



THREE COUNTIES

Financial Management Services Limited

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Post A-Day Opportunities

There are many opportunities in the post A-Day world. Here we summarise several high level opportunities and briefly describe client areas for discussion.

Clients who are:

- in primary or enhanced protection, or
- nearing the allowance levels

will need to be monitored. They may have to stop funding if they are approaching the allowance. Sometimes they may have to start funding again, eg, if they change employment and have to pay contributions into their own pension or if their actual rate of return on their existing fund is not as high as expected.

Clients who are considering retirement late in the day

The waiving of the annual contribution limit in the final year of the contract means that the government has recognised the issue of 'my business is my pension'. In limited circumstances the government has relaxed allowance limits in the final year of the contract. This means that it may be possible to remove value from the client's company and put it into pension's tax protected environment when the client is looking to cash in on their efforts.

Clients running occupational schemes

The trust based occupational scheme set-up may still be right for some but not for others due to additional requirements placed on trustees by the legislation. It is likely many employers will look at alternative types of contract for the company.

Lifting of connected persons transactions rules

The lifting of these rules is helping open architecture to be the norm eg SIPP. There are guidelines relating to connected persons, as opposed to rules, so the next few months will be a 'suck it and see' situation.

S32

There will be some existing EPP and S32 cases with more than 25% tax-free cash which may need a S32 as a transfer vehicle post A-Day, where appropriate.

Employee benefits - review of death benefits

The restriction of 4 x salary for death benefits has been removed. The restriction relating to spouse's pensions has also been removed. Employers can therefore revisit their existing death benefits provision to redesign their scheme in view of this.

New Service Programmes

Since 2002 the Government has been making clear its intention to totally restructure the financial services industry and in particular the way it is remunerated. Three Counties will be meeting these new challenges and continuing to provide our clients with cost effective advice and services.

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Our intention is to continue to develop our company as a provider of high quality financial advice which is both independent and not necessarily financed by the sale of financial services products. Under the new regulations the Government regulator, the FSA, require that advisers wanting to retain independent status (now known as 'whole of market' status) operate a menu of fees for advice on, and management of, clients' financial affairs.

As part of this restructuring the insurance, investment and pension companies have reduced the charges they apply to their policies and contracts. This is, of course, good news for investors, but it does mean that as part of this process they have reduced the commissions they pay to financial advisers, in some cases removing it completely. Meanwhile the regulatory process and costs have increased significantly and brought with it an increase in paperwork and administration time beyond our control.

It is twelve years since Three Counties first recognised the inevitability and desirability of such a change with the introduction of our Premier Client Service in January 1994. This was replaced in February 2002 by our Premier Plus fixed fee service along with the introduction of administration platforms such as Transact and Selestia when running our clients affairs.

As a result of this further review of our client proposition, and following the recent Client Survey that we conducted, we have decided that, in order to continue giving our clients the level of service they would like to receive, and we would like to supply, we will now offer three distinct fee based programmes.

These new programmes will replace our Premier Plus and Standard services and will be called:

- **The Gold Programme** - a proactive and holistic lifestyle programme.
- **The Silver Programme** - a proactive and review based programme.
- **The Bronze Programme** - an entirely reactive programme for those not requiring a regular service.

Over the next 12 months we will be providing full details of what each programme provides and will be speaking with all our clients to determine which Programme is most appropriate to their circumstances. Should you wish to receive details of these Programmes please contact this office.

The Inheritance

This article is based on comments by Adrian Sacco TEP following publication of the recent Finance Bill. Amendments to the bill will be made before it becomes law, probably in July 2006. Adrian is a Registered Trust & Estate Practitioner specialising in IHT and estate planning work for corporate and private clients.

The Budget of 22nd March 2006 contained some totally unexpected provisions that amount to a radical rewriting of the inheritance tax rule book for trusts.

The new rules have effectively re-introduced capital transfer tax for virtually all gifts into trust (bringing back 20-year-old rules) The potentially exempt transfer regime has been abolished for gifts to interest in possession (life interest) and accumulation & maintenance trusts. These trusts have now been brought into the same, punitive tax rules that previously applied only to discretionary trusts - that is to say:

- there is a tax charge on making gifts into trust;
- there is a tax charge on every tenth anniversary of the trust's creation; and
- there is a tax charge when cash or assets are distributed from the trust.

Worse still, these rules don't just catch new trusts. They apply to existing trusts in the following circumstances:

1. in the case of interest in possession trusts if further gifts are made, or if the beneficiary entitled to trust income ceases to be entitled on or after 6th April 2008 but the trust assets are not immediately distributed outright.
2. in the case of accumulation & maintenance trusts if further gifts are made, and if the trustees do not alter the trust before 6th April 2008 so that its

Finance Tax Treatment of Trusts

beneficiaries become entitled outright to trust capital at the very young age of 18 (previously beneficiaries' entitlement to income could be deferred to the age of 25, and entitlement to capital even later than that, without being penalised, tax-wise).

