WAY Investment Services

WAY Investment Services urges Government to take action to restore neutrality of trusts

The Government needs to simplify the taxation system for trusts in order to meet its own objectives, according to WAY Investment Services in its response to the latest consultation on the taxation of trusts.

The Government stated in the consultation that with trusts the *"…tax treatment should neither encourage nor discourage the use of trusts"*. WAY Investment Services believes that complexity in the rules, principally created by the rule changes introduced in 2006, is putting families off from establishing a trust – even when it is the most appropriate form of financial planning to meet their objectives.

Trusts have been used for hundreds of years, with the basic principle of allowing a person (the settlor) to instruct another person (trustee) to manage assets on behalf of a third party (the beneficiary). For example, they are often used by families to manage assets on behalf of children until they are old enough to look after the assets themselves. But the number of trusts in the UK appears to be falling dramatically, with the number of trusts and estates in the UK preparing a self-assessment tax return dropping by around a third from 225,000 in 2003-4 to 156,500 in 2016-17.

Simplifying the tax regime would not necessarily lead to either an increase or decrease in tax revenue from trusts, but would support families using trusts in appropriate circumstances. For example, WAY Investment Services is recommending the NRB is restored to increase in line with inflation. It should also absorb the value of the Residence Nil Rate Band (RNRB), which should be repealed on the grounds that it is neither fair nor simple. WAY also recommends removal of the periodic charge, which accounted for just 3.44% of IHT receipts in the 2017-18 tax year. Instead it should only be levied on exit events when there is a real transaction taking place. This could be achieved in one of two ways:

1. Calculate the periodic and exit charges as currently but defer collection of the periodic charge until an exit event takes place. The periodic charge would be levied on a pro-rata basis in line with the proportion of the trust assets exiting.

   OR

2. Remove the periodic charge as a concept and calculate the exit charge based upon the whole period from entry to exit.

John Humphreys, Inheritance Tax Specialist at WAY Investment Services, comments:

"There is definitely scope to improve simplicity in the way trusts are taxed. Trusts are absolutely not simply the preserve of the rich. There are many scenarios where trusts make sense for families – including those with far more modest estates. The key opportunities lie in assessing the tax within an individual's account, rather than taxing the trust itself. We believe it is perfectly reasonable for the Government to be focusing on the principles of transparency, fairness and neutrality, and

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simplicity – but changes are needed in order to achieve those outcomes. The 20% entry charge, the periodic charge, and the complex application of income tax to trusts are all hurdles which prevent advisers from recommending them and families from choosing them. With the Nil Rate Band having been frozen at £325,000 since 2009, discretionary trusts settled equal to the NRB 10 years are being drawn into paying Periodic Charges simply because of the freeze, which is illogical and unfair, scrapping the massively complicated and unfair Residence Nil Rate Band and adding the same incremental steps to the main NRB (as well as restoring the annual inflation link from 6th April 2021), would remove a significant number of discretionary trusts from Periodic and Exit Tax charges, the total of which accounted for just 3.44% of IHT receipts in the 2017-18 tax year, so the cost to the Treasury would be negligible, but it would significantly reduce the administrative burden for Trustees and go some way towards restoring neutrality between trusts and other forms of IHT and wealth-preservation planning ”

WAY also believes that inconsistencies in the available exemptions for IHT are having unintended effects. Trusts are disadvantaged in comparison with passive investments into some unlisted shares, such as some on the Alternative Investment Market (AIM), and WAY says the two-year rule for passive BPR-qualifying investments and the seven-year rule for gifts should be aligned for IHT purposes. Business relief should still be available on qualifying AIM Shares as it encourages investment into small, growing entrepreneurial businesses. Crucially, this change should apply where the investor is not a key person related to the business itself. WAY says the qualification period should remain at two years for qualifying investments where the owner is a key person within the business, such as interests in a family firm or controlling shareholdings – going back to the original reason BPR was established more than 30 years ago. But for passive investors, a seven-year qualification period would also encourage a sensible minimum investment horizon for such high-risk assets.

Humphreys continues:

“The current rules for BPR risk distorting the purpose of making an investment. Aligning the time taken to qualify for IHT savings would mean that the choice between an AIM investment and gifting capital could be made on its own merits.”

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