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THE TAXATION OF TRUSTS: A REVIEW

Response by Association of Taxation Technicians

1 Introduction

1.1 The Association of Taxation Technicians (ATT) is pleased to have the opportunity to respond to the HMRC document *The Taxation of Trusts: a Review* ('the Review') issued on 7 November 2018[1].

1.2 The primary charitable objective of the ATT is to promote education and the study of tax administration and practice. We place a strong emphasis on the practicalities of the tax system. Our work in this area draws heavily on the experience of our members who assist thousands of businesses and individuals to comply with their taxation obligations. This response is written with that background.

1.3 Trusts provide an ability to ring-fence assets and to separate the care and management of assets from the ultimate beneficiaries. They are a useful and flexible tool for many families. Trusts are also embedded in our legal system, in the ownership of property, the structure of investments, and even in commercial transactions, such that a large number of the public will, perhaps unknowingly, have some contact with some form of trust during their lives. Having a workable system, particularly for smaller family trusts, is very important.

1.4 We appreciate that there are a range of views held about the merits of trusts and trust planning and that there is a concern among some members of the public that trusts are open to abuse and may be used to facilitate tax avoidance. However, where used legitimately, trusts can provide a convenient means of achieving non-fiscal objectives including importantly protection of the most vulnerable in our society. We were therefore pleased to see that the Review acknowledges at paragraph 2.4 that:

> 'Trusts are an intrinsic part of the UK's legal system, and have been in use for centuries. The government wishes to ensure that the many UK individuals and companies using trusts legitimately benefit from a clear and transparent regime that is easy to understand, while also taking steps to ensure that trust taxation does not produce unfair outcomes and that trust structures do not facilitate tax avoidance or evasion.'

We also welcome the desire to move towards an easy to understand regime, given the increasing complexities in recent years.

1.5 We also welcome the statement at paragraph 3.9.3 that the Government wishes to:

'facilitate the straightforward usage of trusts where they are the appropriate legal mechanism.'

[1] https://www.gov.uk/government/consultations/the-of-taxation-of-trusts-a-review

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1.6 At paragraph 3.4, the Review highlights some areas where trusts play a valuable role in society. To this list we would add:

- Managing inheritances/transfer of assets in 'blended' families – where an individual has remarried, or has children from a previous relationship(s), a trust on death is the only practical approach to ensure that the current spouse/partner can benefit from income from (or the use of) assets while ultimately allowing the capital to revert back to children of previous relationships. As divorce, remarriage and blended families are now commonplace, it is essential that practical, affordable trust structures are available which can provide the flexibility to meet the needs of all family members.
- Allowing for the benefits of the trust to be shared flexibly between different individuals or generations as their needs change.
- Providing some element of asset protection in the event of divorce.
- Providing some element of protection for assets intended for an individual who is either subject to a controlling relationship or in a relationship that makes them financially vulnerable.

1.7 Given that the focus of the ATT's work is on UK tax compliance, we have not addressed the Review's questions about non-resident trusts, although we have made some comments on establishing UK residency for a trust.

1.8 As part of our contribution to this Review, one of our representatives (along with representatives from other professional bodies) attended a meeting with HMRC on 9 January 2019 ('the January meeting'). Where appropriate, we refer to and comment on some of the ideas that came out of that meeting.

1.9 We have also had sight of the response by the Low Income Tax Reform Group (LITRG), an initiative of the Chartered Institute of Taxation (CIOT) and would endorse LITRG's comments, in particular in their responses to questions 1, 6 and 7.

1.10 We have also read the report *Exploring the Use of Trusts* published by Ipsos Mori ('the Ipsos Mori report') published in November 2018[2] and have made further comments below.

1.11 Our response is set out below in the following order:

Section 2: *Exploring the Use of Trusts*: The Ipsos Mori report

Section 3: Trust usage and policy principles

Section 4: Trust transparency

Section 5: Fairness and neutrality

Section 6: Simplicity

Section 7: Trusts and income tax

Section 8: Digitalisation of processes

Section 9: Summary and conclusions

1.12 We would be pleased to discuss any aspect of this response further; contact details can be found in section 10.

[2] https://www.gov.uk/government/publications/exploring-the-use-of-trusts

2 *Exploring the Use of Trusts*: The Ipsos Mori report

2.1 The Ipsos Mori report was published alongside the Review in November and looked at the motivations of settlors in setting up trusts.

2.2 We have some concerns about aspects of this report. Firstly, it does not appear to distinguish between setting up trusts in life or on death. It may be that the main motivations for setting up a trust on death (via a Will) are different from the main motivations for setting up a trust in life.

2.3 The report is also not very clear about whether it is describing trusts which have come into existence already, or those which are due to come into effect on death via a Will. In the case study on page 23 where tax was identified as a secondary motivation for creating the trust, the settlor is described as 'taking out a trust for her husband' as if the trust was in existence and created in life. However, the study then goes on to describe what sounds very much like a Will trust, in which the assets are left to the husband on the wife's death via the Will and then onto nephews and nieces. Such a trust is therefore not yet in existence. The case study is then used as an example where being able to reduce tax liabilities was an additional driver for the settlor in creating the trust. Yet not only is the trust not in existence, it is not clear what, if any, tax saving is being achieved through this planning. Assuming that what is being created is a qualifying interest in possession on death for the surviving husband, then the IHT outcome would likely be the same if the assets were left directly to the husband without the trust.

2.4 The report highlights that settlors often believe that they have achieved a tax saving through the use of a trust while agents feel that tax savings are no longer possible through trust structures. Part of the reason for this disparity may be the period that is being considered. An agent will look at the position now, and the current tax rules that would apply when setting up a trust, while settlors may be recalling planning carried out some time in the past and not appreciate that trust law has changed and that such planning would no longer be effective. On page 25 there is an example of an individual recounting planning to avoid Capital Gains Tax (CGT) on disposal of a property. They report gifting a residential property into trust, claiming hold-over to defer the CGT and then allowing the property to be occupied by a trust beneficiary before sale so that the gain that came into charge would be covered by Private Residence Relief. Such planning to 'wash out' CGT has not been possible since the introduction of anti-avoidance legislation in Finance Act 2004 which took effect from 10 December 2003 so this is a situation where a change in the law has addressed a 'loophole'.

