

TRUST AND SETTLEMENTS - INCOME TREATED AS THE SETTLOR'S

This Help Sheet will help you fill in the Trusts etc. Pages of your Tax Return if you are a settlor and:

- you have retained an interest in a trust or settlement, or
- trust income or capital has been paid to or for the benefit of your minor (under the age of 18) unmarried child, or
- the trustees of a settlement made by you have (or are deemed to have) paid a capital sum to you.

The Notes on Trusts etc. tell you how to include the income on your Tax Return.

DEFINITIONS OF 'SETTLEMENT' AND 'SETTLOR'

A 'settlement' is defined as any disposition, trust, covenant, agreement, arrangement or, for certain purposes, transfer of assets.

Although this is a very wide definition, certain transactions are not regarded as settlements. These are:

- outright gifts of property between spouses, provided the gift carries the right to the whole of the income and the gift is not wholly or substantially a right to income only. A gift will not be an outright gift if it is subject to conditions, or if the property or its income can be applied for the benefit of the giver in any circumstances whatsoever
- settlements by one party to a marriage making provision for the other after the dissolution or annulment of the marriage, or while they are separated under an Order of the Court or under a separation agreement, or in such circumstances that the separation is likely to be permanent
- settlements consisting of annual payments made by an individual for bona fide commercial reasons in connection with their trade, profession or vocation
- settlements consisting of covenanted payments to charity
- settlements in which one spouse allocates pension rights irrevocably to the other in accordance with the terms of a relevant statutory scheme
- settlements that do not contain an element of bounty.

A 'settlor' is defined as any person by whom a settlement is made.

A person will be deemed to have made a settlement if they have:

- entered into the settlement directly or indirectly, or
- provided or undertaken to provide funds directly or indirectly for the purpose of the settlement (see Example 1), or
- made a reciprocal arrangement with another person for that person to make or enter into the settlement (see Example 2).

Example 1

You give a sum of money to your brother to settle on your infant children. Your brother does so. Although your brother is the actual named settlor, you will be the real settlor because you have indirectly provided the funds.

Example 2

You agree to settle a sum on your brother's children on condition that he settles an identical amount on your children. You will be the real settlor of your brother's settlement and he will be the real settlor of your settlement because each of you has made a reciprocal arrangement with the other.

HAVE YOU RETAINED AN INTEREST?

In general you will be regarded as having retained an interest in property that forms part of a settlement if that property, any substituted property or the income from the property, can be paid to you or your spouse, or can be applied for the benefit of either of you in any circumstances whatsoever.

Example 3

You settle funds on your grandchild contingently on her attaining the age of 30. The settlement fails to say what is to happen to the property if your granddaughter dies under the age of 30.

You will have an interest in the property because under trust law the settled funds will come back to you if your granddaughter dies under the age of 30. The capital can therefore be paid to you 'in any circumstances whatsoever'.

Example 4

You settle funds on discretionary trusts for your children and remoter issue (grandchildren etc.). The capital is given to such of the beneficiaries as are living on some particular date in the future. There are no other gifts of capital.

You will have an interest in the property because the funds will come back to you if none of the beneficiaries is living on the chosen date.

Example 5

You settle funds on discretionary trusts for your children and remoter issue. Included in the powers given to the trustees is a power to transfer the trust fund to the trustees of any other settlement whose beneficiaries include any of your children and remoter issue, even though other persons are also included.

You will have an interest in the settled funds because the trustees could use the power to transfer the funds to another settlement of which you or your spouse is a beneficiary.

Exceptions

Because the words 'in any circumstances whatsoever' are so wide there are certain circumstances in which you will not be treated as having an interest even though you may have. These are:

- where you give money to another person absolutely (in other words, you give up any rights or control over the money). That person could decide of their own accord to give the money back to you. You will not be regarded as having an interest because the person has complete freedom to do what they want with the money
- where your interest depends on the bankruptcy of some person who is, or may become, beneficially entitled to the trust fund or the income from the fund
- where your interest depends on the assignment of, or charge on, the trust property or its income by a person who is or may become beneficially entitled to it
- where, in the case of a marriage settlement, your interest depends on the death of the parties to the marriage and all or any of the children of the marriage
- where your interest depends on the death of a child of yours who would become beneficially entitled to the trust property or its income at an age not exceeding 25
- so long as someone is alive, and under the age of 25, during whose life the trust property and its income cannot be paid to, or applied for, the benefit of you or your spouse except if that person should become bankrupt or assign their interest or by dealing with it in such a way that someone else acquired the right to take the interest to satisfy or discharge some obligation, for example, the beneficiary borrows money from you and provides their interest as a security for repayment.

