Finance Act 2005

2005 CHAPTER 7

PART 2

INCOME TAX, CORPORATION TAX AND CAPITAL GAINS TAX

CHAPTER 4

TRUSTS WITH VULNERABLE BENEFICIARY

Introductory

23 Introduction

(1) This Chapter contains tax provision in connection with—

- (a) income arising to trustees from property held on qualifying trusts for the benefit of a vulnerable person, and
- (b) chargeable gains accruing to trustees from the disposal of such property.

(2) Section 24 contains provision as to the making of claims for special tax treatment under this Chapter.

(3) Sections 25 to 29 contain provision relating to income tax.

(4) Sections 30 to 33 contain provision relating to capital gains tax.

(5) Sections 34 to 36 apply for the purpose of determining whether trusts on which property is held for the benefit of a vulnerable person are qualifying trusts.

(6) In this Chapter "vulnerable person election" means an election under section 37.

(7) In this Chapter "vulnerable person" means—

- (a) a disabled person (see section 38), or
- (b) a relevant minor (see section 39).

24 Entitlement to make claim for special tax treatment

A claim for special tax treatment under this Chapter for a tax year may be made by trustees if—

(a) in the tax year they hold property on qualifying trusts for the benefit of a vulnerable person, and

(b) a vulnerable person election has effect for all or part of the tax year in relation to those trusts and that person.

Income tax

25 Qualifying trusts income: special income tax treatment

(1) This section has effect in relation to a tax year if—

(a) in the tax year income arises (or is treated as arising) to trustees from property held on qualifying trusts for the benefit of a vulnerable person ("qualifying trusts income"), and

(b) a claim for special tax treatment under this Chapter for the tax year is made by the trustees.

(2) Special income tax treatment applies for the tax year in accordance with sections 26 to 29.

(3) But this section does not have effect in relation to the tax year if the property from which the qualifying trusts income arises (or is treated as arising) is property in which a person who is a settlor (within the meaning given by section 660G(1) and (2) of ICTA) is regarded as having an interest for the purposes of section 660A of that Act (income arising under settlement where settlor retains an interest).

26 Amount of relief

The trustees' liability to income tax for the tax year is to be reduced by an amount equal to—

$$TQTI - VQTI$$

where—

TQTI is an amount determined in accordance with section 27 (income tax liability of trustees in respect of qualifying trusts income), and

VQTI is an amount determined in accordance with section 28 (extra tax to which vulnerable person would be liable if qualifying trusts income were income of his).

27 Trustees' liability: TQTI

(1) For the purposes of section 26, TQTI is the amount of income tax to which the trustees would (apart from this Chapter) be liable for the tax year in respect of the qualifying trusts income arising (or treated as arising) to them in that year (or to which they would be so liable if their liability were computed in accordance with subsection (2) in a case to which that subsection applies).

(2) In a case where—

(a) income arising (or treated as arising) to the trustees in the tax year ("total income") includes income ("other income") which is not qualifying trusts income, and

(b) the trustees have any expenses in the tax year ("the management expenses") which are properly chargeable to total income or would be so chargeable but for any express provisions of the trusts,

there shall be disregarded, in computing the income tax liability of the trustees for the tax year in respect of the qualifying trusts income arising (or treated as arising) to them in that year, such part of the management expenses as bears the same proportion to all those expenses as other income bears to total income.

(3) This section is subject to section 29 (vulnerable person election having effect for only part of tax year).

28 Vulnerable person's liability: VQTI

(1) For the purposes of section 26, VQTI is an amount equal to—

$$TLV1 \quad TLV2$$

where—

TLV2 is an amount determined in accordance with subsection (2) (and subsection (4) where it applies) (total tax liability of vulnerable person), and

TLV1 is an amount determined in accordance with subsection (3) (and subsection (4) where it applies) (what total tax liability of vulnerable person would be if his income included qualifying trusts income).

(2) TLV2 is the total amount of income tax and capital gains tax to which the vulnerable person would be liable for the tax year if his income tax liability were computed in accordance with subsections (5) and (6).

(3) TLV1 is what TLV2 would be if the qualifying trusts income arising (or treated as arising) to the trustees in the tax year in respect of which the trustees are liable to income tax were income of the vulnerable person for the tax year.

(4) Where the vulnerable person is non-UK resident during the tax year—

(a) his income tax liability for the purposes of determining TLV1 and TLV2 is to be computed in accordance with the Income Tax Acts on the assumption that he is resident and domiciled in the United Kingdom throughout the tax year, and

(b) his capital gains tax liability for the purposes of determining TLV1 and TLV2 is to be computed on the assumption that his taxable amount for the purposes of section 3 of TCGA 1992 is equal to his deemed CGT taxable amount.

