



HM Revenue
& Customs

Inheritance tax: A fairer way of calculating trust charges

Summary of Responses
December 2014

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1. Executive Summary

- 1.1 This document responds to the consultation 'Inheritance tax: A fairer way of calculating trust charges', published in June 2014.
- 1.2 HMRC is very grateful to all those who responded or participated in meetings for taking the time to consider the issues raised by this consultation document, as well as for any responses to previous consultation documents on this subject.

Aim of the consultation

- 1.3 This is the third consultation in a series considering the complexity and fairness issues relating to the inheritance tax (IHT) rules for trusts.
- 1.4 The first consultation set out to identify key issues, with the aim of developing options to simplify the system. The second consultation set out a number of policy proposals, with the most substantive proposal being a policy to split the nil-rate band for trusts. The feedback from the consultation raised a number of concerns that respondents had about the proposal.
- 1.5 HMRC listened to these concerns and in the consultation published this summer set out an alternative approach to split the nil-rate band available to trusts. This aimed to address two of the key areas of concern raised; the administrative burden impacts on trustees and the impacts on existing trusts.

Overview of the responses

- 1.6 HMRC received 42 responses from individuals, trustees, practitioners and professional bodies.
- 1.7 While most respondents were in favour of simplifying the rules they were generally opposed to the policy to divide the nil-rate band. The concerns raised by respondents broadly fell into two areas. Firstly, that this would not fall under a policy objective of simplification and would actually add complexity to the system. Secondly that a wide range of trusts would be caught within the new rules and the outcome wasn't 'fair' in most circumstances.
- 1.8 A number of respondents acknowledged one particular area of unfairness that HMRC was right to try and tackle – the use of multiple trusts, otherwise known as "Pilot Trusts", each with their own nil-rate band in order to gain a tax advantage. A small number of respondents suggested proposals for how pilot trusts could be tackled.

HMRC response and next steps

- 1.9 The Government has listened to the concerns raised by stakeholders and at Autumn Statement the Chancellor announced the Government's decision to not split the nil-rate band for trusts.
- 1.10 However, during the consultations and as part of its review of the trusts rules HMRC has also considered avoidance risks with the use of multiple trusts. Building on suggestions from respondents the Government is taking action to tackle this through a targeted approach focusing on pilot trusts.
- 1.11 The Government will also continue to simplify the tax system where possible and remove any administrative burdens where it can. As a result, the calculation of trust charges will be simplified by removing the requirement to include 'non relevant' property.
- 1.12 The Government has published draft legislation on both of these policies alongside this document.

2. Introduction

Background on the consultation

- 2.1 The Government has been clear that one of its key objectives for the tax system is simplification. To that end, in 2012 HMRC published a high level consultation to identify the key issues surrounding the complexity of the tax treatment of inheritance tax for trusts.
- 2.2 The overarching aim of simplification was welcomed by the vast majority of stakeholders who responded to HMRC's initial consultation document. HMRC subsequently published a second consultation setting out options for reform.
- 2.3 Responses to this second consultation were mixed. Respondents were generally positive about proposals relating to aligning and filing payments and the treatment of retained income, with measures on these being legislated for in Finance Bill 14. These are important steps in simplifying the tax system and bringing more clarity and certainty to the tax rules.
- 2.4 However, respondents to the second consultation raised a number of concerns about HMRC's main proposal to split the nil-rate band for trusts between the numbers of trusts created by the same settlor. The main concerns raised related to the fairness of the proposal and the additional burdens that the proposal would put on trustees.
- 2.5 Recognising these concerns HMRC set out an alternative approach to splitting the nil-rate band in a further consultation published in June 2014. This document is the response to this consultation.

The consultation and overview of responses

- 2.6 The consultation 'Inheritance tax: A fairer way of calculating trust charges', was published on 6 June 2014 and closed on 29 August. This was supplemented by meetings with key stakeholders.
- 2.7 The consultation built on responses from the two previous consultations. The document set out a proposal which aimed to address areas of unfairness identified in the system in a way which minimised administrative burdens for those involved, and simplified the system where possible.