If you have any doubts about whether you have an interest under a trust or settlement made by you, you may wish to consult the trustees of the settlement who will also need to know the answer in order to determine their own tax liability.

If you do have an interest, then the trust income arising without deduction for the expenses of trustee(s) is taxable as part of your own personal income. If this increases the amount of tax you have to pay, you can claim a refund from the trustees of any additional tax you pay on such income. Ask your Tax Office for a certificate to do this.

Special provisions for non-domiciled settlors

If you are resident and ordinarily resident in the UK but are domiciled elsewhere, trust income which arises abroad is only treated as yours to the extent that it is remitted to the UK. The trustees will be able to advise you on this point.

HOW TO RETURN YOUR TRUST MANAGEMENT EXPENSES

Additional entries in boxes 13.1 to 13.3

In arriving at the income you include on your Tax Return because you have an absolute entitlement to that income you will have deducted Trust Management Expenses. But where you have retained an interest such expenses are not deductible. That part of the income which is used to meet such expenses is treated as chargeable to tax at the basic rate even if it is income which is normally chargeable at the lower rate only. That is why you need an entry in boxes 13.1 to 13.3.

The amount to be entered in box 13.1 is the amount of expenses which have been deducted in arriving at the income you have included on your Tax Return.

The amount you should enter in box 13.3 is:

- if the expenses have been met out of income which is chargeable at the lower rate, the figure in box 13.1 multiplied by $\frac{5}{4}$.
- if the expenses have been met out of income which is chargeable at the basic rate, the figure in box 13.1 multiplied by $\frac{100}{77}$.
- if the expenses have, exceptionally, been met out of income which has not suffered UK tax (for example, because the trustees are non-UK resident) the same figure as in box 13.1.

Enter in box 13.2 the difference between boxes 13.3 and 13.1.

PAYMENTS TO YOUR MINOR UNMARRIED CHILDREN FROM SETTLEMENTS MADE BY YOU

If you make a settlement in favour of your minor (under 18), unmarried children, any income paid to them or applied for their benefit is your income for tax purposes.

This will also apply to interest credited to a bank account, etc. in your child's name where the capital in the account has been provided by you. Where only part of the capital in an account has been provided by you, you will need to apportion the interest.

The income is not yours for tax purposes if the total income (from all settlements you made) paid to your minor unmarried child does not exceed £100 gross in any year.

Payments of **capital** to your minor, unmarried children may also be treated as your income in certain circumstances. This will apply where a capital sum is paid and there is 'available income' that matches that payment.

To calculate the 'available income' you total the income arising each year since the settlement was made and deduct from it income:

- that has already been treated as yours in earlier years, **and**
- that has been treated as that of a beneficiary, **and**
- that has been paid (either as capital or income) to, or for the benefit of, a beneficiary other than a minor, unmarried child of yours, **and**
- that has been applied to meet expenses of the trustees that were properly chargeable to income (or would have been so chargeable but for any express provisions of the instrument).

If the deductions exceed the total income arising no part of the capital sum is treated as yours for tax purposes.

If the total income exceeds the deductions, the difference is treated as your income as follows:

- if the excess is **less** than the capital sum, it is the excess that is treated as your income
- if the excess is **greater** than the capital sum, it is the capital sum that is treated as your income.

LOANS PAID OR REPAID TO YOU AND OTHER CAPITAL SUMS PAID TO YOU

An amount equal to the available income of a settlement (or the amount of the payment, if less) will be treated as your taxable income if the trustees:

- lend money to you or your spouse, **or**
- lend money to you or your spouse jointly with another person, **or**
- repay a loan to you or your spouse, **or**
- repay a loan to you or your spouse jointly with another person, **or**
- pay a sum to a third party at your direction, **or**
- pay a sum to a third party by virtue of an assignment by you of the right to receive it, **or**
- otherwise pay or apply a sum for your benefit, provided the sum is not fully paid for in money or money's worth.

