

Tax Update

50% New Tax Rate For Trusts

There has been much coverage in the press about the new 50% personal tax rate but one of the ways the 2009 budget affected trusts is that it also introduced a higher tax rate for many trusts.

Discretionary and Accumulation & Maintenance Trusts are entitled to a standard rate tax band of £1,000. The 2009 budget announced that with effect from 6 April 2010 the 40% trustee rate on Discretionary and Accumulation and Maintenance Trusts income above this band will increase to 50%. This means that Trusts will be taxed in the same way as those with income of £150,000 or more, whatever the actual level of taxable trust income.

From 2010/2011 there will be increases to the dividend trust rate to match those for income tax, with the dividend trust rate being increased from 32.5% to 42.5%.

These new rates will be particularly punitive for smaller trusts. In some cases it might be appropriate to change the terms of the trust so that an individual becomes entitled to the trust income on an arising basis rather than being subject to the trustees' discretion. The top rates of income tax would then only be applied to the beneficiary if their total income exceeds £150,000.

The effect of these changes will inevitably be that smaller income distributions are available for beneficiaries. While trusts will have less income to distribute, beneficiaries who receive distributions after 6 April 2010 may benefit from the rise. All distributions made from discretionary trusts will be deemed to be paid net of a 50% repayable tax credit. Accordingly those beneficiaries whose income is not more than £150,000 and do not pay tax at the higher rate may be able to recover the tax credit and obtain a tax repayment.

If the trust is a settlor interested trust, (where the settlor or his/her spouse can benefit), all income is assessed on the settlor although the trustees are primarily liable for tax at the trust rate. Where the Settlor is not a higher rate taxpayer he/she can recover any overpaid tax by the Trustees from the Revenue.

Consideration should also be given to the timing of any distributions, based on both the trust and the beneficiaries' own tax positions in order to minimise income tax liabilities.

The figures replace those announced in the 2008 Pre-Budget Report, which involved smaller tax increases from 2011 to 2012. This acceleration and increase in these trust tax rates suggests that discretionary trusts are being viewed as a justifiable target similar to the highest earners, except for trusts there is no £150,000 threshold before this rate kicks in.

Taxation of Offshore Companies and Funds

New rules were also introduced in the 2009 budget regarding the taxation of interests in offshore companies and funds.

In 2008, the Government harmonised the taxation of dividends paid by offshore companies with that of UK companies, so that foreign dividends benefited from the same one ninth tax credit that UK dividends receive but only where shareholders own less than 10% of the company. This has now been extended to all shareholders, regardless of the size of their shareholding, but only for companies resident in territories that have a double tax treaty with the UK with a non discrimination provision. This tax credit continues to be available to UK resident UK domiciled individuals but not UK non domiciled individuals.

This will also apply to offshore funds structured as companies unless the funds derives more than 60% of its income from interest bearing assets, in which case any distribution will be treated as a payment of interest, taxed at the full rate of income tax and the dividend tax credit will not be available. This will increase the rate of tax for holders of interests in offshore liquidity funds who have hitherto been able to claim the preferential dividend rate on their returns.

If you would like to any more information or would like to discuss any of the issues raised, please contact:

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