance bonds), purchased life annuities or capital redemption policies or bonds may arise from:

- a withdrawal from, or the surrender or maturity of, the policy
- a death triggering benefits under the policy

Even if the policies etc are held by the trust or estate, gains are chargeable on trustees or personal representatives only in certain circumstances. Where the gains are chargeable, they are treated as income for tax purposes so capital losses and the annual exempt amount cannot be set against them.

In many cases, certificates showing the amount of chargeable event gains are issued to policyholders but a gain may still arise, in the absence of a certificate, if any of the following circumstances apply:

- cash or benefits were received
- the policy or annuity was sold or part sold
- a loan was made by the insurer to the trustees or personal representatives or, at their direction, to someone else
- the policy or annuity was a Personal Portfolio Bond during the year

Gains are treated as the income of an estate only if the policy etc:

- continues to run after the death of the beneficial owner
- is not held in trust (other than a bare trust)

Personal representatives need to include these gains in their return only if tax at the basic rate is not treated as paid.

The rules are more complex for trusts but gains are usually treated as the income of the settlor of the trust. Gains are not chargeable on bare trustees but are chargeable on other trustees if:

- the trust is a charity
- the settlor is not resident in the UK
- the settlor has died
- the trust was set up by a company, which is not resident in the UK or has been wound up
- the trust was set up by another trust (depending on the date the policy was taken out)

These are all subject to some general exceptions.

For further information about gains on UK life insurance policies see [Helpsheet 320](#).

For further information about gains on foreign life insurance policies see [Helpsheet 321](#).

For further detailed guidance see [Insurance Policyholder Taxation Manual \(IPTM\) IPTM3000](#).

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**10. Have you checked if interest bearing securities have been sold, transferred or purchased, and if so the accruals basis has been applied and any loss been claimed at the correct time?**

### **Risk**

Special rules apply where interest bearing securities such as government stock (gilts) are transferred. Acquisitions and/or disposals of securities are often overlooked and the accruals basis is often not applied when an acquisition or disposal has taken place. This can lead to an incorrect tax charge

### **Mitigation**

Where securities are held, either by personal representatives or on disabled persons' trusts, check the nominal value of all the securities held. In these cases, if the nominal value of all interest bearing securities held by personal representatives or a disabled persons' trust does not exceed £5,000, there are no reportable profits or losses.

For further guidance see [SAIM4210](#).

Where the nominal value of interest bearing securities held by personal representatives or a disabled persons' trust exceeds £5,000 and in all other cases where securities are held by trustees (regardless of their nominal value) check:

- whether there have been any transactions in interest bearing securities including government loan stock
- the contract notes for details of the transactions
- the accruals basis has been applied
- where a loss arises on a given security, the date the next payment of interest is due

## Explanation

Interest that accrues on securities is treated as a payment to or by either the transferor or the transferee, depending on whether the sale of the securities is with or without the accrued interest (also referred to as sales 'cum-dividend' or 'ex-dividend'). Broadly, where securities are sold cum-dividend or bought ex-dividend the accrued interest is a taxable 'income profit'. Where securities are sold ex-dividend or bought cum-dividend the accrued interest is a loss which can be set against accrued income.

For further guidance see [SAIM4010+](#).

Each kind of security should be dealt with separately, combining the profits and losses. Where a given kind of security has an overall loss, that loss may be set only against interest on securities of the same kind, payable at the next payment date - the loss should be included in box 9.14 on form SA900. The guidance notes on page 20 of the [SA950 Trust and Estate Return Guide](#) explain how to do this. Where the interest period spans the tax year, losses are not allowed until the interest on the securities is taxed in the following tax year. Losses cannot be set against 'income profits' arising on securities that have different interest periods.

For further guidance see [SAIM4120](#).

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**11. In the case of an estate or interest in possession trust, have you considered whether all taxed UK investment income should be shown in question 9 on form SA900?**

## Risk

Certain income, which has tax deducted at source or comes with a tax credit, does not have to be shown in question 9 on form SA900. However, not showing this income may, in certain circumstances, lead to a request for payments on account, which are not strictly necessary.

