ICAEW
REPRESENTATION 27/19

THE TAXATION OF TRUSTS: A REVIEW

Issued 28 February 2019

ICAEW welcomes the opportunity to comment on the Trust consultation published by HMRC on 7 November 2018, a copy of which is available from this link.

Due regard should be given to the law of trusts and the long history of trusts in the UK. Trusts are embedded in our legal systems and are not going to go away or fundamentally change their nature just because HMRC believes that they are used to facilitate tax avoidance, we agree that trusts have been used by some to facilitate tax avoidance but in our view that is a minority of the trusts created and any changes need to accommodate the legitimate use of trusts whilst preventing misuse.

Any changes to trust taxation need to be clearly signposted in advance. A clear plan, well consulted on and considered will result in much better legislation and avoid further complexities in respect of transitional provisions, of which there are already many in the tax system.

As a minimum vulnerable beneficiary trusts need to be changed such that there is no difference tax wise to assets being held absolutely by the beneficiary and being held in a trust because they are unable to manage their affairs themselves.

This response of 28 February 2019 has been prepared by the ICAEW Tax Faculty. Internationally recognised as a source of expertise, the Tax Faculty is a leading authority on taxation and is the voice of tax for ICAEW. It is responsible for making all submissions to the tax authorities on behalf of ICAEW, drawing upon the knowledge and experience of ICAEW's membership. The Tax Faculty's work is directly supported by over 130 active members, many of them well-known names in the tax world, who work across the complete spectrum of tax, both in practice and in business.

ICAEW is a world-leading professional body established under a Royal Charter to serve the public interest. In pursuit of its vision of a world of strong economies, ICAEW works with governments, regulators and businesses and it leads, connects, supports and regulates more than 150,000 chartered accountant members in over 160 countries. ICAEW members work in all types of private and public organisations, including public practice firms, and are trained to provide clarity and rigour and apply the highest professional, technical and ethical standards.

© ICAEW 2019
All rights reserved.
This document may be reproduced without specific permission, in whole or part, free of charge and in any format or medium, subject to the conditions that:
• it is appropriately attributed, replicated accurately and is not used in a misleading context;
• the source of the extract or document is acknowledged and the title and ICAEW reference number are quoted.
Where third-party copyright material has been identified application for permission must be made to the copyright holder.
For more information, please contact: representations@icaew.com

ICAEW Chartered Accountants' Hall Moorgate Place London EC2R 6EA UK
T +44 (0)20 7920 8100 **icaew.com**

KEY POINTS

1. Whilst HMRC here are focussing on the Taxation of Trusts, it should be noted that the vast majority of trusts are not set up for tax avoidance reasons. In very many cases asset protection is the key reason that trusts are used. Whether this is to protect capital from potential divorcing spouses or creditors to not allowing immature beneficiaries control of assets that they are not able to deal with in a measured way, or preventing fragmentation of an asset, taxation is usually a second consideration.
2. We understand that HMRC are considering the 'big picture' in respect of all of the relevant tax law affecting trusts with the potential to make some significant changes. At the same time we also understand that you are looking to remove the grit from the system with respect to the smaller issues.
3. One key issue for HMRC to bear in mind when considering all of the following issues is that trusts exist in English Law and have existed for a thousand years or more. The law of trusts has developed through case law as well as statute over this period and a taxation framework must exist for them. Trusts are embedded in our legal systems and are not going to go away or fundamentally change their nature just because HMRC believes that they are used to facilitate tax avoidance, we agree that trusts have been used by some to facilitate tax avoidance but in our view that is a minority of the trusts created and any changes need to accommodate the legitimate use of trusts whilst preventing misuse. At all stages the general legal position of trusts needs to be considered.
4. Any changes to trust taxation need to be clearly signposted in advance. A clear plan, well consulted on and considered will result in much better legislation and avoid further complexities in respect of transitional provisions, of which there are already many in the tax system.
5. As a minimum vulnerable beneficiary trusts need to be changed such that there is no difference tax wise to assets being held absolutely by the beneficiary and being held in a trust because they are unable to manage their affairs themselves.
6. The US model for taxing trusts may work in the UK; the trust is transparent for all tax purposes and since it would be see through there would be no complexity and no tax leakage just a tick the box exercise. If you do it for yourself and tick the box then for tax everything is seen as still being yours directly. If you establish a trust for a child or elderly parent (or even friend) you can both elect to tick the box and it is viewed for tax purposes as an absolute gift.
7. We hope that this review of the taxation of trusts is a full review and does not simply look at a few tweaks to the legislation.

