The Taxation of Trusts: A Review
Consultation document

Response of the Chancery Bar Association

The Chancery Bar Association ("ChBA") is one of the longest established Bar Associations and represents the interests of some 1.300 members handling the full breadth of Chancery work at all level of seniority, both in London and throughout England and Wales. It is recognised by the Bar Council as a Specialist Bar Association. Full membership of the Association is restricted to those barristers whose practice consists primarily of Chancery work, but there are also academic and overseas members whose teaching, research or practice consists primarily of Chancery work.

Chancery work is that which was traditionally dealt with the Chancery Division of the High Court of Justice, but from 2 October 2017 has been dealt with by the Business and Property Courts, which sit in London and in regional centres outside London. The B&PCs attract high profile, complex and, increasingly, international disputes.

Our members offer specialist expertise in advocacy, mediation and advisory work including across the whole spectrum of company, financial and business law. As advocates, members are instructed in all courts in England and Wales, as well as abroad.

INTRODUCTION

1. The ChBA supports the aims of this project as expressed in paragraph 2.4 of the Consultation document:

> "2.4 Trusts are an intrinsic part of the UK's legal system, and have been in use for centuries. The government wishes to ensure that the many UK individuals and companies using trusts legitimately benefit from a clear and transparent regime that is easy to understand, while also taking steps to ensure that trust taxation does not produce unfair outcomes and that trust structures do not facilitate tax avoidance or evasion."

2. This does, however, require consideration to be given to the intended meaning of "tax avoidance" in this context. The approach should, in our view, be to follow the highest case law authorities in this regard. This is because legitimate, but abusive, tax planning is already effectively discouraged and prevented by the General Anti-Abuse Rule (GAAR). Seeking to legislate to prevent sensible tax planning which falls outside the scope of the GAAR by broadening the legal definition of tax avoidance risks adding significant uncertainty and complexity, when the stated aim of this Consultation is to seek simplicity and tax neutrality. This approach informs our comments below.

3. The ChBA further strongly agrees with the clear statement in paragraph 3.4 of the Consultation document:

> "There is nothing wrong with [the use of trusts] in principle – indeed, there are many circumstances throughout UK society in which trusts play a valuable role."

4. The list of examples of how trusts can be valuable to society which then follows is far from exhaustive. Our members regularly deal with trusts which play a valuable role in society. The importance of being able to hold wealth with experienced professionals, have that wealth managed for current and future generations and the allied protection for the young or naïve individuals is central to the use of many trusts and the use of trusts is often unrelated to (and sometimes contrary to) tax planning or avoidance. The use of trusts must not be discouraged by either deliberate or inadvertent changes to the current system. What can be achieved and should be attempted however, are ease of administration (simplicity), the ironing out of anomalies (fairness) and increased oversight to discourage and counter-act abuse (transparency).

Question 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.

5. We support these aims in principle and consider that this approach is reasonable, subject to the intended meaning of "neutrality" in this context.

6. Fiscal neutrality in the taxation of trusts, which is supported by the ChBA, must be distinguished from *prima facie* equivalence of treatment between taxpayers in different circumstances, where such equivalence does not result ultimately in neutrality or, more importantly, in fairness.

7. For example, there are currently charges in many cases on settlors when assets are put into trusts. Therefore, there are circumstances when, following that charge to tax, neutrality might require a difference in tax treatment for the assets subsequently held on trust from assets held by individuals. Similarly, subject to paragraphs 19 and 20, the essential trust mechanism would be undermined by any attempt to levy tax on the basis of deeming particular beneficiaries of many types of trust to be absolute owners of trust property.

8. While simplicity is always an admirable aim in legislation, fairness should be the overriding guiding principle. Sometimes it will be inevitable that to ensure fair treatment (both fiscal and otherwise) will require a layer of complexity in legislation. The ChBA's firm view is that, provided the benefit of simplicity is always kept in mind, fairness must not be sacrificed for ease of administration. Otherwise, the valuable role of trusts in society, which is acknowledged as a premise of the Consultation, may be undermined simply for administrative ease. That would be most undesirable.

TRANSPARENCY

9. We agree with the general principle set out in paragraph 4.3 of the Consultation document:

> "The government considers that trusts, whether UK resident or non-resident, should be sufficiently transparent that the separation of the ownership of assets and the benefits arising and those who benefit from them is not hidden. In particular the separation should be transparent to those responsible for administering the tax system or investigating criminal activity such as money- laundering or terrorist financing."