(5) For the purposes of this section, in a case where income which has arisen to the trustees (whenever it arose) is distributed to the vulnerable person in the tax year, that income is to be disregarded in computing income tax to which he would be liable for the tax year for the purposes of determining TLV1 and TLV2.

(6) For the purposes of this section, in computing income tax to which the vulnerable person would be liable for the tax year for the purposes of determining TLV1 and TLV2, there is to be disregarded any relief which is given by way of a reduction in the amount of income tax to which the vulnerable person would be liable apart from that relief.

(7) For the purposes of this section—

(a) whether or not a vulnerable person is non-UK resident is to be determined in accordance with section 41(2), and

(b) a non-UK resident vulnerable person's deemed CGT taxable amount is to be determined in accordance with paragraph 3 of Schedule 1.

(8) This section is subject to section 29 (vulnerable person election having effect for only part of tax year).

29 Part years

(1) Where the vulnerable person election has effect for only part of the tax year ("the elected part of the tax year") sections 26, 27 and 28 apply with the modifications in subsection (2).

(2) Those modifications are—

(a) that references to the qualifying trusts income arising (or treated as arising) to the trustees in the tax year are to be treated as references to the qualifying trusts income arising (or treated as arising) to them in the elected part of the tax year, and

(b) that the references in section 27(2) to income arising (or treated as arising) to the trustees in the tax year and expenses of the trustees in the tax year are to be treated as (respectively) references to income arising (or treated as arising) to the trustees in the elected part of the tax year and expenses of the trustees in that part of the tax year.

Capital gains tax

30 Qualifying trusts gains: special capital gains tax treatment

(1) This section has effect in relation to a tax year if—

(a) in the tax year chargeable gains accrue to the trustees of a settlement from the disposal of settled property which is held on qualifying trusts for the benefit of a vulnerable person ("the qualifying trusts gains"),

(b) the trustees would (apart from this Chapter) be chargeable to capital gains tax in respect of those gains,

(c) the trustees are either resident in the United Kingdom during any part of the tax year or ordinarily resident in the United Kingdom during the tax year, and

(d) a claim for special tax treatment under this Chapter for the tax year is made by the trustees.

(2) Special capital gains tax treatment applies for the tax year in accordance with—

(a) section 31 (vulnerable person UK resident during the tax year), or

(b) section 32 (vulnerable person non-UK resident during the tax year).

(3) But this section does not have effect in relation to the tax year if the vulnerable person dies during that year.

(4) The reference in subsection (1)(a) to chargeable gains accruing to the trustees from the disposal of settled property includes a reference to chargeable gains treated as

accruing to them under section 13 of TCGA 1992 (attribution of gains to members of non-resident companies).

(5) For the purposes of this section and sections 31 and 32 whether a vulnerable person is UK resident or non-UK resident during a tax year is to be determined in accordance with section 41(2).

31 UK resident vulnerable persons: section 77 treatment

(1) Special capital gains tax treatment applies for the tax year in accordance with this section if the vulnerable person is UK resident during the tax year.

(2) Section 77(1) (and section 78 and section 79, apart from subsection (6)) of TCGA 1992 are to be treated as applying in relation to the qualifying trusts gains as if—

(a) the vulnerable person were a settlor in relation to the settlement,

(b) the settled property disposed of, and any other settled property disposed of at any time when it was relevant settled property, originated from him, and

(c) he had an interest in the settlement during the tax year.

(3) For the purposes of subsection (2)(b), property is "relevant settled property" at any time when—

(a) it is property held on the qualifying trusts for the benefit of the vulnerable person, and

(b) the trustees would (apart from this Chapter) be chargeable to capital gains tax in respect of any chargeable gains accruing to them on a disposal of it.

32 Non-UK resident vulnerable persons: amount of relief

(1) Special capital gains tax treatment applies for the tax year in accordance with this section if the vulnerable person is non-UK resident during the tax year.

(2) The trustees' liability to capital gains tax for the tax year is to be reduced by an amount equal to—

$$TQTG \quad VQTG$$

where—

TQTG is the amount of capital gains tax to which the trustees would (apart from this Chapter) be liable for the tax year in respect of the qualifying trusts gains, and

VQTG is an amount determined in accordance with section 33 (extra tax to which vulnerable person would be liable for the tax year if chargeable gains were treated as accruing to him under section 77(1) of TCGA 1992 by virtue of section 31 above).

