1.1.5 To treat income and capital of a gift in different ways

Clients will often have two main categories of people they wish to benefit – their surviving partner and their children. The partner may be financially dependent on the client and would need access to the client's resources if he or she died to maintain a reasonable standard of living. If capital were given outright to surviving partners this would leave them free to use it as they see fit. While this may be entirely satisfactory for some clients, others may have either more complex lives or less faith in the ability of their surviving partner to be able to manage those resources appropriately. By using an interest in possession (IiP) trust the income can be paid to the surviving partner while preserving the capital for the children.

Clients who have been married before and have children from that relationship would expect to be able to preserve some or all of their estate for their children to benefit from, but if the estate is given directly and absolutely to a new partner there is no guarantee that any previous children would ever benefit.

A client who has always managed the family's finances and who has left a spouse to care for the welfare of the children rather than carving out a paid career, may feel that the surviving spouse would find suddenly having the responsibility of managing money difficult. Such a client may prefer to ensure that there is sound management of the money by trustees, who would provide a suitable stream of income for the surviving spouse.

In other cases an elderly relative may need help with the payment of outgoings and require income to do this, but have no need of the capital that generates this income, which can be directed elsewhere on the death of that relative to other beneficiaries of the settlor's choosing.

Providing income for beneficiaries while they are too young to handle large amounts of capital is a popular use of trusts for children and grandchildren, thus providing funds for school fees, day-to-day maintenance and other benefits while they are under a specified age. However, the client may feel that at a certain age the children will be responsible enough to have control of their own funds, and the capital will usually pass to them on attaining that specified age.

1.1.6 To save tax

Trusts traditionally have been a way of helping to save capital taxes. For the couple who want to minimise inheritance tax (IHT) on their joint estates, the tax adviser would encourage making the most of various nil rate bands. In the case of lifetime gifts, gifts into trusts up to the value of the nil rate band are, post the changes to IHT introduced with effect from 22 March 2006, still a possibility (see **1.3**). Trusts may typically be used because the chosen beneficiaries are too young to enjoy the amount of cash outright and the donors wish to reduce the capital value of their estates in the hope of living at least seven years from the date of the gift and so gain a fresh nil rate band to set against their estate on death. Equally, the donors may rather see the gift managed for the beneficiaries until they reach a specified age.

Another common situation in which to use a trust is where the donor does not have spare cash to give away but only has chargeable assets which, if given away, would generate a chargeable gain on which the donor would have to pay capital gains tax (CGT) at his or her marginal rate, which could be as much as 28 per cent. If the chargeable assets were gifted to a relevant property trust, for example, the donor could utilise a CGT relief (Taxation of Chargeable Gains Act (TCGA) 1992, s.260) and thus avoid an unwelcome tax bill.

Prior to the introduction in October 2007 of the transferable nil rate band between spouses and civil partners on death (see **11.5**), it was common for the first spouse or civil partner in a couple who died to leave an amount equal to their own nil rate band to a discretionary trust. This would usually be a trust for the benefit of the other spouse or civil partner and their children. The trust gift meant that the settlor's nil rate band would not be wasted by leaving it outright to the surviving spouse or civil partner, who would only have a single nil rate band to set against the joint estate on the later death.

For deaths on or after 9 October 2007, on the death of a surviving spouse or civil partner, any proportion of unused nil rate band (known as the transferable nil rate band – TNRB) will be applied to the nil rate band available at the date of death of the surviving spouse or civil partner (e.g. chargeable estate of £162,500 when nil rate band is £325,000 = 50 per cent of nil rate band is unused) and this will be added to that personally available to that surviving spouse or civil partner (e.g. nil rate band at second death, say £325,000 + 50 per cent of £325,000 [£162,500] = £487,500). The total will not be able to exceed two times the value of the nil rate band applicable at the date of death of the surviving spouse or civil partner (e.g. for a second death after 9 October 2007: 2 × £325,000 i.e. £650,000).

The change was retrospective in that it does not matter when the first spouse or civil partner died, but clearly there are complications where that person died before the introduction of IHT on 18 March 1986.

Despite the introduction of the TNRB, using the nil rate band on the first death by transferring it to a discretionary trust is still a valid option to consider with clients in certain situations:

- Assets in the testator's estate which could be appropriated to the nil rate band discretionary trust are likely to grow in value by a percentage greater than the likely increase in the nil rate band (which is currently frozen at £325,000 until 5 April 2021) between the deaths of the testator and his or her spouse or civil partner.
- Not all clients want their spouse or civil partner to have an absolute interest in all of their estate and would prefer other beneficiaries to receive a legacy on the first death, so leaving everything in the residue to be held on an immediate post-death interest (IPDI) for the spouse or civil partner does not fit the bill. If the spouse or civil partner is in greater need at the time of death the assets could always be appointed to them absolutely or added to the IPDI trust over residue.

- If the testator's spouse or civil partner has already acquired a TNRB from a deceased spouse/civil partner he or she will not be able to use another one, so the testator can make a gift to chargeable beneficiaries rather than waste his or her own nil rate band.
- Separate use of the nil rate band by the testator and the spouse or civil partner means that two discretionary trusts will exist going forward, each within the available nil rate band and so unlikely to be subject to IHT; whereas a trust on the second death using the nil rate band and the TNRB would be twice the nil rate band and hence likely to be subject to payment of periodic charges and exit charges under the relevant property regime (see **Chapter 14**).
- It provides a degree of asset protection which may be particularly useful where one or more of the beneficiaries may be subject to means-tested benefits or where there is a second marriage and there are children from the first marriage who also need to benefit.
- The wealthy testator with agricultural and/or business property eligible for relief at 100 per cent can top up the nil rate band discretionary trust with cash, up to the nil rate band, so as to have some cash available to meet contingencies, as well as those special assets in the trust, for the benefit of chargeable beneficiaries.
- For deaths on or after 6 April 2017, the use of the nil rate band discretionary trust in the estate of the first spouse or civil partner to die may help avoid the loss of the residence nil rate band (RNRB) through the surviving spouse's estate exceeding the taper threshold (for more on the RNRB see **11.6**).

Not only will the trust mechanism generate a saving of tax because of the way in which the assets are held but also it may help to preserve entitlement to either business property relief (BPR) or agricultural property relief (APR) (see **11.3** and **11.4**), where in each case entitlement to relief includes ownership criteria which involve minimum periods of ownership. If outright gifts were made it might be difficult in certain circumstances for the recipient to achieve that ownership period, but if the trustees retain ownership of the assets for the trust period the entitlement to relief is preserved.

1.1.7 To avoid the need to obtain a grant of probate

When an individual dies domiciled in England and Wales, the legal title to the deceased's assets vests in his or her personal representatives (PRs). In the case of a client who leaves a will, the PRs will be his or her executors, and in the case of the intestate, the PRs will be administrators identified by the Non-Contentious Probate Rules 1987, SI 1987/2024 (as amended). To be able to provide evidence of the legal ownership a grant of probate must be issued to the PRs.

While in many estates this is straightforward, once the estate is taxable, accurate valuations are necessary and the PRs will have to undertake a reasonable amount of

work to identify and value all the assets, liabilities and beneficiaries in the estate. All this takes time, and during this period assets cannot be easily changed or managed without a grant.

Although there are procedures which will enable an expeditious grant to be obtained, even this is not instantaneous and could temporarily leave the beneficiaries without access to financial support.

Another factor may be the cost of obtaining probate. In 2017 the government attempted to significantly increase probate fees such that estates worth more than £2 million would have to pay fees of £20,000 rather than £155. With the snap election in June 2017 this proposed increase was withdrawn. It had been criticised not just for its scale but also for the manner of its introduction using the statutory instrument procedure rather than a Bill. These proposals may well be reintroduced at a later date.

The advantage of the trust is that the deceased is not the owner of the assets managed by the trustees. The trustees own the legal title to the assets in the trust fund and so are able to continue managing them following the client's death. This means that the trust's beneficiaries continue to have access to the support that they enjoyed before the donor's death, and more particularly the trustees have authority to switch investments as and when required, allowing them to react to the rises and falls of the markets.

