<u>GENERAL TAX GUIDANCE FOR TRUSTEES OF LIFETIME SETTLEMENTS</u>

<u>LAT / HPP / PILOT (Family)</u>

1. Informing Her Majesty's Revenue & Customs (HMRC)

When setting up the trust HMRC must be informed of the existence of the trust for inheritance tax purposes **only** if the value of the assets (taken together with chargeable transfers of the Settlor in the previous 7 years) exceed 80% (100% if cash) of the nil rate band at the date of transfer. Where this is required this will be done by Affinity using Form IHT100 and associated forms. The trustees have 12 months from the time any initial or additional capital is received into the trust.

The trustees must also inform HMRC of the setting up of the trust for the purpose of setting up self-assessment returns for the income and any capital gains tax liability <u>IF</u> the trust asset is income-producing or there is a capital gains tax liability. This should be done using Form 41G. HMRC should then send the Trustee self-assessment tax returns to the trustees, which they should complete for every tax year. If the kind of asset that is held in the trust will not produce income (e.g. a loan note that is not interest bearing or property occupied by a beneficiary or other person without paying rent) and if there is no capital gains tax liability then there is no need to fill in Form 41G. However, whenever the type of assets change so that income or capital gains are anticipated then Form 41G should be filled in and submitted to HMRC.

2. Income Tax

If the asset produces income, then for a life interest trust the income is charged at the rate of the life interest beneficiary during the currency of the life interest and the liability is for that beneficiary. For a discretionary trust income tax is payable by the trustees on any income that they receive. Individual beneficiaries that receive income from the trust can reclaim some of that tax if their own individual rate is lower. If the Settlor's minor children are the beneficiaries of the trust then the income tax will be assessed on the settlor. It is important that the trustees take professional advice on their income tax obligations.

3. Inheritance Tax

When the trust is set up there is an entry charge of 20% **on any amount in excess of the nil rate threshold** (£325,000 for the tax year 2010/11) taking into account all chargeable transfers in the previous 7 years. Other than that, there are two other inheritance tax charges that trustees should be aware of.

Periodic charge: There is a periodic charge to inheritance tax every 10 years. The tax charge for the first periodic charge will depend on the amount that initially went into the trust but the periodic charge will not exceed 6%. If the asset going into the trust is below the nil rate threshold there will be no inheritance tax charge. An inheritance tax return will have to be completed for the inheritance tax charge if any is due on each 10th anniversary.

Exit charge: There is a charge to inheritance tax when capital funds or assets (not income) are distributed to beneficiaries. The inheritance tax liability will not exceed 6%. The trustees have to send an inheritance tax account to HMRC to account for the inheritance tax charge.

4. Capital gains tax

When the trust is set up there may be capital gains tax payable but the settlor can claim hold over relief to defer the gain. If the property is the main residence of the settlor then main residence relief is normally available. Any time that capital is distributed to beneficiaries the trustees and beneficiaries can also claim holdover relief to defer any capital gains tax on the assets. If capital gains tax is to be paid it should be accounted for in the self-assessment tax returns for the tax year in which the trust is set up or in which the capital distribution is made. If holdover relief is claimed on the gains when the trust is set up then main residence exemption will not be available thereafter if a beneficiary should subsequently live in the property. The trustees are entitled to an annual exemption of half of that available to an individual.

5. Meetings and minutes

The trustees should keep a file of working documents for correspondence and documents relating to the trust. They should also meet regularly, at least once a year, to discuss the trust matters. Among the things that they should discuss at the meeting are the nature of the trust asset, the situation and needs of the beneficiaries, what distributions to make and especially whether to distribute or accumulate income, income tax returns and inheritance tax accounts (where relevant), consideration of their discretions, investment decisions (where relevant) and any other matter that affects the trust.

Note: This information is only intended to provide a general overview and is based on the current law. Trustees should always seek professional advice regarding their obligations in respect of their tax liability as trustees particularly before making distributions.