3 Trust usage and policy principles

3.1 **Question 1) The government seeks views on whether the principles of transparency, fairness and neutrality, and simplicity constitute a reasonable approach to ensure an effective trust taxation system; including views on how to balance fairness with simplicity where the two principles could lead to different outcomes.**

3.2 To respond to this question, we have commented on each of the proposed principles in turn.

3.3 **Transparency** – We agree with the principle that there needs to be sufficient transparency in the relationship between HMRC and a trust such that HMRC can be sure that the correct amount of tax has been paid. We suggest that HMRC is already able to request information necessary to establish that a tax liability is correct, either as part of the standard return process or through their existing enquiry powers.

3.4 We consider that there is a limit to how far the principle of transparency should be carried when considering how transparent the trust should be to its beneficiaries or to third parties. We also have concerns over the reporting burdens that excessive or duplicated transparency disclosures create. How far the principle of

transparency is taken in these cases is influenced significantly by wider trust law and, in particular the extent to which the UK adopts the EU's Fifth Money Laundering Directive (5MLD) after Brexit.

3.5 To ensure a level playing field, any transparency measures need to be enforceable in an appropriate manner for both UK and non-UK trusts. Where this is not possible for non-UK trusts, one approach might be to place obligations on UK beneficiaries receiving benefits from the trust.

3.6 **Fairness** – We agree with the principle that the trust taxation system should be fair. The difficulty lies in establishing what alternative situation to compare the position to – fair in respect to what? We were pleased to see that the Review suggests different comparators in different situations - comparing the position to not having a trust in some instances or to an alternative legal structure such as a company in others. At the January meeting, we discussed a number of options and agreed that there is not one obvious comparator for all situations. Where a tax is potentially 'unfair', presumably on the grounds that it is more expensive than another option, this could be viewed pragmatically as the cost of gaining some non-tax benefit such as greater flexibility, control or protection. Alternatively, it could be viewed as denying the parties access to their preferred structure and forcing them into an alternative structure which is less suitable to their needs.

3.7 We have had sight of the response to this consultation by the LITRG who have suggested that it may be better to look at the particular intention of the trust in order to determine what is fair and we support that proposal.

3.8 **Neutrality** – Again, we agree with the principle of neutrality, but the difficulty is again establishing what the taxation of the trust should be neutral in respect to. The Ipsos Mori report highlighted that an agent would tend to compare the costs of creating a trust to the costs of an outright gift. A settlor, considering that an outright gift was impossible, might make the comparison to the tax costs of retaining the assets in their estate. In the end, both alternatives are reasonable comparators and, in considering neutrality, it may be necessary to consider more than one comparator, as well as the legal and non-tax implications.

3.9 **Simplicity** – This is also a reasonable principle, although there can come a point where simplicity can create unfairness by creating strict boundaries with cliff edge effects, or unintended consequences if there are no provisions for special cases. Between simplicity and fairness, it is sometimes necessary to sacrifice simplicity to ensure fairness for cases on the boundaries.

3.10 Given the complexity of trust tax, particularly for non-UK trusts, simplicity will be very difficult to achieve in the trusts environment, especially if the intention is to make only limited or targeted changes.

3.11 We suggest that a further principle, **consistency**, should also be included. Trusts can have a long life span and can run for more than one generation. Older trusts in particular can have very inflexible deeds and the trustees may not have the powers to make changes to prevent hardship if the trust is negatively affected by major tax changes. Trustees could also find that decisions taken in good faith resulted, after legislative changes, in unexpected consequences and may not have the power to revoke or rescind the decision. Frequent changes do not sit well with inflexible trust deeds. Equally, making special provision for long established trusts to prevent hardship serves to add complexity to the tax code.

3.12 On similar grounds, **certainty** is also important for trusts, as it is for all taxpayers.

4 Trust transparency

4.1 **Question 2) There is already significant activity under way in relation to trust transparency. However, government seeks views and evidence on whether there are other measures it could take to enhance transparency still further.**

4.2 *Background*

In terms of trust transparency, the creation of the Trust Register in July 2017 following the EU's Fourth Anti-Money Laundering Directive (4MLD) represented a major change. Broadly, trusts who pay tax must report details of key individuals involved with the trust such as the settlor, trustees, and beneficiaries (so called 'beneficial owners') and details of the initial assets of the trust via the Trust Registration Service (TRS). The detailed regulations are set out in the *Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017*[3]. The Register is accessible by HMRC and various law enforcement agencies.

4.3 As noted in the Review, further regulations following 5MLD (if adopted) will extend registration requirements to *all* trusts whether or not they incur any tax liabilities and potentially open up the contents of the Register to anyone with a legitimate interest. The scope of *legitimate interest* is yet to be defined.

4.4 In addition to the Trust Register, trustees who meet the definition of a financial institution must comply with various automatic exchange of information (AEOI) measures including the Foreign Account Tax Compliance Act (FATCA) and the Common Reporting Standard (CRS).

4.5 Although not noted in the Review, a trust which participates in certain financial transactions is also required to apply for a Legal Entity Identifier (LEI).

4.6 In summary, a basic family trust set up with assets of less than the nil rate band – say £300,000 – as a relevant property trust by the settlor which is then invested in a managed portfolio which generates an income for the beneficiaries is required to:

(a) Register with the Trust Register via the TRS. The trust is required to disclose all beneficial owners connected with the trust. If the trust has been funded initially with cash it needs to report the amount of cash transferred. If the trust has been set up by transferring an existing portfolio of shares it must report its top eight to nine shareholdings with the balance noted as a portfolio. This is more information than a company holding an investment portfolio would be required to disclose as part of its accounts to Companies House or HMRC.
(b) Complete an IHT100 form reporting the creation of the trust, repeating details of the settlor also reported to the Trust Register although no IHT is due, as the amount of assets exceeds 80% of the nil rate band amount. If shares are transferred instead of cash, a second report of the share details is required as part of the IHT100.
(c) Disclose relevant information to certain counterparties with whom it forms a business relationship (eg accountant, solicitor, bank or investment adviser).
(d) Register for an LEI to engage in financial transactions.
(e) Consider its status under CRS and FATCA. As the trust has a managed portfolio, it is likely to meet the definition of a financial institution and will therefore need to register with the IRS in the USA for a Global Intermediary Identification Number (GIIN). The name of the trust will therefore be searchable

[3] http://www.legislation.gov.uk/uksi/2017/692/made

on the FATCA Search and Download Tool on the IRS website[4]. This will be the case even if the beneficial owners have no connection to the US and the trust has no US investments. The existence of any actual US connections is irrelevant to the status of the trust under FATCA.