1.1.8 Practice points

Trust practitioners should strive to find what is motivating their clients and what objectives they want to achieve. This will help to determine whether or not a trust solution should be proffered and ultimately which type of trust might be the most suitable or appropriate for the client's situation:

- Identify the clients' goals. If you are dealing with two spouses/civil partners make sure that you are aware of both people's views.
- Extract the facts about your clients' resources and dependants.
- Examine with the clients the external environment outside the family: tax, work, political change, etc. It is useful to understand the financial landscape surrounding the clients and how changes to, say, interest rates or tax rates, might affect their thinking.
- Analyse the internal environment within the family – needs, problems, resources, etc. If assets are to be moved from personal ownership to trust ownership it is essential to understand what the risks are to those structures in the event of a family disaster, such as an untimely death or divorce. What problems might such events generate, and what resources might the family need in such circumstances?
- Assess the clients' attitudes to risk. Some clients, for example, are willing to take part in highly contentious tax-saving schemes which are likely to be challenged by Her Majesty's Revenue and Customs (HMRC), whereas other

clients may be unwilling to risk facing an investigation of that sort or to undertake litigation.
- Design the approach, taking into account these factors.

1.2 ALTERNATIVES TO TRUSTS

Traditionally, where a family wished to pass on wealth to the next generation but with a significant element of protection against profligacy or divorce the solution was to create a family trust as a means of splitting the management and control of an asset from its ownership. Ownership would rest with the beneficiaries of the trust but management and control of the asset would reside with trustees appointed for the purposes. The trustees might also have the power to vary the entitlements of the beneficiaries to take into account future changes in circumstances.

The taxation changes to the treatment of trusts in the Finance Act (FA) 2006 and the continuing development of anti-avoidance legislation and punitive income tax rates are a large disincentive to clients against making trusts and yet clients' objectives remain to:

- pass wealth down a generation or more with modest or no tax charges; and
- separate *control* from *ownership* of the assets to be transferred.

Putting cash and most other assets into a trust above the available nil rate band will trigger an immediate IHT charge at 20 per cent. From 6 April 2017 the special trust income tax rates are 38.1 per cent on dividend income and 45 per cent on other income. These tax charges have made trusts less attractive for wealthy clients.

In recent years partnerships have presented a means by which controls can still be left in place but potentially exempt transfers (PETs) might be made for IHT purposes instead of chargeable transfers.

In such partnerships, the partnership assets are owned by the partners, but management and control of the assets reside with a specially appointed 'managing partner'. In this way, the partnership is structured in a similar way to a company, with partners acting in the role of shareholders, and the managing partner acting like the managing director.

This being the case, why use a partnership instead of a company? The main reason is to do with income tax and CGT. Partnerships are 'transparent' for tax purposes, i.e. the income and capital gains of the partnership are subject to tax on the individual partners. By contrast, companies are 'opaque' for tax purposes – the company pays tax on any income and capital gains and there is a further tax charge to pay when shareholders receive a dividend or a payment on redemption of their shares.

Whether or not a partnership pays less tax than an equivalent company depends on an assessment of a number of different factors including the type of income that will be received, the mixture of income vs. gains, the circumstances of the beneficial owners, and the amount that will be paid to the beneficial owners as opposed to the

amount that will be retained within the structure. Until 2010/11, partnerships looked relatively more attractive than companies in the majority of cases.

That situation is changing. The CGT rate for higher earning individuals is 28 per cent on UK residential property and 20 per cent on all other assets, while corporation tax rates are coming down from 20 per cent to 19 per cent in 2018.

1.2.1 Partnership

Partnership is 'the relation which subsists between persons carrying on a business in common with a view of profit' (Partnership Act 1890, s.1(1)). Simple co-ownership of assets does not amount to partnership. There has to be a *business* and there must be an *intention to make a profit* from that business.

The challenge is to be sure that the partnership is trading and not simply an investment business:

HMRC's Property Income Manual says:

> A partnership is unlikely to exist where the taxpayer is one of a group of joint owners who merely let a property that they jointly own. On the other hand, there could be a partnership where the taxpayer is one of a group of joint owners who:
>
> - let the jointly owned property; and
> - provide significant additional services in return for payment.
>
> Much depends on the amount of business activity involved. The existence of a partnership depends on a degree of organisation similar to that required in an ordinary commercial business.

There are different types of partnerships which have different outcomes and degrees of formality. General partnerships can be simple and largely unregulated but they leave the partners with unlimited liability. Limited partnerships are different from general partnerships but still have no legal personality of their own, just the contract between the parties to it.

Each limited partnership will have:

- A general partner who runs the limited partnership. This tends to be a person connected to the donor.
- Limited partners who invest in the limited partnership. These are usually the donees, who would need separate advice on entering into the contract.

If minors are limited partners, note that they may be able to rescind the contract at the age of 18!

By law, limited partners are prohibited from engaging in the management of the limited partnership so the donees will receive their 'gift' without being able to control the underlying assets. In this respect the limited partnership is again similar to a trust. The limited partners are entitled to the income attributable to their interest subject to the general partner's prior right to withhold sufficient funds to meet the obligations and commitments of the partnership.

Wide powers and discretions are therefore vested in the general partner to enable this role to be carried out.

The law imposes a restriction on the withdrawal of capital and this can be expanded upon in the partnership agreement.

From the above, it will be appreciated that the general partner is key because the assets and liabilities are vested in the general partner. Choosing a suitable general partner will involve consideration of the pros and cons of choosing:

- a lay individual; or
- a company; or
- a professional individual.

Choosing a company as general partner is similar to choosing a corporate trustee to manage the trust since it has the advantage of:

- limiting the liability of the individuals involved;
- continuing irrespective of the death or incapacity of its directors;
- permitting the donor to own shares in the general partner and in some cases sit on the board.

However, as with a general partnership the beneficial interests of the partnership belong to the limited partners and so the transfer of funds to the partnership will be a potentially exempt transfer.

All partners are taxed as if they hold a fractional share in the underlying assets proportionate to their interest – that is, there is a 'look through' to the individual partners for tax purposes.

This means that unlike a lifetime gift into trust, gifts made to a partner's capital account are potentially exempt transfers for IHT purposes rather than a chargeable transfer.

There will be no gift with reservation of benefit (GROB) (see **11.1.5**) in relation to the potentially exempt transfers provided donors are excluded from any and all benefit from the gifted partnership shares or assets. The retention of control through being managing partner does not of itself amount to a GROB – see IHTM14394 of the HMRC IHT Manual.

There is no income tax liability on the creation or funding of the partnership although bare trusts (see **Chapter 12**) would be needed if minor children are intended to be partners in the future. However, as long as they are grandchildren and not children of the donor, the settlor-interested trust rules will not apply to such bare trusts (see **Chapter 23**).

If cash or chargeable assets with no built-in gain are transferred to the partnership there should be no CGT either, but if business assets are used these could qualify for TCGA 1992, s.165 hold-over relief. Unlike the creation of a trust, making a potentially exempt transfer will not provide an opportunity to rely on TCGA 1992, s.260 hold-over relief (see **Chapter 16**).

The use of limited partnerships in this manner may constitute a 'collective investment scheme' unless all the partners are given day-to-day control over the management of the partnership.

If the limited partnership constitutes a 'collective investment scheme', the firm which operates the partnership must be authorised by the Financial Conduct Authority (FCA) to do so. This is because establishing, operating and winding up a collective investment scheme is a regulated activity under the Financial Services and Markets Act 2000, s.235.

Regulated activities may only be performed by FCA authorised persons. In order to comply and avoid committing a criminal offence the general partner in a limited partnership must delegate the day-to-day investment authority and management decisions to an FCA authorised person or to persons located outside the UK. For this reason any use of limited partnerships for family partnerships will usually be restricted to the very wealthy, as the simple cost of compliance and managing the partnership will outweigh the taxation benefits of making a potentially exempt transfer in less affluent situations.

