

Consultation Title: The Taxation of Trusts: A Review

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Scottish Land & Estates (SLE) is a member organisation that uniquely represents the interests of both land managers and land-based businesses in rural Scotland. SLE has a Taxation Group which is formed from a number of professional members who closely monitor fiscal policy and application. Representatives have met with the Office of Tax Simplification (OTS) and HMRC and we liaise closely with other stakeholder bodies across the UK through the Agricultural Representatives Fiscal Group. We have long been interested in the operability of taxation policy and guidance as it effects our membership. Trusts play an integral role in asset protection and estate planning and we therefore welcome the opportunity to respond to this consultation.

We recognise the consultation paper to be a high-level document seeking to clarify what underpins the taxation of trusts and how the system works or does not work at this time. SLE is therefore keen to be kept abreast of any future developments following on from this consultation and to more substantively respond to any specific proposals which are brought forward. We also welcome the premise of the consultation that trusts have intrinsic valuable and proper uses. Trusts have been in operation since the Middle Ages and still have a significant role to play in a number of everyday situations and can provide greater flexibility than a will.

In terms of our membership, we would note that similar to other businesses and families, estates may well be in more than a single-ownership model, for a variety of reasons. Trusts may be set up to control and protect family assets; when someone cannot handle their affairs because they are incapacitated; to pass on money or property while they are alive or assets when on death in terms of a will. We are aware from our members that trusts can be set up

for a particular reason at the time, but subsequently the reason can become obsolete and there may in fact not be any tax advantage at times in holding assets in a trust.

Private estates have had to put in place measures to try and keep the core of their estates together as a business entity and had they not in many cases, estates would almost certainly have to be sold to meet death duties/inheritance taxes over time. We welcome the fact that trusts allow for a generational transfer in an orderly manner.

As we mention in response to question 6 the Inheritance Tax (IHT) treatment of trusts should be considered as part of the proposals being brought forward by the OTS rather than simply in relation to trusts. SLE is keen that there is a joined-up approach.

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.

SLE generally agrees with the above uncontroversial principles and considers them to be a reasonable approach, albeit not new. We would, however, suggest that these are open to interpretation and at times as indicated might not be reconcilable in terms of outcome. In particular, “*fairness*” could potentially lead to increased complexity in legislation. Overall, we would suggest that getting the appropriate balance depends upon not reforming systems piecemeal, but by taking an holistic and pragmatic approach. “*Fairness*” should mean having comprehensive, coherent and unambiguous laws in place.

We would add to these a need for “certainty and stability”. There can be a tendency for changes to be made too frequently and without waiting for previous changes to fully bed in and be properly assessed or reviewed. This can lead to taxpayers, who have planned within one legislative framework, being left with unexpected large tax liabilities where rules are changed. SLE believes that the frequent changes to legislation, and its complexity, is one of the significant causes of concern for members.

Lack of certainty is an issue for all types of taxpayer. However, it is worth bearing in mind that trusts are often – for non-tax reasons - used as long-term vehicles for passing wealth between generations. Some of the trusts of which SLE members will have involvement, whether as settlor, trustee or beneficiary go back several generations, whilst a number of others comprise property which has been resettled from earlier trusts.

The long-term nature of trusts therefore needs to be taken into account when contemplating change, and ensure that, as far as possible, changes are well-trailed and subject to the full consultation process as set out in the UK Government’s Tax Consultation Framework. It is therefore positive that this consultation has started at a high level rather than with specific policy proposals.

SLE considers ‘fairness’ can be particularly complex in the trust context. The very nature of trusts is such that an individual may not economically benefit either in terms of income or capital for some years. It is therefore often extremely difficult, in our view, to directly align the economic benefit with the tax burden.

Guidance should relate to policy matters as opposed to individual taxpayers or categories of taxpayer. Uncertainty around taxation systems generally has a negative effect on consumer and business confidence, investment and productivity. Any long-term fiscal uncertainty for the UK could be extremely damaging to its economy.

In addition to the principles above, we believe that those of ‘convenience’ and ‘efficiency’ are important. These can be represented by adequately trained staff and appropriately designed and employed systems/technology. Personnel should be suitably qualified and experienced and understand the tax provisions to ensure that investigation into a taxpayer’s tax liability is focused, efficient and not unduly time-consuming or burdensome. We are aware of member concerns around the quality of technical responses received at times, with particular complications around trusts.

We are pleased to note in the consultation paper that the government acknowledges that the tax system should not discourage individuals from establishing trusts where it would otherwise be sensible to use a trust. However, we are disappointed that there is reference in the consultation paper to particular tax rules “*that may constitute exceptions to the principle of fairness and neutrality*”, but HMRC only provide evidence of when it thinks trusts pay less tax than individuals, whereas the reverse is likely true in many instances.

As mentioned, the significance of “*simplicity*” is of course that increased complexity leads to significant costs for both clients and advisers in understanding and explaining the changes as well as the cost of compliance.

