Finance (No.2) Bill 2023 clause 29: low income trusts and estates in administration

General Features

24 May 2023

CIOT commented on the consultation last summer and have more recently discussed with HMRC details of what is now clause 29 and Schedule 2 of the Finance Bill. Our Parliamentary Briefing explores the new rules, with examples. The changes will take effect from 6 April 2024.

Income from estates in the course of administration

The provisions in the Finance Bill will extend the scope of the existing concession to cover all forms of income from a deceased's estate (potentially therefore including, for example, rental income and dividends rather than just interest), provided that the total income over the course of a tax year is not more than £500. Such income will be exempt from income tax, so that neither the personal representatives nor the estate's beneficiaries will have any income tax liability.

Where estate income exceeds the threshold, all of it is taxed so that the normal rules apply. This is a practical reform that will genuinely simplify the position for small estates and their beneficiaries.

Trusts

The simplicity for estates has not been carried through to small trusts. The difficulty is that although a similar £500 exemption is applied to the income arising to the trustees of a settlement, it is not exempt when distributed to beneficiaries. We pointed out that the measure will actually increase compliance issues for some beneficiaries.

Beneficiaries of interest in possession trusts will receive the trust income (up to £500) gross, without any tax deduction. The trustees will have no obligation to report or pay. This process will help life tenants who are not taxpayers, as they will no longer need to submit repayment claims. However, basic rate taxpayers will still have to pay the basic rate tax due on their trust income. Currently, they may not be filing a tax return at all, as their basic rate liability will have been met by the tax deducted by the trustees. This measure means that they will now have to file.

This measure could increase the number of tax returns required. If there are five basic rate beneficiaries entitled to the trust's income in equal shares of £100 each, five tax returns will be necessary where previously the trustees would have just filed one. This is also the case with higher rate taxpayers, although these taxpayers are more likely to be filing tax returns already.

The position for discretionary trusts is even more complicated. The £1,000 'standard rate' band will be abolished. Instead, the trustees will not have to report income under £500 but any income payment made to a beneficiary will remain subject to the 45% distribution charge. This requires the trustees to undertake complex computations (incomprehensible to many lay trustees) to determine the amount of tax payable on the income distributed, taking any existing tax pool into account.

Where a settlor has more than one current accumulation or discretionary trust, the £500 exemption will be divided by the total number of those trusts, with a minimum of £100 each. This mirrors the approach adopted in relation to the capital gains tax annual exemption for trusts. Interest in possession, settlor-interested, vulnerable beneficiary and heritage maintenance trusts are not taken into account. And, following doubts raised by one of our committee members on the scope of the clause, a government amendment was introduced to ensure that pension trusts are also ignored.

We expressed concern that this measure, while described as a simplification, could increase levels of confusion for trustees of small trusts. HMRC estimate that this measure will affect 37,000 individuals overall but it is possible that the effect could be greater and more adverse for many, maybe most, beneficiaries of small trusts, and may increase their compliance burdens – the reverse of simplification.

The full briefing can be found at: www.tax.org.uke/ref1139

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