

M
&G

Trust School
Lesson 2 -
Taxation of Trusts



This content is based on our understanding of current taxation, legislation and HM Revenue & Customs practice all of which are liable to change without notice. The impact of any taxation (and any tax reliefs) depends on individual circumstances.

Where content includes case studies or examples these are for illustration purposes and are not recommending a specific course of action.

Past performance is not a reliable indicator of future performance. The value of an investment can go down as well as up and your client may get back less than they've paid in.

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Learning Objectives

By the end of this session, you will be able to:

Describe how income tax applies to trusts and distributions

Explain CGT treatment and reliefs available to trustees

Communicate the tax advantages and risks of holding investment bonds in trust

Summarise the IHT framework for trusts, including entry, periodic and exit charges

The Taxation of trusts

Income Tax

- Payable on any income received by the trust
- Different implications depending on whether trust is bare, Interest in Possession (IIP) or discretionary

Capital Gains Tax

- Payable on capital gains within the trust
- Applicable to IIP and discretionary trusts

Inheritance Tax

- Chargeable on capital within “relevant property trusts” on certain events - entry, periodic and exit
- Chargeable on beneficiary where trust is in their estate



Income Tax

Taxation of income



Bare trust



Interest in possession trust



Discretionary trust

Trustees invest £250,000 into a GIA portfolio

- 2% return from dividend generating OEICs (£5,000)
- 2% return from fixed interest OEICs (£5,000)
- 2% capital gains (£5,000)

Bare trusts and income

- Connor, aged 6, is the sole beneficiary of the Absolute trust.
- Connor carries out some ad hoc acting/modelling work and has earned income of £15,000 in the current tax year.

The £5,000 interest and £5,000 dividend income relating to the trust would be taxed as follows:

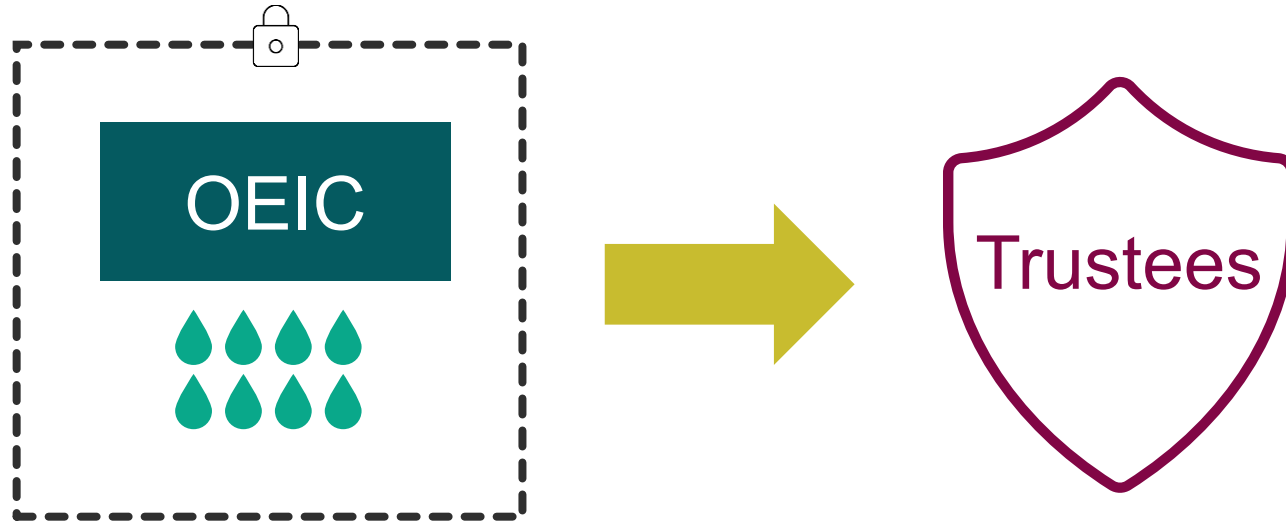


	Source	Amount (£)	Band	Rate (%)	Tax (£)
	Earned income	12,570	Pall	0	0
		2,430	BR	20	486
	Interest	2,470	SR	0	0
		1,000	PSA	0	0
		1,530	BR	20	306
	Dividends	500	DNR	0	0
		4,500	BR	10.75	483.75
	Tax due				1,275.75

Beneficiary completes a tax return

If the settlor is a minor beneficiary's parent, income assessed on the settlor where it exceeds £100 in a tax year

IIP trusts – income tax



Trust property generates income which is taxable in the year it arises (whether distributed or reinvested)

>60% fixed interest = savings income

<60% fixed interest = dividend income

Income on trustees in the tax year it arises

Dividend income – 10.75%

Non-dividend income – 20%

(savings and property income 22% from April 2027)

IIP trusts – Trust taxation



	Source	Amount (£)	Rate (%)	Tax (£)
	Interest	5,000	20	1,000
	Dividends	5,000	10.75	537.50
	Tax due			1,537.50

IIP trusts – Beneficiary taxation



Trust property generates income which is taxable in the year it arises (whether distributed or reinvested)

>60% fixed interest = savings income

<60% fixed interest – dividend income

Income on trustees in the tax year it arises

Dividend income – 10.75%

Non-dividend income – 20%

(savings and property income 22% from April 2027)

Beneficiary assessed in year income arises

Income retains character – allowances available

Credit given for tax paid by trustees –
Can reclaim excess tax paid
(HRT/ART will have to pay more)

IIP trusts – Beneficiary taxation

- Marjorie, aged 75, is the life tenant of the Interest in possession trust.
- Marjorie is retired and has pension income of £25,000 in the current tax year. She has no income from other sources.

The £5,000 interest and £5,000 dividend income relating to the trust would be taxed as follows:

	Source	Amount (£)	Band	Rate (%)	Tax (£)
	Pension income	12,570	Pall	0	0
		12,430	BR	20	2,486
	Interest	1,000	PSA	0	0
		4,000	BR	20	800
	Dividends	500	DNR	0	0
		4,500	BR	10.75	483.75
	Tax due				3,769.75