- 2.8 This consultation retained the idea proposed in the previous consultation of splitting the nil-rate band. One of the main objectives was to ensure consistency of treatment between those individuals who transfer their assets on death and those who make lifetime transfers through the use of trusts. The consultation also addressed concerns raised previously about the impacts of reform on existing trusts.
- 2.9 The key feature of the proposal was to shift the administrative burden of splitting the nil-rate band away from trustees and on to the settlor. The new rules would mean each settlor would be entitled to a 'settlement' nil rate band (SNRB) and they would be required to make an election about how to allocate, in terms of a percentage, their SNRB between settlements.
- 2.10 The consultation also asked whether the simplified method for calculating ten year and exit charges proposed for relevant property trusts should be extended to trusts that fall within the charging provisions for 18-25 trusts. This would mean that the rules for calculations of IHT in these circumstances could continue to mirror the rules for calculating tax on relevant property trusts.
- 2.11 HMRC received 42 responses from individuals, trustees, practitioners and professional bodies. HMRC is very grateful to all responses to this consultation, as well as to previous consultation documents on this subject.

Structure of the consultation response

- 2.12 The remainder of the consultation response is divided into 4 sections:
- Chapter 3 sets out a summary of the responses to the consultation and the Government's overarching response, including the key design features of the policies being taken forward.
 - Chapter 4 provides more detail on the responses to the specific questions set out in the consultation document.
 - Chapter 5 sets out next steps.
 - Annex A sets out the list of respondents.

3. Responses – summary

Summary of responses

- 3.1 The consultation ‘Inheritance tax: A fairer way of calculating trust charges’, was published on 6 June 2014 and closed on 29 August. This was supplemented by meetings with key stakeholders.
- 3.2 Throughout the consultations on this subject the majority of respondents have been supportive of HMRC’s overarching objective of simplification.
- 3.3 While most respondents are supportive of the idea of simplification, they are generally opposed to HMRC’s proposals to divide the nil-rate band.
- 3.4 Several respondents recognised that the proposal set out in this consultation was an improvement and had gone a significant way to address the concerns raised by stakeholders during the previous consultation. Despite this, almost all respondents still strongly opposed the policy as a whole.
- 3.5 Respondents raised a number of concerns which usually fell into one of two broad areas; simplification and fairness.

Simplification

- 3.6 While respondents acknowledged the improvements in the proposal set out in this consultation document, most respondents still felt that this policy did not meet HMRC’s original objective of simplification.
- 3.7 Respondents raised concerns that this policy would create complications to the tax system and would create additional burdens for people involved.
- 3.8 There was also a general feeling that HMRC’s objectives for the proposed policy were no longer about simplification and were now about fairness in the tax system.

Fairness

3.9 Nearly all respondents raised a concern about the impacts and fairness of the policy in one guise or another. The key areas of concern raised were:

- The new regime would affect a wide range of trusts including very small trusts and those used for sensible everyday financial planning, such as in respect of life policies and pension death benefits. Some respondents raised concerns that trusts used for commercial purposes such as funeral plans and travel protection policies would be caught by this measure. A few respondents noted that this policy would impact many people who would not class themselves as particularly wealthy.
- Some respondents noted that this policy would cause a disparity between the treatment of assets given away absolutely and assets held in trust. A large number of respondents suggested HMRC should re-consider their stance on the idea of allowing the SNRB to be renewed every 7 years in order to ensure equal treatment for individuals who give their property away directly and those who held their property in trusts.

3.10 While most respondents raised concerns over the impacts of the policy, a few respondents acknowledged one particular area of unfairness that warranted action. They agreed that HMRC was right to try and tackle aggressive tax planning using 'pilot trusts.'

3.11 Pilot trusts are settlements (usually discretionary) which are initially established with a nominal amount (usually anything between £10 and £100). They are set up during lifetime with a view to substantial funds being added to each pilot trust at a later date, but on the same day. This can be either during the settlor's lifetime or on death via gifts made in the settlor's will. The benefit of pilot settlements is that they are not related settlements for IHT purposes provided they are made on different days and if funds are added to each trust on the same day, each settlement is entitled to its own nil rate band, this creates an advantage with on-going IHT charges.

