ATT welcome, June 2016

Welcomes

01 June 2016

A matter of trust

April and the start of May has been a quiet period at the ATT for the leadership team, with our new executive director Jane Ashton bedding into her role following Andy Pickering's retirement.

I, along with others in the leadership team, hosted a table for our distinguished guests at the Tolley Taxation Awards, which was a great night – we were one of the main sponsors again this year. The Tolley Taxation Awards night clashed with our Admission Ceremony for new members at the House of Lords, but don't worry, Michael Steed, our President, as well as a number of head office staff and Council Members were on hand to make our new members and their families feel very welcome.

The new tax year has been quite a busy period for me; I spent many hours getting myself up to speed with the taxation of trusts.
It was ten years ago, on 22 March 2006, that the trust regime changed fundamentally for the Financial Services industry. Prior to this, the industry used more or less exclusively flexible life interest trusts (interest in possession trusts) for placing life policies in trust and inheritance tax packaged products such as discounted gift trusts and loan trusts – oh, how simple life was in those days! However, after this change we moved to using discretionary trusts more or less exclusively, and a significant number of hours was spent getting up to speed with the taxation and administrative regimes. This month sees some of the first of the Financial Services world trusts reach their tenth anniversary and therefore the first periodic charges we have had to deal with.

I am concerned that there is a potential problem brewing for many lay trustees who are completely unaware of their obligations to complete IHT100s and pay the

periodic tax charge, and they are sitting on a potential tax and penalty time bomb. The reason for this is that the wealth management and financial services industry is responsible for setting up tens of thousands of these trusts since their introduction, the vast majority of which are completely off the HMRC radar.

The reason that most of these trusts are not registered with HMRC is that the investment solution used for many trustees to help them remove the need to submit tax returns and pay income tax is an investment bond, onshore or offshore. An investment bond is a non-income producing asset and will not normally be subject to capital gains tax. This means that trustees satisfy the requirements set out in HMRC's *Trusts, Settlements and Estates Manual* para 1405 which refers to new trusts with no likelihood of income or gains. The manual says that the trustees of such trusts need not notify the trust office of the existence of the trust, as there is no need to issue an annual self-assessment return.

I have been asked to look at a discounted gift trust which was one of the first created post-22 March 2006.

Discounted gift trusts are an inheritance tax planning solution. They are designed to help people who want to reduce their inheritance tax liability but need income to live off so under normal circumstances would fall foul of the 'gift with reservation' rules. However, a discounted gift trust enables a client to make use of the IHT gifting rules whilst retaining an income for life and qualifies for an immediate reduction in their estate for IHT, known as a discount. The client receives an immediate reduction in their estate for IHT, and the balance of the gift falls out of the estate after seven years, but the client receives the income for the rest of their life. HMRC set out their requirements for discounted gift trusts to achieve this objective in a *Technical Note* in 2007.

In the example I have been asked to look at, the value of the assets in the discounted gift trust is £350,000 so on first sight you would assume that it is over the nil rate band and the trustees will have to pay the 6% IHT tax charge. However, if the settlor is still alive, which is the case for this trust, to calculate whether the trust needs to complete an IHT100 or pay IHT you recalculate the discount based on the settlors age at the ten year anniversary. HMRC set out the basis to be used to calculate the relevant property element of the trust in a briefing note (*Number 22*) published on 9 August 2013. In this example, the discount was 25% and therefore it takes the assets for tax and IHT100 purposes to £262,500. The good news for the

trustees is there is no tax liability but the bad news is they are now over 80% of the nil rate band and therefore will have to complete an IHT100.

I am very pro trusts to help with succession planning and IHT planning but the complexity in terms of tax and administration has led to many professional advisers turning their back on them as a planning tool, which is quite sad in my opinion.