BUDGET 2013/14

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Budget 2013 — IHT, trusts and estates overview

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The Chancellor delivered his fourth budget on 20 March 2013. This news item outlines the key points of interest for trusts and estate practitioners.

Tax rates and allowances

Inheritance tax

There were no changes to the rates of inheritance tax. The nil rate band threshold, which has been frozen at £325,000 since April 2009, was scheduled to increase to £329,000 with effect from 6 April 2015. The freeze will now be extended for another three years to 6 April 2018. The measure is part of a proposed package for funding social care costs (see below).
See the Tax Information and Impact Note (TIIN) for further details.

Income tax

As previously announced, the trust rate of tax applicable to discretionary and accumulation trusts is reduced from 50% to 45% from 6 April 2013. The corresponding dividend trust rate is reduced from 37.5% to 32.5%. Consequently, the tax credits attached to distributions to beneficiaries will also reduce. Where trustees are holding undistributed income covered by the tax pool, it would be advantageous for beneficiaries to distribute it before 5 April 2013. There are no changes in the standard rate of tax of 20% for interest in possession trusts and deceased estates.

Capital gains tax

The annual exemption for personal representatives in the year of death, and the two following years, is increased for 2013/14 to £10,900. The annual exemption for trustees is £5,450. There are no changes to the rate of capital gains tax which remains at 28% for both personal representatives and trustees.

Non-domiciled spouses and civil partners.

Transfers between UK domiciled spouses and civil partners are fully exempt from inheritance tax, but where one partner is non-UK domiciled, the exemption is limited. The lifetime limit for exempt

transfers to non-UK domiciled spouses or civil partners is to be raised from £55,000 to £325,000 with effect from 6 April 2013. Thereafter the exemption will rise in line with the nil rate band. SeeTransfers between spouses or civil partners (the spouse exemption). Note that there is no limitation on exempt transfers from a non-UK domiciled partner to a UK domiciled one.

Non-UK domiciled individuals are subject to IHT on assets located in the UK only. The Budget introduces the option for non-UK domiciled spouses and civil partners to elect to be treated as UK domiciled. The effect of such an election would be that their worldwide assets would become subject to IHT, but there will be no restriction on the exemption for assets received from their spouse or civil partner.

The provision is clearly advantageous for couples where the non-UK domiciled partner has few assets outside the UK. The value of their taxable estate will be increased only marginally and transfers from the UK domiciled partner will not be taxed.

Elections must be made in writing to HMRC at any time after marriage or registration of the civil partnership. There will be a provision to backdate lifetime elections up to seven years with an effective date no earlier than 6 April 2013. Once made, the election is irrevocable whilst the individual is resident in the UK. Personal representatives will be able to make the election for a deceased estate within two years of death where the death has occurred after 6 April 2013.

See the Tax Information and Impact Note (TIIN) for further details.

Inheritance tax — deductions for liabilities

Inheritance tax is charged on the net value of an estate after deduction of liabilities. A liability must be deducted from the asset on which it is secured. The Budget introduced provisions to counter avoidance schemes which have been developed to take advantage of this basic rule. The new measures cover circumstances where deductions are considered to be artificial:

- inheritance tax relief is normally given on the value of liabilities as at the date of death. That relief will now be restricted to the amount actually paid to the creditor.
- no deduction will be allowed for a liability which has been incurred to acquire property which is excluded from the charge to IHT. For example, if an unsecured loan is taken out to buy a reversionary interest in settled property, the loan may not be deducted from the taxable estate.
- no deduction against the taxable estate will be allowed for a liability which has been incurred to acquire property on which a relief such as BPR or APR is due. The liability must be deducted from the value of the assets qualifying for relief, which means, of course, that no tax will be saved because the assets are already relieved.

Schemes where investors take out loans to finance shares in, for example, AIM—listed companies will fail to obtain a double deduction by setting the loan against the taxable estate.

However, the new rules do appear to go beyond the remit of artificial avoidance schemes although it is not clear whether a wide application was intended. It is common for business owners to obtain finance for the business by mortgaging their home, since it may be the only asset deemed suitable as a security. Current legislation requires that a debt secured on a property reduces the value of that property — with the consequence that the business loan reduces the value of the taxable estate. The new provisions will alter the present favourable position by requiring the loan to be deducted from the BPR qualifying business assets.

