HMRC Trust Taxation Consultation 2018

Following the Autumn Budget 2017, on the 7th November 2018, HM Revenue and Customs ('HMRC') published their consultation in relation to the taxation of trusts.

The aim of the consultation is to obtain views and evidence on ways in which the rules relating to taxation of trusts can be made:

1. Transparent;
2. Fair and neutral; and
3. Simple

HMRC have asked for feedback as to whether these three aims are reasonable in ensuring improvements to the current taxation on trusts. [1]

The consultation is clear that trusts should not be a vehicle for tax avoidance or evasion, and should simply be used for protection and separation of funds and assets in a variety of different circumstances. In analysing whether this goal is currently being achieved, HMRC has identified issues which cause conflict with the three aims above, which will be discussed in more detail below.

Transparency

The issues identified which may affect the transparency of trust taxation are as follows:

1. HMRC are concerned that individuals and companies are using trusts, especially offshore trusts, in an effort to evade or avoid tax. Currently, all trusts liable for UK tax have to be registered with HMRC and this is being extended to all UK express trusts following the implementation of the EU Fifth Anti-Money Laundering Directive (5MLD) by March 2020. **However, this does not resolve the issue of transparency with offshore trusts and HMRC have requested feedback on how to improve this.** [2]

2. Currently, jurisdiction of a trust is determined by the residence of the trustees or the settlor where the trustees are from a combination of jurisdictions. **HMRC is looking at whether this is an effective, and transparent, method of determining the jurisdiction of a trust and would like feedback on how the advantages and disadvantages on how the territories are determined.** [3]

[1] Question 1 of HMRC consultation
[2] Question 2 of HMRC consultation
[3] Question 3 of HMRC consultation

3. In addition, **HMRC would like information as to what incentivises UK residents to set up trusts offshore, if they are accountable for paying tax in the UK as they would with a UK based trust.**[4]

   HMRC would also like feedback on what measures they can put in place to prevent tax avoidance and evasion for those who choose to place hold their assets offshore.[5]

Fairness and neutrality

In looking at fairness and neutrality, HMRC are concerned with the types of tax applied to trusts and the outcomes on the parties to the trust.

1. Inheritance tax

   Currently, for lifetime trusts set up with a value over the nil-rate band (£325,000 for 2018/19) the settlor will pay a 20% entry charge. If the value remains above the nil-rate band, decennial charges of 6% are payable. If assets are removed from the trust then an exit charge of 6% will also be charged.

   This is also similar for trusts created by Wills, with the exception that all of the deceased's assets, over the nil-rate band value, will be liable to inheritance tax at 40% and then once placed into a trust, will be subject to the decennial and possibly the exit charges.

   To avoid this, HMRC have recognised that settlors either only place assets into a trust up to the nil-rate band value. In a survey completed prior to the consultation being published, it was concluded that settlors prefer to place their assets into a trust over gifting the amount directly to beneficiaries so as to remain in control of the fund, even though gifting the money directly would have no inheritance tax implications, providing they survived the gift by 7 years. This is called a potentially exempt transfer ('PET').

   HMRC recognise that the potential difference in tax outcome for lifetime and Will trusts and PETs is unfair and not neutral and seeks opinions on a reform which achieves both of these principles. [6]

[4] Question 4 of HMRC consultation
[5] Question 5 of HMRC consultation
[6] Question 6 of HMRC consultation

2. Capital gains tax ('CGT')

   In relation to CGT, HMRC are concerned with the following:

2.1 How private residence relief is applied to homeowners who sell their property in comparison to resulting beneficiaries receiving a property, or the sale proceeds, under a trust.

2.2 How trustee management expenses are dealt with in relation to dealing with income tax returns and how the rules relating to this may be unfair in comparison with individuals who manage their own affairs.

2.3 Income and capital receipts in trust law.

2.4 Trusts and transactions dealt with by the courts where parties to a trust do not comply with tax which applies to the trust, either because ineffective professional advice was given or because parties to the trust were attempting to evade or avoid tax. HMRC would like the consequences of either scenario to be fair.

HMRC have asked for suggestions for reform relating to fairness and neutrality regarding CGT. [7]

They would also like suggestions for any other trust taxations that would benefit from fairness and neutrality reforms. [8]

Simplicity

HMRC have identified that there are many elements of trust taxation which are complex and that in some cases this is necessary. However, it is their intention to try and simplify trust taxation so that it is easier to understand.

The issues with simplicity that HMRC have included in the consultation are centred on vulnerable beneficiary trusts ('VBTs) and in particular how income tax and capital gains tax charges can limit the reliefs available. In order to rectify this, HMRC have asked for suggestions on the following:

1. **How VBTs can be simplified, including their interaction with 18-25 trusts.** [9]

2. How the taxation system generally can be simplified, with a focus on creating a 'simplified regime' to improve the assurance that all parties to a trust are paying the correct tax.

[7] Question 7a of HMRC consultation
[8] Question 7b of HMRC consultation
[9] Question 8 of HMRC consultation

3. How to make the administration of calculating and reporting tax of small trusts less onerous and more cost effective in comparison to the amount of tax which may be owed.

4. **How trust taxation can be simplified and possibly amended to avoid unnecessary administrative costs.** [10]

The consultation is currently in its first stage of five and responses to the questions posed can be returned by either post or email by the 30th January 2019.

The text in bold within this note are the basis of the questions being asked for consideration by HMRC, with the questions referred to in the footnotes for reference. We will be submitting our feedback; if you have any thoughts which you would like us to include please let us have your comments in good time for the 30th January 2019 deadline.

[10] Question 9 of HMRC consultation

If you have any queries regarding the consultation and how it may affect a pre-existing trust, or if you are thinking of setting up a trust and would like some advice on the trust taxation that would apply then please contact a member of the Wealth Planning team below, who would be happy to assist you.

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