## Mitigation

Check whether the tax on such income, which does not have to be included on form SA900, makes up 80 per cent or more of the total tax. Where it is 80 per cent or more, show the income in question 9 on form SA900.

## Explanation

Where 80 per cent or more of the total tax due has been deducted at source or is covered by tax credits, no payments on account are needed for the following year. In the case of estates, and interest in possession trusts where relevant income has been mandated to the beneficiaries, details of UK investment income taxed at source or carrying a tax credit do not have to be included in the return.

However, without details of this type of income and where there is other untaxed income elsewhere in the return, the automatic calculation cannot recognise those situations where tax on this income makes up 80 per cent or more. In these circumstances payments on account will be requested unless the income is shown.

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**12. Have you checked that UK investment income has been entered in the correct boxes on form SA900?**

## Risk

We see cases where dividend income has been shown in the boxes for other savings income on form SA900 and vice versa, which will result in an incorrect tax charge. We frequently see amounts of tax deducted or tax credits that do not correspond to the appropriate percentage

rate for the type of income. This can cause delays and may result in a different charge than anticipated. We also see net income shown in the gross income boxes.

### Mitigation

- Check that interest and similar income is shown in boxes 9.1 to 9.14 on form SA900 and dividend type income in boxes 9.15 to 9.28.
- Check that the amount shown for the tax deducted or tax credit is at the correct rate when applied to the gross amount of income (that is the taxable amount, which is the net income plus the tax deducted or tax credit). This is subject to rounding down to the nearest pound - see [Q28](#).
- Check that net income is shown in the left hand boxes in question 9 on form SA900 and gross income (that is, the taxable amount) in the right hand boxes.

### Explanation

We come across many simple mistakes of the type described above. This causes additional work on both sides and delays in dealing with returns. Where we come across mismatched entries, we will use the net figures supplied and amend the others accordingly.

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## Foreign Income

### 13. Have you checked that any foreign dividend qualifies for a UK tax credit?

#### Risk

A UK tax credit on foreign dividends is not due in all cases. The HMRC calculation assumes one is due unless the foreign dividends are specifically shown in the return as not qualifying. A tax credit may therefore be given where none is due.

#### Mitigation

- Check that the dividends qualify for a UK tax credit.
- Enter the amount of the dividend (the amount before any foreign tax was deducted but do not gross it up to include the UK tax credit) in column E on page TF1 on form **SA904 Trust and Estate Foreign** supplementary pages (or page TF2 if the remittance basis applies).
- If no tax credit is due, enter the amount of the dividend in box 4.2B on form SA904 (but see the explanation below if the remittance basis applies).
- If you are self calculating, check you have calculated the tax credit and taxable income correctly.

#### Explanation

A tax credit is due where the company paying the dividend is:

- Not an offshore fund and the trustees or personal representatives own less than 10 per cent of the issued share capital or any class of share.
- Not an offshore fund and is resident in a territory with which the UK has a Double Taxation Agreement that includes a 'non-discrimination' article and is not an 'excluded company'. See the HMRC [list of treaty territories](#).
- An offshore fund, in certain circumstances. Note that some distributions are treated as yearly interest and do not qualify. See page TFN5 of **SA904 - Notes on Trust and Estate Foreign**.

The HMRC tax calculation will automatically give the tax credit, which is equal to 1/9 of the dividend (including any withholding tax) to the entry in box 4.2. If you are self calculating, the taxable amount is the gross dividend, including the UK tax credit. So if a dividend received is £900 (including withholding tax), the UK tax credit is £100 ( $900 \times 1/9$ ) and the taxable amount is £1,000.

If the remittance basis applies you should make a declaration in the 'Additional information' box 4.39 - see page TFN5 of the **SA904 (Notes)**

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#### 14. If Foreign Tax Credit Relief has been claimed, have you identified each separate source of income in the relevant boxes on form SA904?

##### **Risk**

The rates of Foreign Tax Credit Relief (FTCR) vary according to type of income and country. Aggregating income from different sources may result in the wrong rate of FTCR being applied.

##### **Mitigation**

Clearly show the country of origin and enter income from different countries separately.

