The FA 2016 practicalities of investment income for Estates and Trusts

Inheritance Tax and trusts

01 January 2017

A summary of how the FA 2016 changes to the taxation of dividends and interest affect Personal Representatives and Trustees

How personal representatives (PRs) and trustees should account for interest and dividends received by them is now a lot more certain, following amendments made to the draft legislation and clarifications obtained from HMRC. From 6 April 2016 all interest is received gross (with no basic rate deduction) and dividends no longer carry the non-repayable 10% tax credit; in principle, therefore, PRs and trustees should pay the appropriate rates of income tax on the cash sums received. In many cases this will require additional work in reporting the income and accounting for tax, which in 2015-16 and earlier years would not have been necessary under the deduction at source/tax credit regimes.

Estates in the course of administration

For 2016-17 PRs are liable to 7.5% income tax on dividends received, and 20% on all other income. That tax liability may be settled informally, without the need to submit a full tax return, where the estate is not regarded as complex. The criteria for the informal procedure are set out in HMRC's Trust and Estates Newsletter for December 2015 (see http://tinyurl.com/jcyhook), the main condition being that the total income tax and CGT liability for the whole administration period of the estate is £10,000 or less. As a further concession, the April 2016 Newsletter announced that for 2016/17 HMRC will not require notification from trustees or PRs where their only source of income is savings interest and the tax liability is below £100. Even £1 of any other type of income will mean the whole income of the estate or trust having to be

reported. This concession is to be reviewed for 2017/18 onwards. Interest falling within this concession may be handed over gross to a beneficiary, who may have to report it, if that (with other interest they receive) exceeds their Personal Savings Allowance (PSA).

Dividends received by PRs from 2016/17 are now reportable and chargeable at 7.5%. When the PRs make a distribution from the estate to a residuary beneficiary which falls within the rules for determining the beneficiary's share of estate income, it is grossed up at the rate of tax applicable in that year to that type of income, and carries that as a tax credit. For dividends the rate for 2016/17 is 7.5% and the tax credit is repayable in relation to dividends received by the PRs under the new regime. However for dividends received by the PRs in 2015-16 or earlier years, but not distributed (or deemed distributed) until 2016/17 or later, HMRC have confirmed that the net payment made will continue to carry a non-repayable tax credit, but at 7.5%.

From 2016/17 onwards, the net amount of interest distributed to a residuary beneficiary will continue to be grossed up at 20% and carries a 20% repayable credit. The credit derives from the tax deducted at source (for 2015/16 or earlier net interest received) or from the tax actually paid by the PRs for 2016-17 onwards.

Pending the issue of a revised R185 (Estate Income) PRs may continue to use the current version: Box 21 (with a 7.5% non-repayable tax credit) for 2015/16 or earlier dividends; Box 18 (with a 7.5% repayable tax credit) for 2016/17 or later dividends; and Box 17 (savings income) for interest, whenever received, and carrying a repayable 20% tax credit or deduction.

A residuary beneficiary may set their £5,000 dividend nil-rate band (DNRB) against any dividend-type income received from an estate.

Interest in possession trusts, typically Life Interests

From 2016/17 the trustees are (unless the £100 savings interest concession applies) in a position similar to that of PRs in that they are liable to pay 7.5% on dividends and 20% on interest received; previously, their liability for such income would have been covered by the tax credit / deduction at source mechanisms. However HMRC

have confirmed that where such income is mandated directly to the beneficiary, the existing procedures which save the trustees from completing a return continue to apply. Given the necessity for trustees now to pay tax on investment income received, the argument in favour of mandating income to a beneficiary to reduce compliance costs is even more compelling. The beneficiary may shelter the interest or dividends received within their PSA or DNRB, whether or not such income is mandated.

Discretionary or accumulation trusts

For trustees, the first £1,000 of income continues to fall within the ‘standard band’; for 2016/17 onwards dividends within that are charged at 7.5% and interest at 20%; above the standard band the dividend trust rate is 38.1% and other income, including interest, suffers the 45% trust rate. The effective level of charge on a discretionary trust is unchanged. The tax pool rules were amended during the passage of the Finance Bill so that all the tax actually suffered by the trustees (at the various rates) falls into the tax pool, and is capable of franking a distribution to a beneficiary at 45%. Since a discretionary payment to a beneficiary loses the character of its underlying components, the beneficiary is unable to set their PSA or DNRB against it