See the Tax Information and Impact Note (TIIN) for further details.

Estate planning

The Chancellor confirmed the Government's intention to implement the Dilnot Commission proposals for funding the costs of care in old age. It will introduce a cap of £72,000 on reasonable care costs, and extend the means test from April 2016. Currently, those with savings in excess of £23,000 are required to contribute to their care costs but this level of preserved assets is due to increase to £118,000.

The stated purpose of freezing the nil-rate band for inheritance tax is to contribute to the funding of social care.

Practitioners will be aware that the protection of the estate from potential care costs is a prime motivation for clients to engage in estate planning. It goes hand in hand with inheritance tax mitigation. Simultaneously, elderly clients are usually anxious to hold on to more of their wealth than they need for a comfortable lifestyle, because they are afraid of being left unable to pay for care of an acceptable standard. The new proposals, if implemented and maintained, will introduce some certainty into the estate planning process.

See the Budget report, 1.194.

Vulnerable beneficiaries

The Finance Bill 2013 will attempt to streamline the tax rules and definitions relating to vulnerable beneficiary trusts. Vulnerable beneficiaries include disabled persons and young people under the age of 25 who have lost one or both of their parents. It is expected that draft legislation published in January will be amended to correct certain details but no further details have been published as yet.

The broad aim of the amendments is to apply the same qualifying conditions to all types of vulnerable beneficiary trusts. The trust assets are to be applied exclusively for the benefit of the vulnerable beneficiary, with the exception of the lower of £3,000 or 3% of trust assets, which may be applied for

another person. This provision may be useful where trustees want to include other members of the family, or a carer, in their arrangements, perhaps by paying for a shared holiday or a car.

Where qualifying conditions relating to a vulnerable beneficiary are defined by their eligibility for Disability Living Allowance (DLA), they will be transferred to those eligible for the Personal Independence Payment (PIP), which will begin to replace DLA from April 2013.

The provisions do not deal with the anomolies in the income tax rules relating to vulnerable beneficiary trusts.
See the Budget report, 2.82.

Heritage property trusts

A small adjustment is to be made to the business asset hold-over rules which will benefit the settlors of heritage maintenance funds. The current arrangements provide both income tax and capital gains tax relief where a settlor has made a gift of heritage property which he continues to benefit from, such as in an 'open house' arrangement. However, if the trustees provide funds to the settlor for maintenance and repair of the property, the settlor is taxed on the receipt as trading income. An amendment to TCGA 1992, s 169D will, by means of a somewhat convoluted route, result in the trustees being allowed to reimburse the settlor without increasing his tax.
See the Tax Information and Impact Note (TIIN) for further details.

Charities

Small charities may be encouraged by the proposals for a new Employment Allowance of £2,000 per year to be offset against their employer Class 1 NICs. See 'New employers' national insurance allowance' in the Budget 2013 — overview for employers news item (subscription sensitive).

Anti-avoidance

Tax information exchange agreements with Crown dependencies

Jersey, Guernsey and the Isle of Man have entered into tax information exchange agreements with the UK Government as part of the strategy to target offshore tax evasion. Disclosure facilities will also be put in place to allow investors to settle their past tax affairs with HMRC.
Memorandum of understanding: Jersey; Memorandum of understanding: Guernsey ;Memorandum of understanding: Isle of Man

HMRC's offshore evasion strategy

HMRC published its promised offshore evasion strategy document 'No safe havens' on 20 March 2013. Essentially, the strategy is:

- there will be no jurisdiction where UK taxpayers feel safe to hide their income and assets due to:
  - more automatic information exchanges
  - resources that will be focused on the highest priority jurisdictions and specialist staff who will be recruited to identify and profile high-risk taxpayers
- tax evaders will be encouraged to voluntarily pay the tax due
- tax evaders who do not come forward will be subject to sanctions (such as penalties of up to 200% and the potential widening of penalties for offshore matters which are currently limited to income tax and capital gains tax inaccuracies)
- there will be no place for people who facilitate UK tax evasion (the Government will consider widening the powers in relation to high-risk promoters discussed above to encompass facilitators)

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