##### **Explanation**

We often see entries such as 'Various' or 'Europe' in column A on pages TF1 and 2 on form SA904. However, each item of income from each country must be shown separately so the correct amount of FTCR may be established.

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#### 15. Have you checked that Foreign Tax Credit Relief has been properly calculated?

##### **Risk**

Relief may not be due for the full amount of foreign tax withheld or paid. We see claims for Foreign Tax Credit Relief (FTCR) that have not been restricted either in accordance with the relevant double taxation agreement (DTA) or to the amount of UK liability, particularly so in the case of interest in possession trusts.

##### **Mitigation**

- Check the vouchers or certificates for each source of income to establish the amount of foreign tax paid or withheld.
- Check the relevant DTA for each country to see how much relief can be claimed.
- Limit the claim in respect of each item of income so that it does not exceed the UK liability on that income.
- Where foreign dividend income is chargeable at the standard dividend rate (10 per cent) and qualifies for a UK tax credit do not claim relief.

##### **Explanation**

FTCR is limited to the lower of the rate specified in the DTA (which may be nil) relevant to the country where the income arises, or the amount of the UK tax liability on that particular income. Where the liability on dividend income is already satisfied by a UK tax credit no FTCR is due.

Enter the amount of income received before deducting any UK, Foreign or Special Withholding Tax, in column B on form SA904 (in the case of dividends, do not gross them up to include any UK tax credit).

The rate at which FTCR is due is specified in the relevant DTA, which may work out at less than the actual amount of foreign tax paid. Enter the amount, restricted where necessary, in column C on form SA904. The claim cannot exceed the UK tax liability on that income. In the case of dividends, FTCR should be applied to the actual amount (including foreign tax paid or withheld) shown in column B on form SA904 and not the grossed up dividends that include a UK tax credit. The aggregate of all FTCR being claimed should go in box 4.9 on form SA904.

FTCR is normally the most beneficial way to obtain relief from double taxation. However, you may instead claim a deduction for the foreign tax paid against the foreign income. In which case provide details of the country in column A, the amount of income received in column B, the actual amount of foreign tax paid in column C, and net these off in column E on page TF1 (or TF2 if the remittance basis applies) on form SA904. You cannot claim both FTCR and a deduction for the foreign tax paid.

For more detailed guidance see [TSEM3650+](#) and [International Manual \(INTM\) INTM161000+](#).

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## 16. Have you checked that any withholding tax shown in column D on form SA904 Trust and Estate Foreign supplementary pages is actually Special Withholding Tax?

### **Risk**

Special Withholding Tax operates only in certain countries and unlike ordinary withholding tax it may be repaid by HMRC. We often see 'ordinary' withholding tax incorrectly shown in column D on form SA904. This may result in a repayment of tax that is not due.

### **Mitigation**

Check that the income arises in a territory that operates Special Withholding Tax. If it does and Special Withholding Tax has been applied, show the amount in column D on form SA904. Other withholding tax should be shown in column C, subject to the normal FTCR restrictions.

### **Explanation**

Special Withholding Tax is treated as a payment on account of UK tax liability and can be repaid, should it exceed that liability. This tax will be in addition to any other foreign tax deducted. A list of territories operating this can be found on page TFN3 of the [SA904 \(Notes\)](#).

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## 17. Where trust income is partly chargeable at the special trust rates and partly at the standard rates, have you checked that Foreign Tax Credit Relief is properly attributed?

### **Risk**

Box 4.9A on form SA904 is there to ensure that the tax pool calculation is correct in respect of tax charged on income for which Foreign Tax Credit Relief (FTCR) has been claimed. We often see, in the case of a mixed trust, exactly the same amount in box 4.9A as in box 4.9; this will not always be an accurate reflection of the correct attribution. If the attribution of FTCR to income chargeable at the special trust rates is wrong it will result in an incorrect tax pool and tax charge.

### **Mitigation**

Identify the amount of income, for which FTCR has been claimed, that is chargeable at the special trust rates and enter it in box 4.9A on form SA904.