GENERAL POINTS

8. We were very pleased that you extended the deadline to 28 February to allow more private client specialists time to respond once the 31 January tax filing deadline was passed.
9. We believe the consultation is too ambitious in its scope. It should have just focused on UK trusts and the urgent need for reform here. A separate consultation could deal with offshore trusts. Our members have seen very few offshore trusts created by UK resident and domiciled taxpayers in recent years and HMRC should focus instead on making UK trusts capable of fulfilling the needs of society. HMRC should consult with the offshore trust companies to establish how many trusts they create for UK domiciled individuals each year and ask them how important the UK market is to them.
10. In our view HMRC has framed the consultation document purely from their perspective, the slant is wrong and most importantly the starting point is wrong. The document concentrates on anti-avoidance when it should start by focusing on all the good that trusts can do and ask ''are we helping society use this wonderful entity, which was invented in England, and which is now used around the globe (except in the UK where excessive tax penalties have more or less killed it off).'' This is most self-evident in paragraph 5.1 which says "trusts are a

longstanding part of UK law, fulfilling a range of functions in society''. However this is no longer the case, trusts can fulfil a range of functions but the tax rules (particularly IHT) prevent this. The consultation does not address the functionality aspect in any depth and so the questions it asks are not the right ones, this is a lost opportunity. Disappointingly, the consultation, with its nine questions, fails to ask the most important question of all: "*Do trusts fulfil the role needed of them in society (eg in relation to the protection of disabled minors) and, if not, what changes can be made to trust taxation to help them fulfil their role in society? The government seeks examples of where the tax laws prevent the proper use of trusts , for example in providing funds for minors on divorce, for providing a mechanism for holding assets for children with mental disabilities, for asset protection etc.).*'' This is the key question but instead the whole structure of the consultation is overshadowed by an air of suspicion and negativity.

ANSWERS TO SPECIFIC QUESTIONS

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.

11. The question is phrased such that it would be difficult to disagree with the proposition that 'the principles of transparency, fairness and neutrality, and simplicity constitute a reasonable approach to ensure an effective trust taxation system', on the basis that to do so would be to agree that opacity, unfairness and bias and complexity would constitute a reasonable approach.
12. The conflation of these 'virtuous' themes does mean that it then appears more difficult to argue the merits of any one of them. For example, to enable 'fairness' complexity may be required. In the case of large trusts with professional trustees or represented by the requisite professionals who understand the law in depth complexity is not in itself a vice.
13. Fair - This is a subjective term. Whilst everyone would agree that the tax system should be fair, everyone will have a different opinion of what fair is. HMRC's insistence on neutrality as the be all and end all means that we can only consider "fair" in terms of tax advantages and tax avoidance, the question becomes a single one: ''Is it fair, that Mr X can use a trust to pay less tax than Mr Y?'' Instead 'fairness' must look at what trusts can achieve in their function to give us a better society. The question might then become (for example) "Is it fair that Mr X who has a mentally disabled child cannot put monies in trust for her (so he knows that somebody can look after his child when he is dead) without losing 20% in IHT whereas Mr Y can pass his wealth in his lifetime to his very healthy daughter and have no IHT charge?'' Most people would struggle to say that that was fair, right or reasonable. Trusts must be used in a fair way, but that is not the same as 'neutrality' which is a narrow tax concept.
14. Neutral - If it is accepted that neutrality is a desirable feature of trust taxation then what does this actually mean? From the meetings with HMRC it seems that this means that there should be no tax advantage or disadvantage to the use of trusts. In its purest form this is a utopian ideal. To accept that the treatment should be 'broadly neutral' merits more consideration. The 2006 changes mean that in our experience very few trusts are now set up in lifetime in excess of the nil rate band as the lifetime inheritance tax (IHT) charge is a deterrent. For a neutral treatment the initial gift to, at least, an interest in possession trust should be treated as a PET, as previously.
15. This then leads to consideration of whether the charges over the lifetime of the trust approximate to the death charge over a generation. It is broadly accepted that it does, however the number of variables involved in assessing this make this a difficult task.
16. Simple - There have been very many attempts at 'simplification' by HMRC in the past few years. Some of which have been well advanced before being abandoned at a later date (the

