

Trusts for Vulnerable Beneficiaries – part 2 (Lecture P1328 – 11.54 minutes)

In this second part we consider the capital taxes implications for trusts created for vulnerable beneficiaries.

CGT

If the trust is for vulnerable people, trustees can claim a CGT reduction, calculated as follows:

1. Work out what CGT would be payable under the normal rules for trustees.
2. Then work out what the beneficiary would have to pay if the gains had come directly to them.
3. The trustees can claim the difference between these two amounts as a reduction in their CGT payable, using form SA905.

Note that this special CGT treatment does not apply in the tax year when the beneficiary dies.

Example

Trustees of a vulnerable beneficiary trust make gains in 2022/23 of:

- £27,000 on quoted investments, plus
- £120,000 on residential property (which had not been lived in by the beneficiary).

The beneficiary's own income uses up £9,000 of their basic rate band.

Calculate the CGT due by the trustees and the revised figure if a vulnerable beneficiary claim is made.

1. Initial tax due by trustees

- They have an annual exemption of £6,150
- CGT is:

£27,000 @ 20% =	5,400
(£120,000 - 6,150) @ 28% =	<u>31,878</u>
	<u>£37,278</u>

2. If the beneficiary disposed of the assets directly, the position would be:

- Residential property gains (£120,000 - 12,300) = £107,700

(£37,700 - 9,000) = £28,700 @ 18% =	5,166
(£107,700 - 28,700) = £79,000 @ 28% =	<u>22,120</u>
	27,286
- Other gains

£27,000 @ 20% =	<u>5,400</u>
	<u>£32,686</u>

Trustees can therefore claim to reduce the CGT payable from £37,278 to £32,686, by making a claim for a reduction of £4,592.

Making an election

Form VPE1 must be completed for each vulnerable beneficiary. The election takes effect from the date specified on the form. Any income or gains before the date the election takes effect are taxed under normal trust rules, even if the election takes effect part way through the same tax year.

You must make the election no later than 12 months after 31 January following the tax year when you want the election to start.

Inheritance tax

A vulnerable person is defined differently for IHT purposes. These are the situations when trusts for vulnerable people get special IHT treatment:

- For a disabled person whose trust was set up before 8 April 2013 - at least half of the payments from the trust must go to the disabled person during their lifetime.
- For a disabled person whose trust was set up on/after 8 April 2013 - all payments must go to the disabled person, except for up to £3,000 per year (or 3% of the assets, if smaller), which can be used for someone else's benefit.
- When someone suffering from a condition that is expected to make them disabled sets up a trust for themselves.
- For a bereaved minor - they must take all the assets and income at (or before becoming) 18.

The IHT advantages of creating such a trust are:

- Lifetime gifts into trust are PETs rather than being immediately chargeable to IHT;
- Transfers to vulnerable beneficiaries by the trustees do not suffer exit charges;
- There are no 10-year charges on the trust property.

When the beneficiary dies, any assets held in the trust on their behalf are treated as part of their estate for IHT purposes.

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