



ARE TRUSTS DEAD?...

By Danny Clifford

Reports of the death of the trusts as planning tools have been greatly exaggerated.

I suspect the reason people believe that "trusts are dead" is because there is a general awareness that Gordon Brown during his time as Chancellor changed the rules in respect of trusts under the cover of "anti-avoidance". (Gordon claimed everything that he did was either for "anti-avoidance" or "simplification" purposes which is ironic given that by the time he left office we had one of the most complex tax regimes in the world and protests about high levels of tax avoidance).

That aside, the legislation in 2006 did indeed fundamentally change the taxation rules applicable to trusts. However while some aspects (eg: making lifetime trusts subject to harsher IHT rules) were altered to make trusts less favourable, inadvertently this had knock on effects onto other aspects which then became more favourable (eg: increased availability of holdover relief).

Ultimately this meant that trusts became not so much less useful as a planning tool, rather they became less useful in some ways and more useful in others.

So if what was intended was to curtail the use of trusts the legislation singularly failed. Trusts are not only alive and well, but in somewhat rude health. So why might that be of interest to you?

Trusts can be utilised for a number of reasons: asset protection, asset control, flexibility of planning, tax planning, charitable purposes, protection of vulnerable (disabled) beneficiaries to name but a few. They can be created either during one's lifetime or, via a will (or deed of variation) on death.

But merely listing down the potential uses does not give enough detail for you to decide whether a trust might be for you, so below are some examples of situations where, in the last year, I have advised clients to create trusts:

During lifetime a trust can be created into which value can be placed. That value will effectively be removed from the estate of the person gifting it to the trust if they survive for 7 years from the date of that gift. An individual can place up to £325,000 of value into a trust without triggering an IHT liability. However, if the gift had been made outright to another individual the same seven year rule would apply and there would be no £325,000 limit. So why choose to use a trust rather than just make the gift outright to an individual?

I find that contrary to Gordon's somewhat paranoid beliefs, the answer lies not in tax avoidance but in accessing the flexibility and protection that is afforded by a trust. If a gift is made outright to an individual then that

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asset belongs absolutely to them and it is theirs to use as they wish, or indeed lose! If the gift is made into a trust it can be protected in a number of ways:

- The trust can be discretionary which means that the person making the gift does not need to decide at the time of the gift who will benefit from the capital or indeed any income from the asset. That decision can be made at a later date by the trustees. Obviously this can be particularly useful where some of the beneficiaries are minors, or (often) where they are in the early stages of a marriage and the parent just wants to make sure everything is on a solid footing before passing the value on.
- By making themselves a trustee, the person making the gift can continue to control what happens to that asset and who benefits from the asset and any income it generates – provided that they themselves do not benefit.
- By placing the asset in a trust it provides protection against third parties who may have a claim against an individual beneficiary. This can be effective in cases of marriage break-up and/or insolvency / business problems. It also, of course, prevents the beneficiary from being able to squander the asset.

This flexibility and protection enables the donor to make the gift (into trust) and to start the 7 year clock running to remove the asset from their estate while not losing control of the asset and keeping his options open as to where it will eventually end up.

Where the beneficiaries of the trust include persons who have little or no income (eg: minors) there is also an income tax advantage

that can be obtained via a trust. If a higher rate tax payer (eg: grandparent) pays school fees on behalf of a grandchild, they would do so from income that has been taxed at the higher rate. If, however, the funds are generated from a trust asset it is possible to utilise the personal allowances and lower rate tax bands of the beneficiaries to reduce, or eliminate, the tax that would otherwise be due on the income.

On death a trust might be created either for tax planning or for generational planning.

A trust can be created in a will to hold assets on which no IHT liability will arise (for example property covered by agricultural or business property reliefs) which means that those assets need not enter the estate of the surviving spouse where they might later become taxable on the death of that spouse. Yet the surviving spouse can still benefit from any income produced. If this is done, a further potential benefit, if the asset will continue to benefit from APR or BPR, might be for the surviving spouse to purchase the property from the trust, hence enabling the relief to be captured twice – once on the death of each spouse.

