TAXREP 13/13

(ICAEW REP 17/13)

ICAEW TAX REPRESENTATION

VULNERABLE BENEFICIARY TRUSTS

Comments submitted on 6 February 2013 by ICAEW Tax Faculty in response to *Vulnerable Beneficiary Trusts Summary of Responses* published in December 2012 and *draft legislation* published on 17 January 2013 by HM Revenue & Customs

Contents

The Institute of Chartered Accountants in England and Wales
Chartered Accountants' Hall, Moorgate Place
London EC2R 6EA UK
icaew.com/taxfac

T +44 (0)20 7920 8646
F +44 (0)20 7920 0547
E taxfac@icaew.com

INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the *Vulnerable Beneficiary Trusts Summary of Responses* published by HM Revenue & Customs (HMRC) in December 2012 and *draft legislation* published on 17 January 2013.

2. We should be happy to discuss any aspect of our comments and to take part in all further consultations on this area.

3. We responded to the initial consultation document in TAXREP57/12

4. Information about the Tax Faculty and ICAEW is given below. We have also set out, in Appendix 1, the Tax Faculty's Ten Tenets for a Better Tax System by which we benchmark proposals to change the tax system.

WHO WE ARE

5. ICAEW is a professional membership organisation, supporting over 140,000 chartered accountants around the world. Through our technical knowledge, skills and expertise, we provide insight and leadership to the global accountancy and finance profession.

6. Our members provide financial knowledge and guidance based on the highest professional, technical and ethical standards. We develop and support individuals, organisations and communities to help them achieve long-term, sustainable economic value.

7. The Tax Faculty is the voice of tax within ICAEW and is a leading authority on taxation. Internationally recognised as a source of expertise, the faculty is responsible for submissions to tax authorities on behalf of ICAEW as a whole. It also provides a range of tax services, including TAXline, a monthly journal sent to more than 8,000 members, a weekly newswire and a referral scheme.

KEY POINT SUMMARY

8. We are pleased to note that the definition of vulnerable beneficiary has been extended to include those in receipt of personal independent payment by virtue of entitlement to the daily living component at either the standard or enhanced rate. We also welcome the modification such that the trustees will be able to apply small amounts of income and capital without having to prove that it is for the benefit of the vulnerable beneficiary.

9. However, we are disappointed that several of the points raised in our original submission have not been taken into account in the draft legislation and to that extent they are reiterated. We are still of the view that the opportunity should be taken for a complete review of the vulnerable beneficiary trust regime.

10. We have a specific concern with the draft legislation published on 17 January 2013 as it would seem that for trusts created on or after 8 April 2013 the statutory power of advancement in s.32 Trustee Act 1925 will have to be excluded or restricted in order for the trust to qualify as a bereaved minor trust or an 18-25 trust. Our technical analysis of this point is given below.

DRAFT LEGISLATION

The s.32 power of advancement

11. The draft amendments for trusts with vulnerable beneficiaries, issued on 17 January 2013 appear to go further than intended, in that, in addition to *"removing a rule that accepts that a trust does not fail to secure that the income and capital conditions are met by virtue of the existence of a statutory power of advancement. (Removal of the rule will require a qualifying* *trust deed to explicitly deny the trustees' the statutory power during the vulnerable person's lifetime (or other relevant period))…"* for vulnerable beneficiaries, this same restriction appears to have been applied to trusts for bereaved minors (s.71A Inheritance Tax Act (IHTA) 1984) and '18-25' trusts (s.71D). This does not make sense and we believe it is a mistake, especially in view of the proposed relaxation included at ss.71A(3B) and 71D(6C) respectively, which will allow small [as defined] amounts of trust income or capital each year to be applied for someone other than the bereaved minor.

12. The statutory power in s.32 Trustee Act (TA) 1925 is not a power to advance only, but is also a power to apply capital for benefit of the beneficiary. This is not however unlimited: the trustees may not, under the guise of 'benefit' pay capital to a beneficiary in order for them to benefit persons who are not beneficiaries under the trust i.e. they may not seek to circumvent the provisions of the trust deed, in order to benefit non-beneficiaries.

13. The word 'benefit' has been held - inter alia - to allow capital to be paid or applied in paying a beneficiary's debts, in maintaining and supporting a beneficiary, to pay capital outright to the beneficiary provided the trustees are satisfied that it would be for his or her benefit, or to resettle capital for the beneficiary's benefit. The power is often used to – for instance – pay school or university fees, in the case of school fees often receiving a discount for up front payment. The provision of a good education for the beneficiary is surely within the spirit and intent of the qualifying conditions in ss.71A and 71D IHTA 1984, and HMRC has never indicated that it disagrees with that view.

