

## **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 is held 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 or allocates to the other benefits under an approved pension arrangement
- 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 on your children and he will be the real settlor of your settlement on his children because each of you has made a reciprocal arrangement with the other.

### **HAVE YOU RETAINED AN INTEREST?**

If you as settlor have retained an interest in the settlement, the income arising is taxable as part of your own personal income. 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 granddaughter contingent 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 deal 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 Inland Revenue 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 (TMEs)

### 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 trust income which is used to meet trust expenses is treated as chargeable to Income Tax as follows:

- expenses up to the amount of the dividend income are treated as chargeable to tax at the dividend rate(s), **and**
- any expenses in excess of dividend income are treated as chargeable to income tax at the basic rate even if they are paid out of income chargeable at the lower rate.

To give effect to this you need to make entries in boxes 10.15, 10.16 and 10.17 and possibly boxes 13.1, 13.2 and 13.3.

Enter in box 10.15 the lower of:

- a. the trust management expenses you have deducted in arriving at the income included in your Return, **and**
- b. the amount of the trust dividend income.

Enter in box 10.17 the figure in box 10.15 multiplied by  $10/9$ .

Enter in box 10.16 the figure in box 10.17 *minus* the figure in box 10.15.

You will need an entry in box 13.1 if the trust management expenses exceed the amount of the dividend trust income. If they do enter the amount of the excess in box 13.1.

Where there is an entry in box 13.1 you will need to enter a figure in box 13.3 which is:

- the figure in box 13.1 multiplied by  $5/4$ , if the expenses have been met out of income which is chargeable at the lower rate
- the figure in box 13.1 multiplied by  $100/78$ , if the expenses have been met out of income which is chargeable at the basic rate
- the same figure as in box 13.1, 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).

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

## INCOME YOU SHOULD NOT INCLUDE IN YOUR RETURN

There are exceptions to the general rule that if you have retained an interest in the settlement you are taxable on the income arising under the trust or settlement.

### Settlor-interested trusts

From 6 April 2000, if the trust gives money to charity out of income, exclude that income from your Return.

If there is a discretionary payment to charity out of the trust's income, you should exclude that income, including a proportional amount of TMEs. For example, a trust receives £1,000 gross income, and pays £200 TMEs, and gives £100 to charity. You should exclude from your income ( $£100 + (200 \times 100/1000)$ ), that is, £120.

If the trust was required under the terms of the deed to pay a certain amount to a charity you should exclude that income. For example, a trust receives £1,000 gross income including £500 bank interest and £500 rent, and it is required to pay half of the income to charity. You should exclude £250 bank interest and £250 rent from your income. If instead the trust was required to pay all the bank interest to charity, you should exclude £500 bank interest from your income. You should also exclude a proportional amount of TMEs. So if the trust received income of £100 and was required to give half to charity, half the TMEs will be allowable against the half paid to charity.

### Other settlements — interest free or low interest loans to charity

Where you lend money, you are a settlor and retain an interest in the property. But from 6 April 2000, the law says that a 'settlement' does not include an interest free or low interest loan of money by an individual to charity. Do not return interest waived by you on such loans, whether made before or after 6 April 2000.

## SETTLEMENTS MADE BY YOU WHOSE BENEFICIARIES INCLUDE YOUR MINOR UNMARRIED CHILDREN

In A, B and C below the term 'child' means a child or stepchild of yours who is unmarried and under the age of 18.

### A. Settlements made before 9 March 1999 (but excluding funds added to such settlements on or after 9 March 1999)

Any income paid to or applied for the benefit of your child is treated as your income for tax purposes.

Any sum paid to or applied for the benefit of your child will also be treated as your income if there is available income (as described aside) to match the payment.

### B. Settlements made on or after 9 March 1999 and funds added on or after that date to settlements made before then

1. If the terms of the settlement are such that the income would otherwise, before being distributed, be treated as your child's income, that income will be treated as yours for tax purposes. You will need to apportion the income on a just and reasonable basis in the case of funds added on or after 9 March 1999 to an already existing settlement as it is only the income from the added funds which is treated as yours.

2. If the terms of the settlement are such that the income would not, before being distributed, otherwise be treated as your child's income any income treated as yours is computed in the same way as in A aside.

### C. Simple gifts

If you use your own money to:

- purchase assets, **or**
  - open or add to a bank or building society account in your child's name, **or**
  - transfer an existing asset of yours into your child's name
- any income arising from the asset/account is treated as yours for tax purposes. But if you provide only part of the asset/account, only the income arising from that part is treated as yours.

### Exception to A, B and C

If the total income to be treated as yours under the above rules does not exceed £100 gross in any year, no part of it is treated as yours for that year.

### Available income

To calculate this, total the income arising each year since the settlement was made and then deduct from that total, income that:

- has already been treated as yours in an earlier year
- has been treated as that of a beneficiary other than a child or stepchild of yours who is unmarried and under the age of 18
- has been treated for any of the tax years 1995-96, 1996-97 and 1997-98 as that of a child or stepchild of yours who is unmarried and under the age of 18, but only to the extent that it would have been charged to tax on the assumption that the income had been received untaxed. If your child had no other income, the income on which he/she would have been charged will normally be the amount in excess of the child's personal allowance. If your child had other income, for the purposes of calculating how much settlement income would have been charged to tax, you may assume that settlement income is the top part of total income
- has been applied in meeting expenses of the trustees which were properly chargeable to income (or would have been so chargeable but for any express provision of the settlement).

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

An amount equal to the available income as described above 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. If in doubt ask your Inland Revenue office or tax adviser for advice.

**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 to 1**

- 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 to 2**

- 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

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

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
- the aggregate income arising under the settlement that has not been distributed, *minus*
  - 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 in 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 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 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:

- you receive a capital sum from the trustees that is a complete repayment of a loan made to them by you, **and**
- 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.

*These notes are for guidance only, and reflect the position at the time of writing. They do not affect any rights of appeal.*