1.2.2 Family investment companies

A family investment company (FIC) is a private investment company, designed to mirror many of the features of a discretionary trust, the shareholders of which are all members of the same family. It can have limited or unlimited liability and its constitution (its memorandum and articles of association and possibly a shareholders' agreement) can be drafted to suit the family's needs.

The FIC will typically be used to hold investments in the form of shares or land or anything else, though importantly it will not constitute a 'collective investment scheme' under the Financial Services and Markets Act 2000, and will not, therefore be subject to increased regulatory requirements.

As it is a company, it is very flexible. Share rights can be tailored to meet clients' specific needs, for example, enabling income to be paid only to one shareholder, or at different rates to different shareholders.

Control of the FIC rests with the board of directors and the board's powers are largely similar to those of trustees of a trust. The board will determine the investment policy of the FIC and will have control of when and if income is paid to shareholders. Shareholders' rights can be restricted to protect the control of the FIC and the constitution of the company generally.

However, once an asset has been transferred to a company it is very difficult to take it out again without triggering further tax charges otherwise than by way of loan repayment. This is because on a sale of an asset by a company the company pays corporation tax on its profits and the shareholders will have to pay further personal CGT or income tax at their marginal rates on the gains or dividends made to extract those profits.

If the use of an FIC, especially to hold a property to be passed from one generation to the next, is really a long-term vehicle and not something from which

short-term profits are likely to be regularly extracted, then the 'double tax' problem should not be fatal if the right investments are chosen. This being the case, income and gains will be accumulated at the 19 per cent corporation tax rate rather than the 45 per cent income tax rate, which leaves more net income to reinvest.

Remember too that indexation allowance for CGT is available for companies but not for individuals, so there is the opportunity to obtain some relief against inflationary increases in the value of the assets.

1.3 USING TRUSTS

For some people the idea of using a trust is still attractive, but apart from the issue of negligence, clients and their families will not thank an adviser for choosing an inappropriate trust.

Although there are many types of trust, this book considers the practical administrative techniques for the main types of trust found in private practice.

Before 22 March 2006 there were three main types of trust each with its own IHT treatment:

1. *IiP trusts* – taxed on the death of the person enjoying the interest in possession – Inheritance Tax Act (IHTA) 1984, s.49(1).
2. *Accumulation and maintenance (A&M) trusts* – largely IHT free by virtue of IHTA 1984, s.71.
3. *Discretionary trusts* – subject to tax every 10 years and when assets leave the trust – IHTA 1984, s.64 onwards – this is known as the 'relevant property regime'.

From 22 March 2006, the government significantly overhauled the IHT treatment of trusts. The distinction to be made for IHT is whether a trust is 'special' (in which case it may *not* be subject to the relevant property regime), or whether it is not (in which case it *will* be subject to the relevant property regime). For a detailed explanation see **Chapters 11** and **12**.

There have been many articles published advocating the use of trusts in tax planning, and clients will often arrive clutching an article that they have seen in the press. Nevertheless, given the amount of money or asset value available, a trust might not be an appropriate vehicle for a particular client. A trust can be a costly mechanism to operate especially with the increase in regulatory compliance associated with tax transparency. Clients may resent the trust if it is not run efficiently.

Table 1.1 Identifying a whether a trust is 'special'

Relevant property regime	Special
• All discretionary trusts • Any other interest in possession (IiP) which is not special	• Pre-22 March 2006 interest in possession (IiP) • Immediate post-death interest in possession (IPDI) trusts • Disabled person's interest (DPI) trusts • Transitional serial interests (TSI) • Section 71A bereaved minor trusts • Section 71D age 18–25 trusts (start off special then move to relevant property regime when young person reaches 18)
• Pre-22 March 2006 A&M trusts which were not changed by 6 April 2008	

1.4 WHICH TRUST TO CHOOSE?

A trust needs to be flexible enough to enable the trustees to take action to reflect changes in circumstances among the beneficiaries and changes in the tax system throughout the life of the trust.

A simple IiP or IPDI trust is somewhat inflexible in as much as only the beneficiary enjoying the vested interest in income (known as the 'life tenant') is entitled to receive any return and that is limited to the income of the fund. Without any express powers to enable them to do so, the trustees cannot advance capital automatically to the life tenant. Even the implied power to advance capital to those entitled to the capital (known as 'the remaindermen') on the termination of the interest in possession under Trustee Act 1925, s.32 can only be exercised in favour of the remaindermen with the consent of the person enjoying the interest in possession. If the trust was created before 1 October 2014 only up to a total of one-half of the remainder beneficiary's presumptive or contingent interest could be so advanced unless the trust deed stipulates otherwise.

For trusts created on or after 1 October 2014 the Inheritance and Trustees' Powers Act 2014 extended the power of advancement in Trustee Act 1925, s.32 to the whole of a person's presumptive share in the capital of the trust fund.

To make the IiP or IPDI trust more flexible, any such trust should be drafted to include overriding powers of appointment in order to enable the trustees effectively to rewrite the trusts of the settlement as it seems appropriate in the light of any changes to beneficiaries' circumstances or to tax law.

Unless the exercise of these powers was expressed to be revocable the exercise would be a once and for all event, being used only once in respect of any particular part of the fund to bring the trust to an end or change its nature in respect of that part.

By contrast the discretionary trust is very flexible as it gives the trustees the opportunity to decide whether or not to accumulate income as it arises rather than having to pay it out to a particular beneficiary. This enables choices to be made between beneficiaries at any time and from time to time, which can be based on need, reward or any reasonable factor. It allows for the fluctuating needs of all

eligible beneficiaries to be taken into account and enables new beneficiaries who join the class to be considered.

Also, capital payments can be made to any beneficiary in the class, again at any time in exercise of a power of appointment, with provision for what would happen at the end of the trust period if no exercise of the trustees' discretion is made.

Gifts to or for children made during the donor's lifetime will only be PETs if they are outright gifts or bare trusts and where the income and capital belong absolutely to the child as they arise. To the extent that any other type of gift into trust is used (apart from for the benefit of a disabled person) then it will be a chargeable transfer for IHT and the relevant property regime will apply.

Where an individual puts money or other property into a trust to or for the benefit of a relevant child of the settlor, then:

- payments of income made to each child under the trust; or
- amounts applied for the benefit of each child (e.g. the payment of school fees); or
- amounts which would otherwise be treated as income of a relevant child of the settlor (unless the total of gross income for the tax year is £100 or less)

will be treated as the settlor's income and taxed accordingly (Income Tax (Trading and Other Income) Act (ITTOIA) 2005, s.629). For more on settlor-interested trusts see **Chapter 23**.

On death, parents (step-parents and persons with parental responsibility for a child) alone achieve some IHT advantage in creating trusts under either IHTA 1984, s.71A (bereaved minor trusts) or s.71D (age 18–25 trusts). Grandparents and anyone else cannot take advantage of these special trusts for children (see **Chapter 12**). However, anyone can make an IiP trust for a child, which will qualify as an IPDI if the operation of Trustee Act 1925, s.31 is excluded in respect of minor children, or make a bare trust or a relevant property trust.

The tax treatment of each trust is often one of the main factors in selecting the right trust. For example, if the settlor wishes to reduce the estate for IHT purposes on death the settlor may choose to make a trust of an amount equal to his or her available nil rate band and hope to live at least seven years so that the gift will drop out of any charge to tax on death. If the settlor wants to provide for a spouse or civil partner, children and issue, a discretionary trust may be considered, with the resultant relevant property regime applying for IHT, but care will be required to avoid the application of the settlor-interested trust code for income tax and CGT (see **Chapter 23**).

The act of transferring assets to any trust (other than a disabled person's interest) during lifetime from 22 March 2006 is an immediately chargeable transfer for IHT. Any gift of chargeable assets worth more than the nil rate band available will be subject to a 20 per cent IHT charge at the time of the transfer into trust on the excess value over the nil rate band. If the settlor's choice of beneficiaries is limited, an IiP trust looks more attractive, as the income tax rates are simpler and cheaper than using a discretionary trust; however, if it is not desirable for the beneficiaries to have

a vested interest then a discretionary trust should be used, with the result that the harsh special trust rates will apply to the income (see **Chapter 18**).

