Drafting Trusts and Will Trusts, 4th Edn., para. 15.055

Power to Retain Income of Minor

The form used in this book is:

Where trustees may apply income for the benefit of a minor, they may do so by resolving that they hold that income on trust for the minor absolutely and:

(1) The Trustees may apply that income for the benefit of the minor during his minority.

(2) The Trustees shall transfer the residue of that income to the minor on attaining the age of 18,

(3) For investment and other administrative purposes that income shall be treated as Trust Property.

This power is principally concerned with tax; it is useful where the beneficiaries are minor children of the settlor.

For income tax purposes one would like the minor beneficiaries to have an income of their own, so as to use their own tax allowances. This offers a significant tax saving, year after year. To soi-ne extent anti-avoidance provisions counteract the tax advantage. This is done by providing that the child's income should be treated as the income of the parent. That only applies to income:

Paid to or for the benefit of an unmarried child of the Settlor.

So where a settlement is for the benefit of minor children of the settlor, there are three ways trustees can deal with the trust income:

(1) The trustees may apply it for the benefit of the minor children. The disadvantage is that the income will then be taxed as the settlor's income under the anti-avoidance provision just discussed.

(2) The trustees may accumulate it. The income will not be taxed as the parent's income. The disadvantage is that the income win be subject to basic and additional rate tax.

(3) The trustees may retain the income on trust for the child exercising this special power. In that case the income is effectively taxed as the child's income (and up to the personal allowance, escapes tax altogether.)