4.7 While these measures are no doubt beneficial in tackling instances of evasion and abuse, there does come a point where, for a simple trust with no overseas connections, the amount of compliance with transparency measures is disproportionate. Unless there are specific areas of concern, we are struggling to see that for a simple family trust based in the UK, significant additional transparency measures are required. We have though suggested some minor improvements to the approach to collecting information on the Trust Register below in paragraphs 4.10 and 4.11.

4.8 Comments on Transparency and the Trust Register

While we note that a further consultation on the implementation of 5MLD is due, we have included comments on the existing Trust Register below as part of the wider transparency debate. References to regulations refer to the *Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017.*

4.9 ***The Name of the Trust***

When a new company is incorporated, it supplies a proposed name to Companies House. A company cannot have a name which is the 'same as' the name of an existing company. A company may also have to change its name if Companies House upholds a complaint that the name is 'too like' the name of an existing company.

In contrast, there are no similar restrictions in the naming of trusts. While any professionals involved are likely to suggest including some additional information to reduce confusion in their own files, there is nothing to stop the creation of multiple trusts named 'The Smith Family Trust'.

We suggest that to assist in differentiating between trusts with the same or similar name, all trusts on the Trust Register should be issued with a unique *Trust Registration Number* that is associated with the trust throughout its life.

4.10 ***Details of advisers held on the Register***

Under regulation 45(5)(g), trustees are required to register 'the full name of any advisers who are being paid to provide legal, financial or tax advice to the trustees in relation to the trust' on the Register.

In practice, HMRC has advised that they are only looking for details of the agent (if one has been appointed) who looks after the trustees' tax affairs and that trustees should keep their own written records of other advisers.

While this is a welcome simplification, this does mean that the existing Trust Register is not entirely consistent with the underlying legislation and it is not possible to identify connections to specific advisers. We would suggest that trustees should be asked to confirm who has provided legal, financial or tax advice in the previous tax year in line with the regulations. To minimise disclosures, there could be a minimum threshold on the amount paid for the advice before disclosure is required.

4.11 ***Detail of assets held under the Register***

[4] https://apps.irs.gov/app/fatcaFfiList/flu.jsf

Under regulation 45(5)(c) trustees are required to supply:

> 'a statement of accounts for the trust, describing the trust assets and identifying the value of each category of the trust assets at the date on which the information is first provided to the Commissioners (including the address of any property held by the trust);'

In practice, this has been dealt with by asking agents to supply information about the assets placed into trust at the *commencement* of the trust (see page 22 of the FAQ issued by HMRC on 22 November 2017[5]). Subsequent additions to the trust will be captured via self-assessment or IHT reporting if the addition is significant.

For trusts which have already supplied this information via the previous 41G paper form – or for trusts which have been in existence for so long that it would be impossible to establish what was originally introduced into the trust on creation - HMRC conceded that a workaround could be used in which the asset fields were marked as £1.

In contrast, more recently created trusts were set a significantly increased reporting burden from the previous 41G paper process requiring not just a total of any investments as a portfolio for example, but a detailed breakdown of the top shareholdings including, where known, details of the company's UTR.

While we accept that HMRC needs to be informed of transfers into trust, the level of detail for new trusts has significantly increased beyond that which was previously required to a level which is now burdensome. If the assets introduced into trust exceed £325,000 (or £650,000 for joint settlors) then the full details will have been reported as part of an IHT100 return to establish any IHT entry charge. If the trust was created by Will, full details of the assets are likely to have been supplied as part of the probate process.

We consider that it is sufficient to describe a portfolio of shares, as a portfolio of shares. Since the information about assets held at commencement on the Trust Register is not updated then, as time passes, it will soon become out of date. This again suggests that the level of detail requested for share assets does not need to be as great and that HMRC is interpreting the scope of regulation 45(5)(c) too narrowly in this respect.

Furthermore, trusts transacting in financial transactions on recognised stock exchanges are already subject to other transparency measures, such as the requirement to have an LEI.

4.12 We acknowledge that transparency of trust assets could be enhanced by reporting the trust assets annually – similar to preparing annual accounts for a Company. However, we would strongly advise against any such measure on the grounds that this would pose too great an administrative burden and mean that many small trusts would simply become prohibitively costly to run. There would also be a risk of increased non-compliance which would impose additional pressure on HMRC's limited resources.

4.13 *The timing of data updates*

Under 4MLD, once information has been supplied to the Register, trustees are only required under regulation 45(9) to update the information supplied to the Register about changes to beneficial owners (or to confirm that no changes have occurred) in the period following a tax year in which the trust incurs a tax liability. This means that data on the Register about beneficial owners could be significantly out of date, which is not an aid to transparency. For example, a trust which only incurs a liability to tax when the ten-year anniversary charge

[5] https://www.att.org.uk/sites/default/files/171122%20-%20TRS%20Guidance%20FAQ%20-%2022%20November%202017.pdf

arises, could register details for 2016/17 by 31 January 2018 following an IHT charge in that year, but then not be required to update details of their beneficial owners until 31 January 2028.

Transparency could be improved by increasing the frequency of updates on the Register. We anticipate that if 5MLD is adopted, since it removes the requirement for a trust to have a tax liability before it must be included on the Register, trusts will be required to make annual updates. If 5MLD is not adopted, then it might be reasonable to ask a trust to review the details on the Register annually once it has been registered, or at least every five years in line with the point at which HMRC contacts trusts who are not in self-assessment to check if self-assessment returns are now required.