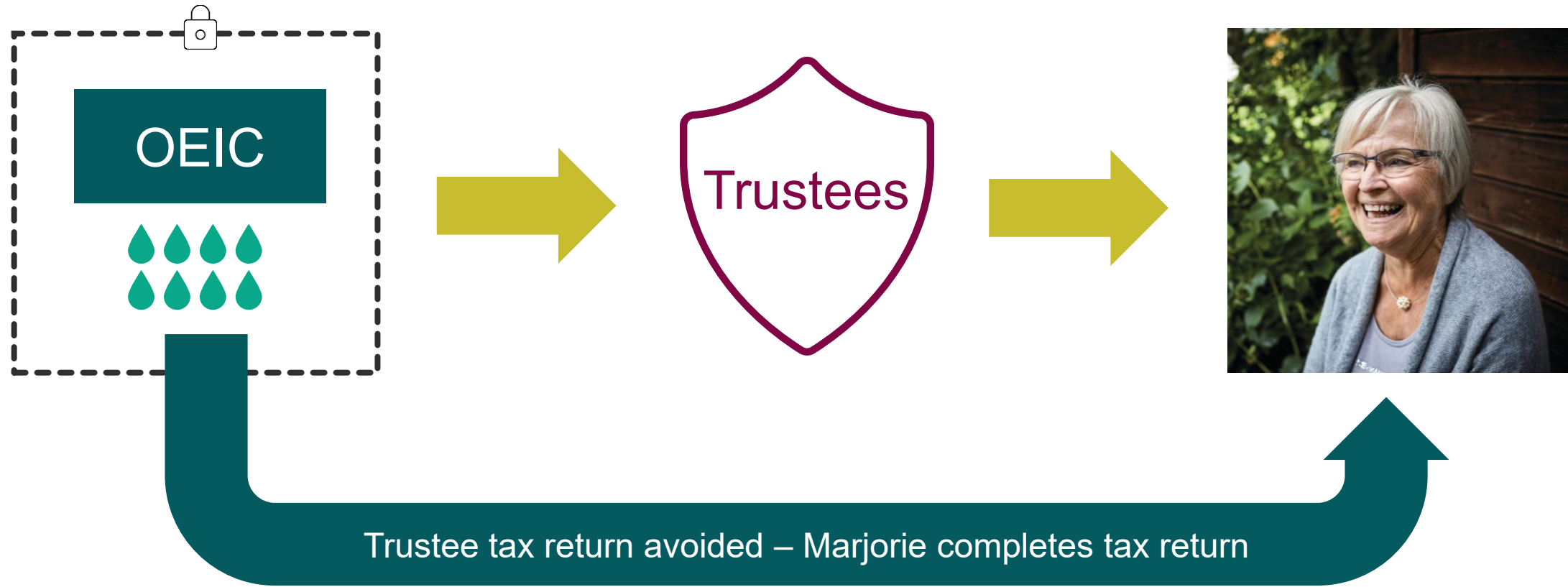


Trustees paid tax of £1,537.50

Marjorie's liability was £1,283.75

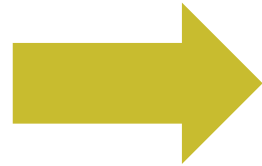
Marjorie can reclaim the difference of £253.75 from HMRC

IIP trusts – Mandate the income?



Trustees cannot deduct trust management expenses from the income if its mandated!

Discretionary trusts and income



Trust property generates income which is taxable in the year it arises (whether distributed or reinvested)

>60% fixed interest = savings income

<60% fixed interest – dividend income

Income assessed on trustees in the tax year it arises

Dividend income – 39.35%

Non-dividend income – 45%

(savings and property income 47% from April 2027)

Discretionary trusts – Trust taxation



	Source	Amount (£)	Rate (%)	Tax (£)
	Interest	5,000	45	2,250
	Dividends	5,000	39.35	1,967.50
	Tax due			4,217.50
	"Tax pool"			4,217.50

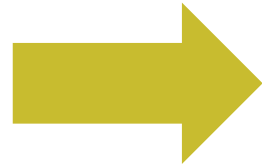
Trustees complete tax return and pay tax to HMRC

Tax paid adds to the tax pool

The tax pool is used to cover 45% tax credit when income is distributed to a beneficiary

If tax pool is insufficient trustees need to pay more tax to HMRC

Discretionary trusts – beneficiary taxation



Trust property generates income which is taxable in the year it arises (whether distributed or reinvested)

>60% fixed interest = savings income

<60% fixed interest – dividend income

Income on trustees in the tax year it arises

Dividend income – 39.35%

Non-dividend income – 45%

Beneficiary assessed in year income distributed

Assessed on “Trust income” (allowances not available)

Credit given for tax paid by trustees – reclaim available for excess tax paid

Discretionary trusts – Beneficiary taxation

- Kevin, aged 60 is a potential beneficiary of a discretionary trust set up in his mothers Will
- The trustees have decided to distribute £10,000 of trust income to him which comes with a tax credit of £4,500
- Kevin is retired, resides in England and has pension income of £25,000 in the current tax year. He has no income from other sources.



	Source	Amount (£)	Band	Rate (%)	Tax (£)
	Pension income	12,570	Pall	0	0
		12,430	BR	20	2,486
	Trust income	10,000	BR	20	2,000
	Tax due				4,486

Trustees paid tax
of £4,217.50

Kevin's liability on the
trust income was
£2,000

Kevin can reclaim
£2,500 from HMRC

Trustees may have to
pay further £282.50
to HMRC

Settlor interested trusts

A “settlor interested trust” is a trust where the settlor or settlor’s spouse is a potential beneficiary of the trusts

Where a trust is settlor interested, income is assessed on the settlor (and trustees)





Capital Gains Tax

Taxation of capital gains



Bare trust



Interest in possession trust



Discretionary trust

Trustees invest £250,000 into a GIA portfolio

- 2% return from dividend generating OEICs (£5,000) ✓
- 2% return from fixed interest OEICs (£5,000) ✓
- 2% capital gains (£5,000)

Taxation of capital gains – bare trusts



- Connor, aged 6, is the sole beneficiary of the Absolute trust.
- Connor carries out some ad hoc acting/modelling work and has earned income of £15,000 in the current tax year.
- He also has dividend and savings income totaling £10,000 from the trust
- His taxable capital gain after his £3,000 annual exempt amount is £2,000

Beneficiary completes
a tax return

Parental settlement rule doesn't
apply to CGT!

