HM Revenue & Customs

Vulnerable beneficiary trusts

Who is likely to be affected?

Those setting up, administering or benefiting from a trust where the beneficiary is in receipt of the care component of disability living allowance (DLA).

General description of the measure

This measure change the tax legislation relating to vulnerable beneficiary trusts ensuring that the tax benefits for these trusts are appropriately targeted following the introduction of the Welfare Reform Act (WRA) 2012.

Policy objective

The current tax definition of a vulnerable beneficiary relies in part on whether they are in receipt of DLA. The WRA 2012 begins the replacement of DLA with the Personal Independence Payment (PIP) and this measure ensures that the definition remains the same as far as possible.

Additionally, the qualifying conditions that limit how trustees can apply the trust capital and income are being harmonised to make the rules easier to understand and use.

Background to the measure

HM Revenue & Customs (HMRC) consulted on changes relating to vulnerable beneficiary trusts from 17 August to 8 November 2012.

Detailed proposal

Operative date

The measure will have effect from 8 April 2013. Transitional arrangements will be provided where a trust ceases to be a qualifying vulnerable beneficiary trust by reason only of the revised income and capital conditions.

Current law

A qualifying vulnerable beneficiary includes, amongst others, a person in receipt of DLA by virtue of entitlement to the care component at the higher or middle rate.

Two different conditions limit how the capital in a vulnerable beneficiary trust is applied and one of two different conditions limits the application of income.

For capital, the trust must ensure that either not less than half the property that is applied during the relevant person's lifetime is applied for that person's benefit; or if any of the settled property is applied while the relevant person is living (or, where applicable, is under the relevant age) it is applied for the benefit of the relevant person.

For income, the trust must ensure either that the relevant person is entitled to not less than half of the income arising from the settled property; or that no such income may be applied for the benefit of any other person; or that during the relevant person's lifetime (or relevant period, as applicable) either that that person is entitled to all of the income arising from any of the settled property; or that no such income may be applied for the benefit of any other person.

Proposed revisions

Legislation will be introduced in Finance Bill 2013 to amend, for the purposes of vulnerable beneficiary trusts, the definition of a qualifying person to include those in receipt of PIP by virtue of entitlement to the daily living component at either the standard or enhanced rate.

Legislation will also be introduced in Finance Bill 2013 to harmonise the capital and income rules so that the capital or income is applied for the benefit of the vulnerable beneficiary. However, trustees will be able to apply small amounts of income and capital without having to prove that it is for the benefit of the vulnerable beneficiary. Secondary legislation will confirm this amount to be the lower of £3,000 or 3 per cent of the trust fund each year. There will be no roll-over of unused amounts.

Summary of impacts

<table>
<tr><td rowspan="3">Exchequer impact (£m)</td><td>2012-13</td><td>2013-14</td><td>2014-15</td><td>2015-16</td><td>2016-17</td><td>2017-18</td></tr>
<tr><td>-</td><td>nil</td><td>negligible</td><td>negligible</td><td>negligible</td><td>negligible</td></tr>
<tr><td colspan="6">This measure is expected to have a negligible impact on the Exchequer. Any impact will be set out at Budget 2013.</td></tr>
<tr><td>Economic impact</td><td colspan="6">The measure is not expected to have any significant economic impacts.</td></tr>
<tr><td>Impact on individuals and households</td><td colspan="6">For some new trusts established from April 2013 the change in definition may have a direct impact on the settlor and trustees and an indirect impact on the beneficiary. To the extent that the beneficiary meets the current qualifying conditions but not the replacement conditions there will be a negative impact; inheritance tax may become payable for those affected by the change, and capital gains tax and income tax advantages may be unavailable. The number of these trusts set up each year which will be affected by the change will be very few in number. Transitional arrangements will ensure there is no impact where existing trusts fail to meet the new income and capital conditions.

There is a potential positive impact for those able to benefit from the provision allowing trust funds to be used in a restricted way without affecting the tax status of the trust.</td></tr>
<tr><td>Equalities impacts</td><td colspan="6">The consultation asked what adverse impacts the then proposals would have on the equality groups and how they could be mitigated.

Two protected characteristics affected by this measure were identified: disability and age.

