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Tax Overview
Vulnerable Persons Trust

This guide is to help you understand the key points of how trusts for disabled persons are taxed.

This is based on the current 2024/2025 tax year rules and therefore could be subject to change.

Your trustees should check with HMRC the current requirements when the trust begins and keep under review until the trust comes to an end.

This guide applies to a person who is incapable of managing their finance and property due to a mental health condition (as per the Mental Health Act 1983) or is in receipt of specified benefits.

Inheritance Tax

- Trusts for vulnerable beneficiaries get special Inheritance Tax (IHT) treatment during the lifetime of the vulnerable beneficiary.
- During the trust there are no ten year periodic or exit charges.
- Payments made by the trustees to or for the benefit of the disabled person during their lifetime are not subject to an IHT charge.
- Distributions of capital and / or income to persons other than the beneficiary may be made so long as they do not exceed the annual limit (currently the lower of £3,000 or 3% of the maximum value of the trust property).
- When the principal beneficiary (i.e. vulnerable person) dies, any assets held in the trust on their behalf are treated as part of their estate and therefore IHT may be charged.

Capital Gains Tax

If assets such as property or investments are sold by the trustees and have increased in value, Capital Gains Tax will be payable by the trustees. The trustees can use the vulnerable persons annual exemption and tax will only be due if the gains exceed this.

- The trustees calculate the CGT as if there was no reduction.
- The trustees then calculate the CGT that the vulnerable person would have been subject to if the gains arose directly against them.
- The trustees can then claim the difference between the two amounts as a reduction.
- The special treatment does not apply in the tax year when the vulnerable person dies.
- On death of the vulnerable person, there is a tax-free uplift of trust funds to Probate value.

Income Tax

Where a trust has a vulnerable beneficiary, the trustees are entitled to a deduction of tax against the amount they would otherwise pay.

- The trustees calculate their income tax liability on the normal basis.
- The tax rate for this type of trust is 8.75% for dividends and 20% for other income.
- The trustees then calculate the income tax that the vulnerable beneficiary would have been subject to if the trust income had been paid directly to them as an individual.
- The trustees then claim the difference between the two amounts, as a deduction from their own income tax liability.

Trust Registration

- This type of trust does not need to be registered with HMRC unless there is a UK tax liability incurred. If this happens, it must be registered within 90 days. Trustees should always check the registration requirements at the start of the trust and as part of regular reviews.

Disclaimer. We hope this provides a useful summary of the current tax position. This is not tax or legal advice and you should always take care to obtain advice relevant to your own situation.

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Tax Overview VPT
How it works in practice

Terry's son, John, has Down's Syndrome.
If John inherited directly, Terry is concerned that John's means-tested benefits could stop and that John could be vulnerable to financial abuse. Terry sets up a trust in his will to protect John's inheritance. Terry appoints his two siblings and eldest son to be the trustees. Terry writes a letter of wishes explaining to his trustees how he wants them to use the trust fund.

The trustees know they must prioritise John as the primary beneficiary but should also consider the circumstances of the other named beneficiaries, Terry's other children.

The trustees can use the trust fund to pay for the additional support John needs and provide treats, holidays and other benefits that will help John's quality of life. They will also protect his inheritance from those who may exploit him. If John's needs are being met, the trustees may make a distribution to the other beneficiaries of the trust of up to £3000 or 3% of the trust fund (whichever is lower) and still qualify for the special tax treatment given to vulnerable persons.

Income Tax
To claim the special tax treatment, the trustees must complete a Vulnerable Person Election form and annual income tax returns. They seek professional help with the tax returns and registering the trust. The trust fund pays for the tax and legal advice that the trustees need. The trustees must calculate what the income tax would be if there were no vulnerable person and then work out what the income tax would be as if it had been paid directly to John. The trustees may then claim the difference between these figures as a deduction from the trust tax liability.

Capital Gains Tax
If the trustees sell investments or property, capital gains tax may be payable if the assets have increased in value since Terry died. Because John is vulnerable, the trustees have John's personal allowance available. If the assets exceed the exempt allowance, the trustees must calculate what the tax would be if there were no vulnerable person and then work out what the capital gains tax would be as if it had been paid directly to John. The trustees may then claim the difference between these figures as a deduction from the trust tax liability. The trustees need to complete a Vulnerable Person Election form for the special tax treatment to apply.

Inheritance Tax
There are no ten-year anniversary charges for inheritance tax on this type of trust. There are no exit charges when the trustees pay money to John. When John dies, the trust will usually be terminated by the trustees and assets distributed to the surviving beneficiaries.

If the trust continues, and none of the beneficiaries qualifies as vulnerable, it will be taxed as a discretionary trust rather than a vulnerable persons trust. There may be ten-year anniversary and exit charges when assets leave the trust.