Jonathan OWEN WILLS & TRUSTS

■ www.jonathanoweniep.com ■ EMAIL info@jonathanoweniep.com ■ CALL 0800 3688596

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 2022/2023 tax year rules and therefore may be subject to change.

Flexible Life Interest Trusts give a life interest to the surviving spouse/C.P. for any income arising. There is also flexibility for loans or gifts of capital to the survivor or other beneficiaries of the trust. Priority is often given to surviving spouse/C.P.

Inheritance Tax (IHT)

- 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% of the value if the amount exceeds 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.
- If the trust contains a former residence of the deceased, the trustees may appoint out the property (within two years of death) to qualifying beneficiaries to claim the Residence Nil Rate Band. This is subject to other qualifying criteria of the RNRB being met.

Capital Gains Tax (CGT)

- 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.
- Trustees have an annual allowance of £6150. If there are multiple trusts, the allowance is shared between them.
- The CGT rate for trustees is 20% and 28% for residential property.

Income Tax

- 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.
- Depending on the beneficiary’s income tax rate, he/she may be able to reclaim some or all of the tax paid by the trustees after receiving an income payment from the trust.