If all the donor has to give are chargeable assets, rather than cash, then making an outright gift (i.e. a PET) may well be too expensive in terms of the CGT charge on the donor in disposing of those assets. If the donor is eligible for relief (perhaps because the assets qualify for TCGA 1992, s.165 hold-over relief) or has significant losses to cover the gains, then a PET may still be suitable.

If, however, the donor does not have the luxury of business assets or other reliefs but does not want to face a large CGT bill, then the only solution would be to make an immediately chargeable transfer to a trust so that the CGT could be held over under TCGA 1992, s.260; for more on CGT generally, see **Chapter 16**.

Therefore, the choice of trust to be used will always be a balancing act between flexibility and taxability; between protection of the beneficiaries and protection of the assets; and will depend upon the type of assets owned and the particular needs of the beneficiaries.

1.5 RELEVANT FACTORS TO CONSIDER

1.5.1 Value of the estate

The smaller the estate, the less likely it is that practical lifetime planning can be done without adversely affecting the security of the donor or his spouse for the future. In estates where the total value of the estate of the donor and spouse amounts to no more than £650,000 (i.e. two times the nil rate band in 2017/18), the likelihood is that the bulk of the value is in the family home.

Since 1986 and the introduction of the anti-avoidance provision relating to 'gifts with reservation of benefit' (GROBs) (see **11.1.5**), a number of tax-saving schemes have tried to reduce the overall impact of IHT on the family home, and some of these schemes involved the use of trusts.

Such was the extent of the government's concern over the loss of revenue as a result of the use of these schemes, that a new charge to income tax was introduced with effect from 6 April 2005, the pre-owned assets tax. This is a charge to income tax on what are defined as 'pre-owned assets'. This charge effectively taxes a certain value each year to income tax in respect of transactions in land, chattels and intangibles which are caught by the detailed rules set out in FA 2004, s.84 and Sched.15, the subsequent Charge to Income Tax by Reference to Enjoyment of Property Previously Owned Regulations 2005, SI 2005/724, and the *Pre-Owned Assets – Technical Guidance* issued by HMRC and subsequently updated.

This charge to income tax effectively discourages the use of all the popular lifetime giving schemes involving the family home apart from those covered by specific exemption or exclusion, with perhaps one exception, the use of the reversionary lease. As a result, most major gifts of interests in the family home will be included in the client's will.

The pre-owned assets charging arrangements are complex, and for a detailed review of this regime see Chamberlain and Whitehouse, *Trust Taxation and Estate Planning* (5th edition expected December 2017), Sweet & Maxwell.

For the smaller estate, both during the parties' lifetimes and on death, it is likely that outright gifts to the other spouse or civil partner will be used to protect the financial position of the surviving spouse or civil partner relying on the TNRB; or the will of the first to die will create an IiP trust which meets the conditions for an IPDI in favour of the surviving spouse or civil partner for life with remainder to any children.

Where the total estates exceed two times the current nil rate band for IHT purposes, each partner needs to own at least the nil rate band's worth of assets. If advantage is to be taken of the RNRB then a qualifying residential interest needs to be in the estate of the surviving spouse (see **11.6**). During lifetime or by deed of variation after the death of the first spouse or civil partner the ownership of assets needs to be separate so that the couple own either independently or as tenants in common sufficient assets to use up their respective nil rate bands and RNRB. Each spouse or civil partner will usually only consider using their own nil rate band (and possibly their own RNRB) as part of their gifts in their respective wills.

Larger estates may be able to make greater use of lifetime planning (albeit in a more restrictive way since 6 April 2005). The adviser will identify which of the lifetime tax reliefs can be utilised in passing on assets now, perhaps protecting any gifts by taking out a suitable life assurance policy which is written into trust for the beneficiaries who would bear any IHT in the event of an untimely death within the seven-year period.

The larger the estate, the more likely it is that trusts will be created during lifetime and possibly also be used on death. It is unlikely that a settlor, the settlor's spouse or civil partner and dependent children can enjoy immediate and continuing benefits from a trust that the settlor creates without it being treated as a GROB for IHT if the settlor benefits, and without the income arising in the trust being taxed on the settlor otherwise. (Note that for tax purposes, same sex couples who enter into a registered civil partnership from 5 December 2005 are treated as if they were spouses.)

So for a trust to be effective for tax purposes and create the potential for some tax savings, settlors who create a trust during their own lifetime must be able to afford to live without access to the resources being placed into the trust. A widow or widower or surviving civil partner can benefit from a trust created by their spouse or deceased civil partner without these difficulties, but not a living spouse or civil partner who was the settlor's spouse or civil partner at the time when the trust was created.

From 22 March 2006 any gift into trust (other than a disabled person's interest (DPI) trust) during the settlor's lifetime will be subject to the relevant property regime and therefore immediately chargeable to IHT if the chargeable transfer exceeds the settlor's available nil rate band.

1.5.2 Choice of available assets

The types of assets in the estate that benefit most from estate planning are those that are likely to grow in value, e.g. business assets, real property. Maximising the use of BPR and APR for IHT at the highest rates should be a priority. (For an explanation of these reliefs, see **11.3** and **11.4**.) Sometimes it is difficult to do this without falling outside the criteria for the reliefs or causing the GROB rules to apply. This is where the use of trusts can often help by providing some control over assets by trustees but passing the value out of the donor's estate.

For a settlor to make a transfer into an *inter vivos* settlement the two critical issues to consider initially will be:

1. Do the settlor and the settlor's spouse or any civil partner in any way depend on the proposed assets to produce income on which they live?
2. Will transferring the assets to the trust fund create a liability to tax?

The choice of assets to transfer into the trust fund will to a large extent depend on the answers to the above questions and also some of the issues below concerning the pros and cons of putting certain types of asset into a trust.

1.5.3 Post-gift income requirements

No gifts can be contemplated if they are likely to leave the prospective donor and the donor's spouse or civil partner with insufficient income on which to live. In the current climate pension policies may be insufficient and some capital assets may need to be retained to generate income to live on. Where the client is self-employed, proper pension provision should be the first priority for any surplus funds so that income levels in retirement are realistic. Only when the parties are satisfied that their likely income levels are sufficient to meet their standard of living both now and on the first death should income-producing assets be divested away from them.

1.5.4 Family circumstances

A single person with no dependants may have a desire to save tax but have no fixed ideas as to whom from a group of relatives, friends and charities they should benefit. The use of trusts again may be appropriate if there are assets that are suitable for transfer, e.g. cash up to the available nil rate band for the benefit of all the donor's nephews and nieces. This trust could, for example, be created when only one nephew or niece had been born and subsequently grow to accommodate all nephews and nieces born within a specified period. Such a trust could equally well be created during the lifetime of the settlor or in the settlor's will. Tax savings will only really be generated with a lifetime gift that is made more than seven years prior to the death of the settlor, otherwise any such gift will simply use some or all of the deceased's nil rate band on death.

A married couple or civil partners with children can make use of exemptions to pass monies between them in order for both to make use of gifts to their children, again perhaps into a discretionary trust, so as to maximise the use of their respective nil rate bands for IHT.

Where the parties are not married or civil partners there is currently no inter-partner exemption for transactions between unmarried people or non-civil partners and therefore any gifts made between them will start to use up the nil rate band. See the case of *Holland* v. *CIR* [2003] WTLR 207 for a failed argument to extend the spouse exemption under IHTA 1984, s.18 to cohabitants. For same sex couples, the Civil Partnership Act 2004 came into force on 5 December 2005, providing those couples who register as civil partners with similar treatment to that available for married couples.

Even though a civil partnership may be entered into by a same sex couple close family members, like sisters, are prohibited from forming one. In *Burden & Burden* v. *UK* (13378/05) ECHR (2006), [2007] WTLR 607 two elderly sisters lived together in a house built for their parents on land near Marlborough. They had lived together all their lives and neither had married. They had inherited the house from their parents and had lived there for 30 years. The house was valued at £875,000 and they held it jointly.