33 Vulnerable person's liability: VQTG

(1) For the purposes of section 32, VQTG is an amount equal to—

$$TLVA - TLVB$$

where—

TLVB is an amount determined in accordance with subsection (2) (total tax liability of vulnerable person), and

TLVA is an amount determined in accordance with subsection (3) (what total tax liability of vulnerable person would be if it included tax in respect of notional section 77 gains).

(2) TLVB is the total amount of income tax and capital gains tax to which the vulnerable person would be liable for the tax year—

(a) if his income for the tax year were equal to the sum of his actual income for the tax year (if any) and the amount of the trustees' specially taxed income (if any) for the tax year, and

(b) if his taxable amount for the tax year for the purposes of section 3 of TCGA 1992 were equal to his deemed CGT taxable amount for the tax year (if any).

(3) TLVA is what TLVB would be if the vulnerable person's taxable amount for the tax year for the purposes of section 3 of TCGA 1992 were equal to the sum of the amount mentioned in subsection (2)(b) and his notional section 77 gains for the tax year.

(4) For the purposes of this section—

(a) the vulnerable person's actual income for the tax year,

(b) the trustees' specially taxed income for the tax year,

(c) the vulnerable person's deemed CGT taxable amount for the tax year, and

(d) the vulnerable person's notional section 77 gains for the tax year,

are to be determined in accordance with Schedule 1.

Qualifying trusts

34 Disabled persons

(1) For the purposes of this Chapter where property is held on trusts for the benefit of a disabled person those trusts are qualifying trusts if they secure that the conditions in subsection (2) are met—

(a) during the lifetime of the disabled person, or

(b) until the termination of the trusts (if that occurs before his death).

(2) Those conditions are—

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

(b) either that the disabled person is entitled to all the income (if there is any) arising from any of the property or that no such income may be applied for the benefit of any other person.

(3) 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 the powers conferred on the trustees by—

(a) section 32 of the Trustee Act 1925 (c. 19) (powers of advancement), or

(b) section 33 of the Trustee Act (Northern Ireland) 1958 (c. 23 (N.I.)) (corresponding provision for Northern Ireland).

(4) The reference in subsection (1) to the lifetime of the disabled person is, where property is held for his benefit on trusts of the kind described in section 33 of the Trustee Act 1925 (protective trusts), to be construed as a reference to the period during which such property is held on trust for him.

35 Relevant minors

(1) For the purposes of this Chapter where property is held on trusts for the benefit of a relevant minor those trusts are qualifying trusts if they are—

(a) statutory trusts for the relevant minor under sections 46 and 47(1) of the Administration of Estates Act 1925 (c. 23) (succession on intestacy and statutory trusts in favour of relatives of intestate), or

(b) trusts to which subsection (2) below applies.

(2) This subsection applies to trusts—

(a) established under the will of a deceased parent of the relevant minor, or

(b) established under the Criminal Injuries Compensation Scheme,

which secure that the conditions in subsection (3) are met.

(3) Those conditions are—

(a) that the relevant minor will, on attaining the age of 18, become absolutely entitled to the property, any income arising from it and any income that has arisen from property held on the trusts for his benefit and been accumulated before that time,

(b) that, until that time, for so long as the relevant minor is living, if any of the property is applied for the benefit of a beneficiary, it is applied for the benefit of the relevant minor, and

(c) that, until that time, for so long as the relevant minor is living, either—

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

(ii) no such income may be applied for the benefit of any other person.

(4) 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 the powers conferred on the trustees by—

(a) section 32 of the Trustee Act 1925 (c. 19) (powers of advancement), or

(b) section 33 of the Trustee Act (Northern Ireland) 1958 (c. 23 (N.I.)) (corresponding provision for Northern Ireland).

(5) In this section "the Criminal Injuries Compensation Scheme" means—

(a) the schemes established by arrangements made under the Criminal Injuries Compensation Act 1995 (c. 53),

(b) arrangements made by the Secretary of State for compensation for criminal injuries in operation before the commencement of those schemes, or

(c) the scheme established under the Criminal Injuries (Northern Ireland) Order 2002 (S.I. 2002/796 (N.I. 1)).

36 Parts of assets

For the purposes of this Chapter references to property being held on trusts include references to a part of an asset being held on trusts if—

(a) that part of the asset, and

(b) any income arising from it (or treated as arising from it),

can be identified for the purpose of determining whether the trusts on which it is held are qualifying trusts.

Vulnerable persons

37 Vulnerable person election

(1) Where trustees hold property on trusts for the benefit of a person, the trustees and that person may jointly make a vulnerable person election in relation to those trusts and that person if—

(a) the person in relation to whom the election is made is a vulnerable person, and

(b) the trusts in relation to which the election is made are qualifying trusts.