14. There is no avoidance motive to be considered here, provided the power is only exercised so that the trust continues to meet the conditions in ss.71A and 71D IHTA 1984. If the exercise of the power were to cause the trust to leave the protected s.71A or s.71D regime, then the trust would be subject to the relevant property rules, and tax would be collected accordingly.

Trusts for bereaved minors and '18-25' trusts

15. When ss.71A and 71D were first drafted, the provisions currently at s.71A (4)(a) and s.71D(6)(a) were not included in their current form. Following representations from the ICAEW, CIOT, STEP and firms in practice during the Committee stages of Finance Bill 2006, these subsections were added in June 2006, to make clear that the existence of the statutory or extended s.32 power in a trust deed would not prevent it from qualifying as either a s.71A or s.71D trust, provided other conditions were met.

16. It was the case – and continues to be – that the drafting of the rest of ss.71A and 71D ensures that, in order to qualify within those sections, there are protections for the child beneficiaries – the greatest of these being at s.71A(3)(b) *"that, for so long as the bereaved minor is living and under the age of 18, if any of the settled property is applied for the benefit of a beneficiary, it is applied for the benefit of the bereaved minor"* [the minor becomes absolutely entitled as against the trustees at age 18, so it is inappropriate to extend this protection beyond that age] and s.71D(5)(b) *"that, for so long as B is living and under the age of 25, if any of the settled property is applied for the benefit of a beneficiary, it is applied for the benefit of B"* [again, B must become absolutely entitled as against the trustees on attaining age 25, so the protection of s.71D(5)(b) covers the period up to that point].

17. It is clear that the mere existence of the statutory (or extended) power of advancement in such cases cannot represent a risk to vulnerable beneficiaries, because the drafting of the sections ensures that the settled property is only applied for their benefit. If the property may be otherwise applied, the trust will not fall within ss.71A or 71D, and will thus be a normal relevant property trust with no advantageous inheritance tax treatment and no added protection for its minor beneficiary at all.

18. The Government's plans make sense in terms of trusts within s.89 IHTA, since s.89 currently only provides that *"not less than half of the settled property which is applied during his life is applied for his benefit"*, i.e. the level of protection for the vulnerable beneficiary is not at the same level as that provided by ss.71A and 71D. It is however perverse to extend this restriction to those sections, which already impose conditions as to the whole of the trust capital and income (subject to the proposed relaxations regarding capital and income of the lower of £3,000 or 3% of the maximum value of the settled property, during any tax year).

19. Accordingly, we would welcome confirmation that this change to ss.71A and 71D was not intended, and confirmation that the proposed changes to s.71A (4)(a) and s.71D(6)(a) will not be included in Finance Bill 2013.

Trusts arising under an intestacy

20. There is also an inconsistency between bereaved minors' trusts arising as a result of intestacy (governed by s.71A(1)(a)) and those which arise under a Will (governed by ss.71A(1)(b) and 71A(2), to which the conditions in ss.71A(3) and 71A(4) (as amended) apply).

21. The statutory power of advancement applies to statutory trusts for issue on intestacy, but this will not prevent those trusts from qualifying as s.71A trusts. However, if the power applies to equivalent trusts written into Wills, it will prevent those trusts from qualifying and they will then be subject to the inheritance tax relevant property regime for trusts. This has the perverse effect that – as the legislation is currently drafted – bereaved minors will potentially be in a worse position if their parents have made a Will (and omitted to restrict s.32 TA 1925 or the Will was made at a time when the s.32 power was not considered a problem) than if they had failed to do so and died intestate.

Grandfathering

22. It appears that these changes are only intended to affect trusts arising after 8 April 2013. However, the grandfathering provisions in para 7, Sch 1, Finance Bill 2013 do not take account of trusts made by Will. This is again perverse since s.71A and s.71D trusts are specifically intended to be created by Will.

23. Wills that have been made before 8 April 2013 and which contain trusts for the testator's children to take say at age 18 or up to age 25, will almost always include either the statutory or an express power of advancement (so as to enable the trust property to be advanced to pay school fees for example or to enable the children to benefit in some other way). However, a Will does not technically come into operation (and so the trusts will not be 'created') until the testator dies and if this occurs after 8 April 2013, the settlement will not be within the current grandfathering provisions.

24. It surely cannot be the Government's intention that clients must incur costs in revising their Wills yet again, following the wholesale revision exercise required following the Finance Act 2006 changes? We therefore propose that grandfathering is extended to include Will trusts established on the death of a person on or after 8 April 2013 where the Will was written on or before 8 April 2013.

E sue.moore@icaew.com

icaew.com/taxfac

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)