

LEGAL ALERT

PRIVATE CAPITAL BULLETIN

Rollits
SOLICITORS

FINANCE ACT 2006 IMPLICATIONS FOR TRUSTS AND WILLS

Rarely has there been such well publicised and vociferous opposition to changes proposed by a Finance Bill. The original proposals relating to the taxation of trusts were unexpected, far reaching and ill thought through. It was only as a result of forceful representations made by the professions that the Government tabled a number of significant amendments before the Finance Act 2006 received the Royal Assent on 19 July. Talk in the press of a "Government u-turn" was, however, overstated and the new rules will still have a significant impact on many existing trusts and on future lifetime tax planning in general.

OVERVIEW

Broadly speaking, the effect of the new legislation is to bring the taxation of all trusts into the existing charging regime for discretionary trusts. Essentially, this means that there will be a charge to Inheritance Tax (IHT):

- when assets are put into trust to the extent that they exceed a donor's nil rate band (currently £285,000) at the lifetime rate of 20%
- when assets come out of trust at a maximum rate of 6%
- every ten years on assets held in trust, again at a maximum rate of 6%
- if a donor does not survive a gift into trust by seven years, at a maximum rate of 20%

Importantly, business property relief and agricultural property relief are both unaffected for IHT and continue to be extremely valuable. In addition, there are important exceptions for trusts for the disabled.

TRUSTS IN WILLS

The Chancellor's original proposals raised the possibility that many Wills leaving a surviving spouse (or civil partner) a right to income (rather than an absolute gift of capital) might not qualify for the spouse exemption on the first death. This would have been disastrous for many families. Fortunately, these provisions were amended so that in such cases the "old" rules should now apply. The spouse exemption will be available on the first death and there will be a charge to IHT on the second death when the assets held in trust will be added to the life tenant's own estate. There will also be a corresponding uplift in the base cost of the trust assets for CGT purposes.

Trusts for children are also affected by the new provisions. Parents wanting to avoid an additional charge to IHT are now forced to leave assets to children at 18. Assets held in trust for children at an age between 18 and 25 will attract an additional IHT charge of up to 4.2% of the value of the trust assets. Other trusts for children and those created by grandparents and others will generally fall into the discretionary charging regime mentioned above.

It is difficult to reconcile these new provisions with the Chancellor's avowed liking for "prudence" as most parents would prefer children to become entitled at an age greater than eighteen and for the assets to be held by trustees whom they have chosen in the meantime. However, for most parents, the protection and flexibility which an age contingency offers will make the additional tax charge a price worth paying.

EXISTING TRUSTS

Existing discretionary trusts are unaffected but all other trusts will now need to be reviewed.

Accumulation and maintenance trusts (broadly, trusts for the under 25's) set up before 22 March 2006 will need to be reviewed in light of the transitional provisions in the Finance Act. A decision will need to be taken by the trustees as to whether to amend the terms of the trust (if they have power to do so) to accelerate the children's interests. Trusts which are amended so that beneficiaries become entitled to capital at eighteen will suffer no additional IHT charge and there will be a small proportionate charge (maximum 4.2%) if children become entitled to capital before age twenty five. Other trusts will fall into the new regime but this may offer welcome flexibility coupled with relatively low rates of IHT. Trustees must however be mindful of their obligations to take proper advice in this tricky area.

Existing interest in possession trusts will continue unaffected during the current interest but should be reviewed to see whether successive interests should be created or accelerated before 6 April 2008. Transitional provisions are available which may make this an attractive option in many cases.

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FINANCE ACT 2006 - PLANNING OPPORTUNITIES

WILLS

- "Nil rate band" trusts in Wills are still an effective tax planning device for married couples or civil partners.
- Parents' Wills leaving assets to children at an age greater than eighteen will need to be reviewed so that the IHT consequences can be considered.

TRUSTS

- Existing A & M and IIP trusts need to be reviewed before April 2008 to decide whether to take advantage of the transitional provisions.
- Bare trusts are broadly unaffected and provide scope for tax planning opportunities.
- No additions should be made to existing trusts without first taking proper advice.

LIFETIME TAX PLANNING

- The new regime encourages earlier lifetime tax planning to make use of the nil rate band. Subject to the seven year survivorship period, the exercise can be repeated a number of times. This can give scope to gift away considerable amounts of wealth, especially for married couples.

