Friends Provident International

Taxation in a trust

For Financial Advisers only

The following guide outlines the general UK taxation rules that can apply when a policy of life assurance or capital redemption when held in trust.

Creation / on-ongoing taxation

When a policy of life assurance or capital redemption is transferred to a trust an immediate IHT charge may apply. On-going IHT charges can also apply.

Trust Type	Type of Transfer	Taxation	On-going
Discretionary	Chargeable lifetime transfer	Immediate IHT charge of 20% applies to the value of the gift that exceeds the settlor's available nil rate band.	Periodic and exit charges apply. (See separate guide)
Absolute / Bare	Potential Exempt Transfer	none	none

Taxation of policy held in trust

A life assurance or capital redemption policy is classed as a non-income producing asset and benefits from gross roll-up. Therefore, the trustees do not need to take account of tax events such as capital gains tax when disposing of underlying asset, or income received by the funds.

Therefore, the policy itself is only subject to taxation when a chargeable event occurs.

When can a chargeable event occur?

When a policy is held in trust, the main occasions a chargeable event will occur are:

- full surrender of the policy;
- part surrenders that exceed the 5% cumulative annual allowance; and
- death of the last life assured that brings the policy to an end

Liability for the gain?

The tax liability for a chargeable event gain will depend on which provision the trust has been setup i.e. discretionary or bare provision. FPIL offer several draft trust deeds that can be taken out on different provisions.

Trust Name	Provision Available
Isle of Man Probate	Settlor is only beneficiary
Beneficiary Trust	Discretionary
Loan Trust	Bare / Discretionary
Gift Trust	Bare / Discretionary
Discounted Gift Trust	Bare / Discretionary
International Flexible / EPT	Discretionary

Discretionary provision

With a chargeable event gain, the taxable person on whom the gain will be assessed will depend on when the chargeable event occurs:

1. Gain is treated as income of the settlor if they are alive and UK resident immediately before the chargeable event, or if the chargeable event occurs in the same tax year as the settlor's death.
2. Gain will be taxed on the trustee(s) if the chargeable event occurs in a tax year after the one in which the UK resident settlor died; or immediately before the chargeable event, the settlor is non-UK resident but at least one of the trustees is UK resident.
3. Where the trustees are non-UK resident and the settlor is also non-UK resident or deceased immediately before the chargeable event, any UK beneficiary receiving a benefit from the trust fund can be liable to tax on amount matched to the distribution.

NB: The above represents the general position. In some cases:

- The gain could be completely free of any income tax. This situation could occur where the settlor died before 17 March 1998 and the original investment has not been altered (i.e. topped up).
- The gain could be divided equally between the settlor and UK trustee. This situation could occur where trust was created by joint settlors and gain occurs in a tax year where only one settlor is surviving.

Bare provision

With a bare trust, the taxation will depend on the type of trust used.

Trust Type	
Gift Trust	The beneficiary is absolutely entitled to the trust fund so any tax liability will fall on the beneficiary. Exception: trust was created for a minor by the parent(s). In this case, parental settlement* provisions apply.
Loan Trust	The beneficiary is absolutely entitled to the trust fund so any tax liability will fall on the beneficiary. Exception: trust was created for a minor by the parent(s). In this case, parental settlement* provisions apply. ⚠ If the trustees created a chargeable event, perhaps when repaying the settlor's loan, then the gain would fall on the absolute beneficiary (even though they have not received any payment).
Discounted Gift Trust	During the settlor's lifetime, both the settlor and named beneficiary have a material interest in the rights under the trust fund. The chargeable event gain would need to be apportioned based on the value of rights of each beneficiary and the donor on an actuarial basis. ⚠ If the trustees created a chargeable event, perhaps when paying the regular income required under the trust, then part of the gain would fall on the absolute beneficiary (even though they have not received any payment). Following the death of the settlor the named beneficiary is absolutely entitled to the trust fund so any tax liability will fall on the beneficiary. Exception: trust was created for a minor by the parent(s). In this case, parental settlement* provisions apply.

***Parental settlement** provisions apply where:

- the beneficiary is a minor who is unmarried and not in a civil partnership; and
- the settlor is the parent of the beneficiary; and
- the chargeable event gain, plus all other income arising from gifts by the same parent to that minor, exceed in total £100 in the tax year in question.

Where the parental settlement provision applies, the whole amount (i.e. the gain) will be taxed as the income of the parent who created the trust.

Rates of taxation

The rate of tax applicable depends on who is liable for the chargeable event gain. Various allowances may be available depending on other income.

Who is liable for the chargeable event	Allowances Available	Tax Rate
Settlor	Personal, Starting Rate of Savings, Saving Allowance	0-45%
Trustees	Trust Allowance	45%
Beneficiary	Personal, Starting Rate of Savings, Saving Allowance	0-45%

Reliefs available

Certain reliefs can help reduce the amount of the chargeable event gain. These include time apportionment relief (TAR) and top-slicing. The availability of these depends on whom is liable for the chargeable event gain.

Who is liable for the chargeable event	Time Apportionment Relief	Notes
Settlor	Yes	Can be claimed
Trustees	No	Cannot be claimed
Beneficiary (Bare)	Yes	Can be claimed
Beneficiary (Discretionary)*	No	* If the trustees were to make an irrevocable appointment in favour of the discretionary beneficiary, then the beneficiary could claim TAR. TAR would only apply from the date of the appointment and for the days that they were non-UK resident.

Who is liable for the chargeable event	Top-slicing relief	Notes
Settlor	Yes	Can be claimed
Trustees	No	Cannot be claimed
Beneficiary (Bare)	Yes	Can be claimed
Beneficiary (Discretionary)	Yes	Can be claimed

Important

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Please note that every care has been taken to ensure that the information provided is current and in accordance with our understanding of current law and HM Revenue and Customs' (HMRC),

You should note however, that we cannot take on the role of an individual taxation adviser and independent confirmation should be obtained before acting or refraining from acting upon the information given. The law and HMRC practice are subject to change.

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