

providing the facts

A Summary of the Budget 2006

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FRIENDS PROVIDENT

Income Tax and Allowances

Income Tax Rates

Rate %	Taxable Income £	
	2005/06	2006/07
10	up to £2,090	up to £2,150
22	£2,091 to £32,400	£2,151 to £33,300
40	over £32,400	over £33,300

Income Tax Personal Allowances

Income Tax Allowance	2005/06	2006/07
Personal allowance (age under 65)	4,895	5,035
Personal allowance (age 65 to 74)	7,090	7,280
Personal allowance (age 75 and over)	7,220	7,420
Married couple's allowance* (aged less than 75 and born before 6 April 1935)	5,905	6,065
Married couple's allowance* (age 75 and over)	5,975	6,135
Married couple's allowance# - minimum amount	2,280	2,350
Income limit for age-related allowances	19,500	20,100
Blind person's allowance	1,610	1,660

* Tax relief given at the rate of 10%

This is also the maximum relief for maintenance payments where at least one of the parties is born before 6 April 1935

[Note that the personal allowances were announced in the 2005 pre-Budget statement, together with the rates for National Insurance and Working and Child Tax Credits. See [here](#) for further details.]

Capital Gains Tax

The annual exemption for individuals and personal representatives has been increased to £8,800 for 2006/07. The exemption therefore increases to £4,400 for trustees.

Inheritance Tax

The nil-rate band for inheritance tax has been increased, as previously announced, to £285,000 in 2006/07, and will increase to £300,000 in 2007/08, £312,000 in 2008/09 and £325,000 in 2009/10.

There were also important changes made to the IHT treatment of trusts and gifts into trust – see later in this summary.

Corporation Tax

The small companies' rate for 2006/07 remains at 19% and applies to companies with taxable profits between £0 and £300,000. The main rate, for profits in excess of £300,000, stays at 30%.

The starting and non-corporate distribution rates have been withdrawn.

Stamp Duty Land Tax (SDLT)

The zero rate threshold for residential property transactions has increased from £120,000 to £125,000 for any transactions on or after 23 March 2006. The 1% starting rate will therefore apply to all transactions of between £125,001 and £250,000.

Some new measures aimed at simplifying and clarifying the law relating to SDLT were announced. In addition, a number of common transactions have been taken outside of the scope of SDLT, including a gift of property where the donee or beneficiary agrees or is required to pay capital gains tax or inheritance tax arising on the gift.

Value Added Tax

The rate of VAT remains at 17.5% but the annual registration limit has been increased to £61,000 for 2006/07.

Pensions

There was little new on pensions, but some significant 'noises' on alternatively secured pension (ASP) and IHT. The Government is not happy that ASP, which was specifically designed for those with a principled religious objection to annuitisation, is potentially being used more widely "to enable individuals to pass on tax-privileged retirement savings to their dependants". The Government is therefore considering how best to restrict ASPs to their original limited purpose.

Pensions and Inheritance Tax

So far as IHT is concerned, the rules for members under age 75 will work largely as they do currently. Where a member dies over age 75 with an ASP, IHT will be chargeable on the scheme administrator on any remaining funds, subject to an exemption for payments to charity and qualification where financial dependants are involved.

IHT - Death before 75

If benefits are paid to a spouse, civil partner or financial dependant, no IHT charge will arise, even if, when in poor health, the member has chosen not to exercise an option in order to preserve the death value. Similarly, if the member was in good health when choosing not to exercise an option, IHT will not be applied even if their health subsequently deteriorates.

In many respects, this is no different to the current situation which is allowed for by HMRC discretionary practice. However the Finance Bill will enshrine this through legislation.

IHT - Death after 75

It was the introduction of the new option of Alternatively Secured Pension that caused the debate regarding IHT and pension funds as it created a new opportunity to preserve pension funds beyond the age of 75. As expected, transfer of these funds to other scheme members, or to the employer, will give rise to an IHT charge. Funds paid to spouses, civil partners and other financial dependants will not be subject to IHT, although on the death of the recipient, any remaining funds will be treated as part of the original member's estate and subject to IHT accordingly.

The estate of a dependant will be liable to the IHT charge in the event of the death of a dependant who 'inherited' benefits from a member who was below age 75 on death.

The scheme administrator will be responsible for payment of the IHT charge. As the IHT charge may not be payable until many years after the death of the member, final 'closure' of the deceased member's estate may not be possible for some time.

Other Changes

Most of the other items on pensions had already been announced in the pre-Budget report. However, the Government confirmed that the [Finance Bill 2006](#) will contain the following:

1. Tighter rules governing allowable investment by member-directed pension schemes.
2. Measures to prevent the recycling of tax-free lump sums where all the following apply:
 - The member receives tax-free cash which, taken together with any other tax-free cash in the previous 12 month period, exceeds 1% of the standard lifetime allowance, i.e. £15,000 for 2006/2007.
 - Because of the cash sum, the amount of contributions paid into a registered pension scheme in respect of the member is significantly greater than it otherwise would be.
 - The cumulative amount of the additional contributions made by the member (or by someone else, such as an employer), exceeds 30% of the tax-free cash sum.
 - The recycling was pre-planned. This occurs when a member (1) decides to use tax-free cash as the means to increase contributions significantly to a registered pension scheme, (2) receives the cash sum, and (3) pays the significantly increased contributions. It also occurs when steps (2) and (3) are reversed. See [here](#) for more details.
3. A rule to amend the calculation of tax-free cash from money purchase arrangements, so that it is the same for scheme pensions and lifetime annuities.
4. A rule to allow bridging pensions.