If a **body corporate** connected with the settlement does any of the above things, it will be deemed to have been done by the trustees but only where the trustees have made an associated payment to that body corporate.

If a payment is made by or to a body corporate that is associated with another body corporate, the payments may be treated as paid by or to that other body corporate, ask your Tax Office or tax adviser for advice if in doubt.

Definition of 'body corporate'

A 'body corporate' is connected with a settlement if it is a close company (or only not a close company because it is not resident in the UK) and the participators then include the trustees of the settlement.

An associated payment is:

- any loan or repayment of a loan to that body corporate by the trustees of the settlement, **or**
- any other sum or asset transferred to that body by the trustees that is not paid or transferred for full consideration in money or money's worth,

that is paid or transferred in the five years ending or beginning with the date on which the capital sum is paid to you.

How to calculate available income

You must first total the income that has arisen since the settlement was made. You then deduct the following amounts:

- 1 Sums paid (except those sums detailed below) by the trustees to any persons in such a way that they fall to be treated as income of those persons for the purposes of Income Tax or would be so treated if those persons were domiciled, resident and ordinarily resident in the UK and the sums had been paid to them there.

Exceptions

- a. payments of interest
- b. payments made to bodies corporate connected with the settlement
- c. payments made to another settlement made by the trustees or by you
- d. payments that are treated as your income as a result of doing this calculation.

- 2 Any expenses (except those detailed below) of the trustees that, in the absence of any express provisions of the settlement, would be properly chargeable to income.

Exceptions

- a. any expenses included in the sums detailed above
- b. any interest paid for which no relief from tax is allowable under any provisions of the Income Tax Acts and which is not paid to you or your spouse
- c. any interest paid (not falling within b. above) in any year where the only sums paid in that year (falling within 1 above) were paid to you or your spouse

d. a fraction of any interest paid, not falling within b. or c. above, calculated in any year using the fraction

$$\frac{A - B}{A}$$

where

A is the whole of the income arising under the settlement in the tax year minus the expenses (apart from interest) detailed in 2 above

B is that part of the sums within 1 above that is paid to persons other than yourself or your spouse.

- 3 The amount of the income which has been used to frank or set against the payments to you or your spouse in earlier years.
- 4 The amounts of any previous payments to you or your spouse.
- 5 The amount of the income that has not been distributed, but that has been treated as yours because you have retained an interest.
- 6 Any sums paid under the settlement to the extent that they have been disallowed as deductions from your total income because the trustees have not distributed them.
- 7 Any sums paid to or for the benefit of your minor, unmarried children that are treated for tax purposes as your income.
- 8 That part of the settlement income that represents income from a close company for an accounting period beginning before 1 April 1989 and that has or could have been apportioned to a beneficiary.
- 9 An amount equal to tax at the rate applicable to trusts (or the sum of the basic and additional rates for years prior to 1993-94) on
 - a. the aggregate income arising under the settlement that has not been distributed, **minus**
 - b. the aggregate amount of income and sums in paragraphs 5, 6, 7 and 8.

You can work out the amount of the undistributed income by deducting the figures from 1 and 2 from the total income arising .

How to measure the charge

Once the amount of the available income has been calculated you need to compare that figure with the amount of the capital sum paid (or deemed to be paid) to you. If the available income is greater than the whole of the capital sum paid to you, it is treated as your income.

If the available income is less, it is that amount that is treated as your income. The balance of the capital sum is then carried forward and is set against the available income of future years for a maximum 11 years or until the capital sum is exhausted.

Complete repayment of loans - restriction of charge

If the capital sum paid to you is a sum paid by way of a loan, then if the whole of it is repaid then no part of it is treated as your income for any tax year after the one in which the repayment occurs.

Repeated loans

Where you have previously received and wholly repaid loans, only the excess of any new loan over the amounts of the previous loans that have been treated as your income will be regarded as a capital sum.

Repayment of loans to trustees

If:

- 1 you receive a capital sum from the trustees that is a complete repayment of a loan made to them by you, **and**
- 2 you subsequently lend to the trustees another amount not less than that capital sum received,

no part of the sum you received under 1 will be treated as your income for any tax year after the year in which you make the second loan.