short-lived settlement nil rate band ('SNRB') being one example of this). Indeed, none of the changes actually made had simplification at their core but were instead about changing parts of the law that HMRC/government did not agree with (for example pilot trusts). Billing these as simplification does not help the perception of these changes within the professions. We responded on previous simplification consultations in TAXreps 50/12 and 39/13 and 40/14.

17. The piecemeal and reactionary way in which the legislation governing the taxation of trusts has evolved means that in many places it is difficult to administer and comply with the legislation in a cost effective manner. There are many smaller trusts and in particular those with lay trustees where navigating the current system is the antithesis of the propounding statement. There is a strong case for treating these smaller trusts differently, freeing both them and HMRC from the current burdens imposed on them.

18. HMRC are concerned that the current taxation of trusts is complex. It certainly is complex. It is however very well understood by professionals and on this alone requires no further tinkering. Simplicity cannot be achieved by adding rules into the tax system, only by removing rules can you achieve simplicity.

19. In addition to these principles the system should be capable of being administered in a cost effective manner and the demands placed upon taxpayers and their agents should be minimised. A further factor is that the existence of trusts, in one form or another within the UK is widespread. The amounts involved are often small, and a conscious decision should be taken to take the vast majority of these small trusts outside of the UK tax system. This means that HMRC could then deploy its resources in a cost effective manner on the larger trusts, and would avoid introducing lay trustees to the (current) complexities of trust taxation and reporting. As an example now that dividends and interest are paid gross more trusts were brought within the self assessment. A de minimis of £100 tax payable for savings income is in place but a dividend of just £1 still needs to be reported and the tax paid.

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.

20. Transparency needs to be defined here. The majority of taxpayers have no wish to be anything other than transparent when dealing with HMRC and other law enforcement agencies and indeed this is the presumption of the Taxpayers' charter. HMRC now has the trust register in place which provides significant amounts of information to HMRC in respect of relevant trusts. There seems little more information that HMRC could be party to that would be of use to it.

21. This therefore makes us wonder whether this 'transparency' is intended to be beyond the scope of HMRC and other law enforcement agencies. If this is the case then we would have to disagree strongly that any further transparency is desirable. Taxpayers are entitled to privacy and there did seem to be a lack of understanding in our discussions with HMRC as to why taxpayers might wish details of their financial arrangements to remain private for example personal security. While it might be interesting to the public to have access, it is not in the public interest and there is no need for wider access.

22. In any case, until the IT behind the trust register actually functions to allow agents to update details and for the trustees to comply with the statements that are required of them on the tax return then it would seem precipitous to introduce any further changes.

23. Given the current registration system that trusts must go through, the implementation of 5MLD (EU Fifth Anti-Money Laundering Directive) should be done with consideration to the number of trusts in existence in this country. In addition, we hope there will be consultation regarding which trusts can be excluded from the 5MLD requirements, what benefit would there be to include for example life policy trusts and arrangements for joint ownership of properties?

24. Why is further transparency needed? Individuals using trusts for criminal purposes will not register them however tight the framework or high the penalties for not doing so. Further transparency will surely result in diminishing returns.
25. A major improvement, certainly from the point of view of taxpayers and their agents, would be to rationalise and streamline the way that registration operates. Care should be taken not to introduce further complexity and recognise that trusts are far more prevalent in the UK than other parts of the EU, with the exception of Ireland. This means that the implementation of the 5MLD needs to be suitably focused to avoid excessive compliance obligations.

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 any other potential options.