For many years the sisters had worried about how the survivor of the two would meet any IHT due in respect of the deceased's interest in the house given they were not covered by IHTA 1984, s.18 relief. One sister had written annually to the Chancellor asking him to change the law to permit the exemption to apply or to raise the nil rate band significantly, something which the Chancellor had singularly failed to do.

The Burden sisters regarded this as discriminatory and a fundamental breach of their human rights.

The sisters lodged an application with the European Court of Human Rights in March 2005 claiming that the imposition of a full 40 per cent IHT charge against a deceased sister's interest in the house would be a breach of both Article 14 of the European Convention on Human Rights and Article 1 of the First Protocol to the Convention.

Article 1 of the First Protocol says:

> Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.

This does not stop a State from enforcing such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties.

Article 14 says:

> The enjoyment of the rights and freedoms set forth in this Convention shall be secured without discrimination on any ground such as sex, race, colour, language, religion,

> political or other opinion, national or social origin, association with a national minority, property, birth or other status.

The sisters were arguing that they were discriminated against under Article 14 to the detriment of enjoying the peaceful use of their possessions under Article 1.

The UK government challenged the admissibility of the claim on the basis that as the two sisters were still alive there was no IHT due as yet and so the matter was hypothetical. The sisters countered this by saying that it was highly likely that one sister would die before the other rather than both die simultaneously; the value of a half share would also be highly likely to exceed the nil rate band given the level of that rate and rising property values and that there was a present impact as it was influencing their decision making as to whether they should dispose of the property. The European Court agreed with the sisters.

The UK government also said that the sisters should have exhausted the domestic remedies before applying to Europe but again the court rejected that argument. Ironically this was partly because the UK government also claimed the sisters were out of time to make the application and the court said that if they were prevented from making a claim under domestic law as a result then it would waive the six month time limit.

By a surprisingly close majority decision of four to three the court found in favour of the UK government. It was recognised that a government has to strike a balance between the need to raise revenue and the need to reflect other social objectives and a government was best placed to gauge that balance. Interference from the European Court would only be appropriate if there was a policy which was manifestly without reasonable foundation.

The court found that the treatment of the sisters as compared to spouses and civil partners was not discriminatory in breach of Article 14, accepting the UK government's argument that the IHT exemption for spouses and civil partnerships was a legitimate tool of a legitimate policy of promoting stability of relationships. The court also recognised that every policy might have hardship at the margins but the domestic government had to strike a balance between raising tax and pursuing policy goals. In this case the margin of appreciation was not exceeded.

Gifts during lifetime between unmarried couples and same sex couples who are not registered as civil partners will be subject to both CGT and IHT. To the extent that the nil rate band is available for IHT, no IHT will be payable at the time. If tax saving is the driving force, then the sooner the process starts the more likely it is that the donor will live long enough (i.e. at least seven years) to ensure that any gifts are outside the donor's estate on death.

More use could be made of the discretionary trust for the unmarried or unregistered partner and any children on the first partner's death if security is the issue. There is no IHT saving apart from the unused nil rate band on the first death, but it makes sense to use a discretionary trust as:

- it takes into account flexibility and protection;

International Tax Compliance (United States of America) Regulations 2013, SI 2013/1962, which came into force on 1 September 2013.

The current FATCA regulations are the International Tax Compliance Regulations 2015, SI 2015/878 and revised guidance notes (dated 29 August 2014); these are regularly updated approximately every six months – see **www.gov.uk/government/publications/uk-us-automatic-exchange-of-information-agreement**.

6.3 COMMON REPORTING STANDARD (CRS)

If your reportable person is resident in a reportable jurisdiction, i.e. a country other than the US, then you will report through CRS. CRS is a result of a new OECD global standard of automatic exchange of tax information which was signed on 29 October 2014 by 51 jurisdictions, including the UK. The UK is one of 48 jurisdictions to commit to implementation by September 2017, with other jurisdictions following a year later. The drafters of CRS used FATCA as the model on which to base CRS. This means that the same or similar concepts and titles are used, such as financial institutions (FIs).

The standard obliges participating jurisdictions to obtain all client due diligence information from their FIs and copy it automatically to the other participating jurisdictions each calendar year. For those jurisdictions implementing by September 2017, FIs will be required to capture data in relation to accounts in existence at 31 December 2015 and new accounts opened on or after 1 January 2016.

Although the terminology is not identical for both FATCA and CRS they are broadly similar. CRS does apply to charities, whereas FATCA does not.

The key terms are:

- **Financial institution (FI)**

  The types of FI that need to make a report are:

  - depository institutions (banks);
  - custodial institutions (brokers);
  - insurance companies;
  - investment entities: solicitors administering trusts potentially get caught under this – either because the trust is an investment entity if managed by the firm's trust corporation which is an FI, or if the firm does not have a trust corporation but instead manages the trust's investments through a discretionary management service run by a wealth manager, whose main income is from managing investments.

    Thus, a *trust* will be an investment entity and therefore an FI if:

    - the trustee is an FI; or
    - the trustee engages an FI to manage the trust; or
    - the trustee engages an FI to manage the financial assets of the trust.

- **Non-financial foreign entity (FATCA)/Non-financial entity (CRS)**

  If the trust you are managing is *not* an FI then it must be a non-financial foreign entity (NFFE) or a non-financial entity (NFE). These entities are either *active* or *passive*.

  To determine whether your trust is active or passive you must look at the source of the investment income. Both FATCA and CRS use the same definition of *passive income*, which includes:

  - dividends;
  - interest;
  - rent;
  - royalties; and
  - net gains from the sale of passive income producing assets.

  If 50 per cent or more of the trust's income is from the above sources then it is a *passive* NFFE/NFE; if less than 50 per cent of the trust's income comes from the above sources, e.g. 51 per cent comes from trading income from a farm owned and managed by the trust, then the trust will be an *active* NFFE/NFE.

  Active NFFE/NFEs do not have to report at all for either FATCA or CRS.

  Passive NFFE/NFEs have no reporting obligations but can be reported on by, say, the trust's bank. This means that every time this type of trust opens an account with an FI (e.g. a bank) the FI is obliged to identify the controlling persons behind the trust.

- **Controlling person**

  A UK FI (e.g. a bank) which has passive NFE account holders (e.g. trusts) must identify the *natural controlling persons*.

  For trusts, a controlling person includes:

  - trustees;
  - beneficiaries;
  - settlor;
  - protector; and
  - any other ultimate controller, e.g. a life tenant.

  For companies, a controlling person includes:

  - shareholders owning more than 25 per cent of the share capital.

    Note: while this is true for FATCA, for CRS, if there are no such shareholders then the natural person who holds the position of senior managing official will be the controlling person – whether or not they hold any shares.

So, if the trust you are managing is a family trust with an ordinary trust bank account, details of that bank account, including names and addresses of the controlling persons can be the subject of a report to HMRC.

Effectively, as a trust administrator you need to have marshalled all the correct information about your trusts under administration. If you have any FIs then you must decide whether you are going to report them or ask an agent to do so on your behalf. If a trust you manage is a passive NFFE/NFE then you need to have the correct information available when asked by an FI because you are effectively self-certifying that the information you have provided to the FI is correct.

It makes sense to have an annual check on all your trust files to ensure that you have identified the type of trust correctly (as it may change) and that you have all the relevant information you need in order to be compliant.

For FI trusts with US controlling persons you need to engage with FATCA.