3.12 Nearly all the respondents who specifically raised pilot trusts believed this could be tackled through a more targeted approach which would be both simpler and fairer than the proposal set out in the consultation.

3.13 A few respondents suggested that the use of pilot trusts could be prevented by aggregating property later added to related settlements

and property added to other settlements (even if not related settlements) on the same day.

- 3.14 Details of the responses to the specific questions asked in the consultation are set out in Chapter 4.

HMRC response

- 3.15 HMRC has considered the responses to this consultation carefully, as well as the responses to the previous two consultations.
- 3.16 The three consultations on this subject have shown that simplification in this area is challenging. One respondent specifically noted the ‘various challenges identified by the previous consultations on simplification.’
- 3.17 Nonetheless, HMRC needs to balance the objective of simplification with wider tax objectives, including ensuring the tax system is fair and does not jeopardise exchequer revenue.
- 3.18 Throughout the consultation process HMRC has identified a number of potentially unfair outcomes of the current system and believes there is a need for reform. HMRC does recognise though the genuine concerns raised with the division of the nil-rate band, which go beyond the complexities that it might create.
- 3.19 HMRC has listened to feedback from the consultation and appreciates that the proposal to introduce a SNRB would have far reaching consequences. While it would help to bring parity between property given away over a life time and property given away on death, it could be seen to create a divergence between the rules for property given away absolutely and property held in trusts. It is not HMRC’s intention to discourage the use of trusts and HMRC understands the majority of trusts are created for reasons outside of tax planning.
- 3.20 Therefore, after listening to feedback from respondents the Government has decided to not introduce a SNRB.
- 3.21 While respondents were opposed to a SNRB, a number of respondents noted the unfairness that people could access multiple nil-rate bands by setting up multiple trusts on separate days and then adding property to those trusts on the same day. Among those who raised this issue there was general support that it should be tackled.
- 3.22 HMRC agrees with this. The use of ‘pilot trusts’ allows significant amounts of property to be shielded from IHT over time, causing a long

term cost to the Exchequer and unfairly benefiting those who do not set up trusts legitimately.

- 3.23 HMRC has built on a proposal put forward by a small number of respondents to develop new rules to stop people being able to access multiple nil-rate bands if they set up multiple trusts on different days and then add property to each of them on the same day.
- 3.24 While this is not part of the original consultation objective of simplification the Government believes that all forms of aggressive tax avoidance should be tackled when identified. This policy enables HMRC to do this, without adding significant complexities to the tax system.
- 3.25 The Government also wants to continue to simplify the rules where possible. Many of the respondents during the second consultation were supportive of simplifying the calculation for a tax charge by removing the requirement to take into account non-relevant property. HMRC is now taking forward this measure, which will help to reduce the administrative burden on trustees.
- 3.26 Further details on both of these measures are set out in the section below.

Key design features of policies being taken forward

New rules targeting avoidance

- 3.27 This measure will introduce new rules about adding property to trusts on the same day to target inheritance tax avoidance through the use of multiple trusts. This will mean that settlements created on the same day will continue to be classed as related for the purposes of calculating the rate of tax applicable to the relevant property trusts. It will also mean that where property is added to two or more settlements on the same day, the property within the other settlements will be brought into account for the purposes of calculating the IHT charges.
- 3.28 The amendment will feed through to the calculations so that the initial value of property in the settlements, together with the property added at a later date is brought into the calculations under section 66(4)(c) Inheritance Tax Act 1984 ('IHTA') for the ten year charge and under section 68(5)(b) IHTA for an exit charge before the first ten-year anniversary and under s69 IHTA for exit charges between

anniversaries and also s71F(9) IHTA for charges on 18/25 trusts at its value at the date of commencement or addition as appropriate.

- 3.29 This will apply to all charges arising on or after 6 April 2015 in respect of all relevant property trusts and 18/25 trusts created on or after 10 December 2014. To prevent forestalling, it will also apply to relevant property trusts created before 10 December 2014 where property is added on or after this date to more than one trust on the same day, with a limited exception for some additions made under a Will executed before 10 December 2014.

