

## Discretionary Trust Tax rates increase by at least 25%

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The recent changes to the taxation of discretionary trusts create an even greater impetus to review existing and proposed trust portfolios. From 6 April 2010, trustees of a discretionary trust will be paying tax at an increased rate of 50% (and 42.5% for dividends) on all income exceeding the trustees' standard rate tax band, normally £1,000. This rate of tax will be paid by the trustees on any income they accumulate or distribute.

This represents a 25% (33% for dividends) increase in tax rates for these trusts, so it is important that the trustees take advice in order to limit the impact of this change.

With regard to investments, there are two main areas trustees should consider:

Investments for capital growth - by investing for capital growth, rather than income, the trustees can utilise their annual Capital Gains Tax (CGT) exemption against capital gains that arise on disposal. Currently this is £5,050 where the settlor (creator of the trust) has only established one trust. Capital gains that exceed the annual exemption will only be taxed at 28% from 23 June 2010, compared to the new trust income tax rate of 50%.

Tax efficient investments - Investment Bonds are technically non-qualifying life assurance contracts, only they now exist chiefly as tax-efficient wrappers for investments. For example, savings income and rental income will be taxed at 20% within a UK life fund, which is significantly lower than the increased 50% rate that now applies to direct investments held by a trust. There is no further tax on UK dividend income within a UK life fund whereas dividend income from directly held investments will now be taxed at 42.5% whether it is reinvested or not. Trustees also need to consider income tax on encashing the Bond. At that time, any chargeable event gain will be taxed on either the settlor or the trustees but, either way, there will be a 20% tax credit for the tax paid within the UK life fund.

Investment Bonds also offer several other attractive features - withdrawals of up to 5% of the original investment can be taken with the income tax deferred, diversification and investment flexibility, simplified administration, segmentation and assignment.

It is therefore important that trustees seek professional investment advice to ensure that the most suitable investments are selected and then "wrapped" within a tax efficient structure, if possible.

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