This measure mitigates the impacts by:

• extending the definition of a vulnerable beneficiary to include all trusts with beneficiaries in receipt of the daily living component of PIP at the standard or enhanced rate: the expected number of claimants in 2015-16 is expected to be approximately 1,230,000 compared to a projected 1,310,000 claimants of the DLA care component at the middle or higher rate;

• maintaining the mental incapacity test; and,

• maintaining eligibility for beneficiaries in receipt of attendance allowance.</td></tr>
</table>

	There are no other envisaged impacts affecting groups which share protected characteristics.
Impact on business including civil society organisations	This measure is not expected to impact on businesses or civil society organisations, because it only relates to individuals and trusts.
Operational impact (£m) (HMRC or other)	None of any significance. HMRC will be applying one set of criteria rather than another and the number of claimants to be checked is expected to be broadly similar.
Other impacts	Other impacts have been considered and none have been identified.

Monitoring and evaluation

The measure will be monitored by tracking the number of trusts claiming the vulnerable beneficiary election relief against CGT or income tax.

Further advice

If you have any questions about this change, please contact Usman Nizami on 020 7147 0046 (email: usman.nizami@hmrc.gsi.gov.uk).

1 Trusts with vulnerable beneficiary

Schedule 1 contains provision about trusts which have a vulnerable beneficiary.

SCHEDULE 1

Section 1

TRUSTS WITH VULNERABLE BENEFICIARY

Inheritance Tax Act 1984

1 IHTA 1984 is amended as follows.

2 (1) Section 71A (trusts for bereaved minors) is amended as follows.

(2) For subsection (3)(c)(ii) substitute—

"(ii) if any of the income arising from any of the settled property is applied for the benefit of a beneficiary, it is applied for the benefit of the bereaved minor."

(3) After subsection (3) insert—

"(3A) Trusts are not to be treated as failing to secure that the conditions in subsection (3) are met by reason only of provision falling within subsection (3B).

(3B) Provision falls within this subsection if it enables the trustees, in any period specified in an order made by the Treasury, to apply for the benefit of a person other than the bereaved minor an amount specified in, or determined under, the order.

(3C) An order under subsection (3B) may, in particular—

(a) make provision relating to amounts of capital or income, or both,

(b) specify circumstances in which subsection (3A) is, or is not, to apply in relation to a trust,

(c) make different provision for different cases, and

(d) include provision having effect in relation to any time before the order is made.

(3D) The power to make an order under subsection (3B) is exercisable by statutory instrument, and a statutory instrument containing such an order is subject to annulment in pursuance of a resolution of the House of Commons."

(4) Omit subsection (4).

3 (1) Section 71D (age 18-to-25 trusts) is amended as follows.

(2) For subsection (6)(c)(ii) substitute—

"(ii) if any of the income arising from any of the settled property is applied for the benefit of a beneficiary, it is applied for the benefit of B."

(3) After that subsection insert—

"(6A) Where the income arising from the settled property is held on trusts of the kind described in section 33 of the Trustee Act 1925 (protective trusts), paragraphs (b) and (c) of subsection (6) have effect as if for "living and under the age of 25," there were substituted "under the age of 25 and the income arising from the settled property is held on trust for B,".

(6B) Trusts are not to be treated as failing to secure that the conditions in subsection (6) are met by reason only of provision falling within subsection (6C).

(6C) Provision falls within this subsection if it enables the trustees, in any period specified in an order made by the Treasury, to apply for the benefit of a person other than B an amount specified in, or determined under, the order.

(6D) An order under subsection (6C) may, in particular—

(a) make provision relating to amounts of capital or income, or both,

(b) specify circumstances in which subsection (6B) is, or is not, to apply in relation to a trust,

(c) make different provision for different cases, and

(d) include provision having effect in relation to any time before the order is made.

(6E) The power to make an order under subsection (6C) is exercisable by statutory instrument, and a statutory instrument containing such an order is subject to annulment in pursuance of a resolution of the House of Commons."

(4) Omit subsection (7).

4 (1) Section 89 (trusts for disabled persons) is amended as follows.

(2) For subsection (1)(b) substitute—

"(b) which secure that, if any of the settled property or income arising from it is applied during the disabled person's life for the benefit of a beneficiary, it is applied for the benefit of the disabled person."

