The Taxation of Trusts: a review

Inheritance Tax and trusts **Personal tax**

01 April 2019

ATT and LITRG have responded to HMRC's wide ranging consultation on the taxation of trusts.

Last year, HMRC launched a wide-ranging consultation on the taxation of trusts. With no specific proposals for reform, the review asked for views on whether the following three principles would make a reasonable approach to ensure an effective trust taxation system – transparency, fairness and neutrality, and simplicity – before going on to ask more detailed questions on how these principles might then be applied. The review also asked about uses and abuses of non-resident trusts, an area which neither ATT nor LITRG have the evidence base to respond on.

Both ATT and LITRG welcomed recognition in the review that trusts are very common, and not just the prerogative of the rich. Used legitimately, trusts are flexible tool for many families, providing protection for children and other vulnerable beneficiaries. Trusts are often the only means of providing an effective transfer of assets between different generations of blended families.

We agreed in theory with the suggested three principles for forming trust tax policy, although the ATT raised some practical concerns and suggested that consistency and certainty were also important, while LITRG suggested that fairness could be best tested by looking at the settlor's intention for the trust.

Our responses also agreed on a number of further points. The review specifically asked about whether it was fair to allow trustees to claim private residence relief on a disposal of a residential property which has been occupied by one beneficiary but then transfer the funds to another beneficiary. We do not feel that this outcome is unfair or lacks neutrality when compared to the sale by an individual of their own home, and our responses highlighted the importance of allowing trustees flexibility to allow different beneficiaries to benefit in different ways.

Both bodies also expressed concerns that many parents consider that 18 is too young for a bereaved minor to inherit and that the current special inheritance tax regime for those under 18 should be extended to 25. The ATT noted that the present age 18-25 trust regime effectively imposes a second tax charge which would not have been the case had the child inherited direct from their parents.

On the income tax side, both our responses highlighted issues with the R40 process and suggested the merits of allowing a 'look through' for certain trusts so that income is taxed directly on beneficiaries.

The review asked for suggestions for further transparency measures and the ATT expressed concerns that for smaller, family trusts with no overseas connections, further measures could be disproportionate and amount to an undue burden. The ATT response went on to propose a number of improvements to the existing Trust Register including:

- Assigning all trusts on the Register a unique *Trust Registration Number* to help distinguish between similarly named trusts.
- Aligning the disclosure of adviser details on the Register with the underlying regulations.

- Ensuring that the data gathered on share portfolios is proportionate, especially since the introduction of the Legal Entity Identifier.
- Clarifying the reporting period for trustees, and introducing a new process for updating trustees' details similar to that for directors on the Companies Register.
- Using the data held to benefit both trustees and HMRC, for example by highlighting impending 10-year anniversary charges.
- Ensuring that the same data is not gathered more than once.

The ATT response also commented on the benefits to agents of digitising more trust self-assessment processes. One more radical suggestion we made was that Inheritance tax (IHT) and self-assessment deadlines should be aligned. 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. Trustees do not always appreciate the differing reporting timescales for IHT and may therefore fail to alert their advisers in time to make the report. In addition, the costs of reporting exits from the trust is often disproportionate to the amount of tax which is due. Allowing smaller trusts to calculate and report all their tax consequences on an annual basis could be much more cost effective for both trustees and HMRC.

LITRG's response made some additional comments about the taxation of estates in administration, suggesting that in simple cases it should be possible to 'look through' the estate and tax income arising directly on the beneficiaries. LITRG also made recommendations in respect of personal injury trusts and the interaction with relevant property trust rules.

The CIOT also responded to this consultation and a summary of the CIOT response is in the article '*Trust Review: CIOT response*'.

The ATT response can be found on the ATT website.

The LITRG response can be found on the LITRG website.