
Corporate

Inheritance tax: A fairer way of calculating trust charges

Response to Consultation
(published 6 June 2014)

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Introduction

1. The Institute of Financial Accountants (IFA) and the Federation of Tax Advisers (FTA) welcome the opportunity to comment on the consultation document in respect of introducing a fairer way of calculating trust inheritance tax charges published by HM Treasury and HM Revenue & Customs (HMRC) respectively on 6 June 2014.
2. We should be happy to discuss any aspect of our comments and to take part in all further consultations on this area.
3. Information about the IFA and the FTA is given below.

Who we are

4. The IFA is an internationally recognised professional accountancy membership body whose members work for small and medium-sized enterprises (SMEs) or who run or work in small and medium-sized accounting practices (SMPs) that advise SMEs.
5. At the IFA, we put small and medium enterprises (SMEs) first, recognizing their role as vital wealth-creators, as employers to more than half of the UK's private sector workforce and as the power behind vibrant urban and rural communities. We hold the interests of small and medium practices (SMPs) in the accounting profession in equal regard.
6. The FTA is the Tax Faculty of the IFA and is the modern membership body for agents who provide tax compliance and planning expertise to SMEs and entrepreneurs. It is the tax representative for IFA and FTA members.
7. We are proud of our unique relationship with our members, who predominantly come from a SME/SMP background. As a professional accountancy body, we aim to provide the very best support and guidance to our members who operate within this arena, frequently tailoring policies and recommendations to meet the unique challenges and trading relationships associated with smaller business.
8. Founded in 1916, the IFA supports over 9,000 members and students in more than 80 countries with a programme of professional qualifications and education. As well as resources, events, training and seminars. IFA members uphold high standards of conduct, confidentiality and ethics and undertake annual continuing professional development (CPD) activities.
9. The IFA is a full member of the International Federation of Accountants (IFAC), the global body for the accountancy profession. As such, the IFA takes its place alongside the UK and Ireland's six chartered accountancy bodies, as well as 135 national and regional accountancy organisations representing 125 countries and jurisdictions.
10. The IFA is formally recognised as an awarding organisation by Ofqual, the public body responsible for monitoring standards, exams and qualifications (other than degrees) in England, underlining the quality of the IFA's work and the integrity of its qualifications; and is authorised by HM Treasury for Anti Money Laundering supervision.

General Comments

11. Thank you for the opportunity to respond on the consultation in respect of introducing a fairer way of calculating trust inheritance tax charges (including simplifying the calculation of charges). We agree that fairness and simplicity for trustees should be at the heart of any changes made in respect of the relevant legislation.
12. Overall we agree that the proposed revised model for calculating trust inheritance tax charges will make the calculations simpler. In particular, removing the need to establish historical information such as related settlements will reduce the workload for practitioners.
13. We consider that the power for a settlor to allocate his settlement nil-rate band between settlements is fairer and far improved from the original proposal of a straight pro-rata split. The ability to allocate it will help prevent disproportionate allocation to small trusts (e.g. those set up to receive pension death benefits or life insurance proceeds). A pro-rata split could have led to potential wastage of the settlement nil-rate band with such trusts.
14. However, we still consider there to be a divergence from the nil-rate band that applies to individuals which refreshes every seven years. This seems at odds with paragraph 1.9 which states that *'The Government wants to ensure that there is consistency of treatment between those individuals who transfer their assets on death and those individuals who make lifetime transfers through the use of trusts.'*
15. Another key concern we have are that the new rules may discourage the use of trusts where there is a non-tax reason for doing so e.g. asset protection and family wealth protection.

Specific comments on the draft legislation

16. In addition to our general comments, our comments on specific questions set out in the consultation document are set out below.

Q1: Are there any other provisions that would need to be made for when a settlor dies that have not been covered in this section?

17. We consider that giving an additional settlement nil-rate band on death will reduce the burden that the new rules place on personal representatives to determine the position regarding lifetime trusts.

Q2: Are there any other features of the existing rules that should be retained under the new rules?

18. For true simplification as few features as possible should be retained. To ensure fairness the pro-rata provisions applying to charges relating to additions and exits should be retained as the consultation document suggests.
19. Similarly having a nil-rate band for existing trusts (as reduced by the settlor's cumulative seven year total) should be retained as it would be unfair for these trusts to share the settlement nil-rate band since they were set up at a time when the old rules applied.
20. One other feature which we consider should be retained is that companies should be entitled to a nil-rate band.

Q3: Are there any aspects of the proposed new rules for allocating the SNRB or calculating the IHT charges that could be improved?