(3) After subsection (2) insert—

"(2A) The trusts on which settled property is held are not to be treated as falling outside subsection (1) by reason only of provision falling within subsection (2B).

(2B) Provision falls within this subsection if it enables the trustees, in any period specified in an order made by the Treasury, to apply for the benefit of a person other than the disabled person an amount specified in, or determined under, the order.

(2C) An order under subsection (2B) may, in particular—

(a) make provision relating to amounts of capital or income, or both,

(b) specify circumstances in which subsection (2A) is, or is not, to apply in relation to a trust,

(c) make different provision for different cases, and

(d) include provision having effect in relation to any time before the order is made.

(2D) The power to make an order under subsection (2B) is exercisable by statutory instrument, and a statutory instrument containing such an order is subject to annulment in pursuance of a resolution of the House of Commons."

(4) Omit subsection (3).

(5) In subsection (4), for the words following "into settlement," substitute "was a disabled person".

(6) For subsections (5) and (6) substitute—

"(4A) In this section "disabled person" has the meaning given by Schedule 1A to the Finance Act 2005."

5 (1) Section 89A (self-settlement by person with condition expected to lead to disability) is amended as follows.

(2) In subsection (1)(b), for the words following "A becoming" substitute "a person falling within any paragraph of the definition of "disabled person" in paragraph 1 of Schedule 1A to the Finance Act 2005".

(3) In subsection (2), after "settled property" insert "or income arising from it".

(4) For subsections (5) and (6) substitute—

"(5) For the purposes of subsection (1)(b), assume—
(a) that A will meet any conditions as to residence or presence that are required to establish entitlement to the allowance or payment in question,
(b) that there will be no provision made by regulations under any of the following provisions—
(i) sections 67(1) and (2), 72(8) and 113(2) of SSCBA 1992,
(ii) sections 67(1) and (2), 72(8) and 113(2) of SSCB(NI)A 1992,
(iii) sections 85 and 86 of WRA 2012, and
(iv) sections 84 and 85 of WR(NI)A 2013, and
(c) that A will not be prevented from receiving the allowance or payment in question by any of the following provisions—
(i) section 113(1) of SSCBA 1992,
(ii) section 113(1) of SSCB(NI)A 1992,
(iii) section 87 of WRA 2012, and
(iv) section 86 of WR(NI)A 2013."

(5) Before subsection (7) insert—

"(6A) For the purposes of subsection (2), ignore any provision falling within subsection (6B).

(6B) Provision falls within this subsection if it enables the trustees, in any period specified in an order made by the Treasury, to apply for the benefit of a person other than A an amount specified in, or determined under, the order.

(6C) An order under subsection (6B) may, in particular—
(a) make provision relating to amounts of capital or income, or both,

(b) specify circumstances in which subsection (6A) is, or is not, to apply in relation to a trust,

(c) make different provision for different cases, and

(d) include provision having effect in relation to any time before the order is made.

(6D) The power to make an order under subsection (6B) is exercisable by statutory instrument, and a statutory instrument containing such an order is subject to annulment in pursuance of a resolution of the House of Commons."

(6) For subsection (8) substitute—

"(8) In this section—

"SSCBA 1992" means the Social Security Contributions and Benefits Act 1992,

"SSCB(NI)A 1992" means the Social Security Contributions and Benefits (Northern Ireland) Act 1992,

"WRA 2012" means the Welfare Reform Act 2012, and

"WR(NI)A 2013" means the Welfare Reform (Northern Ireland) Act 2013."

6 (1) Section 89B (meaning of "disabled person's interest") is amended as follows.

(2) For subsection (2) substitute—

"(2) In subsection (1)(c) "disabled person" has the meaning given by Schedule 1A to the Finance Act 2005."

(3) After that subsection insert—

"(2A) Where the income arising from the settled property is held on trusts of the kind described in section 33 of the Trustee Act 1925 (protective trusts), subsection (1)(d)(v) has effect as if for "A's life" there were substituted "the period during which the income from the property is held on trust for A"."

7 (1) The amendments made by paragraphs 2 to 6 have effect in relation to property transferred into settlement on or after 8 April 2013.

