

# Tax Overview

## Flexible Life Interest Trust

**This guide is to help you** understand the key points of how Flexible Life Interest Trusts are taxed and is based on the current 2023/2024 tax year rules and therefore may be subject to change.

Flexible Life Interest Trusts give a life interest over income for the surviving spouse/civil partner (C.P.). The survivor is also known as the life tenant. There is flexibility for loans or gifts of capital to the life tenant or other beneficiaries of the trust. First priority is often given to meeting the needs of the life tenant and is usually documented in a letter of wishes.

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### Inheritance Tax (IHT)

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- Assets passing into the trust benefit from the spousal exemption for IHT.
  - There are no ten-year anniversary or exit charges whilst the life tenant is alive (unless the life interest is given up early).
  - If payments are made to other beneficiaries, there are no charges to IHT for the trust to pay, however, this will be viewed as a gift by the life tenant so if the life tenant fails to survive seven years this will use up part of the Nil Rate Band allowance on death.
  - On death of the life tenant, the value of the trust fund is combined with his/her own estate and if IHT is due the trust will pay a proportionate amount.
  - The trust fund is then taxed as a discretionary trust.
  - The trust fund will be revalued every ten years and IHT charged up to 6% on the amount exceeding the Nil Rate Band and reliefs at the time.
  - When the trustees make payments to beneficiaries, an exit charge may be applied if the value of the trust exceeds the Nil Rate Band. The amount payable will be calculated based on the length of time held in trust since commencement or if after ten-years has passed the most recent ten-year anniversary date.
  - Trustees may make distributions from the trust fund without an exit charge within the first quarter following every ten-year interval.
- The availability of the Residence Nil Rate Band (RNRB) depends on qualifying criteria being met. If your home is part of the trust, it is possible for all or part of the RNRB to be claimed if providing your trustees appoint out the property of the survivor's trust within two years of his/her death. For the full amount of RNRB to be available, his/her share of the property must be at least £350,000.

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### Capital Gains Tax (CGT)

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- The death of the testator does not create a charge to CGT.
- The trustees receive the trust fund at Probate value – known as the trustees base cost.
- On death of the life tenant, assets held in the trust are given a further tax-free uplift to Probate value
- Charges to CGT arise when property or other assets (providing not exempt) are sold or transferred to beneficiaries and where the value has increased above the base cost.
- From 06.04.2023, trustees have an annual exempt allowance of £3000. This reduces to £1500 from 06.04.24. If there are multiple trusts, the allowance is shared between them.
- The CGT rate for trustees is 20% and 28% for residential property.

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### Income Tax

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- Whilst the life tenant is alive, income is taxed at 20% and 8.75% on dividends. The trustees may mandate income to the life tenant so that he /she pays tax directly through self-assessment.
- On death of the life tenant, discretionary trust tax rates apply. On the first £1000 of income received annually, the trustees will pay tax on this at the standard rate of 20% and 8.75% on dividends. After this, income is taxed at 45% and 39.35% on dividends.
- Beneficiaries may be able to reclaim some or all of the tax paid by the trustees depending on their income.

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## How it works in practice

Barry and Sam are married and have grown-up children from their previous marriages. They want to ensure the survivor is provided for but don't want to leave everything to each other outright. They don't want to risk their own children being disinherited if the survivor changes his/her will or remarries.

Barry and Sam make wills with a Flexible Life Interest Trust.

When Barry dies, his solely owned rental properties, cash and investments go into the trust. The trust can be used to ensure Sam benefits while she is alive, but then passes to Barry's children after Sam dies. The trustees can choose to use their flexible powers to advance capital to Sam if she needs it. The trustees will weigh up Sam's needs against Barry's desire to pass assets to his children.

### Income Tax

Sam has the right to the income generated by the trust assets. If the trustees decide to direct the income to Sam, she can pay the income tax through her own self-assessment return.

If the trustees remain responsible for the income tax, they will pay at the applicable rates (shown on the first page). There is a difference in the trust tax income rates whilst Sam is alive and upon her death when the trust is taxed as a discretionary trust.

### Capital Gains Tax

There is no Capital Gains Tax when Barry dies, because the assets benefit from the tax-free uplift and enter the trust at the date of death value. The trustees have an annual allowance which is half of the personal allowance. If the trustees dispose of assets that have increased in value, the trust will pay Capital Gains Tax at 28% on the rental property portfolio, and 20% on the other assets. Upon Sam's death, a further tax-free uplift will apply to assets held in the trust and private residence relief may be claimable. The trustees can decide to appoint the assets out to beneficiaries or keep the assets in trust if continued protection is needed.

### Inheritance Tax

When Barry dies, assets that benefit Sam can make use of the spouse exemption.



This type of trust has no ten-year anniversary or exit charges.

When Sam dies, the value of the trust fund adds to the value of her own estate, and Inheritance Tax is calculated on the full amount. If the combined total is above Sam's Nil Rate Band, then the trust pays Inheritance Tax on the trust assets, and Sam's estate has to pay the rest.

When Sam dies, the trust will be taxed as a discretionary trust. There may be ten-year anniversary and exit charges when assets leave the trust depending on the value of the trust fund.

The trustees will be able to consider the circumstances of beneficiaries at the time of Sam's death to make their decision on whether to continue or close the trust.

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### Trust Registration

If the trust still exists two years after death, the trustees must register the trust with HMRC within 90 days. The exception is that if the trust incurs a UK tax liability earlier than the two-year anniversary, it must be registered within 90 days of the tax liability arising.