HM Revenue & Customs

Trusts with vulnerable beneficiary

Who is likely to be affected?

Trusts where the beneficiary has a severe physical or mental disability or is a bereaved minor.

General description of the measure

The measure will extend the capital gains tax (CGT) 'uplift' provisions that apply on the death of a vulnerable beneficiary and extend the range of vulnerable beneficiary trusts that qualify for special income tax, CGT and inheritance tax (IHT) treatment.

Policy objective

This measure makes the tax system fairer by enabling more vulnerable people to have property safeguarded for their benefit within a trust whilst ensuring that it is not taxed any more adversely than if it were owned the individuals themselves.

Background to the measure

Special tax treatment applies to trusts established for the benefit of a person who lacks mental capacity, is in receipt of a qualifying welfare benefit or is a bereaved minor. Prior to 2013 this included a person in receipt of the highest or middle rate care component of disability living allowance (DLA). However, this allowance is being phased out for those of working age and replaced by personal independence payment (PIP).

In 2012, HM Revenue & Customs (HMRC) consulted on how best to continue the special tax treatment in light of the welfare reform changes, which led, in Finance Act 2013, to the inclusion of those in receipt of the daily living component of PIP.

Respondents to the consultation argued for a wider scope and a simplification of the tax rules more generally along with removal of anomalies that may distort decisions on the most appropriate trust structure to use. This measure responds to the issues raised by the consultation.

Detailed proposal

Operative date

The CGT 'uplift' provisions will be extended with effect from 5 December 2013 and the range of qualifying vulnerable beneficiary trusts will be extended from 6 April 2014.

Current law

Section 62(1) of the Taxation of Chargeable Gains Act 1992 (TCGA) provides that when someone dies there is no deemed disposal on death and, therefore, death is not an occasion of charge to CGT. The assets in a person's estate are treated as being acquired by personal representatives at their market value at the date of death. In this way, gains accrued up to the date of death are not subject to double taxation under IHT and CGT.

Sections 72 and 73 contain similar rules for property held in a qualifying vulnerable beneficiary trust but require, broadly, that the beneficiary had an entitlement to the income of the trust.

Schedule 1A to the Finance Act (FA) 2005, inserted by FA 2013, defines a 'disabled person'.

Proposed revisions

Legislation will be introduced in Finance Bill 2014 to:

- extend sections 72 and 73 of the TCGA to include qualifying trusts for disabled beneficiaries where the beneficiary has no entitlement to the income of the trust; and
- extend Schedule 1A to FA 2005 to include a person in receipt of the mobility component of DLA at the higher rate or the mobility component of PIP at either the standard or enhanced rate.

Summary of impacts

Exchequer impact (£m)	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
	nil	negligible	negligible	negligible	negligible	negligible
	The measure is expected to have a negligible impact on the Exchequer.					
Economic impact	The measure is not expected to have any significant economic impacts.					
Impact on individuals and households	The measure is intended to make the tax regimes for trusts established for the benefit of a vulnerable person more tax neutral; that is that tax neither penalises nor encourages their use over the same property being held by the person outright. The changes will have direct impacts on settlors and trustees and indirect impacts on the beneficiaries.					
Equalities impacts	The measure will impact most where the beneficiary is unable to manage their affairs by reason of a mental disability, or is in receipt of a welfare benefit.					
Impact on business including civil society organisations	The measure is expected to have no impact on businesses and civil society organisations.					
Operational impact (£m) (HMRC or other)	It is not anticipated that implementing these changes will incur any significant additional costs for HM Revenue & Customs.					
Other impacts	Other impacts have been considered and none have been identified.					

Monitoring and evaluation

The measure will be monitored after implementation through information collected on tax returns and through communication with groups representing those affected.

Further advice

If you have any questions about this change, please contact Alan McGuinness on 03000 585256 (email: alan.mcguinness@hmrc.gsi.gov.uk).

1 Termination of life interest and death of life tenant: disabled persons

(1) TCGA 1992 is amended as follows.

(2) In section 72 (termination of life interest on death of person entitled)—
  (a) in subsection (1B)(a)(iii), for "within section 89B(1)(c) or (d)" substitute ", within the meaning given by section 89B", and
  (b) at the end insert—

"(6) An interest which is a disabled person's interest by virtue of section 89B(1)(a) or (b) of the Inheritance Tax Act 1984 is to be treated as an interest in possession for the purposes of this section."

(3) In section 73(3) (death of life tenant: exclusion of chargeable gain), for "to (5)" substitute "to (6)".

(4) The amendments made by this section have effect in relation to deaths occurring on or after 5 December 2013.

2 Trusts with vulnerable beneficiary: meaning of "disabled person"

(1) Schedule 1A to FA 2005 (meaning of "disabled person") is amended as follows.

(2) In paragraph 1—
  (a) for paragraph (c) substitute—
    "(c) a person in receipt of a disability living allowance by virtue of entitlement to—
      (i) the care component at the highest or middle rate, or
      (ii) the mobility component at the higher rate,", and
  (b) in paragraph (d), omit "by virtue of entitlement to the daily living component".

(3) In paragraph 3, after "rate" insert ", or to the mobility component at the higher rate,".

(4) In paragraph 4, omit "by virtue of entitlement to the daily living component".