(2) But if the settlement was created before 8 April 2013 and no alterations have been made to the trusts on or after that date, nothing in paragraphs 2 to 6 is to be read as preventing property transferred into settlement on or after that date from being property to which section 71A, 71D, 89 or 89A of IHTA 1984 applies.

Taxation of Chargeable Gains Act 1992

8 TCGA 1992 is amended as follows.

9 (1) Section 169D (exceptions to rules on gifts to settlor-interested settlements etc.) is amended as follows.

(2) For subsection (3) substitute—

"(3) The first condition is that, immediately after the making of the disposal—

(a) the settled property is held on trusts which secure that, during the lifetime of a disabled person, if any of the property is applied for the benefit of a beneficiary, it is applied for the benefit of that person, and

(b) the settled property is held on trusts—

(i) which secure that, during his or her lifetime, he or she is entitled to all of the income (if there is any) arising from any of the property, or

(ii) which secure that, during his or her lifetime, if any such income is applied for the benefit of a beneficiary, it is applied for his or her benefit."

(3) After subsection (4) insert—

"(4A) Where the income arising from the settled property is held on trusts of the kind described in section 33 of the Trustee Act 1925 (protective trusts), subsection (3)(b)(i) has effect as if the reference to the lifetime of the disabled person were a reference to the period during which the income is held on trust for the disabled person.

(4B) For the purposes of subsection (3), ignore any provision falling within subsection (4C).

(4C) Provision falls within this subsection if it enables the trustees, in any period specified in an order made by the Treasury, to apply for the benefit of a person other than the disabled person an amount specified in, or determined under, the order.

(4D) An order under subsection (4C) may, in particular—

(a) make provision relating to amounts of capital or income, or both,

(b) specify circumstances in which subsection (4B) is, or is not, to apply in relation to a trust,

(c) make different provision for different cases, and

(d) include provision having effect in relation to any time before the order is made."

(4) For subsections (7) to (9) substitute—

"(7) In this section "disabled person" has the meaning given by Schedule 1A to the Finance Act 2005".

(5) Omit subsection (10).

(6) The amendments made by this paragraph have effect in relation to disposals to the trustees of a settlement on or after 8 April 2013.

(7) But if the settlement was created before 8 April 2013 and no alterations have been made to the trusts on or after that date, nothing in this paragraph is to be read as preventing section 169D(2) of TCGA 1992 from applying in relation to the disposal.

10 (1) Paragraph 1 of Schedule 1 (application of exempt amount and reporting limits in cases involving settled property) is amended as follows.

(2) In sub-paragraph (1)—

(a) for "mentally disabled person or a person in receipt of attendance allowance or of a disability living allowance by virtue of entitlement to the care component at the highest or middle rate" substitute "disabled person", and

(b) for paragraphs (a) and (b) substitute—

"(a) if any of the property is applied for the benefit of a beneficiary, it is applied for the benefit of that person, and

(b) either—

(i) that person is entitled to all of the income (if there is any) arising from any of the property, or

(ii) if any such income is applied for the benefit of a beneficiary, it is applied for that person's benefit,".

(3) After that sub-paragraph insert—

"(1A) The trusts on which settled property is held are not to be treated as falling outside sub-paragraph (1) by reason only of provision falling within sub-paragraph (1B).

(1B) Provision falls within this sub-paragraph if it enables the trustees of the settlement, in any period specified in an order made by the Treasury, to apply for the benefit of a person other than the disabled person an amount specified in, or determined under, the order.

(1C) An order under sub-paragraph (1B) may, in particular—

(a) make provision relating to amounts of capital or income, or both,

(b) specify circumstances in which sub-paragraph (1A) is, or is not, to apply in relation to a trust,

(c) make different provision for different cases, and

(d) include provision having effect in relation to any time before the order is made."

(4) In sub-paragraph (2), for the words from the beginning to "that sub-paragraph" substitute "The reference in sub-paragraph (1)".

(5) In sub-paragraph (6), for the definitions of "mentally disabled person", "attendance allowance" and "disability living allowance" substitute—

""disabled person" has the meaning given by Schedule 1A to the Finance Act 2005; and".

(6) The amendments made by this paragraph have effect in relation to years of assessment beginning on or after 6 April 2013.

