HMRC

TAXATION OF TRUSTS:
A REVIEW

RESPONSE BY THE
AGRICULTURAL LAW ASSOCIATION
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1.0 The Agricultural Law Association

1.1 Background

The Agricultural Law Association ('the ALA') was formed in 1976 and is the UK's largest inter-professional organisation devoted to the law and business of the countryside.

We focus on the law in a non-partisan, apolitical way in order to promote its knowledge, understanding and development among those who advise rural businesses.

The ALA has over 1370 members across diverse professions including lawyers, surveyors, accountants, farm business consultants, academics and members with specific expertise in international trade and investment. We have members from all the principal professional firms in the rural sector and, uniquely, all other principal member organisations within the rural sector.

We are a member of the following current sector cross organisation groups in the UK:

Tenancy Reform Industry Group
Agricultural Representatives Bodies Group (Taxation)
Scottish Land Commission – Tenant Farming Advisory Forum
Land Partnerships Service – National Advisory Group

We are also the largest member association of the European Council of Rural Law.

1.2 OUR RESPONSE

This response is submitted on behalf of the ALA and its members who advise their clients in a rural context on all land and property related matters.

Our members' clients have diversified land and property interests, including residential property that is let to private tenants.

We look forward to working with HMRC on any proposals to amend the taxation of trusts following the completion of this review.

Consultation Introduction

Whilst not wishing to strike an overly negative tone, the general view of the ALA is that the benefits of legislative stability in the field of taxation of trusts outweigh the possible advantages of reform. When engaged in multi-generational planning, especially in the context of farms and estates where projects may take years or decades to deliver results, stability and predictability have a significant value that should not be underestimated. This is doubly so in a wider political and commercial climate where uncertainty prevails.

We have set out our response using the numbered questions as set out in the consultation document as follows:

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.**

Trusts exist to address complex problems. The care of disabled beneficiaries; the management of the competing claims of blended families; and the care and custody of assets that form the basis of multi-generational family farming enterprises all being legitimate examples of such complexities.

Whilst we endorse the principles of fairness and neutrality, we would caution against an overly optimistic view of how simply these complex structures can be taxed. There is significant risk that any reform, however targeted, will introduce perverse incentives or unintended consequences into an already complex system. We would suggest, therefore, that government acknowledge in this context that some things can only be made as simple as possible: not simpler.

Transparency is a laudable policy goal, and we endorse the government's view that opaque structures should not be allowed to facilitate tax evasion.

Nevertheless, settlors and beneficiaries have a legitimate expectation of privacy in the management of their assets, and there are, moreover, commercial imperatives that can require an element of privacy or imperfect information. To cite an agricultural example, farmers wishing to consolidate their land holdings to form a more efficient ring-fenced holding may wish to use trust structures to bid anonymously for neighbouring parcels of land, thus to avoid being 'ransomed'. This legitimately facilitates increased farming productivity by the better deployment of capital and the efficient expansion of farming businesses.

The current moves towards greater transparency also betray a failure properly to grasp the law of trusts or the status of the actors in a trust situation. HMRC's trust registration service, for example, requires beneficiaries to be identified to HMRC even where they form part of a discretionary class. This does not reflect the reality of the arrangements.

To give another agricultural example, a farm may be placed into discretionary trust by a settlor for the benefit of any one or several of her grandchildren, with a view to identifying further to training and experience a suitable successor to the farming business who, in due course will become the main beneficiary of the trust. If a farming successor has already been identified, or indeed, if a given grandchild takes a career away from the farm there may be little or no realistic prospect of them benefiting from the trust unless exceptional circumstances arise. Whilst these grandchildren are minors and even young adults there can be no certainty over who among them will benefit and to what extent. This is not a case of the settlor and trustees being obfuscatory, but rather them utilising a sensibly flexible approach to an uncertain question: who will take over the farm and when?

For the reasons above, we suggest that transparency and simplicity should take second place to fairness and neutrality.

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

   For the reasons set out in our response at 1 above, this is not something we would support.

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.**

   This area is not within the remit of the Agricultural Law Association, so no comment is offered.

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.**

   This area is not within the remit of the Agricultural Law Association, so no comment is offered.

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 the future.**

   This area is not within the remit of the Agricultural Law Association, so no comment is offered.

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.**

With the exception of the points noted below in relation to Vulnerable Beneficiary Trusts, we would not support reform to the Inheritance Tax regime as it applies to trusts.

The current regime is well understood by professional advisors and we have already rehearsed the benefits of stability in this area.

One point, however, should be noted. The assertions in paragraph 5.5.2 of the consultation document that the IHT paid by trusts generates a *"near-neutral outcome over this period to an individual passing the same assets (and only those assets) directly from one generation to the next"* are not strictly accurate. When government consulted on the inheritance taxation of trusts in 2014 ("Inheritance tax: A fairer way of calculating trust charges" (2014)) this assertion was expressed more boldly as:

"The broad aim of the relevant property trust charges is to ensure the equivalent of a full IHT charge [i.e. 40%] is paid on [settled] property once in every generation (30 years)."

