ONSHORE BOND

The impact of the October 2024 Budget on tax and investment planning

The autumn 2024 Budget is already having a seismic impact on investment planning because of the capital gains tax (CGT) and inheritance tax (IHT) changes. The case for individuals and trusts to use Onshore Bonds was already strong, especially after the CGT annual exempt amount for individuals had been cut to only £3,000 and to £1,500 for most trusts. Now the Budget has reinforced this powerful case.

Key changes in the Budget affecting investment planning

- The immediate increase in the main rates of CGT to 18% for basic rate taxpayers and 24% for higher rate and additional rate taxpayers. These changes boost the relative attractions of Onshore Bonds as tax vehicles for both individuals and trusts. See the notes below on changes to CGT.
- Stopping defined contribution (DC) pensions acting as IHT avoidance vehicles for many thousands of investors. This move will turn DC pensions back into retirement income plans and will encourage retirees holding on to DC pensions to start drawing on them. The changes are due to take effect from 6 April 2027, but their impact will be felt much sooner. As a consequence, many clients will seek other ways to mitigate their IHT liabilities.
- Halving the IHT business relief on AIM shares (along with other business and agricultural assets) to only 50% - i.e. an effective IHT rate of 20%. This cut in IHT relief will reduce the attractions of this approach to IHT planning and encourage alternative approaches. See the notes below on changes to inheritance tax relief.

The IHT changes – to DC pensions and to AIM shares and other business relief investments – will pivot the attention of clients and their advisers back to the trust-based plans that were popular for many years.

The gift and loan plans, discounted gift plans and other trust-based arrangements generally use Onshore Bonds as the underlying trust investments because of their attractive tax characteristics. In recent years, these more complicated arrangements were only used by the relatively few clients who had reached their pension limits and didn't want to trust too much to the possible risks of committing too much to an AIM portfolio.

The impact of the Budget on clients' IHT liabilities is potentially massive. A client with a DC pension worth £1million could see an increase of £400,000 in the likely tax on their estate. If such a client had also invested in a £1 million AIM portfolio, their IHT liability could rise by a further £200,000 to a total of £600,000.

With over two years to go before the scheduled change to pensions and over one year before the expected AIM and business asset relief changes, clients and their advisers should start planning now.

Notes on capital taxes changes in the autumn 2024 Budget

The annual exempt amount for individuals and personal representatives will remain at £3,000 for 2025/26. The annual exempt amount of most trusts will remain at £1,500, with a minimum amount of £300 for each trust.

The lower main rate of CGT for basic rate taxpayers will increase from 10% to 18% and the higher main rate for higher rate and additional rate taxpayers will rise from 20% to 24% for disposals made on or after 30 October 2024 (Budget day).

The rate for investor's relief will increase to 14% from 6 April 2025 and increase again to 18% from 6 April 2026. The lifetime limit for investor's relief will be reduced to £1 million for all disposals on or after 30 October 2024. Investor's relief reduces the amount of CGT on a disposal of shares in a qualifying trading company not listed on a recognised stock exchange – e.g. AIM shares.

Notes on changes to inheritance tax

The existing freeze on the IHT nil rate band of £325,000 and the residence nil rate band of £175,000 and its associated taper threshold for estates will be extended to 5 April 2030.

From 6 April 2026, the current combined 100% rate of relief will continue for the first £1 million of combined agricultural and business property for individuals and trusts, except for shares designated as 'not listed' on the markets of designated stock exchanges, such as AIM. The rate for not listed shares and assets about the £1million threshold will be 50%.

Unused pension funds and death benefits payable from a pension will be brought into a person's estate for inheritance tax from 6 April 2027.

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