(7) But if the settlement was created before 8 April 2013 and no alterations have been made to the trusts on or after that date, nothing in this paragraph is to be read as preventing sections 3(1) to (5C) and 3A of TCGA 1992 from applying in relation to the settlement as provided by paragraph 1(1) of Schedule 1 to that Act.

Finance Act 2005

11 FA 2005 is amended as follows.

12 (1) Section 34 (disabled persons) is amended as follows.

(2) In subsection (2), for paragraph (b) substitute—

"(b) either—

(i) that the disabled person is entitled to all the income (if there is any) arising from any of the property, or

(ii) if any such income is applied for the benefit of a beneficiary, it is applied for the benefit of the disabled person."

(3) After that subsection insert—

"(2A) The trusts on which property is held are not to be treated as failing to secure that the conditions in subsection (2) are met by reason only of provision falling within subsection (2B).

(2B) Provision falls within this subsection if it enables the trustees, in any period specified in an order made by the Treasury, to apply for the benefit of a person other than the disabled person an amount specified in, or determined under, the order.

(2C) An order under subsection (2B) may, in particular—

(a) make provision relating to amounts of capital or income, or both,

(b) specify circumstances in which subsection (2A) is, or is not, to apply in relation to a trust,

(c) make different provision for different cases, and

(d) include provision having effect in relation to any time before the order is made.

(2D) The power to make an order under subsection (2B) is exercisable by statutory instrument, and a statutory instrument containing such an order is subject to annulment in pursuance of a resolution of the House of Commons."

(4) Omit subsection (3).

13 (1) Section 35 (relevant minors) is amended as follows.

(2) For subsection (3)(c)(ii) substitute—

"(ii) if any such income is applied for the benefit of a beneficiary, it is applied for the benefit of the relevant minor."

(3) After that subsection insert—

"(3A) Trusts to which subsection (2) applies are not to be treated as failing to secure that the conditions in subsection (3) are met by reason only of provision falling within subsection (3B).

(3B) Provision falls within this subsection if it enables the trustees, in any period specified in an order made by the Treasury, to apply for the benefit of a person other than the relevant minor an amount specified in, or determined under, the order.

(3C) An order under subsection (3B) may, in particular—

(a) make provision relating to amounts of capital or income, or both,

(b) specify circumstances in which subsection (3A) is, or is not, to apply in relation to a trust,

(c) make different provision for different cases, and

(d) include provision having effect in relation to any time before the order is made.

(3D) The power to make an order under subsection (3B) is exercisable by statutory instrument, and a statutory instrument containing such an order is subject to annulment in pursuance of a resolution of the House of Commons."

(4) Omit subsection (4).

14 For section 38 substitute—

"38 Meaning of "disabled person"

In this Chapter "disabled person" has the meaning given by Schedule 1A."

15 (1) The amendments made by paragraphs 12 to 14 have effect for the tax year 2013-14 and subsequent tax years.

(2) But if the settlement was created before 8 April 2013 and no alterations have been made to the trusts on or after that date, nothing in paragraphs 12 to 14 is to be read as preventing a claim being made for special tax treatment under Chapter 4 of Part 2 of FA 2005.

16 After Schedule 1 insert—

"SCHEDULE 1A — Section 38

MEANING OF "DISABLED PERSON"

"Disabled person"

1 "Disabled person" means—

(a) a person who by reason of mental disorder within the meaning of the Mental Health Act 1983 is incapable of administering his or her property or managing his or her affairs,

(b) a person in receipt of attendance allowance,

(c) a person in receipt of a disability living allowance by virtue of entitlement to the care component at the highest or middle rate,

(d) a person in receipt of personal independence payment by virtue of entitlement to the daily living component,

(e) a person in receipt of constant attendance allowance[, or

(f) a person in receipt of armed forces independence payment].

Attendance allowance

2 A person is to be treated as a disabled person under paragraph 1(b) if he or she satisfies HMRC that if he or she were to meet the prescribed conditions as to residence and presence under section

64(1) of SSCBA 1992 or section 64(1) of SSCB(NI)A 1992 he or she would be entitled to receive attendance allowance.