10. This must not, of course, undermine the essential nature of the trust, viz. that there is a separation of legal ownership and beneficial interest in trust assets. It would be wrong, for example, to permit transparency as a guiding principle to result in trusts being treated too often as wholly transparent either for fiscal or asset protection purposes, even where such treatment is pursued with the principle aim "administering the tax system".

11. The EU Fifth Anti-Money Laundering Directive will require registration of all UK express trusts. This raises some complications, for example: (**i**) the definition of an express trust for these purposes may raise complex issues; and (**ii**) it may encourage the use of structures with the effect of a trust which seek to portray themselves differently. We note that a further Consultation is promised on these issues. It will be essential that this is launched with adequate time to permit sensible responses to be sought and acted upon.

12. Similar complexities arise from the proposal that non-EU trusts holding UK real estate must be registered. For example: (**i**) some jurisdictions recognise entities (e.g. Foundations) which are not trusts but which are, in some ways, similar in operation to trusts. These will need to be catered for; (**ii**) trusts often hold assets through companies and questions of piercing the corporate veil arise. Again, the further Consultation must permit adequate time sensibly to address these, and similar, issues.

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

13. A full response to this question should await the further Consultation on the EU Fifth Anti-Money Laundering Directive. The responses to that further Consultation should be carefully considered and the position should be monitored going forward in any event. At present, however, there is nothing that should be done urgently.

TRUST TAX RESIDENCE

The current rules are long-established and, although slightly complex, are well understood by all competent professionals operating in this area. There is no benefit to amending them.

Question 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 on any other potential options.

14. The current system works. Although it is not entirely simple, it is long-standing, well-understood and adequately codified. There is no need to amend it. Any proposed amendments must not be enacted to affect the current legal position under the guise of simplification.

Question 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.

15. UK domiciled individuals who are UK resident might use offshore trusts for non-tax reasons to ensure the societal benefits offered by a trust in this and other jurisdictions. The anti-avoidance provisions in place, including the GAAR have effectively eliminated any tax avoidance opportunities. The transparency rules discussed above are likely to be sufficient to disincentivise anyone seeking to abuse the system by disregarding these anti-avoidance rules or, failing that, to enable action to be taken against them.

16. Non-UK domiciled individuals resident in the UK are taxed differently in several regards relating to their non-UK situs assets and non-UK source income and gains. Offshore trusts enable people to live in the UK and retain this treatment by leaving assets outside the UK, and being taxed only when they benefit from them within the UK. This use of offshore trusts is consistent with the wider principles of the UK tax code for non-UK domiciliaries, including the remittance basis, which was significantly overhauled and codified in 2008 and more recently in 2017 and 2018. This benefits the economy as it encourages sensible economic migration.

17. Abuses of this system have been effectively countered in recent years by new rules deeming long term residents in the UK to be UK domiciled for tax purposes and by deeming people with UK domiciles of origin (who were born here) to be taxed as UK domiciled when they live in the UK. Any further amendments specifically aimed at the taxation of offshore trusts are likely to lead to unfairness, to disincentivise the use of trusts and therefore to detract from their societal benefits, and to add complexity to an already complex area of law.

Question 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.

18. It is considered that the existing anti-avoidance provisions, including the GAAR, the proposed transparency rules and the recent amendments to the tax code widening the deeming provisions for UK-domiciled tax treatment have effectively counteracted the use of non-resident trusts for tax avoidance. Evasion will be counter-acted by sensible transparency rules.

Question 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.

19. We consider that the application of the fairness and neutrality principle should lead to the reform of the changes introduced by the Finance Act 2006 to the treatment of interests in possession created in a person's lifetime. We would support, and believe the wider industry would support, a wholesale repeal of these provisions so that a person could create a trust in their lifetime over which they or another had an interest in possession ('IIP') with the IHT consequence being that the trust is taxed as if it the property were within the estate of the person with the IIP, both at creation and upon death.

20. That is because:

- Such a change is consistent with the **neutrality** principle. A trust where the person has or retains an IIP is and should be regarded as the same as the person owning that property.

- That trusts can be created with IIPs which are treated in this way, and that others also have this favoured treatment is inconsistent with the **fairness** principle. There is no good reason of which we are aware as to why a person can create a qualifying IIP settlement on their death but not in their lifetime.