26. One disadvantage of the current trustee residence rules is the way they seek to apply corporate rules by reference to dependent agents and permanent establishments (these rules were added at the eleventh hour and their removal would introduce a lot of simplicity). The operation of these rules in this context is still not well understood and a simpler series of rules would seem to be more appropriate.
27. There is enough anti avoidance on offshore trusts already including the latest, profit fragmentation. Addressing the problems with the existing transfer of assets abroad provisions would be preferable to introducing more rules.
28. A grace period for individuals to remove themselves as trustee in the tax year of arrival or the year following would be useful. At present, the only limited relief to prevent trusts being imported to the UK when individual trustees commence UK residence relates to individuals who are eligible for split year treatment, and requires them to resign as trustee in the overseas part of the split year (see for example s69(2DA) TCGA 1992). In practice, individuals often seek advice after residence has already commenced, by which point their trust has been imported and cannot be exported again without a CGT charge arising on a deemed disposal of most of the trust assets.

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.

29. There are very few reasons for creating a non-resident trust, the present anti-avoidance legislation is adequate and effective. As noted above our members are not aware that UK resident and domiciled individuals are currently creating offshore trusts. As suggested above, HMRC should seek verification on this via discussion with trust companies about their business model changes to reflect the drop off in the market for such trusts. If HMRC still lack confidence on this issue they should have a simple reporting mechanism before wasting time on new anti-avoidance legislation. Section 218 IHTA 1984 requires a return where a person has been concerned with the making of an offshore trust of which the settlor was UK domiciled. It would be interesting for HMRC to disclose how the number of such returns has varied over say the last twenty five years. A modified version of this section might be a way of monitoring the position running forward.
30. One situation where the establishment of a non-UK resident trust by a UK resident or domiciled person may be advantageous is the establishment of employee benefit trusts. These are sometimes created by companies that form part of substantial international groups of companies or where there is a need to warehouse shares for employees, eg shares are issued on incorporation but it has not been decided who will receive them, or shares are removed from "bad leavers" and need to be held somewhere before reallocation to new

management members. They avoid CGT in circumstances where full income tax is being paid.[1]

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.

31. As stated, these questions detract from the main issue which should be to re-align the tax treatment of UK trusts to ensure 'fairness' within an appropriate definition of that term. We believe that most advisers would report that there is now nil or very small use of offshore trusts for avoidance purposes and that trust companies would turn away such new trusts if they were presented to them. In the experience of our members HMRC are chasing shadows, avoidance and trusts is not currently at the level they fear and they need to switch to a less suspicious and more positive mind when addressing the question of trusts and taxation.

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.

32. The 20% IHT entry charge on creating trusts has effectively stopped the creation of trusts. The government's own analysis shows the decline in the number of trusts, Trusts statistics 2019. This means that trusts are no longer "fulfilling a range of functions in society'' (despite HMRC's claim to the contrary in the consultation). There are multiple examples of this for example it is no longer realistic to create trusts for children who do not have the mental capacity to hold assets themselves. The entry charge needs to be abolished or modified. This need not be the gateway to avoidance as HMRC will still have the concept of 'neutrality' and can ensure that a taxpayer who creates a trust for themselves still has the same IHT treatment as when the assets were held personally (indeed the opportunity could be taken to tidy up the inefficiencies in the gift with reservation rules). The difficulty with modification as opposed to abolition is that (i) it will add more complexity to an area where complexity is already too high and (ii) it will in practice prove very difficult to decide for which type/purpose of trust abolition is required and where it is not. If modification is the preferred way forward, then the charge could be retained for settlor interested trusts (with due regard being given to the gift with reservation of benefit rules). The charge should be relaxed for trusts for children. If this is considered too wide, then there might be a financial cap, albeit at a high level but not so high as to allow generational trusts. Thus, for example, it should be possible to fund a trust for children who need maintenance or provision post a divorce or who will not be able to

---

[1] Capital Gains Tax charges can, in principle, arise when UK resident Employee Share Ownership Trusts (**'ESOTs'**) transfer shares to participants in commercial employee share plans. Any difference between the market value of the shares acquired by the employee and the price paid for them will either be:

- Subject to income tax (and, potentially, both employee's and employer's NIC and, potentially Apprenticeship Levy) as employment income; or
- Exempt from income tax under a statutory tax advantaged employee share plan.

