canada life

Setting up a Personal Injury Trust

for vulnerable clients

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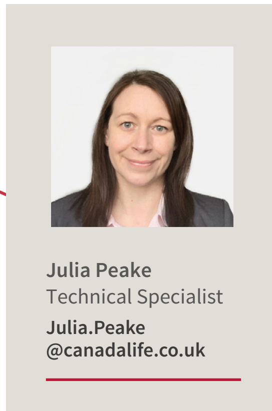
[Technical Eye]



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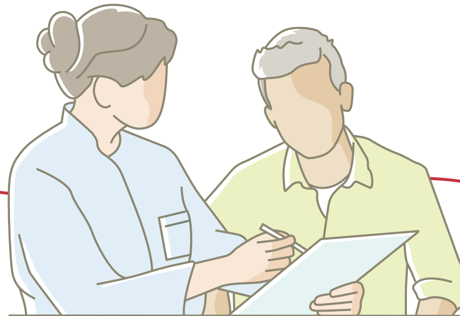


If a client suffers an injury or illness which was caused by a third party (usually because of medical negligence, a road traffic accident, or an accident at work), they can make a legal claim for compensation. If they are awarded a large sum of money, a Personal Injury Trust could be considered to help manage the money.

Why use a Personal Injury Trust?

Personal Injury Trusts are widely used to assist those who have received a negligence settlement. That's because any money held within a Personal Injury Trust will not be considered by the local authority when assessing entitlement to means-tested benefits, provided the Trust is established within 52 weeks of the award being granted.

Deputies, trustees and your role as a financial adviser

If a claimant is unable to make their own decisions, the Court of Protection will nominate a Deputy to make important decisions on their behalf. If they decide a Personal Injury Trust is appropriate, it's important the trustees are chosen carefully as the client could be reliant on this money to provide care for the remainder of their lives. A solicitor firm is sometimes appointed as a professional trustee as it can be overwhelming for someone without experience.

Deputies or trustees appointed to help manage these funds will usually require investment advice, which is where you come in. Your expertise can play a vital role in ensuring a suitable investment and wrapper is chosen to meet the needs of these vulnerable clients.

A Personal Injury Trust can be set up on a bare or discretionary basis

If the Trust is set up as a bare trust, the trustees can make distributions whenever necessary for the injured person's care and maintenance, and, any trust income or gains are assessed on the beneficiary. When they die, the trust will then be wound up and any remaining funds will form part of their estate for Inheritance Tax (IHT) purposes and will be distributed according to their will or laws of intestacy.

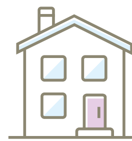
For discretionary trusts, it's a bit more complex. The trustees can apply to HMRC (using their VPE1 form) for the trust to be treated as a Vulnerable Person's Trust, which provides special tax treatment.

A 'vulnerable beneficiary' is either:

- A person who is mentally ill or disabled, in line with Mental Health Act 1983
- Physically disabled and qualify for certain social security benefits
- Someone under 18 who has lost a parent through death

CGT

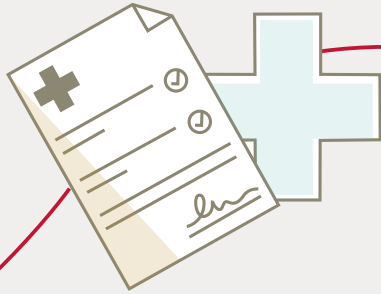
May be due if assets are sold, given away or exchanged



If this election is accepted, income will be assessed on the injured person as settlor of the trust. However, the trustees must pay the tax and credit is given to the settlor for the tax deducted by the trustees. Capital Gains Tax (CGT) may be due if assets are sold, given away, exchanged, or transferred and they've gone up in value since being put into trust. However, this will be treated as if owned by the beneficiary and the full 'annual exempt amount' of £12,300 can be used to offset against any losses, rather than the trustee rate of £6,150. This special CGT treatment doesn't apply in the tax year when the beneficiary dies. An IHT charge arises when the vulnerable person dies or if the trust comes to an end during their lifetime, as this is a settlor interested trust and will form part of their estate.

If the vulnerable person's criteria aren't met and it's set up under a discretionary trust, then the income will be assessed on the settlor, who will get a tax credit to offset against their other income. Any capital gains will be taxed on the trustees at trustee rates and with their annual exemption of £6,150. Depending on the number of trusts the settlor has, this could be split up to a maximum of five.

With regards to IHT, the gift to trust will be a chargeable lifetime transfer, with potential entry charges if the gift is over the prevailing nil rate band of the settlor. Exit and periodic charges could also apply. On the death of the settlor, the trustees will administer the trust fund according to the trust deed.



Investing within the Personal Injury Trust

If a real income is required, using assets such as collectives and shares could be appropriate, but these may be taxed as if in the hands of the beneficiary. Their tax allowances such as the personal allowance, starting rate for savings income, personal savings allowance, the dividend allowance and the annual exempt amount can be used to offset any income or capital gains tax due. It's important to remember that the reporting requirements, such as annual tax returns, would be due and could result in additional costs.

Alternatively, an investment bond (onshore or offshore) could also be considered. Since a bond is a non-income producing asset, the tax administration can be greatly reduced as a tax return is only required if a chargeable event occurs. A gain from an offshore bond can be offset against the individual's tax allowances. With an onshore bond, tax is paid within the fund which results in a basic rate tax credit. This could mean that no further tax is due upon a chargeable event depending on the marginal rate of the beneficiary.

Unlike investments held within an unwrapped portfolio, any fund switching within a bond will not create a taxable event. Onshore and offshore bonds also benefit from a cumulative 5% tax deferred allowance. This means 5% of the amount invested can be taken out of the bond each policy year (for a maximum of 20 years) without an immediate tax charge.

This can be rolled up, so for example, if not taken in year 1 then 10% can be taken in year 2. And because bonds are segmented, individual policies could also be surrendered to meet the needs of the claimant, limiting any tax that might be due upon the chargeable event.

How Canada Life can help you

We know how vulnerable Personal Injury Claimants are. Which is why we have a dedicated service to help you set up and manage a Canada Life Bond using a Personal Injury Trust. By working closely with us, we can ensure the Claimant's financial needs are met as quickly as possible.

For more information, please contact your **Canada Life Account Manager**, or download our **Personal Injury – Court of Protection Guide.**

Legal disclaimer

This document is based on Canada Life's understanding of applicable UK tax legislation and current HM Revenue & Custom's practice, as at March 2022 and could be subject to change in the future.

It is provided for professional advisers only. Any recommendations are the adviser's sole responsibility.

For more information, please contact our technical team at **ican@canadalife.co.uk**

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