4.14 A further issue is the point in time at which the data provided to the Register is correct. Trustees have until the 31 January following the tax year in which a tax liability arose to report any changes to beneficial owners. If a trust is required to report following a tax liability in 2018/19, then there could be further changes to beneficial ownership between 5 April 2019 and the reporting deadline of 31 January 2020. Guidance from HMRC advises that the latest information should be used at the point when the Register is updated. However, this means that data is not comparable between trusts as the data supplied does not relate to a common reporting date, but the date at which the information has been supplied.

We would suggest that, to aid transparency without imposing undue burdens, a similar approach to the Company Register could be adopted for trusts. Companies are required to submit a Confirmation Statement which returns basic information about the Company at a given point in time and thereafter on an annual basis. Changes to directors and shareholders that occur during the year are reported shortly after they have happened.

On this basis, trusts would provide an update of changes to the beneficial owners during the previous tax year and a statement of the position at 5 April. This annual update would continue to sit within the self-assessment cycle and ensure that the authorities could compare the data between trusts more easily. As the report would cover a period it would clarify the reporting requirements when in individual is appointed as a beneficiary for a short period of time and then removed again.

In a similar manner to the reporting of changes to directors, changes to trustees (only) could be reported on a more regular basis as they are responsible for managing the trust. This also ensures that HMRC has up to date contact information. Provided that this could be done simply and effectively via the TRS (currently amendments cannot be made via the TRS) then since a change of trustee is generally done by deed, there is already some administration involved in the change of trustees and updating the Register within a reasonable period of that change should not unduly add to that burden.

4.15 ***Use of Data held by the Trust Register***

(i) Identify 10 year charges

Having gathered a significant amount of data on the Trust Register, we consider that HMRC should be able to use this data to assist in tax collection. One obvious suggestion (which we have made before) is that since the Register contains the creation date of the trust and the nature of the trust, the system should be able to identify when a 10-year charge is due for a relevant property trust. It is not unknown for such charges to be overlooked, and an email or postal reminder issued by the Register six-months in advance of the anticipated charge date should help to ensure that the trustees have the opportunity to take appropriate action. It could also allow HMRC to more easily spot where the charges have been missed.

The Ipsos Mori report highlighted that very few settlors were aware of entry and exit charges, stating on page 28 of the report:

'Awareness of the 10-year anniversary charge was mixed amongst settlors. Typically, they were either aware of the periodic charge but not the finer detail of how much they would need to pay or they were completely unaware that there would be ongoing/further tax charges.'

4.16 *Privacy Concerns for trustees and vulnerable beneficiaries*

While we appreciate that there needs to be sufficient transparency that HMRC can verify a trust's tax position, we have concerns about increasing transparency with other parties by, for example, making details of the register public and/or the proposed access for those with a *legitimate interest* under 5MLD proposals.

Our concerns include:

- Increased fraud risk for those on public registers. New regulations were introduced in 2018 to address the fact that company directors (whose details are publically available at Companies House) are twice as likely to be victims of fraud[6].
- The risk to vulnerable beneficiaries, particularly minors. One of the major uses of trusts, as acknowledged in the Review, is to manage assets on behalf of those who cannot manage them themselves. While the existence of the trust should help to protect beneficiaries in many instances, those such as minors who may receive assets outright in the future could be targeted in anticipation of assets being transferred to them at a later date.
- Deterring those for whom a trust is an appropriate solution from using a trust because of loss of privacy. Reticence to disclose the nature and amount of family wealth should not be taken to indicate that an individual is engaged in tax evasion, but (the desire of some to reveal all on social media not withstanding) simply a natural reluctance to share details of their financial affairs.

Unlike companies, which exist in large part to facilitate trade with third parties and where therefore, transparency of data with counter parties is often necessary, the use of trusts is frequently driven by personal and private relationships in which transparency with third parties other than HMRC/law enforcement is not appropriate.

4.17 **Question 3) The government seeks views and evidence on the benefits and disadvantages of the UK's current approach to defining the territorial scope of trusts and any other potential options.**

4.18 As noted in our introduction, we do not have the evidence base to respond to this question in detail. We would however comment that, since trust residency is determined by reference to the residency of trustees, a UK trust with two trustees where one is non-resident runs the risk of accidentally migrating if the UK trustee dies suddenly. It is possible to plan by appointing either additional UK resident individuals, or a UK-resident trust company if the trust wishes to remain UK resident, but there should perhaps be an option for a UK trust to remain within the UK system in such instances.

4.19 **Question 4) The government seeks views and evidence on the reasons a UK resident and/or domiciled person might have for choosing to use a non-resident trust rather than a UK resident trust.**

4.20 As noted in our introduction, we do not have the evidence base to respond to this question.

[6] https://www.gov.uk/government/news/new-protection-against-identity-fraud-for-company-directors

4.21 **Question 5) The government seeks views and evidence on any current uses of non-resident trusts for avoidance and evasion, and on the options for measures to address this in future.**

4.22 As noted in our introduction, we do not have the evidence base to respond to this question.

5 Fairness and neutrality

5.1 **Question 6) The government seeks views and evidence on the case for and against targeted reform to the Inheritance Tax regime as it applies to trusts; and broad suggestions as to what any reform should look like and how it would meet the fairness and neutrality principle.**

5.2 In order to ensure fairness, any targeted reform should not be made on the basis of IHT alone. In most cases, consideration of IHT charges is balanced by consideration of CGT charges, with specific rules where both could apply. In very broad terms, if an individual chooses to keep their assets they are subject to IHT on death, if they chose to give them away they will be subject to CGT in life.

5.3 In terms of selecting an appropriate comparative to establish neutrality, as noted above in 3.7 this will vary depending on the nature of the trust. Broadly, where the trust is a qualifying interest in possession, then comparing the position to what would have happened if the beneficiary held the assets outright might be a reasonable starting point. For a relevant property trust, comparison to a company is appropriate in some, but not all, circumstances. However, unless the trust is settlor-interested (in which case a range of anti-avoidance provisions have evolved over the years) then comparing to a position that the settlor has not truly effected a gift is unhelpful, and inconsistent with the legal position.