Of course, given the generous treatment of successful PETs, the length of time a potentially taxable person can now expect to live with their wealth before becoming subject to a tax charge on death, the availability of spouse exemptions and the increasingly common practice of generation skipping gifts, non-settled property does not bear anything like this rate of Inheritance Tax in reality. Government was rightly challenged on this inaccurate representation of the equivalence of trusts and lifetime giving in 2014 and it is surprising to find the attempt in this consultation to present the same inaccurate impression again i.e. that the Inheritance Tax treatment of gifts into trust is broadly equivalent to that of lifetime giving; it is not, lifetime giving is by far the more tax efficient.

Whilst there may be inheritance tax advantages to be obtained by the creation of trusts every seven years and the use of trusts over a longer term than 30 years, these potential advantages are counterbalanced by the income tax and capital gains tax disadvantages of trusts. Inheritance tax, therefore, cannot be considered in isolation, especially given that for the other taxes mentioned here trusts are a distinctly hostile environment.

Nowhere in the government's consultation document does it acknowledge that, were tax alone the motive for giving by a settlor, they could employ unlimited PETS. Any person wishing to pursue 'pure' tax mitigation would be best advised simply to make outright gifts. The use of trusts always, therefore, betrays a non-tax motive - be that family business succession planning, asset protection or concern for vulnerable or simply immature beneficiaries. We would submit that government's view of trusts is unduly focused on their admitted use in tax planning and does not adequately acknowledge their myriad of other positive and socially constructive uses.

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 in paragraph 5.6;**
- **b. Any other areas of trust taxation not mentioned here that would benefits from reform in line with the fairness and neutrality principle.**

Trust Management Expenses are asserted to be more generous than those for individuals. However, this ignores the fact that many individuals who prepare self-assessment tax returns do so as the result of some self-employment, which does allow them to deduct some of the costs of managing their affairs from their tax bill.

Moreover, the management of trusts is more complex than the management of personal finances, and yet, due to the reasons for the creation of trusts, is often not a choice.

It seems fair and reasonable for those who have no choice but to incur higher professional costs in the management of their affairs to be allowed some compensation in the tax system for this.

The current policy on Trust Management Expenses is not in line with the principle of neutrality. We suggest that the deductibility of capital expenses and mixed expenses be reviewed in order to bring the management of assets within a trust into closer alignment with the taxation of assets held in other ways. There should, according to the principles outlined in the consultation be neither a tax incentive nor a tax disincentive to holding assets in trust.

We do not agree with the suggestion of a lack of neutrality in relation to Principal Private Residence Relief in 5.6.1. Each person's only or main residence qualifies for the relief, and this is rightly extended to those whose only or main residence is provided by a trust. It is true that the proceeds of a dwelling's disposal might be applied for the benefit of a different beneficiary, but it is equally true that an individual might gift away the proceeds of the sale of their own main residence. Consideration of the application of a relief should, in our view, be confined to the particular disposal and the individual qualifying for the relief. We suggest that the temptation to legislate against hypothetical tax planning on behalf of an imaginary tax payer should be avoided; especially, unless and until evidence of such planning being widely used in practice has been found.

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

We would suggest the abolition of the existing regime in relation to Vulnerable Beneficiary Trusts which, due to successive and cumulative attempts at reform has become unsustainably complex.

The regime should be redesigned from the ground up in consultation with organisations, such as STEP and MENCAP with daily experience administering trusts on behalf of vulnerable beneficiaries.

This, of course, would require a separate consultation.

Our members have found '18 to 25' trusts to be very rarely used due to their complexity.

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 consequences.**

Whilst we would reiterate our previous points about stability in the tax system, the following matters might benefit from some attention if the government is determined to undertake some reform in this area.

It has been our direct experience that the cost of calculating periodic charges can outweigh the tax at stake. *De minimis* limits and reporting thresholds and requirements should be reviewed in this context.

The requirement to establish and defend Agricultural and Business Property relief on a ten yearly basis also represents a departure from the principle of neutrality since the costs, including valuation costs of this can be significant.

We would suggest a move to a true self-assessment approach wherein trustees empowered to make a simplified declaration of 'no tax to pay', with HMRC having appropriate powers to investigate individual cases so as to ensure compliance.

It has also been cogently argued elsewhere (James Kessler QC "The Quest for Fair Inheritance Taxation of Trusts) https://www.kessler.co.uk/wp-content/uploads/2014/08/Kessler-The-Quest-for-Fair-Inheritance-Taxation-of-Trusts.pdf that the simplest routes to simplification of the taxation of trust would be to:

i. Reclassify all transfers to trust as PETs, which would be in line with the fairness and neutrality principle *vis a vis* lifetime giving, and which would greatly simplify the calculation of cumulative totals for the purposes of the relevant property regime;

ii. Revert to the rules that applied between 1974 and 2006 for interest in possession trusts. This would tax interest in possession trusts on the same basis as property held by an individual. This would have obvious benefits in terms of simplicity and would be in line with the principles of fairness and neutrality.

We have welcomed the opportunity to contribute our views to this Consultation and we would be happy to assist HMRC in further discussions on the issues that are raised above.

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