On a different (non-tax) tack, I regularly come across the situation where each spouse is happy to leave everything to the surviving spouse but is adamant that on the death of the surviving spouse the value should pass to their own children. It is not uncommon where one spouse dies for the surviving spouse to find themselves another partner in due course and, possibly another family.

If the asset is left outright to the spouse then the spouse could potentially leave the asset to their "new family" in their will. To ensure that this does not happen, the client can leave the asset not to their spouse outright, but rather into a life interest trust for the spouse with terms that ensure that on the death of the second spouse, the asset passes to their own children. The surviving spouse cannot then redirect the assets in their own will and the

passing on of the asset to the next generation desired by the client will come to fruition.

Of course there are myriad other reasons for creating trusts ranging from the very basic to the extremely complex and clever. Contrary to popular belief I find that the demand for "tax avoidance trusts" is almost negligible. Most trusts that I advise on are set up for a combination of:

- Protection of the assets for future generations together with
- Basic tax planning (to take advantage of reliefs that HMRC would have no issue with)

The added bonus is that trusts set up for such straight forward reasons tend to be very simple (and therefore inexpensive) to create and run.

So the thought I would like to leave you with is not to view a trust as a complex tax avoidance mechanism. In my experience relatively few are used in that way, more often they are used to take advantage of the flexibility and protection that they afford. The fact that often this can be combined with achieving a lower tax bill long term is not usually the driving factor for creating the trust – though it is a neat and welcome side effect.



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NEWSBITES...



Using your own car for work

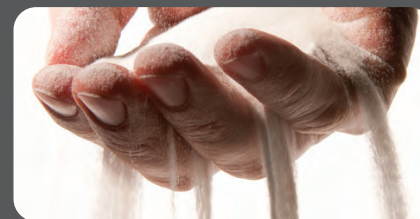
If you use your own car for your employer's business you can be paid 45p per mile for the first 10,000 miles in the tax year and 25p thereafter, with no tax consequences. If you are paid less than this, you can claim tax relief for the difference. The rates are different if your employer provides the car.

Rental income – interest payments

Interest payments on a loan to buy property which you let are allowable against the rent you receive, but there is no tax relief for the repayment of capital. If your payments to the lender include both interest and capital, check that you only include the interest in your tax return.



For further advice on any of these matters please call **Anne Wright** on 01473 220092 or email anne.wright@ensors.co.uk



Losing personal allowances

The personal allowance for those under 65 is currently £7,475 but if your total income from all sources is over £100,000 you start to lose this, and no allowance is due once income reaches £114,950. Over 65's have higher personal allowances, but these are also restricted if income is above £24,000.

THE BIG SOCIETY AND TAX PLANNING...



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It has been well documented over the past year that as a result of the recession, the coalition government is hoping that the third sector (ie: voluntary and charitable sector) will now be responsible for the provision of more services which would otherwise be covered by the 'public purse'. The potential savings for the government are significant but the charitable sector will only be able to provide these services as long as funds are received to cover them.

Fortunately, the taxman assists here, as significant tax reliefs are available in respect of gifts to charity.

Under the Gift Aid scheme, for every £1 in cash donated, the charity is able to reclaim 25p from HM Revenue & Customs. In addition, where the gift is made by a higher rate taxpayer, tax relief can be claimed on the appropriate self assessment tax return. For a 50% taxpayer this could result in additional tax relief of 37.5p. Therefore, for an effective outlay of 62.5p (£1 initial donation – tax relief of 37.5p) the charity has received £1.25 (£1 initial donation + 25p gift aid).

Very tax efficient!

In order for individuals to benefit from this provision they need to have paid sufficient tax (income tax and capital gains tax) equivalent to the tax credit being reclaimed by the charity – 25p in this case. Care does have to be taken to ensure this rule is not breached.

Tax relief is however not restricted to gifts of cash.

A gift of shares in a quoted company to a charity will be exempt from capital gains tax but additionally, the market value of the shares gifted to the charity is deductible from taxable income. Therefore income tax relief is available at the marginal rate.