### **Explanation**

Where box 4.9 is completed there should always be an entry in box 4.9A that cannot exceed the amount in box 4.9. If no part of the FTCR refers to income chargeable at the special trust rates, then enter 'nil'. This ensures that the credit for foreign tax suffered does not enter the tax pool.

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## Business (trade and rental) losses

18. If relief for business losses has been claimed, have you identified the nature of the business from which the losses arise and the year in which the losses arise?

### Risk

There is a difference in the way that property business losses and trading losses can be used but we still see property business losses being applied as though they were trade losses. We also see trading losses brought forward being claimed as losses arising in year.

The allocation of losses incurred in a furnished holiday lettings business has changed. For further guidance please see [Helpsheet 253](#).

### Mitigation

Check the source of income and when the loss actually arose. Then apply the correct rules to these circumstances.

### Explanation

Losses arising from a rental business cannot be set against other, non-rental income unless they arise in the following, limited circumstances:

- certain capital allowances
- certain agricultural expenses

Further guidance on rental losses, including the changes to furnished holiday lettings, can be found in the [Property Rental Toolkit](#).

Trade losses arising in a tax year can be relieved in a number of ways:

- against other income in that year (and, if the losses exceed other income, against chargeable gains)
- by reference to other income in the previous year (and, if the losses exceed other income, by reference to chargeable gains)
- by being carried forward and set against profits of the same trade in later years
- trade losses arising in the 12 months prior to cessation of the trade can be relieved by reference to profits of the final year of trade and the three previous years

Trade losses brought forward from earlier years cannot be set against other income - they can be set against profits of the same trade only.

For further guidance see [Business Income Manual \(BIM\) BIM75005](#).

There were special rules for losses arising in 2008-09 and 2009-10. Those rules allowed any losses remaining unused - after relief had been given against income of the same year and/or the previous year - to be carried back and set against profits of the same trade for up to three earlier years, subject to certain restrictions. These rules do not apply in 2011-12.

For further guidance on these temporary rules see [BIM75415](#).

Trustees and personal representatives cannot claim losses that are available only to 'individuals' rather than 'persons'. Also, further restrictions may apply on the availability of losses for set-off or on the amount of loss available for set-off.

For further guidance see [BIM75700+](#).

For further information on errors that commonly occur when claiming business losses see the [Income Tax Losses Toolkit](#).

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## Trust management expenses

19. If the trustees are claiming trust management expenses, have you checked they are all allowable?

### Risk

Not all expenditure may be claimed as trust management expenses (TMEs). We see cases where expenditure has been claimed as TMEs but is not in fact due.

### Mitigation

Find out what costs have been incurred and why. Check whether they are allowable as TMEs.

### Explanation

To qualify as TMEs, expenses must be:

- an expense of managing the trust and not a distribution - see **TSEM8015**
- properly chargeable, in trust law, to income - see **TSEM8025**

There is some confusion between TMEs and expenses or deductions of a trading or rental business. They are not the same. Expenditure which the trustees incur in carrying on a trading or rental business cannot be claimed as TMEs. It should instead, where allowable, be set against the relevant business income.

The way TMEs are applied depends on the type of trust.

For general information on TMEs see - **Trust Income Tax relief and deductions**.

For more detailed guidance see **TSEM8000+**.

For further information on what HMRC considers to be expenditure properly chargeable to income see **Helpsheet 392**.

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20. If the trustees are chargeable at the special trust rates, has the correct amount of trust management expenses been entered on the return?

### Risk

We see many returns where the amount of trust management expenses (TMEs) has been grossed up. Also in self calculation cases, the complex rules for TMEs have not been applied in the right order, leading to the incorrect tax charge.

### Mitigation

Enter the actual amount of allowable TMEs, before they are grossed up. If you are self calculating, follow the rules on the order in which TMEs are applied and the rate at which they are grossed up.

### Explanation

TMEs reduce the amount of income chargeable at the special trust rates. They do not affect income chargeable in the hands of trustees at the basic or dividend ordinary rates.

