SWW Disabled Persons Trust Factsheet

What is a Disabled Person's Trust?



A Disabled Person's Trust is a type of trust designed to provide financial support to someone with a disability while protecting their entitlement to means-tested benefits and ensuring the trust assets are managed responsibly. It benefits from unique tax advantages not available to most other types of trusts.

To qualify as a Disabled Person's Trust, the arrangement must satisfy the conditions set out in section 89 Inheritance Tax Act 1984. These rules define both the structure of the trust and who can benefit from it.

A vulnerable beneficiary (disabled person) is someone who is eligible for any of the following, even if they do not in fact receive them:

- Adult Disability Payment
- Armed Forces Independence Payment
- Attendance Allowance
- Child Disability Payment
- Constant Attendance Allowance
- Disability Living Allowance for adults
- Disability Living Allowance for children
- Industrial Injuries Disablement Benefit
- Pension Age Disability Payment
- Personal Independence Payment (PIP) with the daily living component
- Scottish Adult Disability Living Allowance

OR

- A person who is incapable of managing their property or affairs due to mental disorder, within the meaning of the Mental Health Act 1983.

This means that the trust must primarily benefit someone who meets one of these criteria. That person is often referred to as the "principal beneficiary" or "main beneficiary" of the trust.

A Disabled Person's Trust can be created during the settlor's lifetime or by Will. They are frequently used by parents or other relatives who wish to provide long-term support for a child or family member who is unlikely to be capable of managing large sums of money or who might lose access to essential state support if they were to inherit outright.

Disabled Persons Trust Factsheet

Key Benefits of a Disabled Person's Trust:

One key reason clients choose to use a Disabled Person's Trust is to ensure that a vulnerable loved one is financially supported without compromising their entitlement to means-tested benefits such as Universal Credit, Employment and Support Allowance, or local authority funded care.

This is possible because the disabled person does not legally own the assets held in the trust. Instead, the assets are owned by the trustees and applied for the beneficiary's benefit. As a result, they are usually disregarded when calculating entitlement to benefits and care support.



The trust structure also provides safeguards and long-term control. Since the trust is managed by appointed trustees, it ensures decisions about money and property are made by responsible adults who can act in the best interest of the disabled person. This is particularly important where the beneficiary lacks capacity or might be vulnerable to exploitation.

From a tax perspective, Disabled Person's Trusts are treated favourably when compared to standard discretionary trusts. Provided the trust meets the legislative requirements, it will be exempt from the periodic and exit charges that typically apply to relevant property trusts.

The trust also offers planning flexibility. It can allow the trustees to exercise discretion in how and when to use the funds, or it can provide a fixed income or capital entitlement depending on the needs of the beneficiary. Trustees may be guided by a non-binding Letter of Wishes from the person who created the trust, helping them make decisions aligned with the settlor's intentions.



How the Trust Works in Practice:

Disabled Person's Trusts can be established in two main ways:

1. By lifetime settlement - The settlor executes a trust deed during their lifetime and transfers money or assets into the trust. This is sometimes referred to as an "inter vivos" trust.

2. By Will - The trust is included in the testator's Will and come into effect on their death. This is particularly common where parents are planning for a disabled child who will survive them.

In both cases, the trust must be set up with the disabled person as the principal beneficiary, and it must comply with the statutory requirements under the Inheritance Tax Act 1984 to qualify for the associated tax advantage.

Disabled Persons Trust Factsheet

Disabled Person's Trust can either:

- Allow the trustees full discretion over how to apply income and capital for the person's benefit.

OR

- Grant the disabled person an absolute fixed interest (such as entitlement to all income)

In most cases, the discretionary model is preferred. It provides greater protection, preserves benefit entitlement, and offers more flexibility to meet changing needs over time.

For a trust to qualify as a Disabled Person's Trust under s.89 IHTA 1984, the assets must be applied for the benefit of the disabled person.

- Under s.89(3) - (3B) IHTA 1984, the trust fund (both income and capital) must be applied primarily for the benefit of the disabled person.

- There is, however, a limited exemption which allows a small amount of income or capital to be used to benefit others (such as family members). This is capped at the lower of:
  - £3,000 per tax year, or
  - 3% of the maximum value of the trust fund in that year.

Trustees are responsible for managing the trust assets prudently, acting in the best interests of the beneficiary, and complying with both tax and reporting requirements. If the beneficiary lacks capacity under the Mental Capacity Act 2005, trustees must make decisions in accordance with the Act's best interests' principles.

Inheritance Tax Treatment:

Disabled Person's Trusts are not treated as relevant property trusts for inheritance tax purposes, provided they meet the qualifying conditions.

This means they are exempt from the 10-year anniversary charge and the exit charge that normally apply to discretionary trusts under section 64 and 65 of the Inheritance Tax Act 1984. This exemption is available both for lifetime trusts and trusts created by Will.

Where a trust is created during lifetime for the benefit of a disabled person, the transfer into the trust is treated as a Potentially Exempt Transfer (PET), rather than a Chargeable Lifetime Transfer (CLT).

- This means that if the settlor survives for seven years after making the transfer, it becomes fully exempt from inheritance tax.
- If the settlor dies within seven years, the value of the transfer is aggregated with their estate and may use part (or all) of the nil-rate band.
- Unlike standard discretionary trusts, there is no immediate lifetime inheritance tax charge on creation, provided the trust qualifies under s.89 IHTA 1984.

Disabled Persons Trust Factsheet

This favourable treatment is a key advantage of Disabled Person's Trusts compared to other relevant property trusts.