The new rules are also going to affect many will trusts – which of course don't take effect until the individuals concerned die. Many married people's wills contained "flexible" life interest trusts for widows and widowers, which would under the old rules have meant no tax on first death, due to the exemption for inter-spouse transfers.

Under the new rules, such trusts will now attract a tax charge on first death unless the will is drafted in a very narrow (and to date unconventional) manner.

This means in practice that many people will need to have their wills reviewed and in some cases rewritten.

In other cases they can safely leave their existing wills in place, but following their deaths their wills are going to need rewriting by already-distressed widows and widowers in order to avoid a tax charge that might otherwise force the sale of family homes and investments, causing potential hardship to surviving spouses.

The Finance Bill was published on 7th April, and Schedule 20 of the Bill contains the detailed draft provisions affecting trusts.

At the same time, a "guidance note" was issued.

Let's count the lies in the "guidance note":

Lie no 1: "The Finance Bill makes absolutely clear that there is no retrospective tax charge"

If applying new rules to existing trusts – even in cases when they aren't (and possibly can't be) varied, or no new money is added to them – isn't "retrospective" then I'll eat my trust drafting quill.

This lie is all the more offensive as the existing trusts that

stand first in line to be caught are accumulation & maintenance trusts. This type of trust was originally introduced by a previous Labour government – and one with apparently a greater sense of social responsibility than the present incumbent – to encourage the making of properly controlled gifts for the benefit of children and young adults.

Lie no 2: "no one who wrote a life insurance policy into trust before Budget Day will have to pay an inheritance tax charge ... The Finance Bill and its Explanatory Notes provide complete certainty that the new rules will not apply to life insurance policies entered into before Budget Day."

It is true that the Explanatory Notes say that there will be grandfathering for existing (pre-Budget day) regular premium life policies – but having gone through the Finance Bill itself, painfully line-by-line – I found no provisions whatsoever in the draft legislation covering this.

In the absence of specific relief in the legislation itself, policy premiums that exceed the paltry annual exemption of £3000, which has not been updated to a more realistic figure in over 20 years, and are not funded from surplus income in order to benefit from the exemption in section 21 of the Inheritance Tax Act 1984, will be chargeable to tax.

And there may also be a tax charge if the trust's "default beneficiary" is unlucky enough to die on or after 6th April 2008 & the market value of the policy at that time exceeds the IHT nil rate threshold. This might be the case even if the policy has not paid out, if the person whose life is insured is terminally ill, for example.

Lie no 3: "all future as well as existing bare trusts are not affected at all by the changes. This ensures straightforward life assurance policies, which, for example, are set up to pay off a mortgage if a person dies, are outside the rules".

How generous. Unfortunately, bare trusts – which are totally fixed, inflexible trusts for the benefit of one person,

or more than one in specified shares, are almost never used. Responsible trust practitioners have routinely discouraged their clients from establishing such trusts as they do not protect wealth adequately when the intended beneficiaries are financially inexperienced or irresponsible young adults.

The life insurance industry has instead used as its standard form of trust over the last 20 years a “flexible trust”, sometimes called a “power of appointment trust”. This form of trust is caught squarely (if not fairly) by the new rules for interest in possession trusts.

Lie no 4: “as the Government has repeatedly made clear, these factors will affect only a very small number of very wealthy people”.

It depends on how you define “very small number”, and how you define “very wealthy”. So far as I can see, these new rules might affect anyone who has (or whose spouse or children have) an estate in excess of £285,000. Given that this figure fails to cover or barely covers the cost of a family home in much of the UK, I’d say that the “very small number” really means “an awful lot of people, actually”, and that “very wealthy” really means “moderately comfortable”.

Lie no 5: “where a trust is set up by a will, the trustees will have 2 years, if needed, to alter the terms of the trust to comply with the new rules”

This assumes that the trustees have a suitable power to effect such an alteration – which is not always the case. Making a suitably tax-efficient alteration will usually need the co-operation of family members who are executor-trustees as well as beneficiaries, and the exercise may bring up conflicts, particularly in cases involving children of a first marriage and widow or widower from a second marriage.

One of the few truths in this “guidance note” is that these punitive new rules will – in the short term at least – raise only a relatively small amount of revenue. It is all the more unfortunate that the inconvenience they will cause is disproportionate.

IHT has always been the biggest political football of all the direct taxes – and Brown & Blair have shown their true political colours in an attack on Middle England as well as the “very wealthy” the new rules claim to target.

The worst thing about these rules remains the fact that they penalise the passing on of wealth in a controlled and responsible manner. Far more outright gifts or bare trusts will be made to or for young adults in order to avoid the new tax charges. At best this socially irresponsible legislation will result in cases of hard-earned wealth being dissipated. It is to be hoped that there will not be cases where any young person’s drink or drug addiction is fuelled as a result, but sadly there are likely to be such victims.

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You should be aware that investment in securities involves risk. The value can fall as well as rise and you may not get back the full amount invested, particularly in the earlier years.

Taxation: All statements relating to taxation are based upon our understanding of the law and Inland Revenue practice in force at the date of this report. There can be no guarantee that the tax position or proposed tax position at the time of investment will endure indefinitely.

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