

TRUST NEWS

Welcome to the latest edition of Trust News. I am pleased to be editing my first edition since joining Creaseys in the summer as Trust Manager. Despite increasing tax rates and frozen tax allowances, there are still plenty of opportunities for the well advised to use trusts to reduce imminent or future tax liabilities, a few of which are discussed below.

Please feel free to pass on Trust News to anyone to whom it may be of interest. Please contact me or your usual Creaseys contact if any of the articles are of interest or if you have any questions relating to trusts or other tax issues.

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Get your distributions right

Many trustees have the power to decide how much income should be distributed to beneficiaries.

Now that the 50% tax rate is hitting a large proportion of trusts, it is essential that trustees review their distribution policy.

- Make sure you do not distribute too much – you will need to take the increased tax liability into account when deciding how much to distribute.
- Beneficiaries may well be able to reclaim some or all of the tax attaching to their distributions. Consider distributing as much income as possible so that beneficiaries can benefit from the tax paid by the trustees.
- Consider giving specified beneficiaries the right to income. This would avoid the 50% tax charge on the trust altogether.
- Make sure distributions are made by 5 April 2011 so that beneficiaries can claim their tax repayments as soon as possible.

Please contact us to discuss your best course of action.

Leave your children a valuable legacy

With the IHT nil rate band (exempt amount) being frozen for the foreseeable future at £325,000, it is often difficult to get funds out of your hands without incurring an IHT liability.

It is paramount to maximise the benefit you can get out of a situation where an IHT charge is unavoidable.

Take the following example; George and Alison are married and wish to leave all their assets to each other, and subsequently to their two children.

When the first of them dies, all assets will pass to the survivor free of IHT. On the death of the survivor, the assets will be subject to IHT after deducting their own nil rate band plus a further nil rate band transferred from their spouse. After tax has been paid, the assets will pass to their children.

In years to come, the children may face a similar situation and similar IHT charges.

George and Alison could however pass on their assets to their children in such a way that they can be protected from IHT for future generations.

If, on the death of the surviving spouse, the assets are passed to a trust for their children's benefit, the IHT payable remains exactly the same. However, this provides a valuable tax planning vehicle for the children.

Indeed, if a number of trusts are set up during George and Alison's lifetime, with assets being transferred to the trusts when the surviving spouse dies, the tax savings in the future can be very sizeable.

Once in the trusts, the value of the assets remains outside of their children's estates. Each trust has its own IHT nil rate band so *no tax* will be payable by the trusts if the value of its assets remains below £325,000 (currently).

There is no limit on the number of these trusts (sometimes referred to as Pilot Trusts) that can be set-up and therefore no limit on the number of nil rate bands available to benefit your children!

These arrangements must be set up during your lifetime and must be drawn up carefully. If you wish to discuss the possibilities, please contact us.

Home 'loan trust' schemes

Some years ago, an IHT planning scheme, which purported to remove the value of your home whilst allowing you to remain living in it, was being widely marketed.

These schemes became unpopular once the 'pre-owned asset tax' was introduced which meant that those partaking in these schemes became subject to an additional Income Tax charge.

Many people left these schemes in place and continue to pay the additional Income Tax charge on the understanding that the house will not be subject to IHT.

Recently however, HM Revenue & Customs have indicated that they have changed their view and believe that these properties may still be subject to IHT when the original owner dies. A test case is expected soon.

If you believe you have undertaken any such planning, please contact us and we will guide you in the best course of action.

Transferable nil rate bands

As most will be aware, when someone dies and leaves all their assets to their spouse, that spouse's executors can claim an additional IHT nil rate band against the value of the estate.

Only one additional nil rate band is available even if the deceased had been widowed more than once.

If someone remarries after being widowed, it is, in some instances, possible to make use of more than one additional nil rate band.

If you or your spouse have previously been widowed and together your assets exceed £650,000, please contact us to discuss how your future IHT liabilities can be reduced.

'Settlor Interested' Trusts

If someone sets up a trust from which they, or their spouse, can benefit, this is known as a 'settlor interested' trust.

The income of the trust will be subject to tax at rates of up to 50%. The income will be treated as if it is the settlor's own income, and if they pay tax at a lower rate than the trust they will receive a repayment of the difference.

From 6 April 2010, any such repayment received by a settlor must be repaid to the trustees and must not be kept by the settlor.

Trust tax returns

Many trustees are not issued with a tax return each year. This may be because historically the trust has received no income or the income is paid directly to the beneficiary.

If a liability does arise because some income is received or a capital gain is realised on an investment, a tax return must be submitted. If a tax return has not been issued for that year, the trustees are required to notify HMRC that a tax return is required by 5 October following the end of the tax year concerned. HMRC have recently indicated that they will not accept tax returns filed after 31 October 2010 if the trustees have not already advised them that a tax return is due, and penalties may be levied.

If you are a trustee and believe that a tax return is due for 2009/10 but has not been issued, please contact us as soon as possible so that any problems can be resolved prior to the filing deadline on 31 January 2011.

Could your Trust pay Capital Gains Tax at just 10%?

The Budget on 22 June 2010 increased the normal capital gains tax rate to 28% for disposals after that date. However, Entrepreneurs' Relief may enable a 10% rate to apply to qualifying gains made after that date and trustees need to consider their position and that of family beneficiaries in order to take advantage of this in appropriate circumstances.

Very broadly Entrepreneurs' Relief may be available to trustees where they own shares in an unquoted trading company, operate a business as a sole trader or as partner or perhaps own land used by an associated

family business. Please contact us for a review as in many cases simple changes can mean the 10% CGT rate applies.

Example

The Elaine Discretionary Trust owns 12% of the shares in Julia Limited, an unquoted trading company. The trust is discretionary so it cannot benefit from the 10% CGT rate.

Possible Solution –

The trustees convert their trust into a slightly different type of trust and transfer enough shares out to the main beneficiary Elaine who is a director of Julia Limited. With appropriate planning, the trust and Elaine will both now get a 10% CGT rate on disposal of the shares.

Why Offshore?

Trusts established outside the UK may still be beneficial in certain circumstances particularly where set-up by clients who are not domiciled or not resident in the UK.

In appropriate cases this gives the facility for tax free gains to be made by the trust although careful planning will be needed to optimise the tax efficiency of distributions to beneficiaries.

Such trusts can also be helpful for people returning to live in the UK in order to wash out capital gains which may have accrued while they lived outside the UK.

Occasionally we find offshore trusts that have been set up for non-tax reasons and are not particularly tax effective. In appropriate circumstances it may be wise to wind these up with appropriate disclosure to the UK tax authorities.