CGT charges in the trust can, therefore, give rise to an element of economic double taxation and reduce the funds available with which to provide employment-related benefits to employees.

CGT relief might, potentially, be available in relation to such transfers (s 239ZA TCGA 1992). However, the relevant conditions are such that this relief can be unavailable and CGT charges arise in relatively common circumstances (eg where the employee has to pay to acquire the relevant shares on the exercise of a share option).

In order to remove this risk of CGT charges arising, UK resident companies often establish ESOTs offshore.

care for themselves after a parents' death (but who are not within the very narrow present definitions which attach to such trusts). It may be argued that there is less need to relax the rule in the case of a very wealthy family who are creating a generational trust for children/grandchildren simply as part of an estate planning exercise. This is why it is imperative that HMRC refocus the starting point of their enquiry. If the question becomes about the need of trusts to serve society then one starts by asking ''what trusts do we need in society and how can we allow them to be funded'' and from this a better solution will flow. Question 6 in the consultation asks for ''broad suggestions as to what any reform should look like and how it would meet the fairness and neutrality principle''. It is considered that any reform will fail to solve the main problem until HMRC widen their definition of 'fairness' and focus on encouraging trusts back into society. A narrower approach would be to build on the existing section 89 IHTA 1984, which is useful, but too narrow in its definition of disabled.

33. In recent years a number of consultation documents have been released by HMRC seeking to simplify the taxation of relevant property trusts, through the introduction of new regimes. None of these proposals succeeded in offering a better solution, and seem to have been predicated on the basis that most lay trustees found the rules difficult to follow. The proposed solutions all adopted a one size fits all approach, which simply repeated one of the drawbacks of the current system. A very large number of trusts fall within the potential ambit of the tax system, and sometimes the cost of calculating the tax due is disproportionately high.

34. One solution would seem to be to introduce a two tier system, whereby low value trusts were taken out of the tax system so that no charge to inheritance tax would apply (and possibly income tax and capital gains tax) after they had been established. The threshold levels would be for HMRC to determine, but the object would be to reduce the costs incurred by HMRC in dealing with such trusts where the tax yield is often de minimis. The second tier of trusts would be subject to the current rules. The value held by such trusts would justify the application of more complex rules.

35. The current rules are well understood by the practitioners who deal with such trusts and by HMRC. Whilst there are areas where change is required, such as in relation to trusts for disabled beneficiaries, they are generally perceived to operate in a fair manner. It may be far easier to reform the current rules on an ad hoc basis, rather than introduce an entirely new system.

36. Taking neutrality at its broadest, the setting up of trusts is not currently (and has not been since 2006) a tax neutral act. Instead, entry charges certainly put off taxpayers setting up trusts when a trust would otherwise be an ideal solution.

37. One thing which should be borne in mind is that changes in the rules drive taxpayer behaviour in a particular way, only for HMRC to decide they don't like that direction and to change the rules again. This uncertain landscape does not provide taxpayers with any of the four principles mentioned in question 1.

38. It was discussed at the HMRC focus group session with professionals that the rate and or frequency of the ten year charge could be amended. One problem with this is the dry trust, which has no liquid assets. With the ten year charge it has been planned for and anticipated for some time; a more frequent charge may prove too difficult to manage.

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.

39. The consultation document lists four scenarios and invites a discussion as to case for and against targeted reform on the basis that the scenarios do not present a neutral result. This approach appears to be mistaken in all of the cases cited.

40. Private Residence Relief - The consultation document suggests that it is unfair that capital gains tax principal private residence relief is capable of being applied where a beneficiary

occupies a property held by the trustees as his or her home. It is suggested that it is unfair that when the property is sold, the capital profits could be used to benefit another beneficiary. In practice this is no different than where a property is given to a family member, and used as their home. If the property is sold, the owner can gift some or all of the capital profits to another.