5.4 *The IHT nil rate band and Trust IHT charges*

Members report to us that, consistent with the Ipsos Mori report, very few individuals are prepared to gift more than £325,000 into trust and incur an entry charge of 20%. Most settlors are reluctant to pay IHT in life, and view this as accelerating a charge which they (personally) will otherwise never have to pay. Excluding cases where APR and BPR are available, it is presumably possible to gather from the Trust Register details of how many trusts are actually being created with assets above this value to confirm this. The upfront charge therefore places a practical limit for most families on the amount that can be put into trust.

5.5 Where an individual can make a gift outright (for example they don't have concerns about the ability of the beneficiary to manage the gift and the beneficiaries are of age) then there is no upper limit to the value of their gift which will, after seven years fall out of their estate for IHT. However, the donor must consider any potential CGT costs on any gain as the gift will be deemed for CGT purposes to occur at market value. This may or may not be less than any upfront IHT charges depending on factors including the amount of gain, tax rates, and value of the assets being gifted.

5.6 It is difficult to say whether or not the effective limit on transferring assets into trust is fair. Some of our members have objected strongly to the limit imposed by the 20% entry charge since not all settlors are in a position to make sizeable outright gifts, either because the potential beneficiaries are too young, unable to manage assets, or the upfront CGT charge is prohibitive.

5.7 Where a settlor is looking to transfer property into trust to provide a home for a beneficiary, the increase in property prices over recent years could mean that it is not possible to settle the complete property without triggering a charge.

5.8 The Ipsos Mori report also highlighted that settlors could chose to settle up to the nil rate band into a trust every seven years to reduce the value of their estate for IHT purposes. Members outside of London report that the number of individuals capable of benefiting from the ability to create new trusts every seven years is limited. In order to carry out this planning, the individual needs not only to have built up sufficient disposable assets but also to have commenced planning some 14 years in advance of their death, by which time the first of the two trusts created has potentially incurred a 10-year anniversary charge.

5.9 At the January meeting, various suggestions were made regarding either reducing or eliminating entry charges and perhaps replacing the exit and anniversary charges with an annual IHT charge on relevant property trusts. While we can see that this might have an appeal to larger estates looking to manage and control more assets in a trust structure, we consider than an annual IHT charge could discourage many families with less significant wealth from using a trust. Even if the charge was a small percentage each year (say 1%) and could generally be expected to be less than any future IHT charge at 40% in the settlor's estate, annual charges are likely to have a deterrent effect for smaller trusts because settlors will not want to start paying IHT in their lifetimes. Smaller trusts may also not have sufficient cash reserves or flexibility to raise funds through the sale of assets to meet ongoing annual IHT charges.

5.10 For smaller trusts, the costs of advice and compliance are proportionally greater and therefore any move to an annual IHT charge would need to involve significantly simplifying the calculation and reporting of the charge.

5.11 The Review notes at paragraph 5.2 that the underlying policy principle is neutrality. On this basis, there would be an argument for the introduction of a trust structure which is transparent for tax, but allows the settlor the advantage of using a trust to separate the legal ownership of assets from the individual who benefits. At present, it is possible to create a qualifying interest in possession trust only on death. It is not possible to a settlor to create a trust which is similarly transparent for IHT in life.

5.12 **Question 7) The government seeks views and evidence on:**

a) **the case for and against targeted reform in relation to any of the possible exceptions to the principle of fairness and neutrality detailed at paragraph 5.6;**
b) **any other areas of trust taxation not mentioned there that would benefit from reform in line with the fairness and neutrality principle.**

5.13 The Review raises four specific areas of concern which we have addressed in turn below:

5.14 *Capital Gains Tax - Private Residence Relief (PRR)*

The Review raises the concern that trustees can claim PRR on a disposal of a residential property which has been occupied by one beneficiary but then transfer the funds to another beneficiary or settlor. We do not consider that this outcome is unfair or lacks neutrality when compared to the sale by an individual of their own home. Once an individual has sold their home, they are free to do as they wish with the proceeds.

5.15 The current approach is reasonable as it allows the trustees flexibility over how different beneficiaries can benefit from trust assets, without their decision being influenced by the tax position. It may be that the trustees have decided that an appropriate use of trust assets is for one beneficiary to be able to live in a property but that, when the first beneficiary moves on (or dies), the property is sold to buy another property, more suitable for a second beneficiary. It may be that the trust is structured such that the beneficiary who has lived in the property is not entitled to the capital, so the capital can only be provided to another beneficiary. It may be that, post-sale, the funds are not immediately used to benefit anyone else. Withdrawing PRR in these

instances because the proceeds have not been transferred to the occupying beneficiary will not increase fairness. Retaining flexibility between beneficiaries and entitlement to PRR based on who is occupying the property maintains fairness. Introducing a test of how sale proceeds are applied, or simply denying trusts PRR altogether, would not result in a neutral outcome.

5.16 *Trust Management Expenses (TMEs)*

The Review notes that relief for TMEs is more generous for trustees than individuals. However, the regime is arguably less generous in some circumstances than the position for a company. Companies are able to claim relief for management expenses in full against corporation tax. A relevant property trust is only entitled to relief from higher rates of tax.

5.17 Unlike individuals, who could choose to manage investments without advice and the associated costs, trustees have a duty of care towards their beneficiaries and must comply with the Trustee Act 2000. This imposes a duty on trustees to obtain and consider proper advice and to ensure that any trust investments are suitable and regularly reviewed. Unless the trustees have the relevant skills to do this themselves, or the costs of advice would outweigh the benefits, many trustees will opt to satisfy those requirements through paying for professional advice. Beneficiaries do not generally have any say over the level of professional costs incurred. Given the potentially more complex investment objectives for a trust with multiple beneficiaries and additional work for the adviser in ID checks and risk assessments it is possible that trusts could incur higher investment management fees compared to an individual. Accordingly, the existing element of tax relief for TMEs is not unreasonable.