(2) A vulnerable person election is an election in such form as the Board of Inland Revenue may require—

(a) specifying the date from which it is to have effect ("the effective date"),

(b) made by notice to the Inland Revenue no later than 12 months after 31st January next following the tax year in which the effective date falls, or within such further time, if any, as the Board of Inland Revenue may by notice have allowed, and

(c) containing the items specified in subsection (3).

(3) Those items are—

(a) such information as the Board of Inland Revenue may require, including in particular information relating to the trusts, the trustees, the vulnerable person and his entitlement under the trusts and any other person connected with the trusts,

(b) a statement that the trusts in relation to which the election is made are qualifying trusts,

(c) a declaration that all the information contained in the election is correct to the best of the knowledge and belief of the trustees and vulnerable person,

(d) a declaration by the vulnerable person that he authorises the trustees to make any claim under this Chapter for any tax year as they consider appropriate, and

(e) such other declarations as the Board of Inland Revenue may reasonably require.

(4) A vulnerable person election is irrevocable.

(5) A vulnerable person election has effect from the effective date until one of the following events occurs—

(a) the person in relation to whom the election is made ceases to be a vulnerable person,

(b) the trusts in relation to which the election is made cease to be qualifying trusts, and

(c) the trusts are terminated.

(6) If the trustees become aware that an event mentioned in subsection (5) has occurred—

(a) they must inform the Inland Revenue that the vulnerable person election has ceased to have effect, and

(b) they must do so by giving notice containing particulars of the event within the period of 90 days beginning on the date on which they first become aware that the event has occurred.

38 Meaning of "disabled person"

(1) In this Chapter "disabled person" means—

(a) a person who by reason of mental disorder within the meaning of the Mental Health Act 1983 (c. 20) is incapable of administering his property or managing his affairs, or

(b) 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.

(2) A person is to be treated as a disabled person under subsection (1)(b) if he satisfies the Inland Revenue—

(a) that if he were to meet the prescribed conditions as to residence under section 64(1) of SSCBA 1992 or section 64(1) of SSCB(NI)A 1992 he would be entitled to receive attendance allowance, or

(b) that if he were to meet the prescribed conditions as to residence under section 71(6) of SSCBA 1992 or section 71(6) of SSCB(NI)A 1992 he would be entitled to receive a disability living allowance by virtue of entitlement to the care component at the highest or middle rate.

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

(a) 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 a hospital or is provided with certain accommodation), or

(b) regulations under section 72(8) of SSCBA or section 72(8) SSCB(NI)A 1992 (no payment of disability allowance for persons for whom certain accommodation is provided).

(4) In this section "attendance allowance" means an allowance under—

(a) section 64 of SSCBA 1992, or

(b) section 64 of SSCB(NI)A 1992.

(5) In this section "disability living allowance" means a disability living allowance under—

(a) section 71 of SSCBA 1992, or

(b) section 71 of SSCB(NI)A 1992.

(6) In this section—

"SSCBA 1992" means the Social Security Contributions and Benefits Act 1992 (c. 4), and

"SSCB(NI)A 1992" means the Social Security Contributions and Benefits (Northern Ireland) Act 1992 (c. 7).

39 Meaning of "relevant minor"

For the purposes of this Chapter a person is a "relevant minor" if—

(a) he has not yet attained the age of 18, and

(b) at least one of his parents has died.

Miscellaneous and supplementary

40 Power to make enquiries

(1) Where a vulnerable person election has been made the Inland Revenue may by notice require the trustees or the vulnerable person by whom the election was made to furnish them with such particulars as they may reasonably require for the purposes of determining—

(a) whether the requirements mentioned in subsection (1)(a) and (b) of section 37 were met at the time the election was made, and

(b) whether an event mentioned in subsection (5) of that section has occurred since the effective date.

(2) The notice must specify the time within which the information must be furnished (not being less than 60 days).

(3) If the Board of Inland Revenue determine—

(a) that either or both of the requirements mentioned in subsection (1)(a) and (b) of section 37 were not met at the time the election was made, or

(b) that an event mentioned in subsection (5) of that section has occurred since the effective date of the election,

they may give notice to the trustees and the person in relation to whom the vulnerable person election was made that the election never had effect or ceased to have effect from a date specified in the notice.

(4) A person aggrieved by a determination of the Board of Inland Revenue under subsection (3) may by notice appeal to the General Commissioners.

(5) The notice of appeal must be given to the Board of Inland Revenue within 30 days after the notice of the determination was given under subsection (3).

