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An Interesting Budget?

Many commentators, when referring to Gordon Browns recent budget, said it was rather a boring event, with little to write about. However, the devil is in the detail, says Chris Budd.

Budgets aren't like they used to be. It used to be interesting to sit down with a cup of tea at the start of the budget, start the stopwatch, and wait eagerly for the news about the price of beer, income tax rates mingled with a few interesting announcements.

These days, we listen to Gordon Brown talk endlessly about how clever he is, and the detail of any interesting changes follows in (literally) several yards piled high of reports.

Trusts and Inheritance Tax

One example of this was budget note 25, which did not even get a mention in the budget statement. However, this has huge impact on taxation of certain types of trust arrangements used in inheritance tax planning.

First, a bit of background. The basic rules of inheritance tax were covered in a recent article in these pages, and can be summarised by: any individual may pass £285,000 (the nil rate band) on to the next of kind; any money left to spouse is tax free; and any amounts left in excess of payments to spouse and the nil rate band are taxed at 40%; any money given away during a lifetime is a potentially exempt transfer (PET), and takes seven years to drop fully out of the estate.

So, simple inheritance tax planning strategy is to give all your money away more than seven years before you die, leaving yourself with an amount equal to the nil rate band (£285,000). Simple really.

However, many people do not wish to take this action for two reasons. Firstly, they need the money to live on (and perhaps the estate isn't easily broken up if property forms a large part of it). Secondly, they do not want to pass money to their children before they reach an age when they will be responsible enough to deal with the money sensibly (the exact age when this happens being something of a personal opinion).

Hence the use of a trust. This allows the money to be 'parked', in that it is held ready for the chosen beneficiaries, but, during that time, is controlled by the trustees (normally the person giving the money away plus one other). Traditionally, this has been an ideal way of getting money out of one's estate without having to loose control of it.

It is the taxation of these trusts which was, somewhat out of the blue, attacked in the recent budget. For example, transfers into the type of trust usually used were also treated as a PET, now they will not. Instead, it is suggested that tax could apply act commencement, during the lifetime and at exit of the trusts, at varying rates. (In technical terms, this brings the interest in position and accumulation and maintenance trusts into the same tax regime as discretionary trusts.)

If you currently have trust arrangements, you should seek guidance from your legal advisors. If you are about to enter into such an arrangement, you should hold off until the full implications of these changes are known. If you have a life assurance policy written under trust, you should seek clarification of the tax position.

I must stress that these changes have come as something of a surprise, and there is much lobbying of the government to seek clarification of how the rules will work in practice. You may therefore need to be patient in getting meaningful responses from your advisors.

Pensions and A Day

Another 540 page document provided confirmation of much of the changes to pension rules from 6th April. Again, this subject has been written about within these pages, however one particular angle has been clarified which could be of great interest to Mature Times readers.

Under old rules, it was necessary to purchase an annuity at age 75. This involves handing the money over to an insurance company, who keep the remaining capital on death. Whilst it is possible to include widows pension, this reduces the initial amount of income paid. Consequently, the alternative, Drawdown, was of interest to those with sizeable funds (say, £100,000 or more), and/or other assets, and/or a willingness to accept investment risk.

It is now possible to continue Drawdown after age 75 (although it is now called alternatively secured income). However, what happens to the remaining capital on death?

It now seems that the value of the fund will be included in the estate when calculating inheritance tax. For those with other assets, this means that 60% of the value of the fund can be passed on to the next generations' pension funds after the death of either the individual, or the surviving spouse. This is great news for pensions, and anyone either taking Drawdown now, or considering taking benefits from their pension fund, should seek professional advice.

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So, it would seem that the budget contained a great deal of interest after all. Let us hope that the next Chancellor has the courage to announce such changes to the House, risk facing their wrath, rather than letting them dribble out over the ensuing few days. It's certainly more fun to watch!

This article is for general information only. Remember past performance is not a guide to future performance and investments can go up as well as down. If you have any doubts in respect of your own personal circumstances you should a full review with an independent financial adviser to get their help and remember, don't leave it to the last minute next year!

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