	Source	Amount (£)	Band	Rate (%)	Tax (£)
	Taxable income	12,570	Pall		
		12,430	BR		
	Capital gain	2,000	BR	18	360
	Tax due				360

Taxation of capital gains – “not bare” trusts



Annual Exemption for trusts

£1,500*



CGT rate applicable to trusts

24%

*divided by the number of trust set up by the settlor subject to a minimum of £300 per trust

Taxation of capital gains – “not bare” trusts



	Source	Amount (£)	Rate (%)	Tax (£)
	Capital gain	3,500	24%	840
	Tax due			840

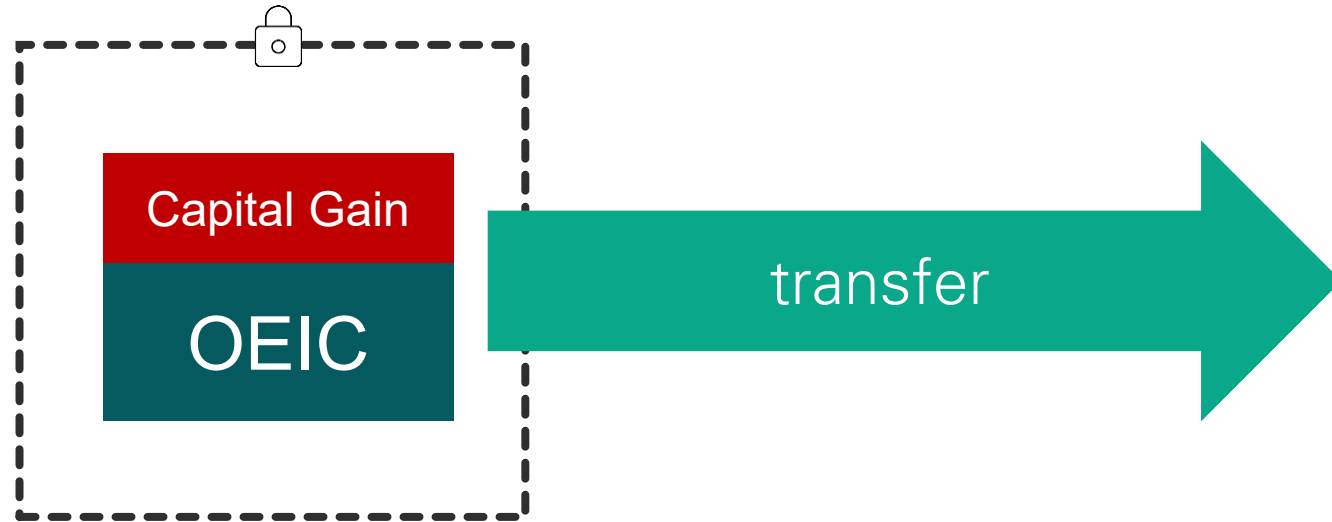
Not
reclaimable

Holdover
relief?

Private
residence
relief?

IIP trusts may
get uplift on
death

Holdover relief



Stock transfer
changes
ownership to
beneficiary

Only applies to
transfers
chargeable to
IHT

Joint election
made by
trustees and
beneficiaries

Acquisition
cost of new
owner based
on original cost



Taxation of investment bonds

Chargeable Events



D

Death giving rise
to benefits



A

Assignment for
money or
money's worth



M

Maturity



E

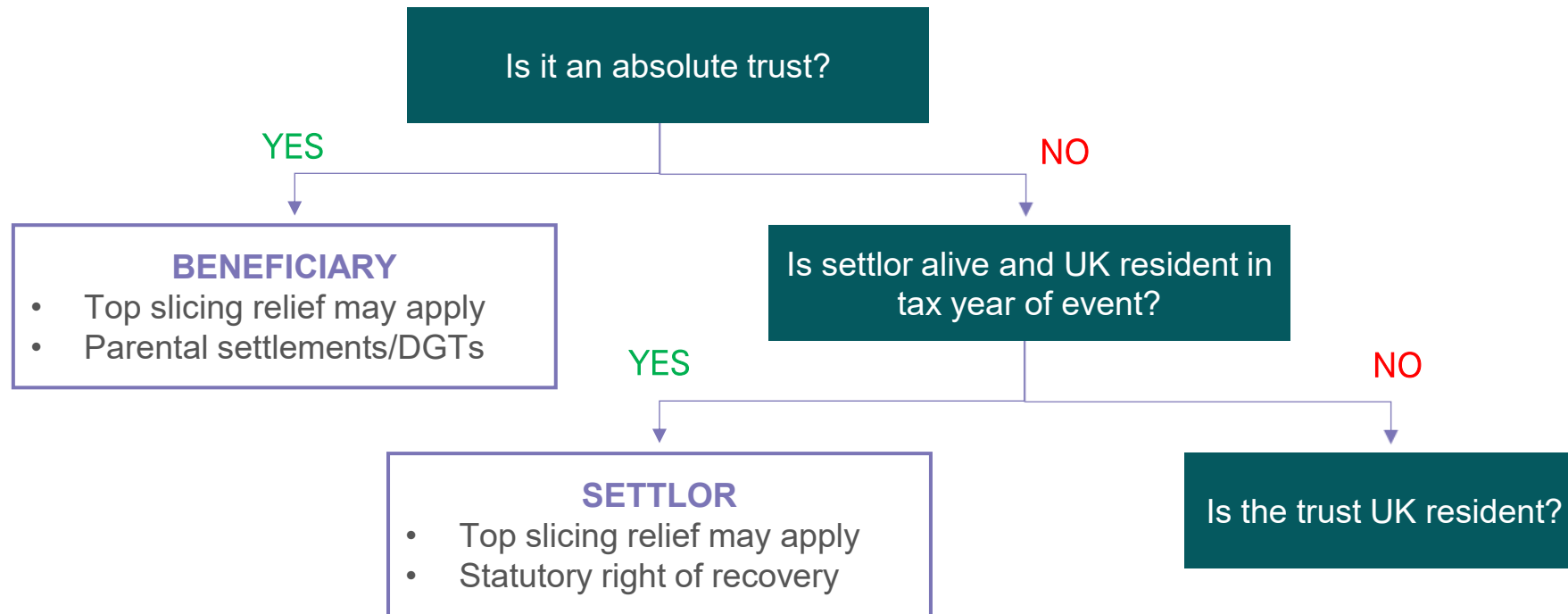
Excess
surrenders and
part assignments



S

Surrender of
segments

Trusts and chargeable events



Trust residence



All trustees are resident in the UK

Trusts set up pre 6 April 2025

Mixture of resident and non-resident trustees – settlor UK resident or UK domiciled when trust set up