If you have self-calculated and are completing a paper return but have not applied the rules in the right order our tax calculation will show a different liability. The rules are:

- TMEs must be applied to dividend type income first
- the full amount of allowable TMEs (including any brought forward from the previous year) should be grossed up at the dividend ordinary rate (multiply by 10/9) to work out the maximum available

- the amount to be applied is the lower of the amount of dividend type income or the grossed up TMEs
- the remaining net allowable expenses should be grossed up at the basic rate (multiply the net amount by 10/8) to get maximum available
- the amount to be applied is the lower of the amount of other income or the grossed up TMEs
- if there are any allowable TMEs remaining, the net amount should be carried forward to the next year

For further guidance see [TSEM8250 to 8255](#).

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## 21. Has a check been made to see whether trust management expenses should be restricted and if so that they have been restricted correctly?

### Risk

There are occasions when TMEs must be restricted and not identifying the appropriate circumstances can lead to the wrong tax charge - this is particularly relevant where there has been a change in the nature of the trust. Also the calculation can be complicated and we often see completed returns where expenses have been applied in the wrong order, the restriction has been made on an incorrect basis and the wrong amounts have been entered.

### Mitigation

- Check whether any of the circumstances apply which require restricting the TMEs.
- Where appropriate, use the work sheet provided to restrict the TMEs.
- Enter the restricted TMEs relating to income not chargeable at the special trust rates or (in the case of non-resident trusts) not chargeable in the UK in question 13 on form SA900.
- Enter only the actual amounts incurred and not the grossed up TME figures.
- Do not subtract the TMEs from the amounts of income shown in the right hand column of question 13 on form SA900.

### Explanation

TMEs need to be restricted where a trust is:

- mixed (partly accumulation or discretionary and partly interest in possession, or partly settlor-interested)
- accumulation or discretionary but where some income is allocated for specific purposes
- non-resident and some of the income is not taxable in the UK

The notes and work sheet on page 24 of the [SA950 Trust and Estate Return Guide](#) may help you restrict the TMEs (where either of the first two bullets above apply). Then check that the total in box 13.20 on form SA900 does not exceed the amount shown in box 13.19. In the case of non-resident trusts with income not taxable in the UK, the appropriate proportion of the TMEs must be attributed to this non-taxable income. If you are self calculating, apply the same ratio to the TMEs as the non-taxable income bears to the total income.

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## Tax pool

### 22. Have you established whether the trustees have made any discretionary payments out of income?

#### Risk

Discretionary payments out of income affect the tax pool. If they are not reported or if payments out of capital are reported where they should not be, the overall tax charge may be wrong. Also where the tax pool is insufficient to cover the tax credit on payments out of income, there is an additional charge on the trustees, which they may not have expected.

#### Mitigation

- Check details of payments made by the trustees to confirm that all discretionary payments out of income are entered on the return.
- Check whether any payments out of capital have been made to a beneficiary to bring his or her income up to a fixed amount or a defined level.
- Keep an up to date record of the tax pool and use the **Tax pool calculator** where appropriate.
- Explain to the trustees there will be an additional charge if there is a shortfall in the tax pool.

#### Explanation

The tax pool is a mechanism for ensuring sufficient tax is paid by the trustees to cover tax credits on payments to beneficiaries. It is important that all discretionary payments out of income are properly recorded and notified to HMRC so that the tax pool is maintained correctly. If it is not up to date the balance carried forward may be incorrect and the trustees may incur an unexpected tax charge.

Actual tax chargeable at the special trust rates (but not notional tax or tax credits) goes into the tax pool. The tax pool is then reduced by the amount of tax credit attaching to discretionary payments out of income.

Exceptionally, trustees may release monies out of capital to bring up a beneficiary's income to a fixed amount or a defined level. This may happen only where the terms of the trust empower them to do so. If so, the total amount of monies released should be treated as a payment out of income.

We come across cases where such a shortfall has not been picked up by the trustees. It is important they understand the interaction between the tax pool and payments to beneficiaries and the consequential tax charges of a shortfall.

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### 23. If discretionary payments out of income have been made, have you checked the correct amounts have been entered in the correct part of the return?

#### Risk

There is sometimes confusion over the amount to show in the return. Entering grossed up discretionary payments out of income that include the tax credit may result in an additional charge on the trustees. Also the nature of the trust, in particular settlor-interested trusts, will determine where in the return the payments should be shown. If they are not shown in the correct part of the return the tax pool calculation will be incorrect.