- Such anti-avoidance problems as these trusts created (of which there were few) are avoided by other provisions including s 102ZA Finance Act 1986.

21. At a more administrative level we consider that:

(i) the method of calculating periodic IHT charges is complex and could be simplified by a flat-rate or slab-rate system. This should not, however, increase the tax burden or it will prejudice neutrality and fairness and discourage the use of trusts with their recognised societal benefits.

(ii) Tax returns could be simplified and should be eliminated for trusts without a UK tax liability in a given period. The specifics of this should be consulted upon. This offers a good opportunity to reduce the administrative burden on professionals and the tax authorities.

Question 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.

22. We take the "possible exceptions" set out in paragraph 6.5 of the Consultation document in turn.

23. It is right, in principle, that disposals of residences by trusts can benefit from principal private residence relief from capital gains tax. Otherwise, the societal benefits of trusts holding properties, e.g. for vulnerable beneficiaries or children, would be lost. The only question is therefore the mechanism. The relevant taxable person for a trust realising gains is the trustee (a deemed person under section 69 TCGA) and yet of course the point of the trust is not to benefit the trustee, but the beneficiaries. Therefore, it is right that the relevant occupier of a residence for relief to be available is a beneficiary. It would interfere with trustee discretion (in an unworkable way, which would strike at the very heart of a trust relationship) if relief were lost if the proceeds were not distributed to that beneficiary if the property were sold. The trustees' key duty is to weigh the interests of all the beneficiaries in taking or refraining from any particular action. Further, it would require wholesale re-visiting of the treatment of trustees under section 69 TCGA if relief were to be attached to one beneficiary but not another.

24. Trustees will typically take on onerous duties and it is right that there should be recognition in the tax code that expenses incurred wholly in the performance of those duties are deductible for income tax purposes. Again, seeking to restrict these in cases where the benefit of the deduction flows through to a particular beneficiary will fetter trustee discretion via the tax system which is a dangerous route to pursue.

25. The difference in tax rates for trustees is a long-established principle. At present, we see no reason to interfere with it; but if reform is necessary, this would be the sole area of those set out in paragraph 5.6 of the Consultation document where we do not see practical impossibilities or serious trust law impediments to so doing.

26. A void or voided transaction is, as a matter of law, deemed never to have occurred. It is wrong to suggest, therefore, that there is any unfairness as regards tax arising from such transactions. It is a central proposition of general law and of tax law that the tax legislation applies to transactions in the real world. If an action did not occur as a matter of law, it can and should have no tax effect. It would be extremely undesirable to seek to interfere with the discretion of the courts via the tax code and dangerous to do so. It would almost certainly be robustly challenged leading to uncertainty.

SIMPLICITY

27. We agree with paragraph 6.2 of the Consultation document, which states:

> "6.2 In the case of trusts, the tax system is in many cases necessarily complex, due to:

6.2.1 the wide-ranging effects that setting up and running a trust can have;
6.2.2 the variety of different types of trust that exist and which must be accommodated by the tax system;
6.2.3 the range of taxes involved; and
6.2.4 the need to ensure fairness of tax treatment between trust users and those that decide to manage their wealth and assets outside of a trust."

28. Sacrificing fairness and the integrity of (**i**) trusts law and/or (**ii**) the tax code, in pursuit of the mirage of simplicity is likely to give rise to more complications in due course. Any simplification should, therefore, be administrative and not affect, except in the limited ways suggested above, the underlying technical position.

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

29. It is true that currently the administration of these trusts is complex and could be simplified. The specifics should be subject of a further consultation but any proposals should not include technical tax questions on the underlying tax treatment of these types of settlement.

Question 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.

30. In our view, it is paramount that trust law is not subverted or found to be incompatible with any tax law amendments. As noted above, a degree of technical complexity is sometimes unavoidable to ensure the integrity of the law and fair treatment. We therefore support only limited reform principally in two areas:

    a. Administrative simplicity is an admirable aim, which should be pursued; and
    b. Anniversary charge calculations could be simplified.

ANNEX TO THE CONSULTATION DOCUMENT

31. We do not, here, comment on the specifics of the summary of the law set out in the Annex to the Consultation document.

Chancery Bar Association Working Group
(Amanda Hardy QC, Richard Dew, Oliver Marre, Alexander Drapkin)
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