- BPR and APR reliefs are still available. Those with private company shares and agricultural assets should take early advantage of these valuable reliefs which mean that gifts can often be made entirely tax free. Those without such assets might look to invest part of their wealth in assets attracting the reliefs; under current rules and subject to a two year ownership period such assets can be completely free of IHT. "AIM" portfolios are becoming increasingly popular for this reason but their investment return will need to be carefully considered.

CONCLUSION

The new rules represent a heavy-handed and ill-conceived change to the settled and well understood regime concerning trusts. The Government has completely failed to appreciate that trusts are used for a variety of reasons many of which are unconnected with tax. However, it may well be that the full impact of the new rules, when viewed in conjunction with available reliefs and the CGT holdover provisions, may not be so onerous as originally thought. New opportunities and structures will undoubtedly emerge but trusts will continue to play an important role in estate planning. The emphasis now has to be on starting that process early.

RECOGNITION FOR ROLLITS' PRIVATE CAPITAL DEPARTMENT

We are delighted to have been acknowledged again as one of the region's top firms for private client work.

The most recent editions of the UK Legal 500 and Chambers Guide to the Legal Profession both recommend Rollits for its personal tax, trust and probate work.

The Legal 500 comments: "No one looks after clients better than Rollits which manages more than two hundred private trusts with assets in excess of £200 million. Caroline Hedges specialises in the restructuring of complex trust funds and contentious trust matters".

Chambers acknowledges: "The highly respected estate planning practice at commercial firm Rollits is commended for its "knowledgeable and efficient" approach. "Excellent" Caroline Hedges acts for a range of wealthy families, landed estates and associated trusts, and her practice focuses on related contentious issues. Head of the private capital department John Lane specialises in personal tax, trust, probate and charity work. He is deemed "exceptionally strong" in estate planning matters and recently advised on the major restructuring of high-value offshore trusts involving multi-jurisdictional issues".

CIVIL PARTNERSHIPS

The Civil Partnership Act 2004 has been in force since 5 December 2005. After just four months, over 6,500 single-sex couples in England and Wales had tied the knot.

A civil partnership offers many of the same advantages as marriage, such as those relating to Wills, estate planning and pensions. If you have entered into a civil partnership, any Will already made will be revoked, and you will need to make a new one. If a civil partner dies without making a Will, the surviving partner has the same rights under the intestacy rules that apply to married couples.

Transfers of property to a civil partner are exempt from inheritance tax. This affords the same estate planning opportunities enjoyed by spouses, and it may be possible to achieve considerable tax savings.



NEW APPOINTMENT TO ROLLITS' PRIVATE CAPITAL TEAM



Rollits has reinforced its commitment to delivering the best private client legal advice to clients with the appointment of Richard Whittaker. Previously with Walker Morris in Leeds, Richard joins Rollits as a Senior Solicitor in the Private Capital Department at Hull.

A law graduate from the UCE in Birmingham and The College of Law in York, Richard qualified in 1997. He will work closely with partners John Lane and Caroline Hedges, specialising in private client matters including wills and estate planning, administration of estates, formation and administration of trusts, court of protection and enduring powers of attorney. Richard is a keen sportsman and currently plays for the first XV of Hullensians RUFC.

John Lane, head of Private Capital at Rollits comments:

"Richard comes to us with a wealth of experience in all aspects of private client work and I am sure he will be a great asset to our existing private client practice. His appointment recognises our continuing strategy of employing senior lawyers to enable us to provide first class private client legal advice and I am delighted to welcome him to the firm."

INFORMATION

If you have any queries on any articles in this bulletin please contact:

John Lane or Caroline Hedges on (01904) 625790

This bulletin is for the use of clients and will be supplied to others on request.

It is for general guidance only. It provides useful information in a concise form.

Action should not be taken without obtaining specific advice. We hope you have found this bulletin useful. If, however, you do not wish to receive further mailings from us, please write to Mrs. Pat Coyle, Rollits, Wilberforce Court, High Street, Hull, HU1 1YJ.

**The law is stated as at 19 October 2006
Wilberforce Court, High Street, Hull HU1 1YJ**

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