

ACCUMULATION & MAINTENANCE TRUSTS

A trust (*settlement*) arises when a person (the *settlor*) transfers assets to trustees, who hold the assets for the benefit of one or more persons (the *beneficiaries*), who will receive income and/or capital from the trust.

A *discretionary trust* exists where trustees have discretionary power as to the distribution of income and capital and nobody is entitled to it as of right.

An *accumulation and maintenance trust* is a special type of discretionary trust. The beneficiaries must all be grandchildren of a common grandparent (not necessarily all children of the same parent), and a beneficiary must receive part or all of the income on or before his or her twenty-fifth birthday. Until then, the income must either be used for his or her maintenance, education, or benefit, or be accumulated.

The income tax position

Income received by the trustees is chargeable on the trustees at 40% (income other than dividends) or 32½% (dividends). However from 2005-06 there is an exemption to charge a lower tax rate on the first £500 of income.

Any income *paid* to beneficiaries who are under eighteen and children of the settlor is treated as the settlor's own income for income tax purposes.

Where income is paid to beneficiaries it is deemed to be after deduction of tax at 40%. Thus income of £600 net is equivalent to gross income of £1,000 from which £400 tax has been deducted.

Accumulated income passing to the child on reaching the appropriate age is treated as capital and hence not subject to income tax.

Capital gains treatment

Transfers into the trust are treated as a disposal at open market value by the settlor. The settlor will be liable to capital gains tax unless gifts holdover relief is available.

Capital gains tax at 40% is payable on disposals of chargeable assets by the trustees, subject to the annual exemption of £4,250 (2005/06).

When a beneficiary becomes absolutely entitled to any chargeable assets of the trust, they will be deemed to be disposed of at market value, and capital gains tax will be payable accordingly. In certain circumstances the trustees' gain can be held over to the beneficiary.

Inheritance tax implications

Transfers into the trust fund are potentially exempt from inheritance tax and will not be taken into account if the settlor survives for seven years.

There is no charge to inheritance tax on property remaining within the trust. Nor is there any charge when a beneficiary becomes absolutely entitled to trust property.

Therefore, the transfer of the whole property via the settlement to the beneficiaries is completely free of inheritance tax.

Tax planning points

A person with children, grandchildren, or others under twenty-five whom they wish to benefit should consider gifting assets into an accumulation and maintenance trust. Provided that person survives for seven years after making the gift, no inheritance tax will be payable.

The trust can be considered as an inheritance tax exempt fund until the children reach twenty-five. There are therefore great tax advantages in putting growth assets into such a trust.

If the gift is to the settlor's own children, it is not advisable for the trustees to pay income to a beneficiary for his or her maintenance etc. while the child is unmarried and under eighteen (in these circumstances it will be treated as the settlor's own income).

Please call us if you would like any further help or information on this subject.

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