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FINANCE ACT CHANGES TO CHILDREN'S TRUSTS

The Finance Act 2006 (FA 2006) sounded the death knell for "accumulation and maintenance" (A&M) trusts. In this Newsletter we look at the ramifications for occupational pension schemes resulting from their demise.

Before FA 2006

Trusts for children

- When distributing death benefits to children, pension scheme trustees often paid the amount into an A&M trust. This allowed income from the trust capital to be either accumulated or used for the child's maintenance and the child's entitlement to the funds to be deferred until age 25.
- Prior to the FA 2006, property in an A&M trust was not subject to inheritance tax (IHT).

FA 2006

The end of trusts for children?

- FA 2006 made several changes to the tax treatment of trusts. It also introduced provisions making it inadvisable to create a new A&M trust from 22 March 2006.
- A&M trusts created before 22 March 2006 are subject to transitional provisions (see box 3 below).
- It is still possible to create a trust for a child but, with limited exceptions, it will be subject to IHT charges.

Transitional provisions

Treatment of pre-22 March 2006 A&M trusts

- The transitional period runs from 22 March 2006 to 5 April 2008.
- Pre 22-March 2006 A&M trusts will not become subject to the new regime (and its taxation) if, during the transitional period, either the children become entitled to the trust property outright or the trust is amended so that they will become so entitled at the age of 18.
- If they are not amended, on 6 April 2008 A&M trusts will automatically be converted into "age 18 to 25 trusts" and will be liable to an IHT charge.

Pre-22 March 2006 A&M trusts

What action should pension scheme trustees consider?

- How likely is it that any of the A&M trusts set up by past distributions from the pension scheme will still be in existence on 6 April 2008?
- If pension scheme trustees identify trusts that may be affected, is it feasible (both in cost and practical terms) to notify the trustees of the A&M trusts about the legislative changes?
- Where pension scheme trustees conclude that it is reasonable to act, a general letter to the trustees of the A&M trusts suggesting they take their own legal and financial advice would suffice.

Options for the future?

- Pension scheme trustees may pay a death benefit into a "bare trust" which arises where property is held for a minor who is entitled to it absolutely but unable to give a valid receipt.
- Administrative powers may be given to the trustees of a bare trust during the child's minority but the child can call for the property to be transferred to him/her as soon as they reach the age of 18.
- Alternatively, trustees could pay the death benefit to a parent or guardian to be used for the child without any formal trust.
- As noted in box 2, it is still possible to create a new trust for a child but, in general, it will be subject to IHT charges if the fund is large enough. Specialist tax advice should be obtained by trustees contemplating this option.

Conclusion

- Depending on the amounts of money involved and the level of tax charges that might apply, trustees' options for the payment of death benefits to children have been truncated.
- Going forward, trustees should assess carefully whether it is appropriate to use a trust vehicle which may incur tax charges rather than pay a benefit to an adult on a child's behalf or simply allow a child to become absolutely entitled to the money at age 18.

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