#### Mitigation

Enter the actual amounts of the discretionary payments out of income on form SA900 and not the grossed up amounts. Identify any payments where the trust is settlor-interested. If you are

completing the return for a Heritage Maintenance Fund or employment related trust, check the notes on page 25 of the SA950.

### **Explanation**

Payments to beneficiaries are usually entered in question 14 on form SA900. The amount entered is grossed up automatically by the HMRC tax calculation. So if a grossed up amount is entered it is effectively grossed up again and more of the tax pool is used, which can lead to an overstated charge on the trustees.

Payments to beneficiaries of settlor-interested trusts are treated differently to other payments as they do not carry a tax credit at the trust rate. Such payments should be shown in box 21.11 'Additional information' at the end of form SA900. If the trust is settlor-interested and this is correctly shown in question 8 on form SA900, the tax pool is automatically suspended in the HMRC tax calculation.

If the trust is part settlor-interested and part not, you should calculate the tax pool in respect of discretionary payments made from income that arises only to the part which is not settlor-interested. That amount should be shown in box 13A.1 on form SA900.

Where a trust is not settlor-interested but payments are made to the minor unmarried children of a settlor of the trust, the normal tax pool rules apply although the tax credit is available to the settlor rather than the child. They should be shown in question 14 as normal but, as such payments are chargeable on the settlor, you should tick the box at the end of the entry.

Payments made out of capital (other than the exception mentioned in paragraph 3 of the explanation to Q22 should not be shown in question 14 on form SA900.

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## **24. If you are self-calculating, have you checked that the amount of tax going into the tax pool is correct?**

### **Risk**

Not all tax chargeable on the trustees goes into the tax pool. Adding the wrong amount of tax to the tax pool may lead to an incorrect charge on the trustees.

### **Mitigation**

Check you have applied the rules correctly. Use the **Tax pool calculator** where appropriate.

### **Explanation**

All actual tax chargeable on the trustees at the special trust rates goes into the tax pool with one exception. Where foreign dividends are chargeable at the dividend trust rate but do not qualify for a UK tax credit, the trustees account for all the tax at that rate but the amount that goes into the tax pool is restricted to 22.5 per cent.

Notional tax and tax credits (for example tax that is treated as paid on UK life insurance gains, UK dividends and certain foreign dividends) do not go into the tax pool. So, where tax is payable at the dividend trust rate (32.5 per cent) and part of it is accounted for by a 10 per cent tax credit, the amount that goes into the tax pool is restricted to 22.5 per cent.

Tax chargeable at the basic rate on non-dividend type income that falls within the Standard Rate Band also goes into the tax pool.

For further guidance see **TSEM3021**.

Where the amount of the tax pool (including any unused amount brought forward) is less than the tax credit, the trustees are chargeable on the shortfall.

For further guidance see **TSEM3023**.

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## General

### 25. Have you checked the appropriate amount of standard rate band has been claimed?

#### **Risk**

The standard rate band applies where any income is chargeable at the special trust rates. It is an entitlement and not subject to a claim but returns often have no entry in box 9A.1 on form SA900 to show the amount due. Without an entry we may be unable to process the return. Also showing the wrong amount of relief will lead to an incorrect tax computation.

#### **Mitigation**

In every case where any income is chargeable at the special trust rates, enter the amount of standard rate band due in box 9A.1 on form SA900.

Liaise with the trustees who should be able to tell you the number and type of settlements the settlor has made. Where the settlor has made two or more settlements, make sure the standard rate band is apportioned.

#### **Explanation**

The standard rate band is mostly relevant to accumulation and discretionary trusts though it may apply to interest in possession trusts in certain situations. Because the amount can vary we depend on the entry in box 9A.1 on form SA900 to apply the correct amount.

The general rule is that the first £1000 of income, which would otherwise be chargeable at the special trust rates, is chargeable at the basic or dividend rate depending upon the nature of the income. This amount must be restricted where a settlor has made another settlement - the amount of standard rate band is apportioned between the number of settlements made by the settlor though the minimum entitlement is £200.