Non UK resident trust

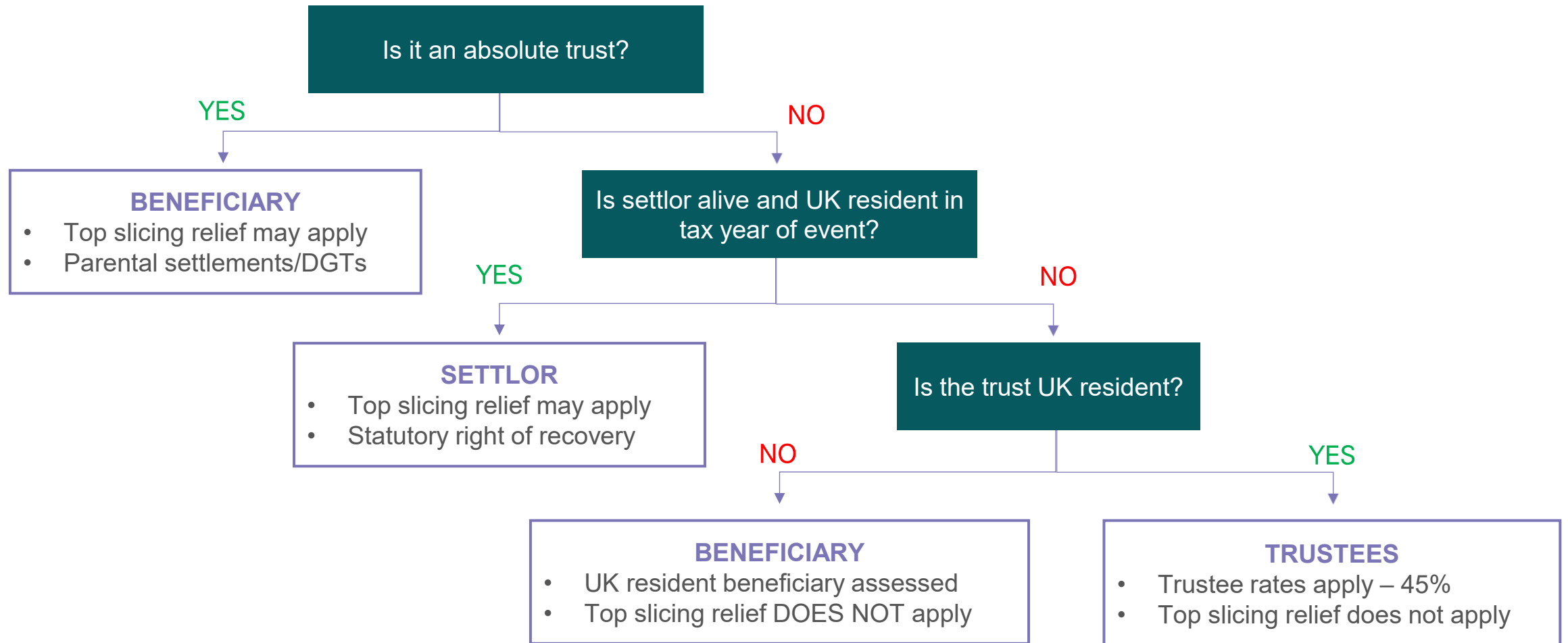
All trustees are resident outside the UK

Trusts set up pre 6 April 2025

Mixture of resident and non-resident trustees – settlor NOT UK resident and not UK domiciled when trust set up

Trusts set up post 6 April 2026 domicile is ignored

Trusts and chargeable events

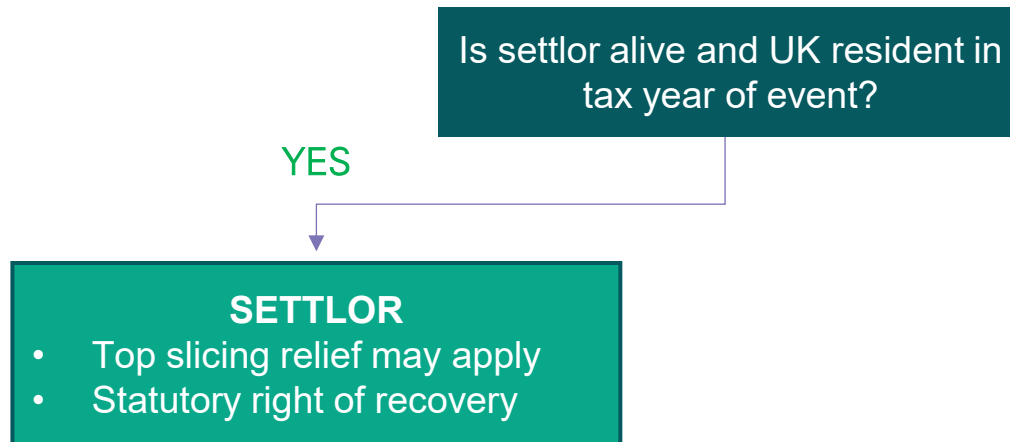


Scott



- Scott, who lives in England, set up a discretionary gift trust in 2020 with £325,000
- The trust was set up with an investment bond
- In 2025 Scott, in his role as trustee, decided to encash part of the bond and distribute cash to one of the beneficiaries.
- The encashment triggered a chargeable gain of £20,000

Who is assessed on the gain?



Jackie and John



- Jackie and John are the settlors of a trust set up in 2013
- It's a discretionary trust which held various investments including an onshore investment bond.
- The bond was set up on a lives assured basis with Jackie and John as the only lives assured.
- John passed away in 2020
- Jackie passed away in May 2026 resulting in a chargeable event.
- The chargeable gain certificate showed a gain of £200,000 and the trustees wonder how this will be taxed.
- The remaining trustees are their sons who are both UK resident.

Joint settlor (non bare) trusts



**Jackie's
£100,000 share**



**John's
£100,000 share**

Is settlor alive and UK resident in tax year of event?

YES

NO

SETTLOR

- Top slicing relief may apply
- Statutory right of recovery

Is the trust UK resident?

YES

TRUSTEES

- Trustee rates apply – 45%
- Top slicing relief does not apply

£100,000 gain included in tax return for year of death

John's share



	Source	Amount (£)	Rate (%)	Tax (£)
	Savings income	100,000	45	45,000
	Tax credit			20,000
	Tax due			25,000
	"Tax pool"			0

