TAXREP 28/14
(ICAEW REPRESENTATION
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FINANCE BILL 2014: CLAUSE 56: TERMINATION OF LIFE INTEREST AND DEATH OF LIFE TENANT: DISABLED PERSONS AND

CLAUSE 284: TRUSTS WITH VULNERABLE BENEFICIARY: MEANING OF "DISABLED PERSON"

ICAEW welcomes the opportunity to comment on the Finance Bill published on 27 March.

This briefing has been prepared on behalf of ICAEW by the Tax Faculty. Internationally recognised as a source of expertise, the Faculty is a leading authority on taxation. It is responsible for making submissions to tax authorities on behalf of ICAEW and does this with support from over 130 volunteers, many of whom are well-known names in the tax world. Appendix 1 sets out the ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark proposals for changes to the tax system.

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SUMMARY OF MAIN POINTS

1. Clause 56 extends the capital gains tax free uplift to market value to assets held on trust for the benefit of a disabled beneficiary to include trusts for the benefit of a disabled person where the beneficiary has no absolute entitlement to the income of the trust (that is assets held on a qualifying section 89(2), IHTA 1984 or section 89A(4) trust).

2. Clause 284 extends the definition of disabled person used in relation to trusts with a vulnerable beneficiary to include those in receipt of the mobility component of disability living allowance at the higher rate or the mobility component of personal independence payment at either the standard or enhanced rate.

WHAT THE CLAUSES ARE INTENDED TO DO

Clause 56

3. On death assets held absolutely by an individual or held on a qualifying interest in possession trust for a beneficiary who had the right to the income from those assets are marked up to market value at the date of death without charge to capital gains tax (CGT). The logic for this is that the assets are liable to inheritance tax (IHT) and to charge CGT and IHT on the same assets would be penal.

4. Where the assets are held in a relevant property trust there is no such CGT free uplift to market value and no IHT on the death of a beneficiary; IHT is charged every ten years at a maximum rate of 6% and on exit from the trust.

5. For qualifying disabled beneficiaries there are special rules for IHT purposes (there are also special rules for income tax and capital gains tax but these come within the vulnerable beneficiary regime – sections 23 to 45 and Schedules 1 and 1A of FA 2005 - and are not relevant here).

6. Broadly, for all trusts where there is a "disabled person's interest" (as defined by section 89B) IHTA 1984) there is no periodic charge to IHT. Instead the value of the trust fund is treated as part of the beneficiary's estate on death liable to the full 40% IHT charge. Unfortunately, the CGT legislation was not aligned with the IHT treatment so for discretionary trusts for disabled persons there was an IHT charge on death but no CGT free uplift to market value resulting in an unfair double tax charge.

7. Clause 56 corrects the misalignment by extending the CGT free uplift to market value on death to assets held in a discretionary trust for a qualifying disabled person.

Clause 284

8. An individual is currently classed as a "disabled person" if they are entitled to the care component of the disability living allowance at the highest or middle rate or are entitled to the daily living component of the personal independence payment. Clause 284 extends the definition to include those in receipt of the mobility component.

WHAT ICAEW IS CONCERNED ABOUT

9. We have pointed out several times the anomaly regarding the double tax charge on the death of a qualifying disabled person with a discretionary trust and are pleased to note that action in the guise of Clause 56 is now being taken to harmonise the tax position. We also welcome the proposed change to clause 284.

10. However, in our view there is much more that needs to be done with regards to vulnerable beneficiary trusts. As expressed in our TAXREP 13/13 and TAXREP 57/12 a complete review of the vulnerable beneficiary tax regime as a whole (across all the taxes not just IHT) is needed.

11. The tax system for vulnerable beneficiaries is not generous, indeed due to the inadequacy of the current provisions the beneficiary is frequently in a worse position tax-wise compared to when the assets are held personally. We cannot see any justifiable reasons for this; the restrictions already imposed on how the trust property is used mean that such trusts can only be used for protecting vulnerable individuals. For example, a transfer to a trust in excess of the nil rate band will give rise to an IHT charge so the transfer of assets owned by a disabled person into a vulnerable beneficiary trust for themselves will give rise to an IHT charge even though the trust is only required to protect the individual financially.

12. Trusts for vulnerable beneficiaries should be wholly transparent for all tax purposes. A vulnerable person should be treated in the same way by the tax system whether assets are held personally or via a qualifying trust. The existence of a qualifying trust (interest in possession or discretionary trusts should be possible) or sub-trust should be ignored for tax calculation purposes such that the vulnerable beneficiary is taxed as if he or she holds the assets directly. The tax due should be paid by the Trustee from the trust property.

13. The definition of vulnerable beneficiaries should be widened. For example, a category to cover anyone over the age of 65 should be included. While not all over 65s will be vulnerable many will be (or have the potential to be if targeted by unscrupulous individuals), so they should be protected. In addition, closer consultation by HM Treasury and HMRC with the mental health charities, such as Rethink Mental Illness whose response we included as an Appendix to TAXREP 57/12 to ensure that the definition of vulnerable person caters adequately for those with fluctuating capacity is necessary.

14. HMRC does not provide software for trust self assessment forms SA900 so this could give rise to additional expense for the trustees if they have to purchase commercial software. If the trusts were totally transparent and the income and gains were entered on the self assessment of the vulnerable beneficiary this could save costs for HMRC and the trustees.

RECOMMENDATIONS

15. A complete review of the definition of a "disabled person" is required.

16. The tax system for vulnerable beneficiary trusts should be changed such that they are totally transparent for all tax purposes. A trust is used to protect a vulnerable individual and to penalise an already disadvantaged person by imposing higher tax charges than would otherwise be the case is iniquitous.

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 icaew.com/en/technical/tax/tax-faculty/~/media/Files/Technical/Tax/Tax%20news/TaxGuides/TAXGUIDE-4-99-Towards-a-Better-tax-system.ashx)