(5) The amendments made by this section have effect—
  (a) for the purposes of sections 89, 89A and 89B of IHTA 1984, in relation to property transferred into settlement on or after 6 April 2014, and
  (b) for all other purposes, for the tax year 2014-15 and subsequent tax years.

EXPLANATORY NOTE

TERMINATION OF LIFE INTEREST AND DEATH OF LIFE TENANT: DISABLED PERSONS

SUMMARY

1. Clause [1] extends, from 5 December 2013, the capital gains tax (CGT) uplift provisions that apply to property held on trust for the benefit of a vulnerable beneficiary to include trusts for the benefit of a disabled person where the beneficiary has no absolute entitlement to the income of the trust.

DETAILS OF THE CLAUSE

2. Subsection (2)(a) extends section 72(1B)(a)(iii) of the Taxation of Chargeable Gains Act 1992 to include all disabled person's interests as defined by section 89B of the Inheritance Tax Act 1984 within those interests to which section 72(1) applies, in particular sections 89B(1)(a) and (b) that provide for interests where the person with the interest is treated as beneficially entitled to an interest in possession in the trust property. Section 73(2A)(a) applies this extension automatically to section 73 in the same way that it applies for section 72. The effect of this change is to apply the same capital gains tax treatment to property within a vulnerable beneficiary trust for a person with a disability where the beneficiary has no interest in possession in the trust property as is available where the beneficiary does have an interest in possession.

3. Subsection (2)(b) inserts new subsection 72(6), which deems that an interest in possession for the purpose of section 72 includes an interest within the meaning of section 89B(1)(a) or (b) of the Inheritance Tax Act 1984.

4. Subsection (3) amends section 73(3) in order to apply new subsection 72(6) for the purpose of section 73 in the same way that it applies for section 72.

5. Subsection (4) provides for commencement.

BACKGROUND NOTE

6. Section 62 of the Taxation of Chargeable Gains Act (TCGA) 1992 contains provisions concerning CGT on death.

7. They provide that when someone dies there is no deemed disposal on death and, therefore, death is not an occasion of charge to CGT. The assets in a person's free estate are treated as being acquired by personal representatives at their market value at the date of

death. In this way, gains accrued up to the date of death are not subject to double taxation under inheritance tax (IHT) and CGT.

8. Property held on trust is normally subject to IHT at 6 per cent every ten years. As an exception, property held on qualifying trusts for a vulnerable person are taxed to IHT at the normal 40 per cent rate on the death of the vulnerable person as if the property was held by that person rather than the trustees. The exception applies where the person has an interest in possession in the trust property (broadly, an absolute entitlement to the income of the trust). It also applies where the person does not have an interest in possession by deeming that an interest in possession was held.

9. Sections 72 and 73 of the TCGA 1992 contain provisions similar to those in section 62 for property held in a qualifying vulnerable beneficiary trust. However, this is currently restricted to only those trusts where the beneficiary has an actual interest in possession in the trust property. This requirement is distorting decisions on the most appropriate trust structure. The measure extends sections 72 and 73 to include trusts where the vulnerable beneficiary is treated as having an interest in possession.

10. If you have any questions about this change, or comments on the legislation, please contact Alan McGuinness on 03000 585256 (email: alan.mcguinness@hmrc.gsi.gov.uk).

EXPLANATORY NOTE

TRUSTS WITH VULNERABLE BENEFICIARY: MEANING OF "DISABLED PERSON"

SUMMARY

1. Clause [2] extends from 6 April 2014 the definition of "disabled person" used in relation to trusts with a vulnerable beneficiary to include those in receipt of the mobility component of disability living allowance at the higher rate, or the mobility component of personal independence payment at either the standard or enhanced rate.

DETAILS OF THE CLAUSE

2. Subsection (2)(a) extends that part of the definition of "disabled person" at Schedule 1A to Finance Act 2005 that applies to recipients of disability living allowance to include those in receipt of the mobility component at the higher rate (as well as those in receipt of the care component at the highest or middle rate); and subsection (2)(b) extends that part that applies to recipients of personal independence payment to include those in receipt of the mobility component (as well as those in receipt of the daily living component).

3. Subsections (3) and (4) make consequential amendments to paragraphs 3 and 4 of Schedule 1A to ensure that a person is treated as a disabled person if he or she would be entitled to receive the relevant disability living allowance or personal independence payment were it not for them being resident outside the UK or in a care home, hospital or prison.

4. Subsection (5) provides for commencement.

BACKGROUND NOTE

5. Special tax rules exist for trusts with a disabled beneficiary. The rules:

- reduce 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; and
- ignore the normal charges to inheritance tax for trusts; instead, the property is treated as part of the beneficiary's estate on their death.

6. Finance Act 2013 introduced a common definition of "disabled person" at Schedule 1A to Finance Act 2005.

7. Disability living allowance consists of a care component and a mobility component. The care component is payable at three rates – highest, middle and lowest. The mobility component is payable at two rates – higher and lower. Following the introduction of the Welfare Reform Act 2012, the allowance is being phased out for those of working age.

8. Personal independence payment consists of a daily living component and a mobility component. Both the daily living component and the mobility component are payable at two rates – standard and enhanced.

9. If you have any questions about this change, or comments on the legislation, please contact Alan McGuinness on 03000 585256 (email: alan.mcguinness@hmrc.gsi.gov.uk).