Tax Overview Vulnerable Persons Trust

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Vulnerable Persons Trust

This guide is to help you understand the key points of how trusts for disabled persons are taxed.

This is based on the current 2021/22 tax year rules and therefore could be subject to change.

Your trustees should check with HMRC the current requirements when the trust begins and keep under review until the trust comes to an end.

This guide applies to a person who is incapable of managing their finance and property due to a mental health condition (as per the Mental Health Act 1983) or is in receipt of specified benefits.

Inheritance Tax

- Trusts for vulnerable beneficiaries get special Inheritance Tax (IHT) treatment during the lifetime of the vulnerable beneficiary.
- During the trust there are no ten year periodic or exit charges.
- Payments made by the trustees to or for the benefit of the disabled person during their lifetime are not subject to an IHT charge.
- Distributions of capital and / or income to persons other than the beneficiary may be made so long as they do not exceed the annual limit (currently the lower of £3,000 or 3% of the maximum value of the trust property).
- When the principal beneficiary (i.e. vulnerable person) dies, any assets held in the trust on their behalf are treated as part of their estate and therefore IHT may be charged.

Capital Gains Tax

CGT is payable by trustees. They can claim a relief in a similar way to income tax relief:

- The trustees calculate the CGT as if there was no reduction.
- The trustees then calculate the CGT that the vulnerable person would have been subject to if the gains arose directly against them.
- The trustees can then claim the difference between the two amounts as a reduction.
- The special treatment does not apply in the tax year when the vulnerable person dies.
- On death of the vulnerable person, there is a taxfree uplift of trust funds to Probate value.

Income Tax

Where a trust has a vulnerable beneficiary, the trustees are entitled to a deduction of tax against the amount they would otherwise pay.

- The trustees calculate their income tax liability on the normal basis.
- The tax rate for this type of trust is 7.5% for dividends and 20% for other income.
- The trustees then calculate the income tax that the vulnerable beneficiary would have been subject to if the trust income had been paid directly to them as an individual.
- The trustees then claim the difference between the two amounts, as a deduction from their own income tax liability.

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