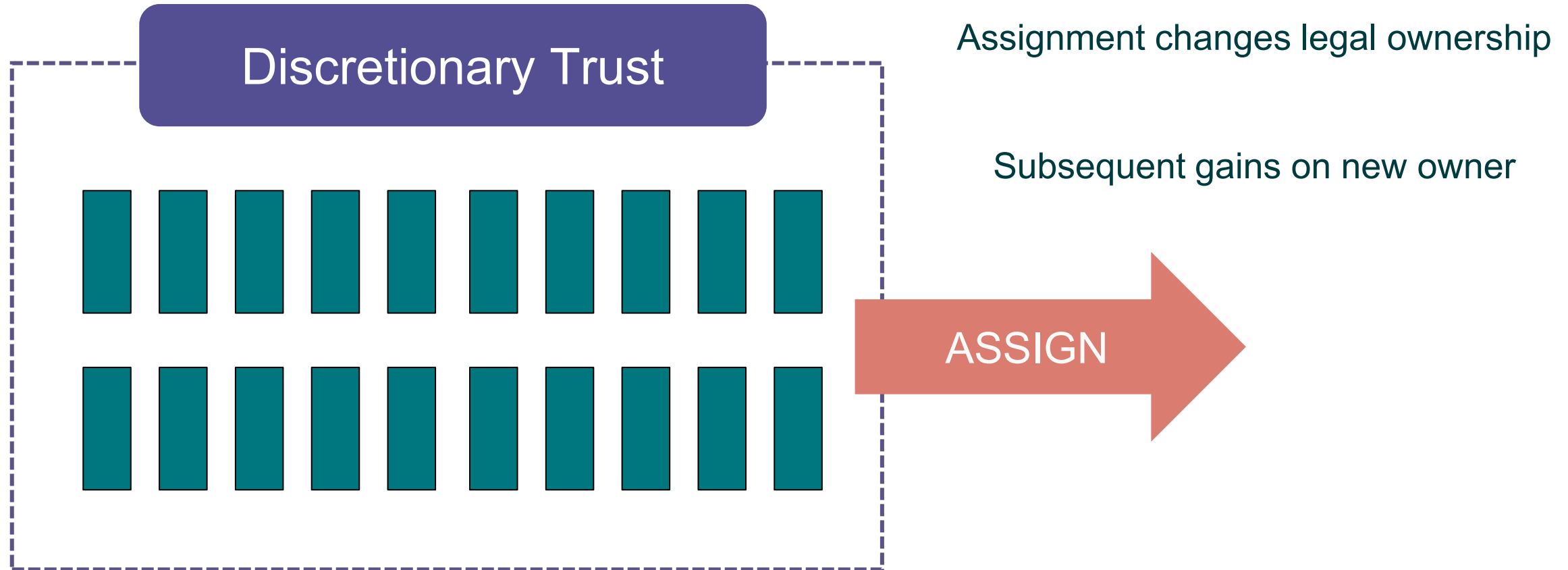
Onshore gains come with 20% tax credit

Trustees complete tax return and pay tax to HMRC

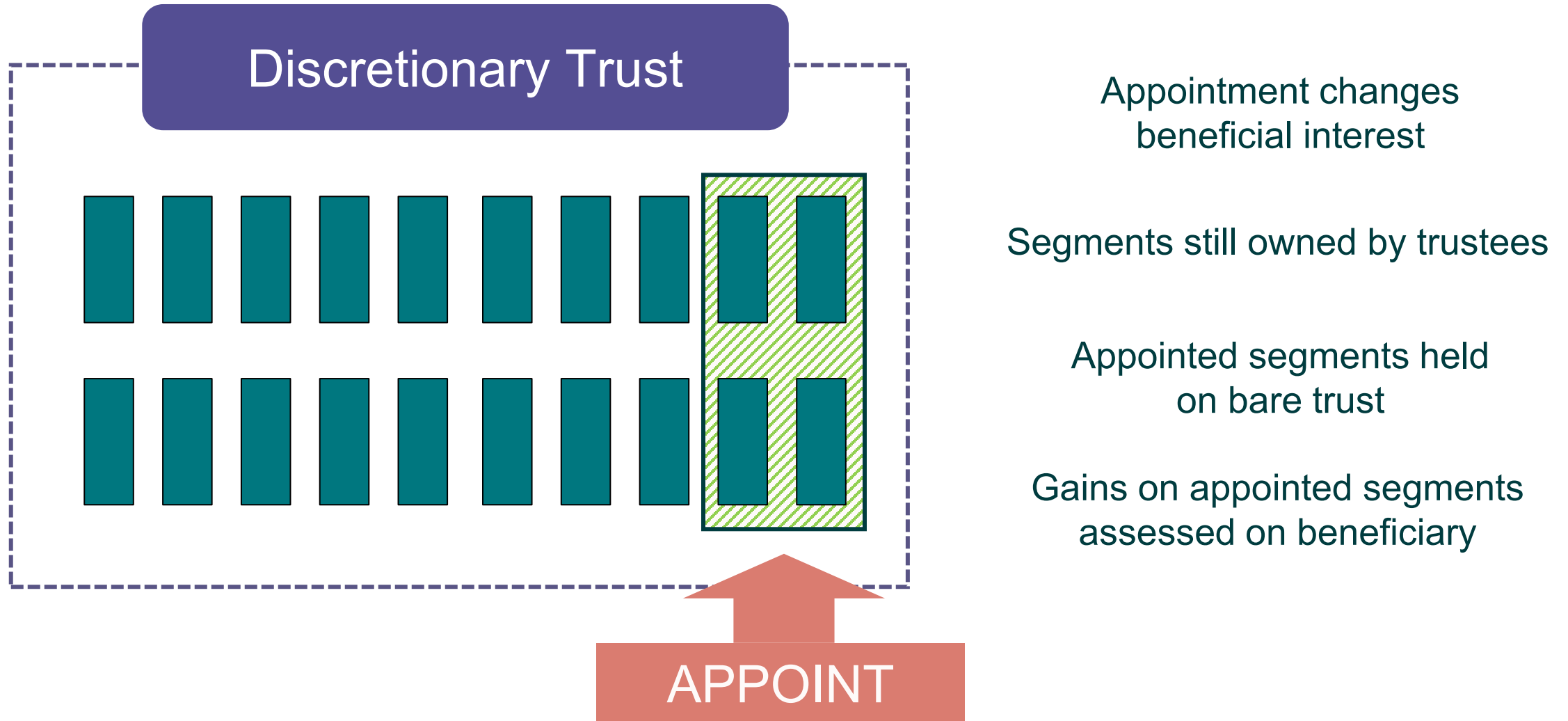
Tax paid does not add to the tax pool

No trustee tax credit when proceeds distributed to a beneficiary

Assignment to a beneficiary



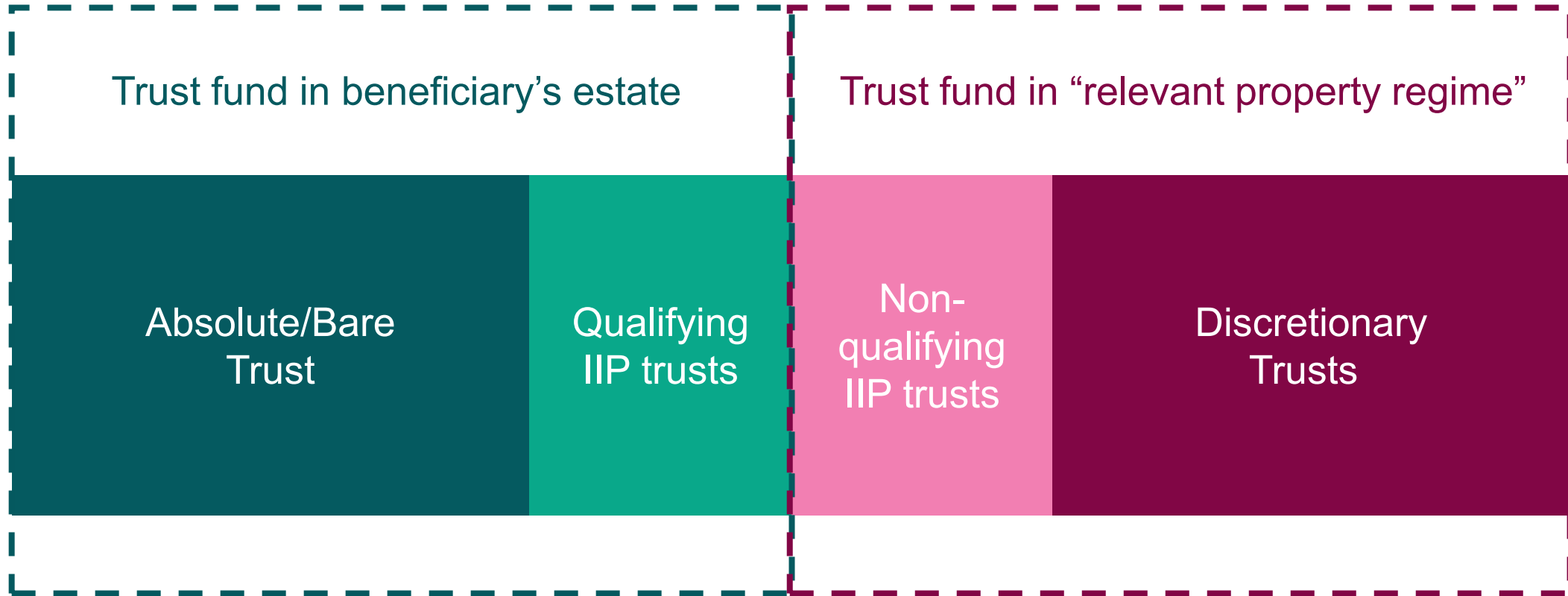
Appointing in favour of a beneficiary





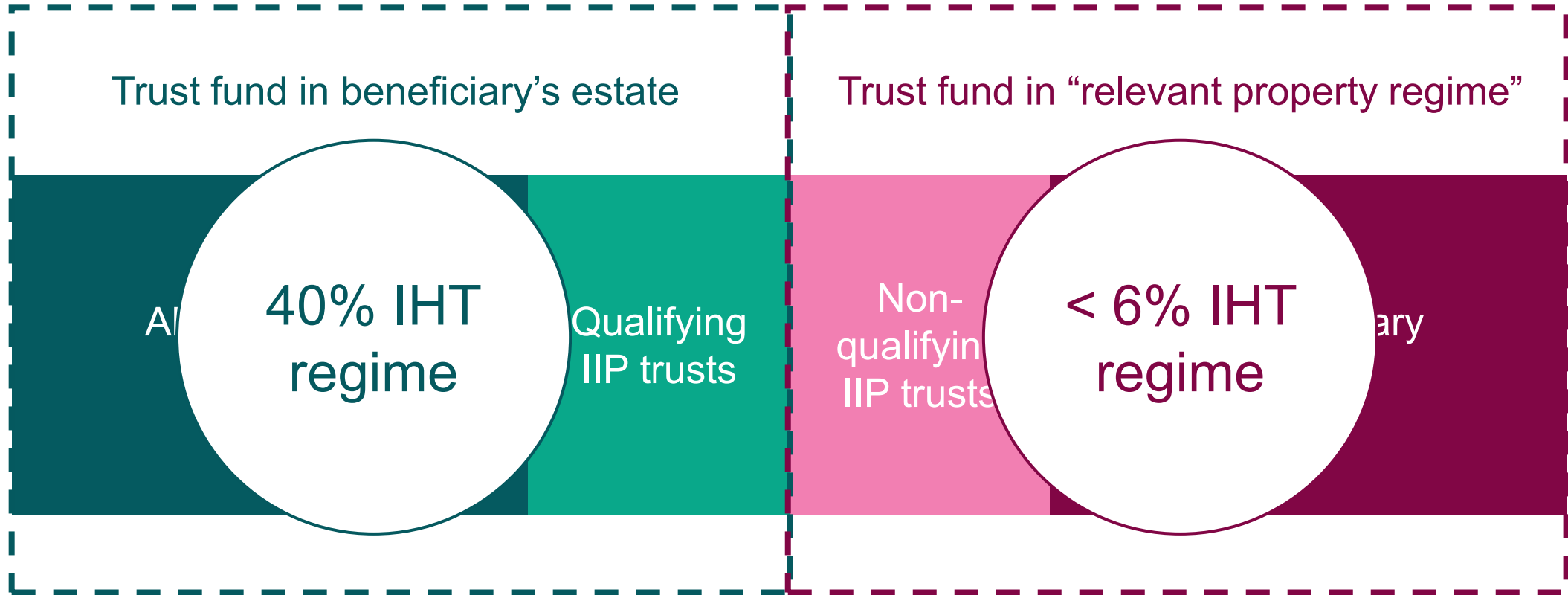
Inheritance Tax

IHT treatment of the trust fund



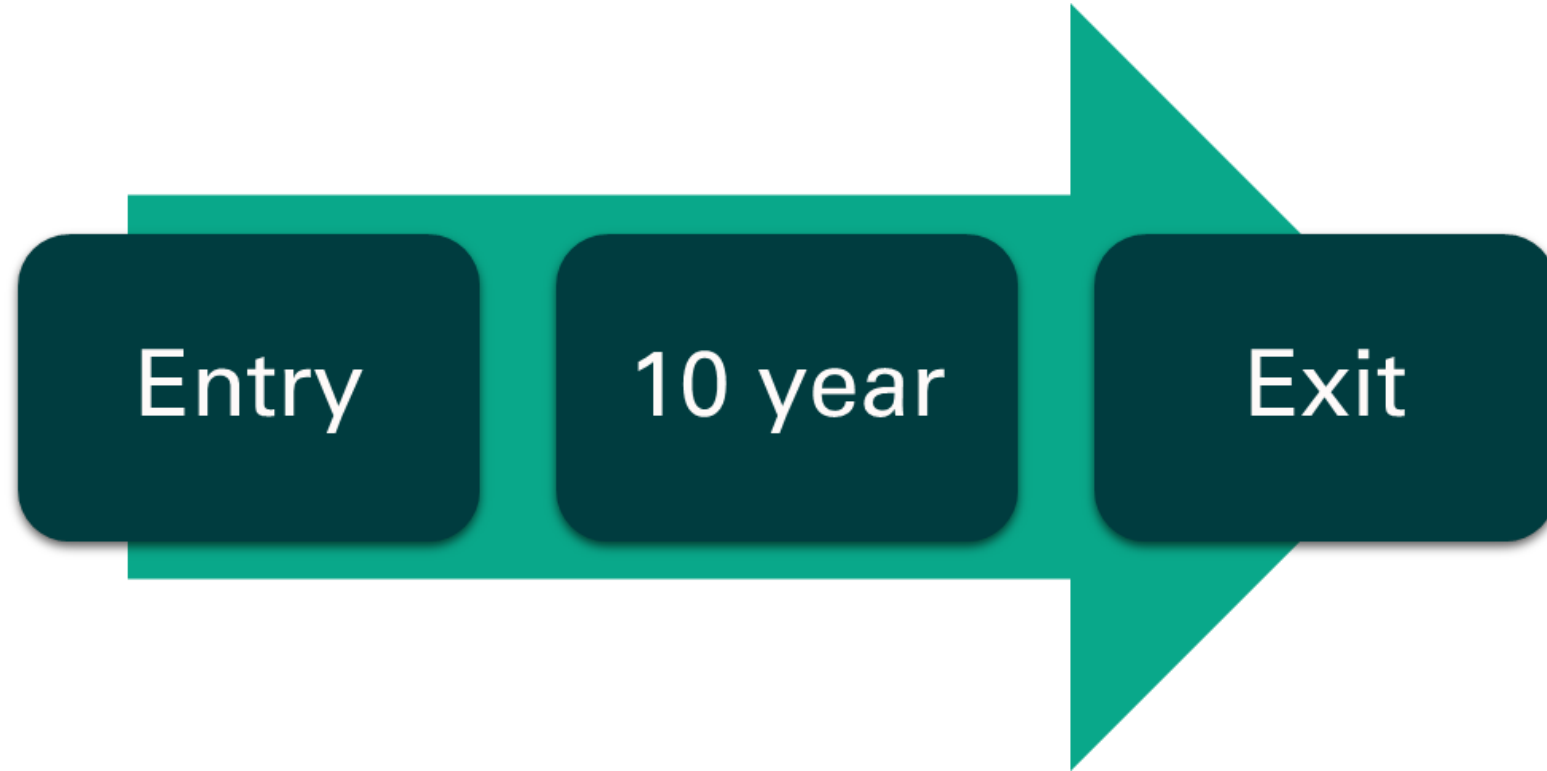
*Some exceptions e.g. trusts for vulnerable beneficiaries, trusts for bereaved minors, 18-25 trusts