If the trust is created by Will, the assets are treated as part of the testator's estate for IHT purposes on death but again the trust is not subject to the relevant property regime going forward.

For inheritance tax purposes, the disabled person only needs to meet the qualifying conditions at the time the assets are transferred into the trust. Once the trust is set up and qualifies under s.89 IHTA 1984, it continues to benefit from the favourable IHT treatment, even if the disabled person later ceases to meet the statutory definition.

However, for income tax and capital gains tax, the favourable treatment depends on the trustees making a Vulnerable Person's Election. This election is made jointly with the disabled person (or their guardian) and must be maintained on an ongoing, annual basis. If the conditions cease to be met, or the election is not made, the trust reverts to the standard (less favourable) trust tax regime for those taxes.

In certain circumstances, a Disabled Person's Trust can also benefit from the residence nil-rate band (RNRB) under section 8K IHTA 1984, provided that the trust receives qualifying residential interest, and the disabled beneficiary is a lineal descendant of the deceased. However, the rules are complex, and specialist advice is strongly recommended when claiming the RNRB via a trust.



Capital Gains Tax:

Where no Vulnerable Person's Election is Made:

For capital gains tax (CGT) purposes, a Disabled Person's Trust is treated more favourably than other trusts.
Under section 1K of the Taxation of Chargeable Gains Act 1992 (TCGA 1992), the trust is entitled to the full annual exemption available to individuals (currently £3,000 for the 2025/26 tax year), rather than the lower rate available to most trusts (half the individual exemption).

Additionally, hold-over relief is available under section 260 TCGA 1992 for lifetime transfers into a Disabled Person's Trust. This allows capital gains on the transferred assets to be deferred, avoiding a CGT bill at the time of transfer. The gain is effectively "held over" and only realised when the asset is eventually sold or transferred out of the trust.

If the trust holds a residential property that the disabled person occupies as their main home, it may be eligible for principal private residence relief (PPR) under section 225 TCGA 1992, provided the conditions are met. This could allow the property to be sold free of CGT, though detailed eligibility requirements must be considered.

Trustees are responsible for reporting and paying CGT when a chargeable disposal is made and for registering the trust with HMRC's Trust Registration Service (TRS).

Disabled Persons Trust Factsheet

Where a Vulnerable Person's Election is made:

Where the trust qualifies as a vulnerable beneficiary trust, the trustees may jointly elect within the vulnerable beneficiary to apply the special tax regime under section 23-45 Finance Act 2005.

If a Vulnerable Person's Election is made for a tax year:

- The trustees first calculate CGT in the normal way, using trust rates and allowances, and
- They then calculate what the CGT liability would have been if the gains had arisen directly to the vulnerable beneficiary.

The trustees' CGT liability is then reduced so that it is no more than the amount the vulnerable beneficiary would have paid personally.

This can be particularly beneficial where the vulnerable beneficiary:

- Has unused CGT exemptions, or
- Pays CGT at a low (basic rate) rates than trustees.

Where the election applies, the trust is also entitled to the full individual annual CGT exemption, rather than the reduced trust allowance, provided the statutory conditions are met.

The election must be made annually and may be withdrawn or not renewed if it is not advantageous in a particular tax year.

Income Tax:

Where no Vulnerable Person's Election is made

The income tax treatment of a Disabled Person's Trust depends on how the income is used and whether it is mandated to the beneficiary or retained by the trustees.

If the trust mandates income to the disabled person (i.e. automatically pays income directly to them), that income is treated as the beneficiary's own income and taxed at their marginal rate. This can be advantageous if the disabled person has little or no other income and therefore pays little or no tax.

If the trustees retain control over the income and choose how and when to apply it, the trust is treated as a discretionary trust for income tax purposes. This means the trust pays tax at the trust rate, which is currently:

- 39.35% on dividend income, and
- 45% on all other income.

Disabled Persons Trust Factsheet

However, where the income tax is paid out to the disabled person, they may be able to reclaim some or all of the tax by completing a Self-Assessment return, depending on their personal tax position.

It is important for trustees to maintain accurate records and file tax returns where required. Where the income is not mandated, trustees may also need to issue form R185 (Trust Income) to the beneficiary to enable any tax reclaim.

Where a Vulnerable Person's Election is made

Where a Vulnerable Person's Election is in place, the trustees may reduce their income tax liability so that it is no greater than the income tax the vulnerable beneficiary would have paid if the income had arisen to them directly.

In practice:

- Trustees calculate income tax in the normal way, and
- Then calculate the vulnerable beneficiary's notional personal tax liability, taking into account their:
  - Personal allowance
  - Marginal tax rates
  - Other income

The trustees' income tax liability is reduced by the difference.
This can result in a significant tax saving, particularly where the vulnerable beneficiary has little or no other income.
Where trust income is accumulated, the reduced tax liability forms part of the trustees' tax pool. The election must be made jointly and annually and only applies for the tax year in which it was made.

Final Points:

Disabled Person's Trusts are a powerful tool for families who want to provide long term financial support to a vulnerable loved one without putting them at risk of losing vital state support.

These trusts offer flexibility, protections, and favourable tax treatment, but they must be set up carefully to ensure the legal and tax requirements are met.

Each situation is different, and this guide is intended as an overview rather than legal advice.

Disclaimer

This factsheet is provided for general informational purposes only and is not intended, and should not be relied upon, as legal advice. SWW accepts no responsibility or liability for any actions taken on the basis of this note, and members should seek independent legal advice where appropriate.