5. An extension to the circumstances in which migrant member relief can be claimed.
6. Measures to allow life cover to continue without affecting a member's enhanced protection.

The Budget also announced the start of a [consultation](#) on extending the exemption for workplace pensions promotions to third parties.

Individual Savings Accounts

The current ISA limits of £7,000 for the stocks and shares component and £3,000 for cash will be retained to April 2010.

Modernising the Tax System of Trusts

The 2005 Budget introduced a new standard rate band for all trusts and a new tax regime for certain trusts for vulnerable beneficiaries. Further measures have now been introduced to modernise the tax system for trusts and bring the capital gains tax and income tax regimes closer together. The main changes are:

- The standard rate income tax band has been increased from £500 to £1,000
- A common meaning of 'settled property' leading to a common meaning of 'settlement'
- A common meaning of 'settlor'
- Provision for the trustees of a settlement to be treated as a single person
- A common test to decide whether trustees are resident in the UK
- Provision for the trustees to elect that a sub-fund be treated as a separate settlement in certain circumstances
- The income of settlor-interested trusts will be taxable on the settlor
- A measure to legislate the existing practice of not taxing beneficiaries receiving discretionary income from the trustees of settlor interested trusts and
- Modification to the rules which determine whether a settlor has an interest, so that account is taken of dependent minor children.

Some of the changes proposed in the consultation exercise, such as income streaming, are not being introduced at this time.

Inheritance Tax (IHT)

The current IHT rules for accumulation and maintenance (A&M) trusts and interest in possession trusts have been radically altered. Any transfers into these trusts were previously potentially exempt transfers (PETs). Unless the trust is set up for a disabled person, a transfer into the trust will now be a lifetime transfer. This will result in an immediate tax charge of 20% on lifetime transfers that exceed the IHT threshold. These trusts, referred to as 'relevant property' trusts, will also suffer the charges which previously only applied to discretionary trusts i.e. periodic charges of up to 6% and exit charges. The new rules will apply on and after 22nd March 2006 to new trusts and additions to existing trusts. Transitional rules provide for a period of adjustment for certain existing trusts up to 6 April 2008.

Special rules will apply to A&M trusts that:

- Are created on death by a parent for their minor child who will be entitled to the assets at age 18,
- Are created on death for a life tenant whose interest cannot be replaced, or
- Are created either during the settlor's lifetime or on death for a disabled person.

Such trusts will retain their special status which means any transfer into trust will still be treated as a PET.

Where existing A&M trusts provide for the beneficiary to be absolutely entitled at age 18, or where the trust terms are amended before 6 April 2008, their current IHT treatment will continue.

The main consequence of these changes is that a life tenant will not have an interest in possession in the trust assets for IHT purposes.

Capital Gains Tax

The changes which have been made to the IHT treatment of trusts have a number of capital gains tax (CGT) implications:

- Transfers into and out of 'relevant property' trusts will be eligible for hold-over relief, and
- The special CGT treatment of trust assets on the death of the life tenant under an interest in possession trust will be restricted to assets that are subject to the new IHT rules.

Real Estate Investment Trusts (REITs)

For companies or groups whose main business is property investment, a new regime exempts income from and gains made on property from tax, providing certain conditions are met. Companies and groups can elect to join the regime with effect from 1 January 2007 and will be known as UK-REITs (Real Estate Investment Trusts)

Qualifying rental income and gains on disposals of investment properties will be exempt from corporation tax. (Other profits and gains will be subject to corporation tax in the normal way).

Venture Capital Trusts (VCTs)

With effect from 6 April 2006, the rate of income tax relief on VCT investments has been cut from 40% to 30%. The minimum holding period for VCT shares to qualify for this relief has been increased from three to five years.

The, restrictive, existing rules regarding the qualifying rules for a VCT "investment" have been rewritten. From 6 April 2007, any money that a VCT holds (or is held on its behalf) will be treated as an investment for the purposes of these rules.

The value of relevant assets of any company raising money under a VCT, after 6 April 2006, may not exceed £7 million immediately before the investment and £8 million immediately afterwards. These are significant reductions from the current limits of £15 million and £16 million.

Enterprise Investment Schemes (EISs)

From 6 April 2006, the EIS investment limit for income tax relief at 20% is being increased from £200,000 to £400,000.

The maximum value of EIS shares that can be treated as having been issued in the previously tax year (allowable only to investments made in the first six months of any tax year) has also been doubled to £50,000.

For shares to qualify as an EIS investment, the relevant assets of the company raising money, may not exceed £7 million before the investment and £8 million afterwards (as for VCTs). The current rules continue to apply for shares issued after 6 April 2006 providing they were subscribed for before 22 March 2006.

Tax Avoidance

The rules requiring disclosure of tax avoidance schemes are to be extended to include the whole of income tax, corporation tax and capital gains tax, with effect from 1 July 2006.

The capital gains tax 'bed and breakfasting' rules have been amended to include acquisitions made at a time when a person is resident or ordinarily resident in the UK but is 'Treaty non-resident'.

Action has been taken to counter avoidance schemes that use options over shares and securities. These measures take effect from 2 December 2004.

