

Finance Bill 2023 - Trusts and estates (Lecture P1374 – 13.06 minutes)

Clause 29 introduces Schedule 2, which makes various amendments to the taxation of beneficiaries of estates and trusts in order to simplify the operation of the legislation.

Taxation of beneficiaries of estates

S656 and s657 ITTOIA 2005 are amended. These apply to income from UK estates (s656) and foreign estates (s657). The legislation states that the tax is charged on the income arising in the year and is grossed up for the purposes of computing the liability. The amendment removes reference to 'for that year' for the grossing up calculation.

S663 ITTOIA is then rewritten so that the grossing up is by reference to the tax rate paid by the personal representatives at the time the income arose, rather than when it is paid to the beneficiary.

As an example, an estate receives interest income of £1,000. The rate of tax when it is received is 20% so £200 is paid in tax. The balance of £800 is paid out to the beneficiary when the basic rate of tax has risen to 25%. The gross income treated as paid to the beneficiary is £1,000 and they will have extra tax to pay even if they are a basic rate taxpayer.

Similar amendments are made to s668 ITTOIA, which deals with a situation where an individual's share in an estate is reduced. Any amendment to the income is grossed up by reference to the rate borne by the personal representatives at the time the income arose rather than the point at which the adjustment to the income entitlement arises. There is a consequential provision to determine which income is treated as being paid in this circumstance. Firstly, you apportion income between different persons on a just and reasonable basis. Secondly, it is assumed that income is paid out of the income liable to the highest rate of income tax first.

S670 and s680 ITTOIA 2005 are amended, although the explanatory notes state that this is a re-ordering of the legislation rather than an actual change. It confirms that stock dividends and release of loans to participators in close companies are treated as having an income tax credit of 0%.

S680A and s680B ITTOIA 2005 are amended to make it clear that estate income which is derived from dividends is to be treated as dividend income of the beneficiary and that estate income which is derived from savings income is to be treated as savings income of the beneficiary. This clarifies that such income can be reduced by offset of the dividend allowance or savings allowance as appropriate.

Similar amendments are made to CTA2009 where the beneficiary is subject to corporation tax rather than income tax.

These changes come into effect from 6 April 2023 (income tax) or 1 April 2023 (corporation tax).

Low income trusts and estates

The legislation at s23 ITA 2007 which sets the template for calculation of income tax liability is amended so that net income at step 2 of this calculation is taken to be nil where the net income is £500 or less. This is described as the 'de minimis estates amount'. There is an equivalent provision for trusts called the 'de minimis trusts amount'. It is important to note that this is not a 'nil rate band' as if the net income is more than £500 it is taxed in full.

Where the trust is a relevant settlement, this £500 limit is divided by the total number of qualifying settlements (including the relevant settlement) although the limit cannot fall below £100.

A relevant settlement is any other current settlement, unless it does not have any trust rate income for the tax year or, throughout the year, the income is treated as that of the settlor, a qualifying vulnerable beneficiary or it is a qualifying heritage maintenance settlement.

The provisions that tax the first slice of income for an accumulation or discretionary trust at the normal income tax rates, rather than the trust tax rates, will be repealed. This 'standard rate band' has been £1,000 for several years.

The impact on trusts is going to be relatively minor.

Example

Discretionary trust with income of £10,000 arising from property

Currently:

£1,000 @ 20%	£200
£9,000 @ 45%	£4,050
Total	£4,250

Going forward

£10,000 @ 45%	£4,500
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It should be noted that this does not affect later parts of the calculation, such as the tax pool adjustment for payments to discretionary beneficiaries, so this does not disappear if the trust is within the de minimis trusts amount. This means that discretionary trusts with income under the de minimis are not going to be building up tax pool amounts, so that tax will have to be paid for distributions to be made to the beneficiaries.

Example

A trust has income of £450 per year for 10 years and then wants to distribute this to the beneficiaries.

No tax has been paid by the trust but any income being distributed will carry a tax credit. If the full £4,500 was paid out, the trust would be left having to find £3,681 of tax as the £4,500 would be grossed up at 45/55 to find the tax credit. In reality, the maximum that could be paid out would be £4,500 net of trust tax of 45% ie £2,475.

A beneficiary's liability to tax on estate income is removed, where that income has been paid from income within the 'de minimis aggregate income'. There are equivalent amendments to the corporation tax provisions in relation to beneficiaries' income from estates. There is no change for income from trusts due to the income still carrying the normal tax credit.

These changes will take effect from 6 April 2024 (income tax) or 1 April 2024 (companies).