Consultation Response

Taxation of Trusts

Date: 26th February 2019

Introduction

1. The CLA is the membership organisation for owners of land, property and businesses in rural England and Wales. We help safeguard the interests of landowners, and those with an economic, social and environmental interest in rural land. Our members own or manage around half the rural land in England and Wales and more than 250 different types of businesses.

2. Trusts have been part of the English legal system for centuries, and are used for myriad reasons – rarely to do with tax – for example to protect against minors inheriting, imprudent beneficiaries, unwise marriages etc.

3. Historically, trusts have been used by farming families to provide ongoing management of farmland and businesses and, in many instances, sub-trusts and amalgamation of trust properties have occurred leading to convoluted calculations, complexity in taxation and delays after reporting to HMRC. A clearer taxation structure and easier compliance for trusts would be welcomed for such trustees and beneficiaries.

4. The present inheritance tax (IHT) regime for trusts cannot be said to be either transparent or fair. That regime ought (as originally intended) to mirror individual ownership so far as possible and the suggestion above would result in trusts being taxed in an equivalent manner to personal ownership. They would then be neutral for inheritance tax, which is both more appropriate and makes the choice of whether to use trusts or not one about issues other than tax, such as preventing a child from becoming demotivated by inheriting at a young age or to preserve family assets for future generations.

5. While there is the concern from the government that offshore trusts are or are perceived to be tax evasion or avoidance structures, the taxation of these needs to include other aspects and legislation that simply does not impact on domestic trusts. If, post-Brexit, the UK is no longer a part of the single market, then the UK no longer has to ensure that its tax law complies with the fundamental EU Treaty principle of non-discrimination amongst member countries. This, therefore, means that UK resident trusts no longer need to be aligned to the same rules as their offshore counterparts – which are the trusts seen as most likely to be used for tax avoidance.

6. There are good reasons where an offshore trust could and would be used (overseas beneficiaries, assets held in other countries, settlor's tie to different jurisdiction). In the context of this consultation, it seems that much of the transparency, fairness and simplicity has been discussed and implemented in line with the government's positions of domicile and deemed domicile, and that this consultation should be aimed squarely at the domestic trust taxation and the issues surrounding their taxation.

Key principles – Transparency, fairness, neutrality

Transparency

7. Currently, legislative compliance that impacts on trust ownership and beneficial interests for both offshore and domestic trusts is already in place through the Foreign Account Tax Compliance Act (FATCA), the Common Reporting Standard (CRS), Persons with Significant Control (PSC) register and the Trusts Register, which is held under the umbrella Trusts Registration Service (TRS). Future planned legislation includes a register of offshore owners of UK property and an increase in information to be held on the TRS when the EU fifth's Anti Money Laundering Directive comes into force (or its post-Brexit equivalent). Clearly, there is a need for legislation to be in place to prevent terrorism financing and money-laundering activities but this needs to be proportionate to its impact on trusts and it seems hard to make trusts any more transparent given the existing legislation, as well as future legislation requirements, along with current inter-country reporting requirements that can be utilized.

8. Trust reporting is already more onerous than business reporting. For example, company directors and PSCs have to provide their name, nationality, occupation, date of birth and a correspondence (service) address, and a home (residential) address. The TRS, in contrast, will hold far more information including the full detail of the trust, the description and value of each class of assets, and the settlor, trustees, any person exercising effective control and named beneficiaries need to provide name, date of birth, telephone number, email, National Insurance number (NINO) (if available). If no NINO is available (i.e. because they are non-UK resident); then their passport or ID card information including country of issue, passport/card number, passport/card expiry date and address. Classes of beneficiaries are also to be named. This is far more detail than for other estate planning vehicles (e.g. a family limited company).

9. It should also be noted that there are many variations on trusts and certain trusts such as life policy trusts and trusts of land should not be included in registration reporting as it would be a disproportionate where a) a trust may have no ultimate benefit and the large amounts of them would make it onerous on the schemes administrators and/or b) where a legal record already exists (e.g. registered land on the land registry).

10. Life policies are very often held in trusts for family members for entirely benign reasons. Such trusts are invariably passive and, in many cases, forgotten about until the death of the life assured. To require the registration of such trusts would impose a burden on families that would be very hard to discharge.

11. Trusts of land are common place (for example, co-owned property such as the matrimonial home), and where this ownership occurs, then such properties are automatically held on a trust of land – albeit that the existence of the trust is very probably entirely unknown to the property owners – and registering these trusts (in addition to any legal registration that may already have been undertaken), would, again, be onerous.

12. Any further transparency could start to impact on entrenched legal concepts, for example secret/semi-secret will trusts. While there is an argument that these are not trusts in the

true sense of the meaning, common law has agreed that for the greater good (often to prevent fraudulent ownership) that such trusts can and do exist. Even though the trust register is not available for public viewing given that such trusts rely on their secret/semi-secret status then any further transparency risks removing people's reliance on an accepted legal instrument.