IHT treatment of the trust fund

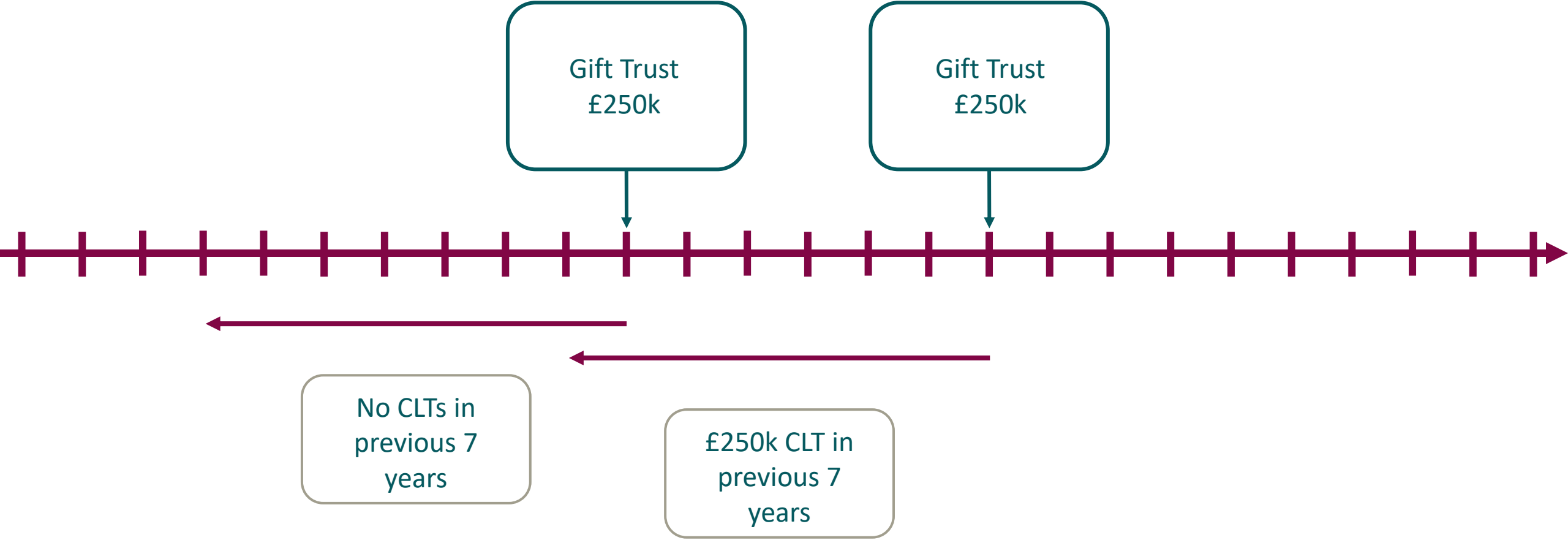


*Some exceptions e.g. trusts for vulnerable beneficiaries, trusts for bereaved minors, 18-25 trusts

Relevant Property Trusts



Entry charge



Excess over the nil rate band is taxed at 20%*

Entry charge

Excess over the nil rate band £175,000

If trust pays the tax....

$$£175,000 \times 20\% = £35,000$$

If the settlor pays the tax....

$$£35,000 \times 1.25 = £43,750$$

Loss to the estate over the NRB
is $£175,000 + £43,750 = £218,750$

Periodic charge

1	Notional lifetime transfer (A)	A
2	Less NRB available (B)	B
3	Difference (C)	$C = A - B$
4	Notional IHT (D)	$D = C \times 20\%$
5	Effective rate (E)	$E = D/A$
6	Actual rate (F)	$F = E \times 3/10$



What do you need?

Notional lifetime transfer (A)

Trust value at midnight the day before the 10 year anniversary*

PLUS

- The value of any “related settlements”
- The value of any “same day additions”

Available NRB for the trust (B)

Nil Rate Band at the date of the 10 year anniversary

LESS

- The value of any “chargeable transfers” in the 7 years before the trust commenced
- The value of any capital payments to beneficiaries in the previous 10 years

* Reduction for qualifying BR/AR assets

What do you need?