Simplifying the calculation of trust rules

- 3.30 In order to simplify the calculation of trust rules the requirement to include non-relevant property in the calculation of the rate of tax where appropriate for both the section 66 IHTA ten year and section 68 and section 69 exit charges will be removed.
- 3.31 This will apply to all charges arising on or after the 6 April 2015, regardless of when the trust was created.

Other changes

- 3.32 In addition to the changes outlined above, the Government is making changes in the following areas to the relevant property legislation to provide more certainty and to clarify the effect of the legislation.
- 3.33 **Claims for conditional exemption:** Where a claim is made in respect of an IHT ten year charge, the legislation will be amended so that the requirement that a claim must be made and the property designated before the date of the ten year charge is removed and will instead allow trustees to make a claim for exemption within two years of the ten year charge arising.
- 3.34 **Settlements created by individuals before March 2006 giving themselves an interest in possession or to their spouse/widow/civil partner/surviving civil partner:** Amendments will be made to the legislation so that “a qualifying interest in possession” is substituted for “an interest in possession” in each place that it appears. This will mean that it is now clear that in cases where one party to a couple succeeds to a life interest to which their spouse or civil partner was previously entitled during the latter’s lifetime and that interest is not a transitional serial interest then section 80 will apply at that time (because neither spouse would then have a qualifying interest in possession) with the result that there is no doubt that the settled

property will be treated as being comprised in a settlement and therefore subject to the relevant property charges.

- 3.35 **Appointments for the benefit of the deceased's surviving partner:** Amendments will be made to the legislation relating to property that is settled by will. It will provide that where property is left in trust in which no interest in possession subsists and an appointment is made within 3 months of the date of death of that property to the spouse or civil partner of the testator, that appointment can be read back into the will and exemption from IHT can apply. Section 144 IHTA is amended so that the provisions of section 65(4) IHTA, which prevent a charge to tax arising in the first three months after the settlement commenced, or with a ten-year anniversary, shall not apply to appointments out of property settled by Will. This will ensure that where an appointment is made within three months of the date of death in favour of the deceased's surviving spouse or civil partner, it can be read back into the will and exemption under section 18 IHTA can be given.

4. Responses – further detail

- 4.1 In addition to the changes outlined above, the Government is making changes in the following areas to the relevant property legislation to provide more certainty and to clarify the effect of the legislation.
- 4.2 This chapter sets out the questions asked in the consultation and provides some detail on the responses received. It follows the order of the consultation document.
- 4.3 These questions relate to specific design elements of the new SNRB proposed in the consultation. Given the Government's decision not to take forward the proposal we have kept this section brief. The Government's overarching response is set out in chapter 3. Nonetheless, HMRC is grateful for all the detailed responses received.

Death of the settlor

Question 1: Are there any other provisions that would need to be made for when a settlor dies that have not been covered in this section?

- 4.4 Many respondents raised a concern that the SNRB could be wasted on death if it has not been completely allocated. Respondents also noted that many trusts are established by Will, with some people having written their Wills without the expectation of this tax change. A number of respondents suggested that the SNRB should be refreshed on death or else reallocated sensibly by the personal representative. Some respondents also suggested that the SNRB should be transferred between spouses following a death.
- 4.5 A number of respondents also raised a concern about the difficulty with record keeping and the burden that will be placed on executors and personal representatives. It was suggested that HMRC should maintain records, which can be made available to personal representatives when needed.

The nil rate band for existing trusts

Question 2: Are there any other features of the existing rules that should be retained under the new rules?

- 4.6 A wide range of points were raised in response to this question. For example, a number of people noted the various reliefs currently available and suggested these should remain. Other respondents

suggested that companies should be entitled to a nil-rate band and many people raised a suggestion about the SNRB being refreshed every 7 years.

Question 3: Are there any aspects of the proposed new rules for allocating the SNRB or calculating the IHT charges that could be improved?