5.18 Income and capital receipts in trust law

The Review expresses concern that trustees have the opportunity to dispute whether an item is capital or income under trust law and thus, in effect, to manipulate the position in order to benefit from lower CGT rates. We have not had any similar concerns reported to us, but we have had concerns raised, particularly for the unrepresented, that is it difficult and confusing for trustees to establish if an item is capital or income, so that they run the risk of not paying sufficient tax and being charged interest and penalties.

5.19 Areas which have been reported to us as providing a particular challenge include:

- The position for chargeable event gains. While s461 ITTOIA is clear that, when taxable on the trustees, chargeable event gains are deemed to be taxable as income, with tax paid (above any notional 20% tax credit on a UK bond) eligible to enter the tax pool, the guidance at TSEM3210 or on GOV.UK[7] does not indicate whether distributions of receipts from the bond will continue to be treated as capital such that the tax pool cannot be recovered.
- Where regular distributions are being funded from capital this can, in certain circumstances, still be taxable as an income distribution by the trust. Trustees can find this treatment confusing when the cash has physically come from the disposal of capital assets.

5.20 Trusts and transactions declared void by the courts.

We have no comments on this area.

[7] https://www.gov.uk/guidance/trusts-and-income-tax

6 Simplicity

6.1 **Question 8) The government seeks views and evidence on options for the simplification of Vulnerable Beneficiary Trusts, including their interaction with '18 to 25' trusts.**

6.2 We received from a member the following feedback regarding Vulnerable Beneficiary Trusts:

'I agree that the practicalities of Vulnerable Beneficiary Trusts are so burdensome that I cannot deal with them for the kind of fee that a client is willing to pay. A really easy option here is for such a trust to not be taxed to income tax at all so that the beneficiary receives all the income gross and declares it on their own personal tax return in exactly the same way as a beneficiary who has all the income mandated to them or one who has been granted a temporary interest in possession. In many instances a vulnerable beneficiary does not want to declare their income to the trustees and it is not right that they currently have to.'

6.3 In respect of 18-25 trusts, these exist because very few parents are prepared to allow their child to inherit at the age of 18, even though appointing the assets out of trust at that age to the bereaved minor is the most efficient option for IHT. Despite IHT being charged on the estate on the parent's death, any parent who wants their child to benefit from having their share of their inheritance managed beyond the age of 18 must accept that the estate will be further reduced by an additional charge of up to 4.2% of the value of the estate (after any exemptions). This is arguably not neutral as, if the child simply inherited outright from their parent, there could be no second charge between the ages of 18-25 apart from in unfortunate situations where the child also died. The parent's estate therefore incurs additional IHT in securing the management of the estate until the child is considered old enough to manage it themselves. It is difficult to see that it is reasonable for there to be additional IHT charges because the deceased parent wished to introduce a delay in the child inheriting absolutely until the age of 25.

6.4 **Question 9) The government seeks views and evidence on any other ways in which HMRC's approach to trust taxation would benefit from simplification and/or alignment, where that would not have disproportionate additional consequences.**

6.5 We have a range of comments in this area:

6.6 *Alignment of reporting dates*

For smaller trusts in particular, one change to trust taxation which could both simplify administration and reduce administration costs might be to consider aligning the various reporting dates for income tax, CGT and IHT.

6.7 The self-assessment system and the Trust Registration Service reporting deadlines are already aligned, with trustees required to provide information by 31 January following the tax year. Bringing the IHT reporting deadline to a 31 January deadline, and reporting on exits from the trust on a tax year basis, could reduce costs by allowing the trustee or their agent to deal with all reporting and tax issues for the trust in one go. It should also reduce the risk of exits from the trust being unreported.

6.8 For many smaller trusts, all the necessary information to prepare the tax return is contained in the investment manager's end of tax year accountant's pack. This is generally issued in May/June following the end of the tax year. From this, the agent or trustee can establish details of not only income and gains but also appointments from the trust. Often the costs of reporting exits from the trust is disproportionate to the amount of tax which is due. Trustees also do not always appreciate the differing reporting timescales for IHT and may therefore fail to alert their advisers in time to make the report. By reporting all the tax consequences for that year – income

tax, CGT and IHT – this would enable all aspects to be dealt with together, and, by extending the self-assessment forms, could allow all data to be submitted electronically to HMRC.

6.9 Alternatively, consideration should be given to at least aligning the submission deadlines for the IHT100. This suite of forms currently has two separate return submission deadlines. Generally, a deadline of six months from the end of the month of the chargeable event applies, but for chargeable lifetime transfers during the transferor's lifetime made between 6 April and 30 September the deadline is the end of April in the following year.

6.10 ***Reporting limits***

Since the introduction of SI 2008/605 and SI 2008/606, immediately chargeable lifetime transfers of cash or shares made after 6 April 2008 and exit charges or anniversary charges occurring after that date do not need to be reported if the chargeable value (including chargeable transfers in the previous seven years where appropriate) does not exceed 80% of the nil rate band. While this is a helpful simplification, it still requires a number of reports to be made even though no tax is at stake. Where, for example, a trust is set up with £300,000 in cash, an IHT100 is required even though no IHT is due and (provided that the cash generates an income tax liability or is invested in shares or property such that a tax liability is triggered) details of the trust and the assets on creation will have been supplied to the Trust Register.

6.11 Assuming that the provisions of 5MLD are implemented, then HMRC will be informed of the trust creation via the Trust Register regardless of whether or not such a trust goes on to generate a tax liability. Consideration should be given as to whether, if 5MLD provisions are adopted (so that all trusts are reported together with details of assets on creation), an IHT100 is only required where there is actual tax to pay.

6.12 ***Tapering***

Members report that taxpayers' understanding of how gifts into trust can benefit from taper relief is limited. In practice, taper relief only benefits those able to make larger gifts in excess of £325,000. We have provided more detailed comments on taper relief to the OTS as part of their review of IHT as tapering has wider implications.

7 Trusts and income tax

7.1 At January's meeting, we were invited to comment on trust income tax, as well as IHT matters. We have therefore included some further comment on income tax and self-assessment here.