41. From discussions with HMRC it seems that there are particular concern over 'schemes' being sold to parents of children going to University and the use of settlor interested trusts to return the capital to the parents once children have been through university and PPR has been claimed in respect of the adult child beneficiaries occupation. As exactly the same result can be achieved without the use of trusts but without giving the parent the security that their child cannot sell, gift, gamble away the property we are not sure why there is an objection to what is in essence asset protection.
42. Trust Management Expenses – It is suggested that such expenses are unfair because they are tax deductible in quantifying the income of the beneficiaries and would not be deductible if the same expenses were incurred by an individual. This overlooks that the property interest has been divided and that the income beneficiary and the capital beneficiary have diametrically opposing financial interests. This division does not exist where a single person owns the income and capital interests.
43. Businesses obtain a deduction for accountancy fees so why shouldn't trusts? Settlor interested trusts are unable to claim a deduction and allowing it in life interest trusts recognises the economic reality of the situation. The beneficiary has no say in the deduction of costs from his share of income. It is a decision for the trustees who must take established trust law into account. It is inequitable to tax a beneficiary on something that has not been received and cannot be received as it has been spent on something else.
44. Income and capital receipts in trust law – It is suggested that having different rules as regards the taxation of trust income or capital can result in complexity and tax treatment that differs from cases where a single person held both the income and capital interests in the property. In the past this divergence was used to achieve tax savings. As a result of successive legislative changes these opportunities have reduced significantly. There is no clear reason for changing the way that such interests are taxed, given that legally the interests of the parties involved in the trust differ where some hold capital and some income interests.
45. It should be noted that many capital receipts are taxable at the special trust rates as s482 ITA 2007 already taxes common capital events (share repurchases, offshore income gains and chargeable event gains) to the special rate of income tax applicable to trusts.
46. Trust and transactions declared void by the courts – The consultation documents suggests that the ability to seek an equitable remedy before a court and reverse a mistake made by a settlor or a trustee in a tax neutral manner is unfair. The thinking here is unclear, as it would appear to be more unfair for such mistakes to be remedied, but to be taxed as if they had not. Indeed this could result in multiple tax costs where the original step that is being reversed had a tax cost, and the reversal of the same produced further tax costs.
47. It was suggested at one meeting that HMRC believed that some advisers implemented planning with a view that should this later be declared void by the courts that the tax effects were nullified. It would seem incredibly unlikely to us that any planning undertaken by qualified professionals would be based on this premise, the costs and personal financial risk to the trustees would stop any professional from undertaking such a high risk strategy.
48. The consultation document invites comments in relation to other areas of trust taxation that would benefit from reform in line with the principles fairness and neutrality:
    a) Trusts for disabled beneficiaries – The rules here would benefit from a general overview. They are complex, and over engineered and fail to deal with the social need to provide for disabled beneficiaries in a tax efficient manner.
    b) Trusts for settlors with intermittent mental capacity – There is a case for introducing a trust which simply acts as the settlor/beneficiary's alter ego but has no tax advantages. The purpose would be simply to protect the settlor/beneficiary without having to rely on

a Lasting Power of Attorney which can sometimes prove to be difficult especially where the donor has intermittent capacity.

Question 8

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

49. The present law for children with medical difficulties is too narrow and prevents trusts fulfilling their proper role in society. The definition of disabled trusts should be widened (or the IHT entry charge removed as suggested above). We are aware of situations where a parent whose child was not able to hold or manage money was very concerned what would happen to her in the event of his death. He was a wealthy man of great principle and as such had taken his child out of receiving the attendance allowances as he felt that his wealth meant the family did not need them. In order to create a trust he had to have the daughter registered to receive the allowance (see section 89 et seq IHTA 1984).
50. Ideally trusts for vulnerable beneficiaries should be taxed in the same way as if the beneficiary held the funds absolutely, so no IHT entry charge, periodic or exit charge and included within the beneficiary's estate on death, income tax and capital gains tax charged as if the assets were held outright and no tax impact if the beneficiary fluctuates in and out of capacity.

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.