3 A person who is (or is treated as) a disabled person under paragraph 1(b) is not to cease to be (or to be treated as) such a disabled person by reason only of—

(a) provision made by regulations under section 67(1) or (2) of SSCBA 1992 or section 67(1) or (2) of SSCB(NI)A 1992 (non-satisfaction of conditions for attendance allowance where person is undergoing treatment for renal failure in hospital or is provided with certain accommodation), or

(b) section 113(1) of SSCBA 1992 or section 113(1) of SSCB(NI)A 1992 or provision made by regulations under section 113(2) of SSCBA 1992 or section 113(2) of SSCB(NI)A 1992 (general provisions as to disqualification and suspension).

Disability living allowance

4 A person is to be treated as a disabled person under paragraph 1(c) if he or she satisfies HMRC that if he or she were to meet the prescribed conditions as to residence and presence under section 71(6) of SSCBA 1992 or section 71(6) of SSCB(NI)A 1992 he or she would be entitled to receive a disability living allowance by virtue of entitlement to the care component at the highest or middle rate.

5 A person who is (or is treated as) a disabled person under paragraph 1(c) is not to cease to be (or to be treated as) such a disabled person by reason only of—

(a) provision made by regulations under section 72(8) of SSCBA 1992 or section 72(8) of SSCB(NI)A 1992 (no payment of disability allowance for persons for whom certain accommodation is provided), or

(b) section 113(1) of SSCBA 1992 or section 113(1) of SSCB(NI)A 1992 or provision made by regulations under section 113(2) of SSCBA 1992 or section 113(2) of SSCB(NI)A 1992 (general provisions as to disqualification and suspension).

Personal independence payment

6 A person is to be treated as a disabled person under paragraph 1(d) if he or she satisfies HMRC that if he or she were to meet the prescribed conditions as to residence and presence under section 77(3) of WRA 2012 or section 76(3) of WR(NI)A 2013 he or she would be entitled to receive personal independence payment entitlement by virtue of entitlement to the daily living component.

7 A person who is (or is treated as) a disabled person under paragraph 1(d) is not to cease to be (or to be treated as) such a disabled person by reason only of—

(a) provision made by regulations under section 85 of WRA 2012 or section 84 of WR(NI)A 2013 (exclusion of certain care home residents),

(b) provision made by regulations under section 86 of WRA 2012 or section 85 of WR(NI)A 2013 (exclusion of certain hospital in-patients), or

(c) section 87 of WRA 2012 or section 86 of WR(NI)A 2013 (exclusion of prisoners and detainees).

Interpretation

8 In this Schedule—

["armed forces independence payment" means armed forces independence payment under a scheme established under section 1 of the Armed Forces (Pensions and Compensation) Act 2004,]

"attendance allowance" means an allowance under section section 64 of the SSCBA 1992 or section 64 of the SSCB(NI)A 1992,

"constant attendance allowance" means an allowance under article 8 of the Naval, Military and Air Forces etc. (Disablement and Death) Service Pensions Order 2006 (S.I. 2006/606),

"disability living allowance" means a disability living allowance under section 71 of the SSCBA 1992 or section 71 of the SSCB(NI)A 1992,

"HMRC" means Her Majesty's Revenue and Customs,

"personal independence payment" means a personal independence payment under section 77 of WRA 2012 or section 76 of WR(NI)A 2013,

"SSCBA 1992" means the Social Security Contributions and Benefits Act 1992,

"SSCB(NI)A 1992" means the Social Security Contributions and Benefits (Northern Ireland) Act 1992,

"WRA 2012" means the Welfare Reform Act 2012, and

"WR(NI)A 2013" means the Welfare Reform (Northern Ireland) Act 2013."

EXPLANATORY NOTE

VULNERABLE BENEFICIARY TRUSTS

SUMMARY

1. This Schedule ensures, for the purposes of defining a vulnerable beneficiary trust, that a disabled person includes individuals in receipt of Personal Independence Payment by virtue of entitlement to the daily living component; and harmonises rules that limit how the capital and income of these trusts may be applied.

DETAILS OF THE SCHEDULE

2. Paragraph 1 provides for the amendment of the Inheritance Act (IHTA) 1984.

3. Paragraph 2 amends section 71A of IHTA 1984.

4. Subparagraph (2) amends section 71A(3)(c)(ii) to provide that any of the trust income that is applied is applied for the benefit of the bereaved minor.