Some firms may not have engaged with the process and others may not have undertaken trust work before. Whatever the reason for not acting, what follows is a reminder, for trusts not yet registered and for new cases taken on in the future, of the need to have a system in place:

- A decision must be made whether your firm is an FI or your client trust is an FI.
- If they are not, then they must be a NFFE and you need to ascertain whether it is an active or a passive one.
- Use a checklist to record your decision in your trust's permanent records. It must be reviewed and updated annually.
- If you determine that there is an FI then registration will be required. The US registration system can be accessed via **www.irs.gov/fatca-registration**.
- Online, create a FATCA account; complete the form; sign and submit the signed registration form to the site and then following approval you will be issued with the Global Intermediary Identification Number (GIIN) – a special number for that trust.
- Once the trust is registered you need to decide whether or not *you* are going to submit a FATCA return on behalf of an FI – if you are, then your firm will need to register with HMRC using HMRC's online services. This service is available through the Government Gateway. If you are not, then you need someone else to provide this service for the trust, e.g. a wealth manager or an accountant.
- To access the FATCA service at HMRC you will need an 'Organisation' type Government Gateway account. If you have not got this then read about what you have to do at **www.gov.uk/government/publications/foreign-account-tax-compliance-act-registration-guidance-fatca/automatic-exchange-of-information-registration-guidance**.
- HMRC will then provide you with a FATCA ID for your firm and an HMRC registration identification number for each FI you have registered.
- If the trust is an FI but you do not wish to register directly – then you have to use an intermediary to do it such as a withholding agent, i.e. a wealth manager or broker.
- For each of the FIs you are reporting on you need to submit FATCA returns to HMRC for each calendar year by the following 31 May.

- On 16 March 2015 HMRC announced that UK resident trusts with nil returns did *not* have to submit reports following changes by the Internal Revenue Service (IRS).

6.4 LEGAL ENTITY IDENTIFIER

The Financial Conduct Authority has established a framework called the Legal Entity Identifier (LEI) to enable the London Stock Exchange (LSE) to verify the source of funds entering the market. The problem seems to be that this system does not anticipate stock exchange investments being held by non-corporate entities such as trusts.

The regulations require the LSE to issue an LEI to an entity before permitting that entity to trade on the Exchange. This requires a set-up fee of £115 + VAT and then an annual renewal fee of £70 + VAT.

From 3 January 2018 trusts must apply for an LEI and it is a requirement that the data supplied to the LSE can be validated against a 'local authoritative source' such as a public register of official documentation. In the case of a company this presumably is met by reference to Companies House.

The problem for trusts is that there is no publicly accessible trust register or other 'local authoritative source'. Validation would therefore presumably require an examination of the trust deed to see who is entitled to the beneficial interests and who was appointed as trustee. The trust deed is a confidential private document and not available for wider distribution.

Bare trusts have been excluded from the requirement to obtain an LEI but all other trusts will be obliged to obtain one. Apparently, discretionary trusts which cannot disclose trust details must self-certify and not supply a copy of the trust deed; however, in all other cases the LSE has said it will accept the first few pages of the trust deed.

Trustees need to be aware that without an LEI the trust will not be able to buy, sell or transfer LSE quoted stock so should be asked to authorise disclosure of trust documents sufficient to obtain an LEI.

6.5 REGISTERS

6.5.1 Companies – persons with significant control

From 6 April 2016 a company needs to keep a register of persons with significant control (PSCs) of the company or LLP – Companies Act 2006, Part 21A as amended. From 30 June 2016 this information became publicly available via the Companies House register. Failure to comply will be a criminal offence for companies, officers and PSCs.

Trust companies and corporate trustees are affected, also charitable companies. PSCs have to be identified by the company and the company must send that person a

notice asking them to confirm or correct their details. The details cannot be entered on the register without this confirmation.

Who are PSCs?

PSCs are individuals who:

- hold (directly or indirectly) 25 per cent or more of the shares in the company;
- hold (directly or indirectly) 25 per cent or more of the voting rights in the company;
- have the right (directly or indirectly) to appoint or remove directors with a majority of the voting rights on the board;
- have the right to exercise, or actually exercise, significant influence or control over the company;
- have the right to exercise, or actually exercise, significant influence or control over the activities of a trust or firm, the trustees or partners of which satisfy one of the other conditions.

Trust companies need to create and maintain a PSC register since trustees are likely to receive notices seeking information about individuals with significant control or influence over the affairs of a company or over the activities of the trust.

A relevant legal entity (RLE) is a legal person that meets the following conditions:

- if it were an individual it would be a PSC; and
- it is subject to its own disclosure requirements.

That is, it is subject to Part 21A of the Companies Act 2006 if it is basically a traded company (a Disclosure and Transparency Rules 5 issuer) or if it is of a description specified in the regulations.

Trustees are likely to be asked to register because of holding shares in the trust company if:

- they were individuals they would meet the PSC conditions;
- they are a UK trust corporation which is registered as an RLE; or
- they are offshore trust corporations – they will not be an RLE and specialist advice will be needed.

Notices – for PSC register information

Trustees who control a company will need to send notices to those with significant influence or control. If a relevant person holding shares or voting rights fails to respond then the trustees will have to serve a warning notice. If that does not work, then the trustees will have to issue a restrictions notice.

A restrictions notice freezes a person's interest in the company so that any transfer will be void and the rights cannot be exercised – i.e. no voting and no

payment of dividends. The service of a restrictions notice is not mandatory but a company has to take reasonable steps to identify PSCs and RLEs, so it may prove necessary.

6.5.2 Trusts registers

England

In order to comply with the Fourth EU Directive on Money Laundering, Member States had to transpose the Directive into domestic law. The implementing legislation must oblige all trustees to gather information to identify the settlor, the trustees, the protector (if any), the beneficiaries or the class of beneficiaries, and any other natural person expressing effective control over the trust.

The UK complied by introducing the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017, SI 2017/692 (MLR 2017) with effect from 26 June 2017. Under the Directive and MLR 2017 it is necessary to distinguish between two different categories of trusts:

- those where a trust generates tax consequences; and
- those where a trust does not generate tax consequences.

In the former case, it is necessary for each Member State to ensure that the required information is held on a central register which will be accessible by competent authorities, including government agencies.

In the latter case, the trustees hold on to the required information and only pass it to competent authorities when required to do so. It will *not* be held on a central register, at least for now, although the Fifth EU Directive on Money Laundering when it comes into force is likely to make all trusts registrable.

MLR 2017 puts the burden on the trustees to gather and supply the relevant information on the central register to HMRC. It, as the 'competent authority' in the UK, has developed a new online Trust Registration Service for reporting purposes. It is mandatory rather than voluntary (i.e. not like Form 41G) and came initially into operation for trustees only on 10 July 2017.

The new registration system is intended to:

- replace the old paper registration system with an online one;
- roll out in two tranches in October 2017 and January 2018:
  - trustees had until 5 October 2017 to register new trusts;
  - trustees have until 31 January 2018 to make online amendments to existing trusts.

Professional agents acting for trustees have experienced severe practical difficulties in accessing and using the Trust Registration Service due to a myriad of different problems with the software. As a result, the normal due dates for requesting a trust tax return and for registering a trust on the system (which should be 5 October

following the end of the tax year and 31 January following the end of the tax year respectively) have been deferred on several occasions to enable no penalties to be levied. At the time of writing, the deadline for registering new trusts and complex estates is 5 January 2018 and for registering existing trusts is 5 March 2018. These extensions of time apply only for this first year of operation.

The Trust Registration Service (TRS) is designed to gather information about people. It will run in parallel to the self-assessment system with its processes and procedures for dealing with tax assessment and collection. The TRS will require the following:

- *All* trusts with UK tax consequences to be registered, i.e. trusts which would need to file an income tax or CGT return (SA900) but also those which do not but do have a periodic charge, say, for IHT. In that case, registration will be required when that event occurs.
- Trustees to update the register each year if a trust generates UK tax consequences.
- Trustees to ensure and confirm that the Trust Register is up to date, guaranteeing obligations under MLR 2017 are complied with. This includes trusts that have already been registered using Form 41G.
- No registration of trusts that have already closed, where the lead trustee or agent has received a letter from HMRC confirming its records show the trust has ended.
- Any new trust with UK tax consequences to obtain a Unique Taxpayer Reference through the system to be able to complete and submit the SA900.
- Details of assets which have been transferred into the trust at the start, including addresses and values – just as would have been entered on Form 41G. There are six classes of asset provided for in the service and 10 lines for entry in respect of each. Where there is a portfolio of shares there will be insufficient space on the system to list more than a few and so in line 9 it should be specified that there is a portfolio and the total of the remainder provided.
- Identities of the settlor, trustees, (any) protector, all (if any) others exercising any control over the trust, beneficiaries, including names, dates of birth, national insurance numbers of UK residents, addresses, and passport or ID numbers for non-UK residents in default of a national insurance number.
- Email addresses will also be required of the lead trustee and the agent so that communications can be made electronically with the lead trustee if any variations are made subsequently to the register which HMRC wishes to verify as authorised.

