Also in the event that the trustee takes care of the payment of the taxes on behalf of the beneficiary, it is the beneficiary who is tax-liable.

10.3. Interest in Possession Trust

In this form of trust, the beneficiary, in this case also called the *income beneficiary*, is entitled to receive the income generated by the trust. The trustee must give the entire income of the trust (after deduction of expenses incurred and taxes paid by him) to the income beneficiary. It is possible that the beneficiary is entitled to receive these payments for his entire life, in which case he is referred to as a *life tenant*.

The income beneficiary has however no claim to the trust's capital. In most cases, the capital is destined for another beneficiary and intended for payments at a future date (which is usually determined in advance). Such a beneficiary is called a *remainderman* or a *capital beneficiary*. *Interest in possession trust*, the trustee has more rights than in the bare trust. For instance, he may also make payments to the beneficiary out of the trust capital.

Taxation

The trustee is tax-liable for all income earned, in particular:

- Rental and trading income is subject to a base rate of currently 22%.
- Dividend income realised in the UK is subject to the regular dividend tax rate of currently 10%; the tax credit associated with the net dividend reduces the taxes to be paid be the trustee.
- Income from savings (such as interest) is subject to a reduced rate of currently 20%. Income which is already subject to final taxation at source is accordingly deducted from the tax assessment basis.

The beneficiaries receive the payments after deduction of the taxes and fees that the trustee has paid out of the income. The income is used for certain purposes and the trustee's expenses need to be covered, too.

Payments to the beneficiaries are subject to the regular tax rates; however the beneficiaries receive a tax credit for taxes paid by the trustee.

In the event that a beneficiary is in the lowest bracket or tax-exempt at all, he may have a part or all of the taxes paid refunded. There are however no tax credits for dividend taxes. If a beneficiary is in a higher tax bracket, he or she must make additional tax payments.

Only very few *interest in possession trusts* are taxed at special rates. However, in some cases special rates may apply, for instance when a company buys back own shares from the trustees or where the trust involves *vulnerable beneficiaries* (these are beneficiaries that need special protection).

10.4. Discretionary Trust

The trustee has more discretionary power as to the use of income generated by the trust assets. Even if he has received instructions on who the beneficiaries should be, he can decide on the amount to be paid, which beneficiaries or groups of beneficiaries are to receive the payment, how often, and on the terms of the payments.

It is in his discretion to distribute or retain income realised. If the trust income is not distributed to the beneficiaries, it becomes part of the trust assets.

Taxation

The trustees are subject to taxation at special rates for the income earned. Dividends and similar other income are to be taxed at the dividend trust rate (32.5% since 2004-2005), and further income is to be taxed at the rate applicable to trusts (40% since 2004-2005). Since 2005-2006, the first GBP 500 of the trust income are, depending on the nature of the income, either subject to a basic rate of currently 22%, a reduced rate of 20%, or the normal dividend rate of 10%. (Before 2005-2006, this amount was subject to a special rate.)

The income received by the beneficiaries has already been subject to a 40% deduction which is the rate currently valid for trusts. The payments are thus treated as if they were made after deduction of tax. If, however, the beneficiaries are base-rate taxpayers or are not tax-liable at all, they may have the tax refunded. If they are subject to a higher tax rate than the 40% applied, no further tax will be due.

If the trustee is authorised to retain income, he can transform the income into capital. If this capital is then paid out in later years, it is no longer considered a distribution of income, but capital paid out, which is not subject to taxation.

Since 2004/2005, particular regulations apply to beneficiaries deserving special protection; these are persons who are mentally or physically disabled or persons who are under the age of 18.

10.5. Accumulation and Maintenance Trust

The beneficiaries have a claim to the assets (or at least to the income from the assets) only after they have reached a certain age (age of 25 at the latest). In the meantime, the trustees