Notional lifetime transfer (A)

Trust value at midnight the day before the 10 year anniversary*

PLUS

- The value of any “related settlements”
- The value of any “same day additions”

Available NRB for the trust (B)

Nil Rate Band at the date of the anniversary

Section 67 IHTA 84
Recalculate NRB based on 7 years prior to an addition to the trust

“related transfers” in trust commenced

any capital payments to beneficiaries in the previous 10 years

* Reduction for qualifying BR/AR assets

Notional transfer

GIFT
TRUST

Full value
of the trust

DISCOUNTED
GIFT TRUST

Discounted value
of the trust

LOAN
TRUST

Value of the trust
less the
outstanding loan

Case study



Jennifer set up a discretionary gift trust in July 2016 (almost 10 years ago)

The initial gift was £325,000 and this was invested into an investment bond.

There have been no top-ups to the trust although £50,000 was distributed to a beneficiary approximately 3 years ago to help towards a house purchase.

Other than the trust, the only gift Jennifer has made was in October 2014 when she made an outright gift to her daughter of £100,000.

The trustees have been paying an ongoing advice charge to a financial adviser totalling £16,250

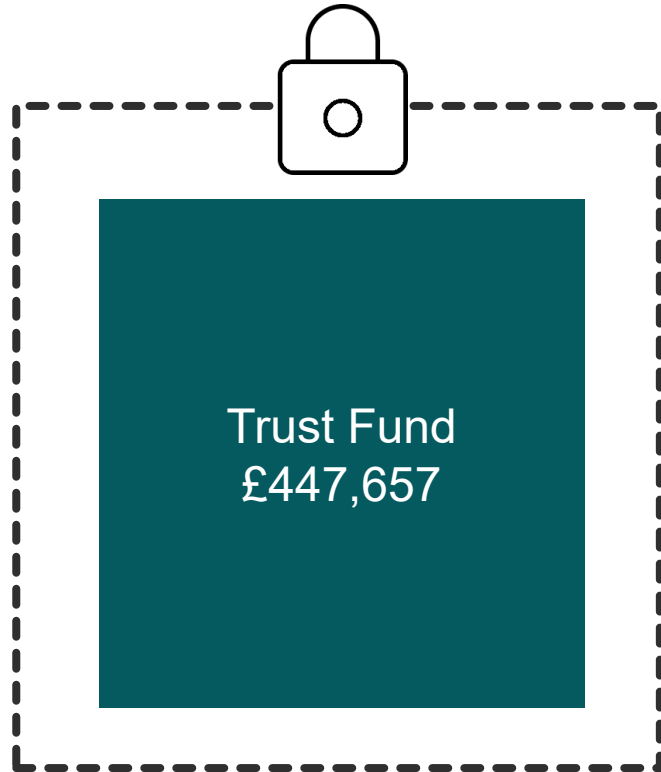
The bond is now worth £447,657

Case study – calculating the rate

	Calculate notional transfer (A)	A	£447,657
	Calculate trust's available nil rate band (B)	B	£325,000 - £50,000 = £275,000
	Difference (C)	$C = A - B$	£447,657 - £275,000 = £172,657
	Notional IHT (D)	$D = C \times 20\%$	£172,657 \times 20% = £34,531.40
	Effective rate (E)	$E = D/A$	£34,531.40/£447,657 = 7.714%
	Actual rate (F)	$F = E \times 3/10$	7.714% \times 3/10 = 2.314%

The actual rate is reduced proportionately for property that hasn't been relevant property for the full 10 years

Paying the tax



IHT due

$$£447,657 \times 2.314\% = £10,358.78$$



Periodic charge paid from the trust fund



IHT due 6 months after the end of the month of the 10 year anniversary



Trustees complete form IHT100d

Exit charge on capital distributions

In the first 10 years



If there was no entry charge there will normally be no exit charge in the first 10 years (failed PET may alter this)

Between 10 year anniversaries



No periodic charge at last 10 year anniversary = no exit charge in following 10 years

If yes then exit charge will be proportion of periodic charge (max 6%)

No exit charge if distribution is within 3 months after a 10 year anniversary

Exit charge



Further down the line the trustees decide to distribute £100,000 of the trust capital to a beneficiary.

This happens 3 years after the 10 year anniversary.

There have been no additions to the trust and the nil rate band remains at £325,000

This means the rate calculated at the 10 year anniversary of 2.314% is still correct

Exit charge due

$$£100,000 \times (2.314\% \times 12/40) = £694$$

Recalculation of the rate is required if there is addition to the trust or NRB changes

IHT charges

Entry charges - IHT100a

Paid 6 months after the month
in which the event occurred



HM Revenue
& Customs

Gifts and other transfers of value

IHT100a

When to use this form

Use this form to tell us about a lifetime gift or other transfer of value on which Inheritance Tax is immediately payable. You'll need to refer to the IHT100a Notes when completing this form.

Periodic charges - IHT100d

Paid 6 months after the month
in which the event occurred



HM Revenue
& Customs

Relevant property trusts principal (10 year) charge

IHT100d

When to use this form

Use this form to tell us about a charge arising on the 10 year anniversary of a trust. You'll need to refer to IHT100d Notes when completing this form.

Inheritance Tax reference number (if known)

Exit charges - IHT100c

Paid 6 months after the month
in which the event occurred



HM Revenue
& Customs

Relevant property trusts proportionate (exit) charge

IHT100c

When to use this form

Use this form to tell us about the charge arising on an exit from a trust. You'll need to refer to the IHT100c Notes when completing this form.

Inheritance Tax reference number (if known)

Learning Objectives

By the end of this session, you will be able to:

Describe how income tax applies to trusts and distributions

Explain CGT treatment and reliefs available to trustees

Communicate the tax advantages and risks of holding investment bonds in trust

Summarise the IHT framework for trusts, including entry, periodic and exit charges



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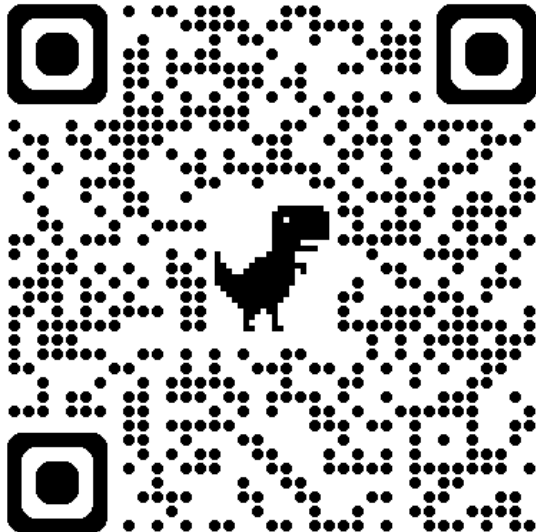
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questions?



Thank
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