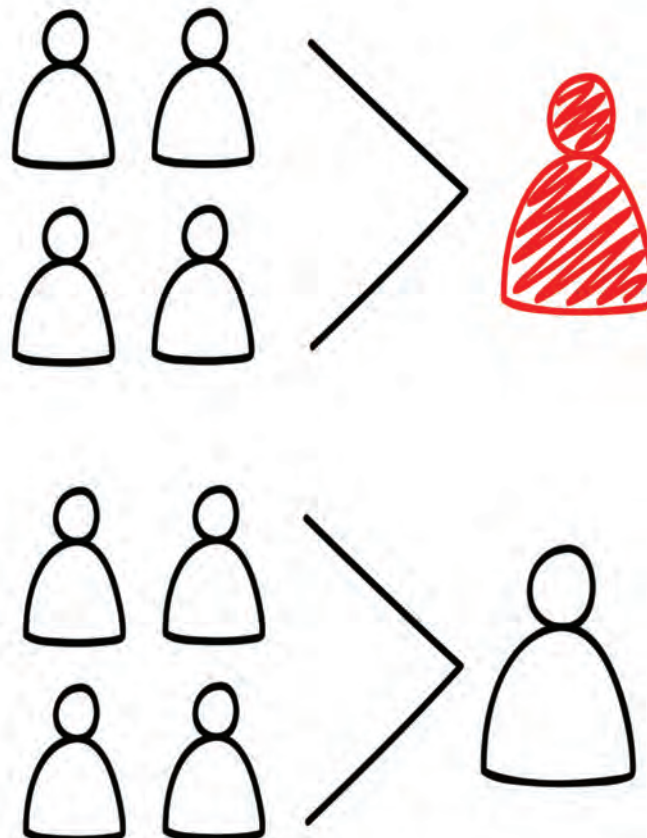
Similarly, when land or property is gifted to charity the tax reliefs work in the same way as they do for gifts of shares.

Where the charity receives a gift of shares or property it will not pay any income tax or capital gains tax in respect of income received or on proceeds received if the asset is disposed of. However, the charity does not receive any additional tax refund from HMRC as is the case for cash donations.

Where significant donations are being considered it may be appropriate to take proactive tax advice to ensure the maximum amount of tax is saved. This could be:

1. Spreading the payment over 2 tax years to maximise tax reliefs at the highest rate;
2. Considering whether to sell an asset and gift the resulting cash to the charity or simply gift the asset. Where a capital loss is to be realised it is generally more efficient to sell the asset and gift the cash. The donor has the benefit of off-setting the loss against other capital gains as well as obtaining the income tax relief.

Tax reliefs are readily available for giving to charity; but good planning will ensure you can play your part in the most tax efficient manner.



THE LATEST ON YOUR PENSION...

There have been a number of significant changes to pension regulations since our last comments on the subject, set against a backdrop of press speculation on proposals to accelerate the increase to State Pension age in response to an ageing UK population.

Following an attempt to simplify pension regulations, which became effective from 2006, several of the taxation limits imposed on private pension arrangements are being revised. One of these limits is referred to as the lifetime limit which sets a ceiling over which the derivation of benefits from pension funds can be taxed at a higher rate of 55% on the excess capital value. The limit is currently £1,800,000 and is set to fall back to £1,500,000 on 6 April 2012 which to the unwary wealthy pensioner could cost as much as £165,000 in avoidable tax. Protection can be sought from falling into this tax trap and I would urge anyone potentially at risk to review their pension arrangements as soon as they practically can. Protection would depend on not making further investments into pensions.

This is an interesting proviso when balanced with the impending reform of work place pension schemes. Effective between October 2012 and September 2016, depending on numbers of staff, employers will have to make membership of a contributory pension scheme



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the default position for the vast majority of the UK workforce. Individuals will have the right to opt out which would be of critical importance for anyone in the above, at first glance enviable, position.

On a different point the government have maintained the freedom not to have to buy an insurance based annuity when deciding to take income from approved pension funds, within regulated limits, depending simplistically on life expectancy. An extension of this freedom now exists for individuals who can prove guaranteed approved pension income, including State Pension entitlement, in excess of £20,000 p.a. In this situation unfettered funds can be withdrawn from one's pension arrangement entirely at the discretion of the investor (if they are aged over 60) although they would be liable to income tax on the funds extracted in that year. Such a strategy would have to be carefully analysed before being enacted although it is refreshing to observe such liberty.

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