5. Subparagraph (3) adds new sections 71A(3A) to (3D) to IHTA 1984, which enable HM Treasury to provide by Order the circumstances when amounts applied for the benefit of persons other than the bereaved minor do not disqualify a trust from being a qualifying trust for the benefit of a bereaved minor.

6. Subparagraph (4) omits provisions that disregard the existence of a statutory power of advancement.

7. Paragraph 3 amends section 71D of IHTA 1984.

8. Subparagraph (2) amends subsection 71D(6)(c)(ii) to provide that any of the trust income that is applied is applied for the benefit of the person aged between 18 and 25.

9. Subparagraph (3) adds new subsections 71D(6A) to (6E) to IHTA 1984, which make provision in relation to protective trusts; and enable HM Treasury to provide by order the circumstances when amounts applied for the benefit of persons other than the person aged between 18 and 25 do not disqualify a trust from being a qualifying trust for the benefit of a person aged between 18 and 25.

10. Subparagraph (4) omits provisions that disregard the existence of a statutory power of advancement.

11. Paragraph 4 amends section 89 of IHTA 1984.

12. Subparagraph (2) amends section 89(1)(b) to provide that any of the trust capital or income that is applied is applied for the benefit of the disabled person.

13. Subparagraph (3) adds new sections 89(2A) to (2D), which enable the Treasury to provide by order the circumstances when amounts applied for the benefit of persons other than the disabled person do not disqualify a trust from being a qualifying trust for the benefit of a disabled person.

14. Subparagraph (4) omits provisions that disregard the existence of a statutory power of advancement.

15. Subparagraphs (5) and (6) amend the definition of a disabled person and define it as having the meaning given by new Schedule 1A to the Finance Act 2005 (introduced at paragraph 16 to this Schedule).

16. Paragraph 5 amends section 89A of IHTA 1984.

17. Subparagraph (2) applies the new definition of disabled person at new Schedule 1A to the Finance Act 2005.

18. Subparagraph (3) amends section 89A(2) to provide that any of the trust income that is applied is applied for the benefit of the disabled person.

19. Subparagraph (4) amends sections 89A(5) and (6) to include the assumption that the beneficiary is entitled to receive personal independence payment when resident outside the UK or in a care home, hospital or prison.

20. Subparagraph (5) adds new sections 89A(6A) to (6D), which enable the Treasury to provide by order the circumstances when amounts applied for the benefit of persons other than the person with a condition expected to lead to a disability do not disqualify a trust from being a qualifying trust for the benefit of a person with a condition expected to lead to a disability.

21. Subparagraph (6) amends subsection (8) to include definitions for "WRA 2012" (the Welfare Reform Act 2012) and "WR(NI)A 2013" (the Welfare Reform (Northern Ireland) Act 2013).

22. Paragraph 6 amends section 89B of IHTA 1984.

23. Subparagraph (2) applies the new definition of disabled person at new Schedule 1A to the Finance Act 2005.

24. Subparagraph (3) makes provision in relation to protective trusts.

25. Paragraph 7 provides for the commencement of paragraphs 2 to 6.

26. Subparagraph (2) grandfathers for existing trusts the current limitations on how income and capital can be applied.

27. Paragraph 8 provides for the amendment of the Taxation of Chargeable Gains Act (TCGA) 1992.

28. Paragraph 9 amends section 169D of TCGA 1992.

29. Subsection 2 amends subsection 169D(3) to provide that any of the trust capital that is applied is applied for the benefit of the disabled person; and that any of the trust income is similarly applied or that the disabled person is entitled to all of the income.

30. Subparagraph (3) adds new sections 169D(4A) to (4D), which make provision in relation to protective trusts; and enable the Treasury to provide by order the circumstances when amounts applied for the benefit of persons other than the disabled person do not disqualify a trust from being a qualifying trust for the benefit of a disabled person.