For further guidance see **TSEM3012**.

If an interest in possession trust has any deemed income (sums that are capital in trust law but treated as income for tax purposes) it is chargeable at the special trust rates so the standard rate band will be relevant. Deemed income may be shown in various boxes, for example, under the headings 'Gains on UK life insurance policies...' and 'Deemed income' in question 9 on the SA900 and in box 3.22 on form **SA903 Trust and Estate UK Property**. Where they are present the entitlement to standard rate band must also be shown in box 9A.1 on form SA900.

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### 26. If you are completing a paper return, have you checked that it is the correct return for both the client and the year?

#### **Risk**

Most paper returns are barcoded and are specific to a taxpayer reference and year. HMRC uses the barcode to log receipt of the return. If a barcoded paper return is used for a different client or year, it may be allocated to the wrong customer record or to the wrong year and result in late filing reminders or penalty notices being raised.

#### **Mitigation**

Using the HMRC Online Services to file online will avoid this problem.

If you are completing a paper return:

- check the Unique Taxpayer Reference (UTR) and name and address match your client
- check the return is for the right year

If necessary you can obtain a form SA900 without a barcode from our website.

The principle also applies to the use of barcoded payslips. They are year specific and using the wrong one can lead to the incorrect allocation of monies and issue of demands.

For further information see [Online Services](#) or go to [Find a form](#).

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## 27. Have figures on the return been rounded up or down as appropriate?

### **Risk**

If you self-calculate and do not round up or down the automatic tax charge calculation will differ from your calculation. This often leads to unnecessary correspondence, delay and occasionally surcharges.

### **Mitigation**

Any income or gains arising should be rounded down and any tax credits and tax deductions should be rounded up to the nearest complete pound.

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## 28. If a repayment is requested, have you checked whether any charges are due?

### **Risk**

Completing question 18 on form SA900 to request the repayment of overpaid tax usually prevents the overpayment being set against a tax charge becoming due. We often see cases where question 18 on form SA900 has been completed even though the intention is to set the overpayment against an upcoming charge, which leads to unnecessary correspondence.

### **Mitigation**

Before completing question 18 on form SA900 check to see if:

- a credit will arise
- whether it can be off-set against a charge becoming due
- Only complete question 18 on form SA900 if you want a repayment rather than a set off.

### **Explanation**

Overpayments and credits cannot usually be used to offset a charge if a repayment has been claimed.

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## 29. Have you checked whether the details of the trustees or personal representatives have changed?

### **Risk**

If changes are not notified in question 20 on form SA900 we may correspond with the wrong person or send items to the wrong address.

### **Mitigation**

Check whether there have been any changes to the names and addresses of the trustees or personal representatives and show them in question 20 on form SA900.

### **Explanation**

We need up to date information to ensure that we deal with the correct person and the correct address. Any changes must be shown in question 20 on form SA900 - it is not sufficient to do so elsewhere in the return or in a covering letter.

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### 30. Have you let the beneficiaries and/or settlor know the amount of their taxable income?

#### **Risk**

Providing insufficient information to beneficiaries or a settlor (in the case of a settlor-interested trust) may mean they cannot complete their return or repayment claim correctly.

#### **Mitigation**

- Use the appropriate version of the R185 series of forms.

#### **Explanation**

The use of form R185 is not mandatory but it provides a convenient way of passing on details of taxable income to the beneficiaries and/or settlor. However, trustees of an accumulation or discretionary trust have a legal obligation to provide beneficiaries, on written request, with a statement detailing discretionary payments made and the tax credit attaching to them. The personal representatives of a deceased person's estate are also legally obliged, on written request, to provide a statement showing income payments made to beneficiaries of the residue of the estate, and the tax paid on that income.

For estates use form **R185(Estate Income)**, for trusts use form **R185(Trust Income)** to advise beneficiaries of their taxable income.

For further guidance in the case of interest in possession trusts see **TSEM3760+**.

For trusts which are settlor-interested also use form **R185(Settlor)** to advise the settlor of their taxable income.

For further guidance see **TSEM4573+**.

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