7.2 Under the present system, the income of a relevant property trust is taxed at higher rates - 38.1% for dividend income, 45% otherwise - subject to any TMEs and allowing for up to £1,000 of income to be taxed at basic rates, depending on the number of other trusts the settlor has.

7.3 An income tax charge of 45%/38.1% on the income in a family trust can be off-putting to settlors considering establishing a trust for the first time. Members dealing with small to medium size trusts report that the settlors of these trusts are not necessarily paying 40% tax on their personal income, let alone 45%, as many families are asset-rich without being higher rate taxpayers. However, comfort is provided by the fact that as long as it is possible to distribute income to beneficiaries then, since in many cases the beneficiaries will either be basic rate taxpayers or not liable to income tax at all because their income is under the personal allowance, the tax accumulated in the trust tax pool can be recovered. While this is administratively cumbersome, and settlors

can struggle to understand the tax pool created as part of this process, it does result ultimately in a neutral outcome.

7.4 We presume that part of the rationale for charging income in relevant property trusts to higher rates is to discourage settlors from trying to benefit from lower tax rates by spreading income around a number of trusts and/or allow trusts to benefit from being able to roll up income at lower tax rates. However, given the effective limit since the 2006 changes on the amount of assets that can be settled into a relevant property trust in the first place, (and various anti-avoidance measures that mean settlors who retain an interest in the trust are still taxable on trust income) we wonder if there is still a need to impose the very highest rates on trust income?

7.5 Alternatively, to simplify the process for smaller trusts, there could be an option where the trust income and gains were under certain limits for the trust to pay no tax provided that all income was distributed for the year. (In practice distributions would have to occur after the tax year had ended when the income was known.) Effectively this would allow certain trusts to opt into a simplified system. Trustees could supply the beneficiaries (and HMRC) with an R185 which the beneficiary would include on their tax return if needed. Beneficiaries whose income was under the personal allowance would need to take no action. Beneficiaries who were not in self-assessment but have PAYE could have their trust income dealt with via a P800 since details had been reported to HMRC via the R185. This would avoid the circular process of the trust paying tax over and the beneficiary reclaiming it. To enable HMRC to track income from the trust and match it to the relevant beneficiary, the R185 would need to include more details about the beneficiary than it does at present – for example a date of birth and an NI number for beneficiaries over 16. Beneficiaries could confirm the information supplied to HMRC by going to their Personal Tax Account (PTA).

7.6 At the January meeting, it was suggested that changes should be made to remove the need for the trust to pay a large amount of tax and the beneficiaries to recover it by allowing the trust to pay two sets of rates – a higher rate if the income was not distributed, and a lower or nil rate if income was distributed. Any undistributed income would not be entitled to a tax credit at a later date. The higher tax charge would be a cost of deciding to keep the income in the trust. The lower charge (or nil charge) would apply to distributed income, which would be taxable on beneficiaries.

7.7 While the suggestion referred to in 7.6 above provides simplification by removing the need for a tax pool, we think that the increased tax cost would put those trusts which are not in a position to distribute income – for example because the trustees are accumulating income for a future cost or it is not considered appropriate for the beneficiary to have access to the funds at that stage – at a disadvantage. While the tax pool adds complexity, it does ensure that ultimately the income is taxed on the beneficiary at the rate appropriate to them when they do receive the funds.

7.8 On the other hand, we wonder if there is potentially an argument that the £1,000 basic rate allowance adds unnecessary complexity, for little practical benefit. When the trustees of a relevant property trust come to distribute income, it must be franked by a 45% tax payment in the tax pool. Trustees of smaller trusts can be caught out and over-distribute if they have only previously paid tax at the basic rate band and there is insufficient tax in the tax pool. There is an argument that, in these cases, the £1,000 is unhelpful and (once divided between more than one trust) irrelevant.

7.9 Instead of providing a basic rate band for all relevant property trusts, the number of trusts with a very small income that are not required to report their income under self-assessment could be extended. At present, trusts whose only source of income is savings income which generates a tax liability of less than £100 are, as a

result of an interim arrangement[8], not required to complete self-assessment returns for 2017-18. It would be helpful if this interim arrangement could be formalised and apply to all forms of income (particularly dividend income) where the trust's liability is under £100.

8 Digitalisation of processes

8.1 From the administrative perspective, one major simplification to save time and costs would be to enable more trust processes to be completed online/digitally. We note that a fully integrated digital system for Inheritance Tax was a key recommendation of the OTS's first report into their Inheritance Tax Review published in November 2018[9]. We would support moves to increase digitisation of the IHT system which includes trusts, in addition to improvements to the TRS. (We understand that HMRC are currently working on a separate micro-site to improve the user experience of the TRS.)

8.2 From an income tax and CGT perspective, it is possible to submit a trust SA900 return online, but there is a general understanding in the agent community (which we have been unable to confirm directly with HMRC) that processes are not as automated for trust self-assessment and that some element of manual re-keying of data is carried out by HMRC after the return has been submitted electronically. This can introduce errors and delays in the process.

8.3 Typical errors in trust return processing include the issue of incorrect late filing penalties for trusts filed electronically after the paper filing deadline of 31 October but before the online filing date of 31 January. For the 2017/18 year, 653 trust returns processed on 2 January 2019 received incorrect late filing penalties following 'human error in processing.'[10] One member has reported to us that similar errors have affected their clients for the last six years, resulting in additional costs and wasted time for both agents and HMRC in cancelling these penalties.

8.4 A major part of the process of recovering tax for beneficiaries is the completion of the R40. This is intended to be a simplified mechanism to recover over-paid tax. These cannot be filed electronically from agent software so, unless the beneficiary can prepare the claim online via existing channels themselves[11], the agent will generally prepare a paper R40 for signature. Many beneficiaries prefer the support of an agent to attempting the reclaim themselves, concerned about reclaiming the correct amount. An online claim may not be appropriate or possible where the beneficiary is a minor. It appears that an NI number is required to create a Government Gateway account and therefore we are not clear if those under 16 can have a Personal Tax Account.