- 4.7 A large number of respondents raised the suggestion that the SNRB should be refreshed every 7 years. A smaller number of respondents suggested that the 6% flat charge was too high and that the SNRB should not be reduced to take into account distributions between 10 year anniversaries. A number of respondents also suggested introducing a de minimus into the design of the policy.
- 4.8 A number of other suggestions were raised which covered a range of design areas. Some respondents suggested administrative changes including online submissions being available, HMRC keeping records and trustees being notified when the SNRB is allocated. One respondent enquired about guidance and raising awareness among tax payers. They suggested that many people with life insurance policies may not be aware that they are settlors and that they fall within this new legislation.
- 4.9 Some respondents raised a concern about the different treatment for pre and post 6th June 2014. This was raised particularly in relation to trusts created to hold death benefits. One respondent suggested that the rules could dissuade pension members from changing provision and that trusts holding death benefits should be excluded from the rules.
- 4.10 A number of respondents raised a question about provisions being made for circumstances where the settlor loses mental capacity.

Question 4: Are there any aspects of the existing rules that would no longer be necessary under the new rules?

- 4.11 Many respondents noted that as existing trusts are grandfathered and may last for 125 years under English law the current provisions will need to remain in force for some time.

Question 5: Are there any other impacts for example on cost or equality that should be taken into account?

- 4.12 Respondents raised a number of impacts that this proposal could have. Many respondents noted the additional administrative costs and burdens on trustees, settlors and HMRC. A number of respondents raised a concern over the level of understanding people will have and pointed out that many people impacted might not have access to professional advice.
- 4.13 Other impacts raised included a concern relating to the cost impacts on people, and the fact that these may occur but would not be felt for the first 10 years and so are not covered in the Tax Impact Information Note.
- 4.14 Another impact raised by one response was that people would be more likely to pass property on directly rather than hold it in a trust. They suggested that this would expose more family assets to risks.

Age 18 – to – 25 trusts

Question 6: Should the simplified method for calculating ten year and exit charges proposed for relevant property trusts be extended to trusts that fall within the charging provisions for 18 – 25 trusts?

- 4.15 Responses were mixed on this question. Most respondents said that the new simplification calculation rules should be extended to include 18-25 trusts, although some disagreed. A number of respondents also suggested that the SNRB should not apply to these trusts and some respondents suggested that charges on these trusts should be abolished altogether.

5. Next steps

- 5.1 After listening to feedback from this consultation the Government has decided to not introduce a SNRB. Instead HMRC has built on a proposal put forward in a number of consultation responses to tackle an area of tax avoidance within the use of multiple trusts, known as pilot trusts.
- 5.2 HMRC is also taking forward a simplification measure to remove the requirement of non-relevant property from the calculation of trust rules. This received support from many stakeholders during the second consultation document.
- 5.3 These measures were announced by the Chancellor at the Autumn Statement. Draft primary legislation for including in Finance Bill 2015 has been published alongside this response document. HMRC would welcome comments on the draft legislation.
- 5.4 Further information on the detail of these measures was set out in chapter 3.

Annex A: List of consultation respondents

In addition to 4 responses from individuals the following representative bodies and firms responded:

Association of Accounting Technicians
Association of British Insurers
Association of Taxation Technicians
Baker Tilly
BDO LLP
Boodle Hatfield LLP
Canada Life
Chancery Bar
CLA
Clarke Willmot LLP
Deloitte
Ernst and Young LLP
Frank Hirth PLC
The Fry Group
HartBrown
HMG Law LLP
Institute of Chartered Accountants in England and Wales
Institute of Chartered Accountants Scotland
Institute of Directors
Institute of Financial Accountants
James Hay Partnership
Johnston Carmichael LLP
The Law Society
The Law Society Scotland
Linklaters LLP
London Society of Chartered Accountants
Maurice Turnor Gardner LLP
Meridian Private Client LLP
Mills and Reeve LLP
Moore Stephens LLP
Old Mill Accountancy LLP
OneE Consulting Limited
Patricia J Arnold and Co Ltd
PricewaterhouseCoopers LLP
Saga Accountants Ltd
Society of Trust and Estate Practitioners
The Association of Corporate Trustees
Thomas Eggar LLP