Information can only be entered on to the register if the lead trustee or the agent has a government ID obtained through the Government Gateway. Once the agent is provided with a reference he can register all the organisation's trusts and the lead trustee will not be involved until there is a variation, which may occur later, needing

authorisation. Most of the delay with the new system and many of the problems with logging on relate to the obtaining of a new ID from the Agent Services Account team.

In completing the forms online the details can be saved for up to 28 days before submission and during this time you can alter and correct anything. Once you are ready, you submit the information and it can then only be 'corrected' later by a variation.

Once you are happy with the details you can print off a summary of the data you have provided to the system before you confirm submission – which provides an opportunity to check it again before it goes permanently into the system.

Worryingly, a report from the Information Commissioner's Office (**ico.org.uk/media/about-the-ico/consultation-responses/2017/2013938/ico-response-hmt-money-laundering-regulations-20170412.pdf**) expresses grave concern over the risk of identity theft from access to the information on the register. The ICO's concern is real, since even before the Fourth EU Directive on Money Laundering came into effect the European Commission published an amended version to combat terrorist funding, which is to form the basis of a Fifth EU Directive on Money Laundering.

The Trust Register was to apply to only taxable trusts based on their tax returns and the contents of the register were only to be accessible by the authorities in each country and *not* by the general public. The proposed Fifth EU Directive on Money Laundering would require publicly accessible registers of beneficial ownership of companies and trusts.

The EU Parliament has had two votes on this issue and favours overwhelmingly public access for EU citizens to the beneficial ownership details of *all* trusts.

French Trusts Register

On 30 June 2016, the French Trusts Register went online, putting the information about the trust's name, trustees, settlor and beneficiaries in the public domain. There were no protections for vulnerable beneficiaries. It was suspended a few weeks later pending a challenge in the courts by an 89-year-old US citizen who lives in France. The case was heard in October 2016. The Constitutional Court confirmed that the register could lead to an infringement of the right to privacy and such infringement must be proportionate to the goal of fighting tax evasion.

The register in its then form was banned as Parliament had not provided appropriate boundaries. However, the reporting requirements remain. It is anticipated that another register will be created, which restricts access to those dealing with tax fraud and tax evasion only.

The register is compiled from information filed in reports to the French tax authorities which has been required since 1 January 2012. Failure to comply with the tax requirements is met with a fine of at least €20,000 or 12.5 per cent of the value of the trust assets, if higher.

gains (see **Chapter 23**). From 6 April 2006 the income will be subject to tax at the special trust rates irrespective of the settlor's own personal tax rates.

10.2.2 Trustees

Once the trust is up and running, tax will affect both the trustees and the beneficiaries in different ways. Annually, income tax may be payable by the trustees on any income received by them, as the general rule for income tax is that tax is levied on the person who receives the income (although there are some anti-avoidance exceptions to this treatment). There is no separate code for income tax as it applies to trustees. Trustees are not 'individuals' and so cannot be entitled to personal allowances. Neither are they liable to higher rate income tax as such since this is only charged on individuals. Instead, the trustees will pay income tax at the savings, standard and special trust rates, depending on the type of assets and type of trust (see **Chapter 18**).

For CGT purposes, trustees can be liable during the annual administration of the trust assets on any changes in the assets in the trust fund, such as sales and gifts of trust assets. Profits or losses can be realised on the disposal of chargeable assets by the trustees who will be assessed to CGT, after exemptions and reliefs, including the trust annual exemption, in just the same way as an individual realising gains. The rates for CGT with effect from 6 April 2017 are: 28 per cent on UK residential property and 20 per cent on all other assets (rates are different for earlier years). However, a special feature of CGT and trusts is that there are a number of cases which give rise to 'deemed disposals' for CGT, such as a beneficiary becoming absolutely entitled to the assets in the trust. The trustees must remember to calculate the CGT due at these times and reserve sufficient monies or assets to meet the tax liability before making distributions to the beneficiaries (see **Chapter 16**).

The liability of trustees is personal, yet joint and several, so trustees should take care on accepting office to ascertain the current tax status of the trust and obtain confirmation that all taxes due have been paid or are provided for. Otherwise, a poorly advised trustee could be taking on a problem trust with tax charges due which would exhaust the fund and give rise to personal liability for the trustee. One possible reason for this would be the migration of a beneficiary abroad causing the clawback of a previously held-over gain. More simply, it could be that the trust was created during the lifetime of the settlor and that settlor has died causing a PET for IHT to become chargeable on the trust fund.

IHT may become chargeable on the trustees of a trust fund when the trustees themselves make transfers of value. Obviously in a trust situation this will be where capital assets from the trust fund are given by the trustees to the beneficiaries, as a result of which the fund decreases in value. Depending on the type of trust the transfer may be treated as a PET by the life tenant, or a chargeable transfer in a relevant property trust, or a chargeable event in a trust subject to IHTA 1984, s.49(1) treatment because the life tenant has died (see **11.1.5**).

10.2.3 Beneficiaries

Beneficiaries are not personally subject to IHT unless a distribution by the trustees is specifically made from the capital of the trust to them subject to tax. Even then, in practice, this usually means that any IHT will be deducted before the net capital is distributed. Otherwise, it is usually the trust fund and therefore the trustees who bear the IHT. The exception to this treatment would be where the settlor has caused a reservation of benefit by being included personally. In this case, the value of the fund will be taken into account on the settlor's death as part of calculating their IHT liability on death.

With CGT the trustees may involve the beneficiary by using hold-over relief in relevant property trusts but otherwise, in general terms, the act of making a capital distribution to a beneficiary will trigger a charge on the trust fund rather than the beneficiary. There are anti-avoidance provisions which enable gains to be assessed on the settlor and even on a beneficiary.

The tax treatment of income will depend on the nature of the beneficiary's entitlement under the trust. The income received by the beneficiary will either be net of the standard and lower rates of income tax if the trust is an IiP trust, or where there is no IiP it will be net of the trust rate. The exception is where the income is mandated direct to the life tenant, in which case it may have been received gross. HMRC confirmed in its Trusts, Settlements and and Estates Manual at TSEM3763 that where income is mandated direct to the beneficiary and does not pass through the hands of the trustees, there is no statutory basis for taxing the trustees. The beneficiary will therefore be responsible for returning and paying tax on the income. This is particularly relevant from 2016/17, as interest and dividends are now paid gross. The beneficiary may be able to shelter the income using their personal savings allowance (PSA) or dividend nil rate band (DNRB).

Where the trustees have been taxed on the income, the beneficiary is entitled to receive a Statement of Trust Income (Form R185) indicating the amount of tax deducted from their income distribution over the tax year. This certificate forms the beneficiary's evidence of tax deducted, for use in their own personal tax affairs. If they are a higher or additional rate taxpayer they may have to pay some more income tax in respect of the trust income. Conversely, if they are a basic rate or non-taxpayer they may be able to use the tax certificate to claim the tax deducted by the trustees back from HMRC through their own tax return or repayment claim.

10.3 DEFINITION OF 'SETTLEMENT'

Currently there are different definitions of 'settlement' for each tax.

A settlement is defined for IHT (IHTA 1984, s.43) as any disposition of property that is:

1. Held in trust for persons in succession or for any person subject to a contingency.

2. Held upon trust to accumulate the whole or part of the income of the property. The accumulation of income may be obligatory or only possible by the exercise of a power to accumulate income surplus to that paid out by the trustees for the benefit of any persons.
3. Charged with the payment of an annuity or similar payment for any period.