8.5 Members report every year issues with poor quality data processing of paper R40 forms, resulting in incorrect calculations, delays in obtaining refunds (especially since bank details can no longer be supplied on the R40) and difficulties in following up these forms in the system. The professional costs of resolving these issues often vastly exceed the amount of tax at stake, leading many members to absorb these costs as a goodwill gesture to their clients.

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[8] https://www.gov.uk/government/publications/hm-revenue-and-customs-trusts-and-estates-newsletters/hmrc-trusts-and-estates-newsletter-april-2017#administration-period

[9] https://www.gov.uk/government/publications/office-of-tax-simplification-inheritance-tax-review

[10] https://www.accountancydaily.co/hmrc-admits-tax-return-penalty-error

[11] https://www.gov.uk/government/publications/income-tax-claim-for-repayment-of-tax-deducted-from-savings-and-investments-r40

8.6 If the current approach of taxing relevant property trusts at higher rates and then allowing the beneficiaries to recover the difference between their personal tax rate and the trust tax rate is to continue, then streamlining the R40 process to allow digital submissions from agent software and inclusion of beneficiary bank details would be a great benefit.

9 Summary and conclusions

9.1 We welcome this Review of trusts and the Government's aim to '*facilitate the straightforward usage of trusts where they are the appropriate legal mechanism.'*

9.2 Our key observations in respect of trust usage and policy principles (section 3) are:

- The three proposed principles of transparency, fairness and simplicity are reasonable, although not straightforward to apply.
- Further principles of consistency (see 3.11) and certainty (3.12) would be helpful given that trusts can be in existence for many generations.

9.3 Our key observations in respect of trust transparency (section 4) are:

- We have concerns that further transparency measures for UK-based family trusts would be disproportionate and amount to an undue burden (see 4.2-4.7).
- Given that detailed information on taxable trusts is now being gathered on the Trust Register, consideration should be given to how to use that data effectively including:
    - Assigning all trusts a unique *Trust Registration Number* (see 4.9).
    - Bringing the disclosure of adviser details more in line with regulations (see 4.10).
    - Ensuring that the data gathered on share portfolios is proportionate (see 4.11).
    - Clarifying the reporting period for trustees and bringing updates in line with the Companies Register (see 4.13 and 4.14).
    - Using data to identify 10-year anniversary charges to HMRC and trustees (see 4.15).
    - Ensuring that the same data is not gathered more than once (for example reported via the TRS and also on an IHT100).

9.4 Our key observations in respect of fairness and neutrality and targeted reform to the IHT regime (section 5) are:

- We consider that changes to the IHT regime cannot be made without first considering the effect for CGT and other taxes (see 5.2).
- The 20% lifetime charge is seen as a barrier by settlors wishing to create a trust and some of our members would like to see the limit on the value of assets that can be placed into trust lifted (see 5.6).
- We have concerns about the idea of increasing the frequency of IHT charges from every ten years as it could discourage many families from using a trust (see 5.9).
- We consider it reasonable that trusts can claim PRR where a beneficiary has occupied a residential property without needing to consider how the sale proceeds are then used (see 5.14 - 5.15).
- We also consider that the current treatment of TMEs is reasonable (see 5.16 -5.17).

9.5 In respect of simplicity (section 6) our key points are:

- The process of dealing with income tax for vulnerable beneficiary trusts could be simplified (see 6.2).

- The additional IHT charge on exit in an 18-25 trust is potentially unfair (see 6.3).
- The whole income tax, CGT and IHT regime could be simplified for smaller UK-based trusts if it was possible to make a single annual report of the trust's income, gains and IHT charges for a given tax year. (see 6.6-6.8).
- Given the additional data now received via the TRS, the reporting exemptions provided by SI2008/065 and SI2008/606 could be made more generous (see 6.10-6.11).

9.6 Our key observations in respect of income tax for trusts (section 7) are:

- The 45% rate for income tax is off-putting to many settlors – those advising outside London report that the settlors are not necessarily paying 40% tax on their personal income, let alone 45%, as many families are asset-rich and not higher rate taxpayers (see 7.3).
- Given the changes to trusts in 2006, and the various settlor-interested anti-avoidance measures, the 45% rate may no longer be appropriate or necessary (see 7.4).
- Taxation for trusts and beneficiaries could be simplified for smaller trusts who distribute all their income by taxing the income only in the hands of the beneficiaries (see 7.5).
- In the meantime, while the tax pool adds complexity, ultimately it does result in a neutral outcome and provides trustees with the flexibility to accumulate income knowing that tax paid can be recovered by the beneficiaries on subsequent income distributions (see 7.7).
- The benefit of the £1,000 basic rate band should be considered (see 7.8). It may be more helpful to increase the scope of exemption from self-assessment for trusts with a very small income (see 7.9).

9.7 We have also commented on potential digitalisation of more processes for trusts (section 8) and we would like to see:

- The OTS's key recommendation of a fully integrated digital system adopted (see 8.1).
- Improvements to the SA900 for trusts (see 8.2-8.3).
- Digitisation of the R40 process for agents (see 8.4-8.6).

10 Contact details

10.1 We would be pleased to join in any discussion relating to this Review. Should you wish to discuss any aspect of this response, please contact our relevant Technical Officer, Helen Thornley on 07773 087125 or hthornley@att.org.uk.

The Association of Taxation Technicians

11 Note

11.1 The Association is a charity and the leading professional body for those providing UK tax compliance services. Our primary charitable objective is to promote education and the study of tax administration and practice. One of our key aims is to provide an appropriate qualification for individuals who undertake tax compliance work. Drawing on our members' practical experience and knowledge, we contribute to consultations on the

development of the UK tax system and seek to ensure that, for the general public, it is workable and as fair as possible.

Our members are qualified by examination and practical experience. They commit to the highest standards of professional conduct and ensure that their tax knowledge is constantly kept up to date. Members may be found in private practice, commerce and industry, government and academia.

The Association has more than 9,000 members and Fellows together with over 6,000 students. Members and Fellows use the practising title of 'Taxation Technician' or ‘Taxation Technician (Fellow)’ and the designatory letters 'ATT' and 'ATT (Fellow)' respectively.