

Trusts

A. Introductory Note

This note accompanies the HMRC statistics on trusts, drawn from data captured from trusts within the income tax and capital gains tax Self Assessment regime. The tables complement our published statistics on trusts within the inheritance tax (IHT) regime.

The notes that follow describe:

- the different types of trust covered by our statistics;
- the major tax regimes that apply to trusts;
- the compilation of the statistics;
- the content of the tables.

This introductory note presents only a simplified description of the tax regime that applies to trusts. More detailed information on trusts can be found elsewhere on the HMRC website.

B. Types of Trust

A trust is an obligation binding a person (an individual or a company) called a 'trustee' to deal with property in a particular way, for the benefit of one or more beneficiaries. The following types of trust are covered by these statistics:

Discretionary Trusts

Trustees of a discretionary trust generally have 'discretion' about how to use the income of the trust. They may be required to use any income for the benefit of particular beneficiaries, but the trustees can decide how much is paid, to which beneficiary or class of beneficiaries payments are made, how often the payments are made and what, if any, conditions to impose on the recipients.

The trustees may, or may not, be allowed to 'accumulate' income within the trust for as long as the law allows rather than pass it to the beneficiaries. Income that has been accumulated becomes part of the capital of the trust.

Accumulation and Maintenance Trusts

An accumulation and maintenance trust is one in which the beneficiaries become entitled to the property or at least the income when they reach a certain age (no more than 25). The trustees can use the income for the maintenance of the beneficiary before the date on which that beneficiary becomes entitled to the property or to an interest in possession in that property¹.

¹ It is impossible to set up any new accumulation and maintenance trusts for IHT purposes on or after 22 March 2006 and the rules for existing trusts change with effect from 6 April 2008. From that date, the beneficiary of an accumulation and maintenance trust must become absolutely entitled to the property in the trust on or before their eighteenth birthday. More details, including those relating to transitional arrangements, are given at <http://www.hmrc.gov.uk/trusts/index.shtml>.

Trustees of an accumulation and maintenance trust are given power to 'accumulate' the income of the trust until a certain date, at which time the beneficiary, or beneficiaries, are entitled to the property of the trust or to the income arising from that property.

In addition, a mixed trust is a mixture of more than one type of trust, for example an interest in possession trust and a discretionary trust.

Interest in Possession Trusts

This type of trust exists when a beneficiary, known in this case as an 'income beneficiary', has a current legal right to the income from the trust as it arises.

The trustees must pass all of the income received, less any trustees' expenses and tax, to the beneficiary.

The income beneficiary need not, and often does not, have any rights over the capital of such a trust. Normally, the capital will pass to a different beneficiary, or beneficiaries, at a specific time in the future or after a specific future event.

Depending on the terms of the trust, the trustees might have the power to pay capital to a beneficiary even though that beneficiary only has a right to receive income.

C. Income Tax and Capital Gains Tax

The income tax and capital gains tax treatment of trusts differs according to the type of trust.

Taxation of Discretionary Trusts and Accumulation & Maintenance Trusts

The trustees of discretionary trusts are liable to tax on income received at special rates of tax that apply to discretionary trusts. Dividends and other similar income are chargeable at the dividend trust rate (32.5% from 2004-2005), and other income is chargeable at the trust rate of 40% (from 2004-2005). From 2005-2006 the first £500 (increased from 2006-2007 to the first £1,000) of trust income which would normally be chargeable at the special trust rates is instead taxed at the basic rate (currently 20%), or dividend ordinary rate (currently 10%), depending on the nature of the income.

In the period during which the trustees can accumulate income, the trustees of an accumulation and maintenance trust are taxed in the same way as in a discretionary trust. As a consequence, the income tax returns of discretionary trusts and accumulation & maintenance trusts cannot be distinguished. Statistics relating to these trusts are therefore grouped together in the tables.

Taxation of Interest in Possession Trusts

The trustees are normally chargeable to income tax on income received, so rent, trading and savings income are chargeable at the basic rate (currently 20%), UK dividend income is chargeable at the dividend ordinary rate (currently 10%).

Savings income usually has tax deducted at source by the bank or building society, and this is taken into account in taxing the trustees. Similarly, the tax credit attached to the net dividend meets the trustees' liability.