13. Paragraph 4.13 of the consultation confirms that the risk of exploitation of UK trusts is low and therefore any further transparency would not be proportional to the aims in regard to the transparency of trust ownership and benefit.

14. It should be noted that there is a natural nervousness among the wider population when being asked to divulge information knowing that it will be held out of their control but with significant ramifications if there is a data breach, and much of the transparency surrounding trusts will also be about maintaining confidence in systems.

Fairness

15. One of the 2006 changes that did not 'land as well as it might' was the introduction of the 18-25 trust in wills, so it would be helpful if these were abolished and the bereaved minor's trust was extended to age 25.

16. Most people want to leave assets in trust later than a child's 18th birthday, usually because they don't want the child to become demotivated by inheriting at a young age or are concerned about how a child will deal with the money/who will be attracted to them and they are prepared to pay the price of the 18-25 trust regime if necessary. But that price (in the form of a tax charge on the 25th birthday) seems hard to justify and creates an odd hybrid relevant property regime (RPR) trust (i.e. a trust with no 10-year charges but with an exit charge).

17. The rules can also lead to complications and produce odd results. For example, some children will take a right to income within 2 years of the death (under section 31 TA 1925) and therefore have an immediate post-death interest (IPDI), while others will not and will be within the hybrid RPR 18-25 tax regime. Families therefore face a mix of different tax regimes for their children purely because of the ages they happen to be at their parents' deaths, when all that they want is for their children to all be treated (and taxed) in the same way, receiving the same amounts and at an age not usually later than 25.

18. There is also a completely different regime for other children, such as grandchildren (who will usually inherit if a child has predeceased their parents) but no logical reason why this should be the case. All of this has to be explained to clients when they make their wills, which can be tricky, is irritating for them and is quite hard to justify.

19. The 2006 changes created a basic unfairness in that an outright gift of £1m to a child is a potentially exempt transfer (PET) and escapes IHT if the donor survives by 7 years, but if that same gift is made to trust for him/her there is a 20% upfront cost in the form of the lifetime chargeable transfer (LCT) and then periodic charges while property remains in the trust as well as exit charges when any property leaves the trust. Furthermore, where a

settlor survives the 7 years, there is no refund of the LCT. People making trusts find this very hard to understand and feel unfairly penalised.

20. Could this be replaced by a system under which assets within a trust are **either** within someone's IHT estate **or** in the 10-year charging regime (i.e. there is a choice) in a more logical way than we have had since 2006? So, for example, a gift into trust for a child (whether they take an immediate interest in possession [IIP] or an IIP on attaining a certain age) would constitute a PET and sit in the child's IHT estate, thus having the same IHT effect as an outright gift to them. If their interest were taken away in favour of their sibling or their child, that would constitute another PET; or if it were taken away in favour of a discretionary trust then there would be an LCT after which 10-year charging would apply.

21. While the consultation states that because trustees can set trust management expenses (TMEs) against income tax (IT) liabilities that may lead to a 'benefit', and also that income and capital receipts and their classification under trust law can allow for trustees to not be taxed either at the trust tax rates or the marginal rates of an income beneficiary; however, these points do not take into consideration that a trust has to complete tax returns where income is generated, whereas individuals have the choice of having/not having additional income producing assets that would give rise to a self-assessment tax return and, therefore, this benefit is outweighed by the fact that in all trusts beneficiaries have little say how income is produced plus often a beneficiary cannot claim capital and should not be expected to have to pay the same rate of tax as an outright owner of assets.

Neutrality

22. The current system results in some IIPs being subject to the LCT, exit and periodic charges whilst some are not. This is simply down the timing of the gift (on death or in life) and does not reflect the length a trust might be in place. Given that an IIP is meant to benefit a clearly defined beneficiary (mainly for protective purposes, not tax mitigation purposes), such charges make it prohibitively expensive to give away assets into such a trust (whilst still having a generous regime for outright gifts). This seems both illogical and confusing, and ensures that IIP trusts which are a good mechanism and long-established in English law, do not have parity (or neutrality) compared to an outright gift. Allowing for gifts to an IIP (whether inter vivos or on death) to automatically be a PET would create greater fairness at the outset.

23. The removal of private residence relief (PRR) in relation to trust real estate does not make sense from a policy view. PRR is granted to everyone who only has one property or has elected a property to receive PRR (i.e. you can only ever have one PPR). The concern that trustees may get PRR and then use that money for something else is not a mischief that needs to be remedied – particularly as, in practice, on the sale of trust property, the most usual route is for trustees to purchase another property for the same or another beneficiary. Using the PRR for a tax 'benefit' can be found in various other situations which are not legislated against e.g. 2 people wish to get married and have their own separate properties, prior to marriage one or both sell their property and each receive PRR, which they may not have received in full if they had sold after their marriage. To remove PRR would not be fair and would no longer be tax neutral.