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

There are a range of existing and forthcoming transparency measures from anti-money laundering due diligence to other disclosure and reporting rules. SLE’S view is that these existing measures should become fully operational, should be allowed to bed in, and their effectiveness be properly evaluated, before any further changes are contemplated. If “*fairness*” is an aim, then trusts should not require to be any more transparent than companies, as otherwise the other underpinning principle of “*neutrality*” is also impacted.

There also requires to be clarification in terms of “unfair outcomes” which is an undefined and vague term. We recall that in 2016 HMRC published its own definition of tax avoidance, which “involves bending the rules of the tax system to gain an advantage that Parliament never intended” and such clarity is required here.

SLE feels that there is a need to carefully balance a right of access to information with the potentially detrimental consequences that such transparency can have. One example is the difficulty which transparency might cause within a family. Many trusts are established to provide a measure of protection – for example, a parent or grandparent will usually not want their children/grandchildren who are trust beneficiaries to know the value of a fund established for their benefit or will want to withhold this information until the beneficiaries reach a certain age. Article 8 of the Human Rights Act 1998 (the right to respect for privacy and family life) provides robust and legitimate reasons why details about beneficiaries should not be made available to the general public. The need to respect the privacy of individuals should be given proper weight in any consideration of transparency.

One of the potential benefits of increased transparency is greater efficiency for HMRC. However, any such benefit is in danger of being lost if it does not put in place the right processes to make effective use of the data they hold, including effective checking mechanisms where it seems that there is an anomaly. This should include taking a more collaborative approach with taxpayers and their advisors – at least initially -

where there appears to be a discrepancy, helping compliant taxpayers demonstrate that all income has been correctly disclosed quickly and allow HMRC in turn to focus resource more effectively.

A key point is that any review of transparency provisions should also look at whether HMRC is in a position to make effective use of the data it receives. SLE is concerned from member experience that, without changes to current working practices, any incorrect or misinterpreted information reported to HMRC will lead to an increased number of enquiries where there has in fact been full and correct disclosure. This would both be stressful and costly for trustees, and an inefficient use of HMRC resource.

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 potential options.

SLE is not sufficiently informed to provide substantive comment on this area, but would simply request that the UK Government should ensure that it considers the wider context when making any decisions, including examples of other jurisdictions and any other options should not be for the sake of change only. It is worth noting that families are increasingly international and may hold assets in several different jurisdictions or have family members who work outwith the UK.

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.

SLE understands that there are generally no fiscal advantages of a UK resident and domiciled individual establishing a non-resident trust rather than a UK resident trust. If the beneficiaries are all non-UK resident and the settlor is excluded from benefit this may be a reason for having a non-resident trust.

We understand that there are clear fiscal advantages for UK resident but not UK domiciled individuals establishing non-UK resident trusts. However, this is not an area in which SLE is sufficiently engaged to offer further views and we gather offshore trusts are not a main focus of this consultation.

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.

SLE is not aware of any trusts established for illegal purposes, including tax evasion and would condemn any such practice.

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.

As we await the second tranche of the OTS's review to be published later this year, it is important to consider any reform holistically. Arguably, the priority for review should be the administrative simplification which the OTS has already identified, which would have benefits for all those interacting with the IHT regime, including trustees. SLE would recommend waiting sight of the second part of the OTS publication before considering the position in relation to trusts in isolation.

It is our understanding that IHT calculations can be very complicated and time consuming, even where very low amounts of IHT are actually payable. Further, it needs to be remembered that a trust can be subject to a range of charges, even where IHT is not payable.

- 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.**

The starting point should be that the UK Government should avoid making changes where the result will be to replace one unfairness with another (unless there are other overriding benefits).

Income tax reporting requirements on very small trusts can be onerous, as can the communication required between trustees and beneficiaries in respect of repayment of income tax. Part of the notion of "*simplicity*" referred to at question 1 can be resolved by looking at the administration of trusts, which where cumbersome or expensive can dissuade people from using trusts when it would otherwise be suitable or legitimate in the circumstances. This goes against the principle of "*neutrality*".

Where an individual sets up a lifetime discretionary trust for asset protection purposes, for the benefit for herself and her family, she is not only subject to the ten-year regime (and 20% entry charge), but also remains with the 'gift with reservation of benefit' regime and is therefore subject to double taxation. If the notion is to establish tax "neutrality" and "fairness" to both tax collector and taxpayer, double taxation in this way will need to be addressed.

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

There is clearly a need for trusts for individuals who cannot manage their own affairs due to age or infirmity. It would make sense for income and capital gains tax alignment with those trusts with disabled or bereaved young persons as beneficiaries. SLE agrees that a streamlining in this area would be worthwhile, not least as it is an obvious example of where a trust is being used for demonstrably important protective purposes.

- 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.**

Given the imminence of Making Tax Digital (MTD) we would welcome further UK Government advice as to how MTD will work effectively for unincorporated entities including trusts. We feel this would assist both HMRC and taxpayers in the medium to longer-term.

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