31. Subparagraph (4) applies the new definition of disabled person at new Schedule 1A to the Finance Act 2005.

32. Subparagraph (5) omits provisions that disregard the existence of a statutory power of advancement.

33. Subparagraph (6) provides for the commencement of paragraph 9.

34. Subparagraph (7) grandfathers for existing trusts the current limitations on how income and capital can be applied.

35. Paragraph 10 amends paragraph 1 of Schedule 1 to TCGA 1992.

36. Subparagraph (2) provides that any of the trust capital that is applied is applied for the benefit of the disabled person; and that any of the trust income is similarly applied or that the disabled person is entitled to all of the income.

37. Subparagraph (3) adds new paragraphs 1(1A) to (1C), which enable the Treasury to provide by order the circumstances when amounts applied for the benefit of persons other than the disabled person do not disqualify a trust from being a qualifying trust for the benefit of a disabled person.

38. Subparagraph (4) omits provisions that disregard the existence of a statutory power of advancement.

39. Subparagraph (5) applies the new definition of disabled person at new Schedule 1A to the Finance Act 2005.

40. Subparagraph (6) provides for the commencement of paragraph 10.

41. Subparagraph (7) grandfathers for existing trusts the current limitations on how income and capital can be applied.

42. Paragraph 11 provides for the amendment of the Finance Act (FA) 2005.

43. Paragraph 12 amends section 34 of FA 2005.

44. Subparagraph (2) provides that any of the trust income that is applied is applied for the benefit of the disabled person or that the disabled person is entitled to all of the income.

45. Subparagraph (3) adds new sections 34(2A) to (2D), which enable the Treasury to provide by order the circumstances when amounts applied for the benefit of persons other than the disabled person do not disqualify a trust from being a qualifying trust for the benefit of a disabled person.

46. Subparagraph (4) omits provisions that disregard the existence of a statutory power of advancement.

47. Paragraph 13 amends section 35 of FA 2005.

48. Subparagraph (2) amends section 35(3)(c)(ii) to provide that any of the trust income that is applied is applied for the benefit of the bereaved minor.

49. Subparagraph (3) adds new sections 35(3A) to (3D), which enable the Treasury to provide by order the circumstances when amounts applied for the benefit of persons other than the bereaved minor do not disqualify a trust from being a qualifying trust for the benefit of a bereaved minor.

50. Subparagraph (4) omits provisions that disregard the existence of a statutory power of advancement.

51. Paragraph 14 applies the new definition of disabled person at new Schedule 1A to the Finance Act 2005.

52. Paragraph 15 provides for the commencement of paragraphs 12 to 14.

53. Subparagraph (2) grandfathers for existing trusts the current limitations on how income and capital can be applied.

54. Paragraph 16 inserts new Schedule 1A to FA2005.

55. Paragraph 1 of new Schedule 1A provides a list of the various meanings of “disabled person”.

56. Paragraphs 2 to 7 treat a person as a disabled person if he or she would be entitled to receive a relevant payment or allowance were it

not for them being resident outside the UK or in a care home, hospital or prison.

57. Paragraph 8 defines various terms used in the Schedule.

BACKGROUND

58. Special tax rules exist for trusts for the benefit of a vulnerable beneficiary. In essence, the rules:

- reduce, following an election and annual claim, the trustees' tax liability on income and chargeable gains to an amount that, broadly, would be chargeable on the beneficiary if the gains had accrued and/or the income had arisen directly to that person;
- extend the annual exempt amount of chargeable gains that applies to trusts to match that available to individuals;
- ignore the normal charges to inheritance tax for trusts; instead, the property is treated as part of the beneficiary's estate on their death.

59. The Welfare Reform Act 2012 introduces the Personal Independence Payment, which will replace Disability Living Allowance (DLA) for working age people (16 to 64). The existing definition of a vulnerable beneficiary for tax purposes relies in part on whether the person is in receipt of DLA, so a new definition is required.

60. Current limitations on how the income and capital of a qualifying vulnerable beneficiary trust can be applied differ between taxes. In some cases, up to 50% of the capital can be applied for the benefit of a person other than the vulnerable person without the loss of the favourable tax position.

61. HMRC consulted on the changes brought into effect by this Schedule between 17th August and 8th November.

62. If you have any questions about this change, or comments on the legislation, please contact Alan McGuinness on 020 7147 2766 (email: alan.mcguinness@hmrc.gsi.gov.uk).