The beneficiaries are entitled to the income from the trust after deduction of charges properly met by the trustees out of income, income that the deed directs is to be applied for specific purposes, and trust management expenses properly chargeable to income.

They are taxed on this in the normal way, and are entitled to credit for tax paid by the trustees or deducted at source. If beneficiaries are starting rate taxpayers or non-taxpayers they will be able to reclaim some or all of the tax paid, though tax credits on dividends cannot be paid. If they are liable at higher rates, further tax will be due.

D. Inheritance Tax

The rules relating to the IHT treatment of trusts and transfers into trusts are complex and were changed significantly in Finance Act 2006.

Lifetime transfers into discretionary trusts are immediately chargeable for IHT. Assets in such trusts might also be subject to a ten-yearly periodic charge, or exit charges if they are removed before a ten year anniversary (or between anniversaries).

Before 22 March 2006, lifetime transfers into interest in possession trusts or accumulation & maintenance trusts were "Potentially Exempt Transfers" for IHT and were not immediately chargeable.

On or after 22 March 2006, all lifetime transfers into trust are immediately chargeable to IHT unless, broadly, the trusts are for a disabled person within the IHT definition.

Trust assets will be subject to the periodic and exit charges unless, broadly, the trusts are:

- created on death by a parent for a minor child who will be fully entitled to the assets in the trust at age 18; or
- interest in possession trusts effected by will or under the law relating to intestacy, to which the beneficiary becomes beneficially entitled on the death of the testator or intestate; or
- created either in the settlor's lifetime or on death for a disabled person.

However, small value transfers into trusts will continue to incur no IHT, and the trust itself will incur no IHT liability if the value of assets in the trust remains below the IHT threshold. Consequently most transfers into trust will not result in an IHT charge and most trusts will not pay IHT. More detailed guidance on the

IHT treatment of trusts is given at <http://www.hmrc.gov.uk/trusts/index.shtml>.

E. The Statistical Tables

The statistics on the income and capital gains of trusts are drawn from data captured from all those trusts which make a full Self Assessment return.

Trusts which hold only non-income producing assets will not in general be part of the Self Assessment regime and therefore will not be covered by the tables. The statistics are derived from data captured by December 2008 and should cover the vast majority of returns expected for 2006-07 and previous years.

Two broad types of trust are identified: trusts paying tax at the special trust rates – which cover discretionary trusts and accumulation & maintenance trusts; and those which do not, i.e. interest in possession trusts. The table does not provide a detailed analysis of the estates, charities and small numbers of non-standard trust types which make Self Assessment returns; although the table does indicate the total number of returns from this group.

Table 13.1. provides statistics on the numbers of trusts making Self Assessment returns in each year since 2002-03. It also provides statistics on the total income and capital gains declared by these trusts, broken down by the type of income and the type of trust.

Table 13.2. shows a breakdown by size of the numbers of trusts making Self Assessment returns (where size is defined as total income excluding capital gains). It also shows the distribution of total income between trusts of different sizes.

These tables supplement the statistics on trusts we have previously published on as part of HMRC Statistics. These tables include:

Table 12.1. Total IHT receipts from lifetime transfers, broken down between Entry charges and periodic and exit charges, annually since 1998-99.

http://www.hmrc.gov.uk/stats/inheritance_tax/12_1_sep05.pdf

Table 12.7. Assets held in discretionary trusts at ten year anniversary, broken down by size of trust, for each year since 1994-95.

http://www.hmrc.gov.uk/stats/inheritance_tax/table12-7-jul05.pdf

Table 12.8. Assets held in discretionary trusts at ten year anniversary, broken down by numbers holding particular assets and values of particular asset types.

http://www.hmrc.gov.uk/stats/inheritance_tax/table12-8-jul05.pdf

Tables 12.7 and 12.8 relate only to those trusts which pay IHT charges. The numbers of such trusts are considerably smaller than the total number of trusts within Self Assessment.

G. Enquiries and Further Information

Enquiries about statistics on trusts should be addressed to Jackie Orme, KAI Analysis, HM Revenue & Customs, Room 2/68, 100 Parliament Street, London SW1A 2BQ. A telephone enquiry number is given in the 'enquiry points' page.

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