haysmacintyre
financial planning

hfp | trustee investments

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When considering trust investments, trustees have a duty to:

- Ensure investments are suitable
- Consider the tax effect of investments
- Review investments on a regular basis
- Take professional advice

Since April 2004, the tax treatment of investments within trusts has changed with the increase in the Trust tax rate from 34% to 40%. This rate is due to increase to 50% from April 2010. This change does not affect Interest in Possession Trusts where all the income is distributed and the beneficiary is taxed according to his/her rate. However, the position for Discretionary and Accumulation & Maintenance (A&M) Trusts has worsened whether income is accumulated or paid to beneficiaries.

The following is only intended for example purposes and is not intended as advice as to the suitability of any particular course of action. Trustees should seek appropriate tax or financial advice where needed.

income (excluding dividends)

The following paragraphs cover the current (2009/10) position where income of the trust exceeds £1,000 per annum (from 6th April 2006 - it was £500 previously)

Accumulating savings income within a discretionary or A&M trust will mean 20% tax deducted at source followed by a further 20% of the gross income deducted by the trustees. £1,000 net interest (£1,250 gross) will suffer further tax of £250 leaving £750 net. Rent, received gross, will have 40% tax deducted by the trustees.
If the income is immediately distributed to the beneficiary, the trustees simply pay over the income and provide a tax voucher. The beneficiary is then able to reclaim tax unless he/she is a 40% taxpayer. Using the example for savings income above, the recovery would be:

A 40% tax payer can reclaim	Nil	receives	£750
Basic Rate tax payer can reclaim	£250	receives	£1000
Non tax payer can reclaim	£500	receives	£1,250

UK dividends

The Trust tax rate for UK dividends increased from 25% to 32.5%. A net dividend of £1,000 (gross £1,111.11) accumulated in a discretionary or A&M trust becomes £750 (£1,111.11@ 32.5% = £361.11 less tax credit of £111.11 = £250).

However, if the trustees distribute the income, the most they are able to distribute is £600 as the tax credit cannot be used to frank the trustees' tax liability when distributing income originally derived from dividends. The beneficiary can then only reclaim tax as follows:

A 40% tax payer can reclaim	Nil	receives	£600
Basic Rate tax payer can reclaim	£200	receives	£800
Non tax payer can reclaim	£400	receives	£1,000

investment bonds

If the trust assets are invested in Investment Bonds, the net income position for the taxpaying beneficiary can be significantly enhanced, although this does depend on the beneficiary's own situation. Within the bond, the life assurance company will suffer 20% tax on savings income or 10% on dividends (ie. no further tax to pay). Income accumulates within the bond and if the object of the trust is to accumulate income, no further tax is payable. Hence in each of the above examples the accumulated income would be £1,000 rather than £750 - an improvement of 33%.

If trustees wish to distribute, they could take withdrawals from the bond of up to 5% per annum and treat these as advances of capital to the beneficiary (provided they have the power to do so). For up to 20 years there will be no further tax to pay on these withdrawals either by the trustees or by the beneficiary. Thus the net income received by the beneficiary assuming £1,000 of income reinvested in the bond would be:

A 40% tax payer receives	£1,000
Basic Rate tax payer receives	£1,000
Non tax payer can receives	£1,000

After 20 years the tax position would need to be considered. It may be possible to assign the bond to the beneficiary. If the beneficiary then encashes the bond and is not a higher rate taxpayer in the year of encashment, there will be no further tax to pay. If all the beneficiaries are 40% taxpayers, the withdrawals could continue and the trustees would simply be liable for tax of 20%, being the Trust Rate on the whole withdrawal (credit being given for 20% tax assumed to have been paid within the bond). There would then be 4% (or, say £800) available for distribution with no further tax liability on the part of the beneficiary.

Furthermore, if a suitable managed fund is chosen, the trustees can satisfy their duty to appoint a professional investment manager. Advice will still be required on suitable managed funds and, for this purpose, haysmacintyre financial planning will be pleased to assist.

Please note, this briefing does not seek to address the Inheritance Tax position of trusts, for which separate advice will need to be taken.

Levels and bases of, and reliefs from, taxation are subject to change. Any tax reliefs referred to are those currently applying and their value depends upon the individual circumstances of the investor.

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