

## Budget Update for Wealth Management Clients

### Summary

This appeared to be another dull steady as she goes budget. In fact for wealth management clients there were some significant announcements that did not figure in the speech at all. The key story is changes to the inheritance tax regime. The stockmarket is likely to react benignly. The property sector has probably received a one off fillip.

### Key planning points

#### 1) Major changes to inheritance tax and trusts effective immediately

Interest in possession and accumulation and maintenance trusts have been used widely by clients. They have been used both for tax planning and non tax planning reasons. They are devices that allow assets to pass down through the generations but with the owner of the wealth retaining some control over how assets are invested and when beneficiaries actually receive the "inheritance".

Most interest in possession and accumulation and maintenance trusts will be taxed as if they were discretionary trusts. Transfers above the nil rate band (£285,000 for 2006 / 07) will trigger an immediate liability to inheritance tax. Trusts will also be liable to a 10 year periodic charge and an exit charge.

This is retrospective taxation. Existing accumulation and maintenance trusts will be caught by the new regime unless the beneficiaries (typically children or grandchildren) become absolutely entitled to capital and income at the age of 18. The effect on existing interest in possession trusts will depend on the detail of the trust wording.

Action recommended – do not panic – there is bound to be a lot of debate around this subject. It is easily the most significant matter in the budget as far as private clients are concerned. If the legislation goes ahead those with accumulation and maintenance and interest in possession trusts will need professional advice. Those considering inheritance tax planning will clearly have to be mindful of the new legislation. It does presumably mean that virtually all trusts will be eligible for Capital Gains Tax holdover relief – but the tax free uplift on death for trust assets will disappear.

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## 2) Inheritance Tax on pension funds clarified

Under the new pensions legislation which comes into force in two weeks, there will no longer be a compulsion for those with pension policies to purchase an annuity at age 75. We have at last received clarification that if an individual dies post 75 and has not exhausted his pension fund then it will be liable to inheritance tax. This is not a huge surprise.

Action recommended – the key point is that under some circumstances unused or undrawn pension funds are now at least inheritable. The fund left over can be passed to your children's pension fund. Reconsider pension contributions as a way of reducing current income tax liabilities. Review structure of pension arrangements

## 3) Real Estate Investment Trusts ( REITs ) will start on 1 January 2007

REITs are popular in other countries including USA, Australia and the Far East. They are analogous to unit trusts that invest in shares except that REITs invest in property. The REITs themselves will have very low taxation burdens but must distribute virtually all income.

Action – Watch this space. REITs will be a welcome addition to the investment adviser's tool box and are likely to be suitable for clients, but it is too early to say anything more definite. Existing property companies will have to think long and hard about whether they should convert to REITs. I predict that the weekend broadsheets will be full of advice on REITs

## 4) Venture Capital Trusts changes

As widely predicted the VCT rules have been tightened. Tax relief is cut from 40% to 30%, holding period for new investments extended from 3 to 5 years, various other changes.

Action – None – don't let that tax tail wag the investment dog.

## 5) Gilts

Gilts are loans to the government. Like other loans they pay interest until the capital is repaid. Mr Brown promised to issue more long dated gilts. It is unlikely that he will issue enough to significantly push down the price of gilts. Pension funds are effectively forced buyers of these assets.

Action – if you already hold gilts then no particular action. If you are considering further investment then discuss with your adviser the merit of gilts, gilt funds and other debt investment vehicles.

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## 6) Champagne tax not increased but beer tax up by 1p per pint

Action – Switch from London Pride to Cristal and enjoy the irony of a Labour Chancellor bringing in the above measures.

The above is merely a selection of what appear to the most relevant points for private clients. Do not take action nor refrain from taking action without receiving advice specific to your specific circumstances. Hillier Hopkins will accept no liability for the consequences of actions taken or not taken as a direct or indirect result of the content of the above bulletin. We have to add these caveats because we live in an absurdly litigious world. If you think the above might affect you give your normal adviser a call – they will be pleased to hear from you. Matters can also of course be discussed at your next review meeting.

Ben Sherwood © 23 March 2006

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