21. We consider that for parity with individuals the settlement nil-rate band should refresh every seven years. An example is given in 2.30 of the consultation document to support the settlement nil-rate band not refreshing.

The example makes the point that *'In this scenario the next generation avoids any IHT charges altogether because of the previous generation's use of multiple nil-rate bands.'* However, this result can also be achieved using the refreshment of the personal nil-rate band (i.e. it can be used to pass on wealth to the next generation who, in turn, can do the same).

22. Another improvement which we would like to see is that exit charges should not be accounted for in ten year charge calculation to avoid double charging. Assets distributed suffer inheritance tax charges over the period up to their exit but then effectively generate a further charge as they increase amount on which 6% is charged at next ten year anniversary. This double charging is best illustrated by examples.
23. Suppose £625,000 is settled on trust and there are no distributions in the first 20 years. Assuming no growth and the trust is allocated 100% of the settlor's settlement nil-rate band (which remains constant at £325,000) **the total charges after 20 years would be £36,000** i.e. two ten year charges of £18,000 each (£625,000 - £325,000 = £300,000 x 6% = £18,000).
24. If, however, £325,000 is distributed after, say, 19 years, the total tax charges over the first twenty years increases by £8,424 to £44,424 despite there being no additional value within the trust:

First 10 year anniversary (as above)		£18,000
Exit charge ($£325,000 \times 2.88\% \times 36/40$)		£8,424
Second 10 year anniversary:		
Value (£625,000 - £325,000)		£300,000
Less: SNRB	£325,000	
Less: Exits	(£325,000)	<u>Nil</u>
Chargeable		<u>£300,000</u>
10 year charge @ 6%		£18,000
Total charges		£44,424

* The effective rate for the exit charge, based on the first 10 year anniversary, is 2.88% ($£18,000 / £625,000$)

25. To avoid this double charging we believe consideration should be given to restricting the impact distributions have on the nil-rate band at the next ten year anniversary. This could be done by reducing the nil-rate band only to the extent of the percentage of the nil-rate band that the distributions utilised at the previous ten year anniversary. In the above example the £325,000 distributed used up 52% of the nil-rate band at the last 10 year anniversary. Reducing the deduction from the nil-rate band at the next 10 year anniversary to £169,000 ($52\% \times £325,000$) would reduce the second 10 year anniversary to £8,640:

Second 10 year anniversary:		
Value (£625,000 - £325,000)		£300,000
Less: SNRB	£325,000	
Less: NRB of exits	(£169,000)	<u>(£156,000)</u>
Chargeable		<u>£144,000</u>

10 year charge @ 6%

£8,640

26. Total charges are now £35,064. This gives a fairer result - the only difference from the first example (i.e. where no distribution is made) is due to the £325,000 distributed not being in the settlement for a full 10 years.
27. Another area of improvement we would like to see relates to compliance. New trusts will need to calculate inheritance tax charges under the old rules in 2014/15 then under the new rules in 2015/16. Therefore calculations for distributions in 2014/15 will still require the need to consider historical information, involving unnecessary complexity. We understand that this is aimed at avoiding changes to IHT returns before 2015/16 but perhaps filing and payment dates for distributions in 2014/15 by new trusts should be extended by treating such distributions as arising on 6 April 2015. This will allow all calculations for new trusts to be under the new rules.
28. In our opinion further simplification could be achieved by basing proportionate reductions for distributions and additions on days rather than the current quarterly system.
29. Finally we also consider that settlors should be given up to the filing date of a return to amend the allocation of the settlement nil-rate band. Trustees may not include the settlor and so may make a distribution without consulting the settlor which does not give the settlor the opportunity to review the allocation.

Q4: Are there any aspects of the existing rules that would no longer be necessary under the new rules?

30. We consider that in order to achieve true simplicity the historical chargeable total for existing trusts should simply be the chargeable transfers in the seven years before the trust is created and should no longer be recalculated when there are additions to the trust. Additions fall under new rules so should not have any impact on existing trusts.

Q5: Are there any other impacts for example on cost or equality that should be taken into account?

31. There will be an additional burden on personal representatives who may not have full knowledge of all lifetime trusts nor sufficient information to be able to find out this information.

Q6: Should the simplified method for calculating ten year and exit charges proposed for relevant property trusts be extended to trusts that fall within the relevant charging provisions for 18-25 trusts?

32. We believe that to achieve the objective of simplicity and fairness these trusts should fall within the new regime but that it would be appropriate for there to be a separate nil-rate band for allocation between all such favoured trusts.

Should you wish to discuss our responses further, please contact AdamL@ifa.org.uk in the first instance.