51. It is clear that there are very many places where HMRC could score an 'easy win' to remove the 'grit from the system'. One of these is the current position where trustees pay tax, supply an R185 to the beneficiary who puts it on their tax return and either reclaims or pays the excess tax due. This is clear duplication of effort for taxpayers and HMRC. Further digitisation should enable this process to be rationalised. Streaming this income in some way would be helpful.
52. Another example is the settlor interested trust. The trustees pay tax on the income and the settlor enters the income on their return complete with the tax credit, any resulting tax repayment is then repaid to the trustees. It would be much simpler for the settlor to simply enter the income on their return and pay whatever tax is due and claim this from the trustees. This would save an inordinate amount of time and resources for HMRC as well as the trustees and the settlor. This wasted time is not "seen" by HMRC as the trust return and settlor's return are dealt with entirely independently.
53. The tax on small trusts is much too high. The income is small, yet subject to 45% tax with the accompanying rigmarole of tax claims to get the tax back. This is a costly waste of money and income streaming should be introduced. There was a proposal for this some years ago but it was dropped on the grounds that dealing with the tax pools was in the 'too hard to do box". How much tax is really collected from these type of trusts? Why not be bold and restrict the income tax rate applicable to trusts to trusts with much larger incomes. Tax pools are unnecessarily complex and should be restricted to a limited period only. Clarity is also needed on the taxation of accumulations paid out in later years. As with the settlor interested trusts HMRC do not see the time wasted and consequent staff costs of collecting and then repaying tax.
54. There are numerous trusts which should be taken out of the IHT regime altogether such as travel insurance trusts, commercial trusts established to warehouse some sort of commercial right, pension scheme death benefit trusts for partners/self-employed and plain vanilla life assurance trusts.
55. In very many cases dealt with by agents, the costs of calculating exit or 10 year charges are disproportionate to the tax involved. In very many cases the professional fees will be greater

than the tax due. There could therefore be scope to provide an option for the trustees to pay a flat rate of tax under certain conditions. For instance, the top rate of tax for a ten year charge is 6%. If an exit event then happens after two years the maximum rate of tax due would be 1.2%. Rather than going through the intricate and complex calculation to determine the precise tax rate, it would be more cost effective for some taxpayers to simply pay the 1.2%. An election below a certain de minimis could be provided.

56. Alternatively, exit charges could be fixed at a flat rate of n/10 x 6% for all taxpayers after accounting for reliefs such as business property and agricultural relief.

57. Another issue which was discussed at the HMRC focus groups in some detail was HMRCs seeming keenness for some 'look through' treatment of trusts. In respect of settlor interested trusts this would seem to make sense. It could be subject to a one off election. The creation of such a settlement as well as ten year anniversaries and exit charges would be tax neutral for all taxes. As a settlor interested trust no deduction would be available for trust management expenses. This would mean that an increasingly elderly population would be able to settle assets on themselves as an asset protection mechanism.

58. Another possibility is to copy the US model to have tax transparent trusts for all tax purposes. Since it would be see through there would be no complexity and no tax leakage. It could be a tick the box exercise. If you do it for yourself and tick the box then for tax everything is seen as still being yours directly. If you establish a trust for a child or elderly parent (or even friend) you can both elect to tick the box and it is viewed for tax purposes as an absolute gift.

59. The Office of Tax Simplification (OTS) recommended in its Review of unapproved employee share schemes: final report (January 2013) that a new statutory shareholding vehicle be considered, which, subject to appropriate safeguards to prevent abuse, would be exempt from the inheritance tax, CGT and other tax charges that can give rise to operational difficulties for bona fide ESOTs (see Chapter 6 of that report).

60. HMRC and the Treasury subsequently consulted on this proposal, but determined not to proceed (see Employee shareholding vehicle: summary of responses (December 2014)). However, HMRC and the Treasury undertook to keep the relevant issues under review (see Employee shareholding vehicle: summary of responses, para. 4.2). This current consultation on the taxation of trusts is perhaps the time to revisit the OTS recommendations for a new statutory ESOT.

APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see https://goo.gl/x6UjJ5).