

TRUST NEWS – FEBRUARY 2010

We are proud to act for well over 300 Trusts and have a team of specialists who deal with the tax and accounting requirements of these valued clients. In some cases we are very pleased to act as trustees, either personally or through our nominee company Creaseys Trustees Limited.

We set out below some current topical issues which may be of interest to trustees and their advisers as well as those who are beneficiaries of trusts.

1. 50% Rate Hits Trusts!

From 6 April 2010, individuals will pay 50% income tax on any annual income they have over £150,000, but a very large number of trusts will be paying this 50% tax rate on trust income over just £1,000. Trustees in this position should look to accelerate income if at all possible (e.g. family company dividends) so as to pay tax at the lower 40% rate. In addition, consideration should be given to distributing income prior to 6 April 2010 or investing in tax efficient products.

For example, single premium life insurance bonds can act as a wrapper for a wide variety of underlying investments, from equities and unit trusts to cash.

Where all trust income is distributed and it comprises dividend income, the overall effective rate of tax can be as high as 57%! Trustees may look to convert into a different type of trust giving beneficiaries a fixed right to income. In that case, the rate of income tax will fall to that paid by the beneficiary. We have advised many family trusts to consider this mechanism or indeed to possibly wind up a trust prior to the hike in income tax rates. Trusts that currently accumulate income will be particularly badly affected.

Trusts owning properties should, where possible, consider deferring repair and maintenance expenditure until after 5 April 2010 thereby increasing the tax relief available by 10%. There are many other simple, but effective steps that, if considered within the next few weeks, can save tax of 10%.

2. Minimising Capital Gains Tax

At present, most trusts pay Capital Gains Tax ('CGT') at a flat rate of 18% on disposals of assets and there is currently an annual exemption of £5,050. Trustees may look to invest for capital growth to get the benefits of lower CGT, but of course need to be mindful to balance the interests of all beneficiaries.

Some trusts may be able to structure their assets to take advantage of the 10% CGT rate that arises from entrepreneurs' relief. This may apply where, for example, shares in unquoted trading companies are held or properties are used by a connected party.

Trustees will need to take considerable care to ensure that they do qualify for entrepreneurs' relief. In the case of discretionary trusts this relief is unlikely to apply and even for life interest trusts, it is probably necessary for the life tenant to be an employee of the company concerned and to have shares in the company in his or her own right. Entrepreneurs' relief may mean just 10% tax on the first £1 million of gains.

3. 'Settlor Interested' Trusts

Sometimes in the past, an individual may have transferred assets to a trust of which he, his spouse or minor children are beneficiaries, perhaps to trigger a CGT charge or enable a particular relief to be claimed, before it is abolished. Such trusts are usually transparent for income tax and inheritance tax (IHT) purposes and hence their only real benefit has usually been CGT. Many such trusts may have outlived their usefulness and we have advised many of them to be wound up. This is partly because such trusts often cannot benefit from the 10% CGT rate arising for entrepreneurs' relief – see 2 above, but also because they are generally likely to have outlived their usefulness.

4. Trust Accounts

An increasing number of our trust clients are having accounts prepared in order that the trustees and beneficiaries can monitor what assets are held, the split between income and capital accounts, the success or otherwise of the investment policy and what payments are due to various family members.

At Creaseys this work is headed up by Malcolm Brewer and although there is a cost, most trusts find the production of annual accounts to be of considerable benefit. This will also assist trustees in maintaining their obligations under the Trustee Act, giving peace of mind and minimising the dangers of litigation.

5. Trusts to avoid CGT

We have seen a few cases recently where gifts of assets pregnant with capital gains (e.g. property, quoted shares) have been transferred to a family trust which then, perhaps after a year or two, chooses to transfer those assets out to family beneficiaries. Provided this is planned properly and the trust has real substance and meaning for the family, there should be no tax to pay on the transfers in and out of the trust. If the individual had transferred the assets direct to the family members concerned, there would have been significant CGT to pay.

6. Offshore Trusts – Rebasing Election

We advise many offshore trusts. In many cases, non domiciled and non resident clients are setting up offshore trusts to mitigate capital taxes, despite the toughening up of the rules over the last year or so, particularly for non domiciled clients. These trusts are particularly appropriate for assets likely to increase substantially in value.

A benefit of offshore trusts in existence at 5 April 2008 is the ability to elect to rebase assets for CGT purposes to market value at that time. It is essential though that the trustees make an election by 31 January following the tax year in which the first capital payment was made to any non domiciled beneficiary (post 6 April 2008). It may well be appropriate for offshore trustees to make this election now so that it is not forgotten at a later date. Usually there is no downside to the election, assuming chargeable assets have increased in value by 5 April 2008 compared to acquisition cost.

7. Avoiding the dreaded 10 year charge!

The majority of trusts will need to make a payment on account of IHT every 10 years and trustees need to be mindful of their obligation in most cases to make a return at that time and to pay the required amount of IHT. Consideration should always be given to transferring assets out of the trust prior to the 10 year anniversary, as normally this can be done at a much lower tax cost than if they continue to be held. Trustees holding business and agricultural property need to check that the relevant conditions are still satisfied to obtain the maximum possible relief from IHT. Alternatively, trustees might think, in the run up to the 10 year anniversary, of investing in such assets to avoid the IHT charge (although normally they need to be held for a minimum of 2 years before the anniversary date to get the best possible result).

8. Limiting Trustees' Risks

The Trustee Act 2000 has placed a greater duty of care onto all trustees (not only those considered to be professional trustees) on the grounds of special knowledge, experience or professional status.

Every trust that holds investments must have a written Statement of Trustee Investment Policy and this must be reviewed at least annually to ensure that the requirements of beneficiaries, the performance of the investment managers against suitable benchmarks and the situation in the investment markets are monitored and reviewed. Such a Statement should identify the beneficiaries, the trust property and the investment managers, and declare the objectives for capital and income generation.

It is becoming increasingly important to maintain written minutes of decisions taken by trustees, not only to record why a certain course of action was decided upon, but also why alternative courses of action were discarded. In this way a subsequent challenge relying on the benefit of hindsight may be more successfully resisted.

The appointment as a trustee is becoming increasingly risky and professional advice should always be sought if you are in any doubt as to your responsibilities and how to meet them. The retention of adequate records and evidence is crucial for all trustees.

We are able to help trustees to prepare a suitable Statement of Trustee Investment Policy and can also recommend investment advisers that will be suitable to the needs of a particular trust.

9. Trusts and life policies

Many people think that trusts do not affect them; often forgetting the fact that many years ago they may have written a life assurance or pension policy into trust (i.e. naming beneficiaries) or may have taken advantage of the IHT planning opportunities presented by what are called Gift and Loan Plans.

Care needs to be taken in the first instance to ensure that these trusts are identified and then either to confirm that they are exempt from the Relevant Property rules, or to ensure that the 10 year IHT charge reporting obligations are properly complied with.

10. Conclusion

We very much hope that readers find this Trust News of interest and please do not hesitate to contact us about any trust or tax matters, however big or small.

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