(6) All such adjustments shall be made, whether by discharge or repayment of tax, the making of assessments or otherwise, as are required to give effect to a determination under subsection (3) (despite any limitation on the time within which any adjustment may be made).

(7) In subsection (6) "tax" means income tax or capital gains tax.

41 Interpretation etc.

(1) In this Chapter—

"the Board of Inland Revenue" means the Commissioners of Inland Revenue (as to which, see in particular the Inland Revenue Regulation Act 1890 (c. 21)),

"the Inland Revenue" means any officer of the Board of Inland Revenue,

"notice" means notice in writing, and

"tax year"—

(a) in relation to income tax, means a year of assessment within the meaning of ICTA (see section 832(1) of that Act), and

(b) in relation to capital gains tax, means a year of assessment within the meaning of TCGA 1992 (see section 288(1) of that Act).

(2) For the purposes of this Chapter—

(a) a vulnerable person is UK resident during a tax year if he is either resident in the United Kingdom during any part of the tax year or ordinarily resident in the United Kingdom during the tax year, and

(b) a vulnerable person is non-UK resident during a tax year if he is neither resident in the United Kingdom during any part of the tax year nor ordinarily resident in the United Kingdom during the tax year.

(3) Sections 30 to 33 and Schedule 1 are to be construed as one with TCGA 1992.

(4) To the extent that any provision of this Chapter would not, apart from this subsection, form part of Income Tax Acts, the provisions of the Income Tax Acts are to apply for the purposes of any references in the provision relating to income arising (or treated as arising) to a person or to the income tax liability of a person.

42 Application in relation to Scotland

(1) This Chapter applies in relation to Scotland with the following modifications.

(2) In section 23(5), for "trusts on which property is held for the benefit of a vulnerable person are qualifying trusts" substitute "property held in trust for the benefit of a vulnerable person is held in qualifying trust".

(3) In section 31(3)(a), for "on the qualifying trusts" substitute "in qualifying trust (in the same trust as the settled property disposed of)".

(4) In section 34—

(a) in subsection (1), for "those trusts are qualifying trusts if they" substitute "the property is held in qualifying trust if the trust purposes", and

(b) in subsection (4), for "on trusts" substitute "in a trust".

(5) In section 35—

(a) in subsection (1), for "those trusts are qualifying trusts if they are" substitute "the property is held in qualifying trust if the trust is",

(b) in that subsection, for paragraph (a) substitute—

"(a) constituted by the appointment of an executor dative to administer an intestate estate where the relevant minor has a right to any of the estate,", and

(c) in subsection (2), before "which" insert "the purposes of".

(6) In section 36, for "the trusts on which it is held are qualifying trusts" substitute "it is held in qualifying trust".

(7) In section 37—

(a) in subsection (1), for paragraph (b) substitute—

"(b) property held in the trust in relation to which the election is made is held in qualifying trust.",

(b) in subsection (3)(b), for "the trusts in relation to which the election is made are qualifying trusts" substitute "property held in the trust in relation to which the election is made is held in qualifying trust", and

(c) in subsection (5), for paragraph (b) substitute—

"(b) property held in the trust in relation to which the election is made ceases to be held in qualifying trust,".

(8) Sections 34(3) and 35(4) do not apply to Scotland

(9) Unless otherwise modified by this section, any reference to anything being held on trusts is to be construed as a reference to it being held in trust.

(10) Unless otherwise modified or disapplied by this section, any reference to trusts is to be construed as a reference to a trust or the trust (as appropriate).

43 Penalties under TMA 1970

(1) Section 98 of TMA 1970 (special returns, etc) is amended as follows.

(2) In the first column of the table insert at the appropriate place—

"section 40(1) of the Finance Act 2005".

(3) In the second column of the table insert at the appropriate place—

"section 37(3) of the Finance Act 2005;", and

"section 37(6) of the Finance Act 2005;".

(4) For the purposes of that section, any information, statements or declarations given or made jointly by trustees and a vulnerable person are to be treated as given or made by the trustees.

44 Consequential amendments

(1) In section 687(3) of ICTA (payments under discretionary trusts: amounts to be set off against income tax assessable on trustees in respect of tax credit), after paragraph (k) insert—

"(l) the amount of any income tax determined in accordance with section 26 of the Finance Act 2005."

(2) In Schedule 4B to TCGA 1992 (transfers of value by trustees linked with trustee borrowing), in paragraph 3(2), after "in that year" insert "(otherwise than by virtue of section 31 of the Finance Act 2005)".

45 Commencement

This Chapter has effect for the tax year beginning on 6th April 2004 and subsequent tax years.