Other Points

24. The way in which the trustees' annual allowance is split in regard to capital gains tax (CGT) is quite hard to justify and causes unnecessary expense. There is already a de minimis provision in regard to the allowance so it would be more straightforward to have a standard allowance per trust. A small fixed allowance would be easier to administer and is unlikely to cause any 'mischief' as it seems highly unlikely that settlors will create and fund the administration of multiple trusts rather than one just to receive a couple of thousand pounds' worth extra of CGT allowance.

25. An example of this is with the sub-division of a farm and farmland held in trust. This is a common occurrence as, over time, family interests in farming differ, or there are issues with divorce, spendthrift children, or minors inheriting or where an outright gift or the winding up of the trust would not be suitable. The CGT treatment of such sub-divided funds is already complex as on their creation it depends on whether or not there is a deemed disposal. Wherever possible, trustees will try not to create a deemed disposal but sometimes due to family circumstances it is necessary to do so and as well as creating a disposal for CGT at the time, such new trusts then reduce the CGT allowance pot and also adds additional compliance when reporting gains.

26. Section 81 IHTA provides, basically, that property moving between settlements will be treated as remaining in the first settlement unless someone becomes absolutely entitled to it. However, in practice things get complicated where assets move from one trust to another and you end up with several 10-year dates for one trust, in addition to which that section is not very clearly drafted.

27. Section 81 IHTA can become practically impossible to operate as it stands, as in the following example. Assume that a plot of land was appointed in 2005 from one A&M trust to another; so the 10-year charge for that land will be the same as for the original trust and that is clear enough. There can be tricky points because of the costs of extra IHT returns etc., although that is probably manageable whilst the land is still owned. However, if the land is sold, even though initially you know what the proceeds of sale are, over time they get mixed up with other monies going in and out, some will be reinvested, some will fund expenses etc., and it becomes impossible to tell what exactly derived from the first settlement unless everything is kept (and accounted for) in separate sub-funds. However, that is itself quite burdensome and may well negate the original aims of the appointment, which was probably to try to simplify/rationalise ownerships.

28. All of this could be solved fairly easily. Perhaps one could devise some form of charge so that where Trust A has transferred a property direct to Trust B, on Trust B's next 10 year charge one would have the normal 10 year charge in relation to the property that has always been Trust B property and some form of "catch up" charge devised to have the effect of bringing the Trust A property now in Trust B into line with the Trust B property, such that going forward you could simply look at all the Trust B property together and charge it on Trust B 10 year dates. Quite how that "catch up" charge would be calculated depends on wider considerations of simplifying the calculations.

29. The point obviously would be to prevent there being any loss of IHT by HMRC simply because assets have moved from one Trust into another and to capture that at the earlier point i.e. if after the transfer from Trust A to Trust B in fact the Trust A 10 year charge would happen before the Trust B 10 year charge, perhaps the Trust A property now in Trust B would not be subject to that 10 year charge and would face its next 10 year charge at the same time as the Trust B 10 year charge but there would be some form of time apportionment (and even perhaps something equivalent to an interest charge) so that in effect the missing period would be caught up at that point.

30. This might make that first calculation more difficult and add a little complexity there but going forward for the long term, the situation would then be entirely straight forward without any of the complexities that arise from having had different assets in one trust being treated for IHT as if they are in two trusts.

31. HMRC now take an extremely long time to deal with issues that are at all complex, either following a death or in relation to 10-year charges. (It can take about a year even to receive a substantive acknowledgement to a 10-year charge return.) These delays lead to additional costs for taxpayers because of the time taken both to chase HMRC and then to revisit issues when they raise questions months after the return was submitted/we had responded to their previous enquiries.

32. There are clearly resource issues within HMRC but, because of the delays, taxpayers are being subjected to much greater compliance costs than they should be in relation to both trusts and complex estates.

Conclusion

33. Non-resident trusts have many issues not faced by resident trusts and trying to place these together in one consultation is not workable. Legislation that applies to one, will not apply to the other and therefore consulting on transparency and fairness for all trusts is an unfeasible task.

34. What should not be forgotten is that English law is fortunate in that it allows for myriad situations to be dealt with via established trust principles (second marriages, spendthrift children, secret children, succession planning) that often have little or anything to do with 'saving tax'. In practice, most people would prefer the easier route of gifting during lifetime with no additional safeguards, legal documentation and compliance expenses, but have chosen to do so to protect family and future generations. The trust taxation regime for domestic trusts has already been tightened up (c.f. pilot trust planning) and beneficial ownership and other legislation that could be used to combat terrorist financing/money laundering have also been in place. The reality is that many people who wish to abuse the system, or pursue criminal ends are more likely to use a corporate structure (particularly an offshore or multi-layered corporate structure) than a trust.

35. While there is an argument that trusts may have more beneficial tax treatment over a generation, in practice, the reality is that where someone gifts substantial amounts of money via gift or trust, the gift will usually be more tax effective from the donor's point of view where they make a PET and survive 7+ years. The most tax inefficient route is where

a taxable estate holds onto all the wealth or set up will trusts for non-exempt beneficiaries. In reality, this is what most people do.

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