A lease granted for life or lives or for a period ascertainable only by reference to a death will also be treated as a settlement unless full consideration is paid.

It should be noted that bare trusts are not included in this definition of settlement and therefore remain outside the scope of the relevant property regime (see **12.2**).

For CGT, settled property is any property held on trust other than property held for any person absolutely entitled as against the trustee or property held for any person who would be so entitled but for being a minor or under a disability (TCGA 1992, ss.60 and 68).

Income tax distinguishes between settlements under which beneficiaries are entitled to the income from the trust property and those where it may be accumulated.

Stamp duty land tax (SDLT) adopts the same approach as CGT (Finance Act (FA) 2003, s.105 and Sched.16). However, where trustees acquire a chargeable interest in land they are treated, in trusts other than bare trusts, as purchasers of the whole interest acquired and not just the bare legal title (FA 2003, Sched.16, para.4).

10.4 TAX COMPLIANCE FOR TRUSTEES

10.4.1 Basic principles of self-assessment

The body of trustees is 'the taxpayer' for tax purposes and therefore responsible for the annual income tax and CGT compliance. This is done by filing a self-assessment tax return using form SA900 – **www.gov.uk/government/uploads/system/uploads/attachment_data/file/604287/sa900-2017.pdf**.

Help in the completion of the return can be obtained by referring to both the notes which accompany the form on HMRC's website and HMRC's Trusts and Estates Toolkit. Returns are usually filed online, but it is still possible to file a paper return. The due dates for filing are:

- online: 31 January following the end of the tax year;
- paper: 31 October following the end of the tax year.

The basic premise of self-assessment means that the trustees must calculate how much income tax and CGT is payable on income and gains of the trust and pay the correct amount of tax accordingly. However, HMRC will calculate the tax for the trustees where a paper return is filed by 31 October following the end of the tax year and issue a tax calculation.

For compliance purposes, trustees need to determine the following:

1. Whether they are liable at the special trust rates.
2. Whether they are resident in the UK for tax purposes.
3. The correct level of the CGT annual exemption.
4. The correct trust status for tax purposes.
5. The correct proportion of standard rate band available.

On receipt of the tax return, HMRC simply processes it to see if it is valid (e.g. checking whether the return has been signed, or whether there are any obvious arithmetical errors). Later, HMRC will check and compare the return with information from other sources. If there is a risk that the return is incorrect, HMRC may initiate a compliance check. Some returns will be investigated on a random basis. HMRC expects the taxpayer to get it right first time, but may make minor amendments and issue a revised tax calculation. All HMRC calculations should be checked.

Under the self-assessment system the current year basis of assessment is used for all income and gains, i.e. income tax will be charged on the income or profit arising in the tax year itself, or on the profits arising in the 12-month accounting period ending in that year.

It has previously been possible to agree with HMRC that an annual return is not required where it would be a nil return, for example in an IiP where the income is mandated to the life tenant and there are no chargeable gains. The beneficiary would include mandated trust income on their tax return. If the income had tax deducted at source, the basic rate liability of the beneficiary was satisfied and for those beneficiaries not chargeable at the higher or additional rate, no individual self-assessment return would be needed.

In such cases, the onus was on the trustees to review the position annually and file a return for a specific year if, for example, gains were made in excess of the CGT trust annual exemption.

From 6 April 2016, most UK interest is paid gross as are all UK company dividends. As a result, where the special trust rates do not apply, such as with an IiP, the trustees are liable to pay income tax at 20 per cent on interest and 7.5 per cent on dividends. All trusts which have tax events are now obliged to register the trust with the Trust Registration Service – see **6.5**.

HMRC's Trusts and Estates Newsletter of April 2016 confirmed that where the only source of trust income is interest and the tax liability is less than £100 (which appears to include CGT even though this is not specified), no return would be needed for the year 2016/17. Additionally, HMRC has confirmed that where such income is mandated directly to the beneficiary, the practice where trustees do not need to file a return will continue to apply. This strengthens the case for mandating income to a beneficiary to reduce compliance costs. The beneficiary may be able to shelter the interest or dividends received using the PSA and/or the DNRB, regardless of whether such income is mandated.

10.4.2 Procedural guidance: have you got the right tools?

1. Under self-assessment, the trustees as taxpayer must complete the Trust and Estate Tax Return for each trust where a return is issued or where income and gains arise which are not to be shown on, say, the life tenant's tax return (see **Chapter 18**). Supplementary schedules may need to be completed for a particular trust depending upon the nature of the income and any chargeable gains. These separate schedules and any self-assessment forms and leaflets are usually downloaded from **www.hmrc.gov.uk**, but paper returns may still be ordered by telephoning HMRC's Self-Assessment Orderline which, at the time of writing, is open weekdays from 8 am to 8 pm and from 8 am to 4 pm on Saturdays.
2. Have you registered as a taxation practitioner or agent with HMRC? This enables you to receive information on self-assessment and other taxation matters.
3. Has the trust been registered using HMRC's trusts online service? This mandatory service was launched in July 2017, in response to the Fourth EU Directive on Money Laundering. Trustees are required to register existing and new trusts. Further details can be found at **6.5**.
4. Have you authority to act as the agent of the trustees of a trust? HMRC normally requires tax agents to complete form 64-8, which is authority from the taxpayer for HMRC to liaise with the tax agent.
5. It will be important to view the information available on HMRC's website (**www.hmrc.gov.uk**) where documents such as Briefs and Technical Notes provide the views of HMRC's technical specialists on particular issues. They do not replace formal Statements of Practice but do provide HMRC's view of the law. HMRC issues the Trusts and Estates Newsletter periodically which highlights changes to tax law and practice.
6. Clients may need to be educated on how self-assessment works. Prepare information explaining the basics, not least the record-keeping requirements. Details of record-keeping requirements can be found on HMRC's website and it may be useful to acquaint clients with this (**www.gov.uk/keeping-your-pay-tax-records/overview**).
7. Prepare a precedent letter to send to clients setting out when a return needs to be requested, the importance of providing you with all the information needed to complete the return within a specified period, the dates for payment of tax, and the sanctions for failing to request and complete a return or pay the tax on time. It is important to stress that HMRC requires full disclosure and that this is the only basis upon which you can accept instructions.
8. Set yourself a clear work programme allowing sufficient time to complete and submit all your trust returns on time and issue statements of income to beneficiaries early enough for them to submit their own returns by 31 October following the end of the tax year, if they wish. The advantage of submission by 31 October is that HMRC will calculate the tax liability for the taxpayer.

9. It is often necessary in smaller practices to arrange for some extra help during the busy self-assessment period from September to January when the trust administrator is still administering the trusts, but also needs to ensure all the tax returns are in on time. This may entail outsourcing the preparation of accounts and tax returns if there is insufficient capacity within the office to meet the deadlines. This may change with the advent of Making Tax Digital (MTD) (see **10.6**).
10. The use of computer software is essential and in due course, mandatory updates under MTD will be filed online. Computer software enables you to collect data and subsequently carry forward repetitive information to future years without re-entering the data. This improves accuracy, enables you to make a speedier response to queries than can be done with a manual approach and enables online filing up to the final deadline of 31 January (see **10.6**).

10.4.3 HMRC powers under self-assessment

Following the merger of the Inland Revenue and Customs and Excise in 2005, a huge project of alignment of powers was carried out by the new HMRC, which updated and aligned aspects of compliance for different taxes.

Compliance checks

'Compliance checks' is the term for any type of activity or inspection where HMRC checks that someone has complied with their tax obligations, e.g. to check that records are kept or a return which is filed is accurate.

Each year, HMRC collects millions of pieces of information from a range of sources including banks and the Land Registry. In addition, in recent years, a number of Tax Information Exchange Agreements have been entered into with offshore jurisdictions, which widens the information available to HMRC. The tax authority uses Connect, a computerised risk assessing tool, to cross-match this data, enabling it to create a profile of the taxpayer from which to identify the most likely returns for enquiry. A full enquiry can be launched into the perceived more serious cases, in contrast to the majority of more basic returns, where a simple letter or telephone call may be sufficient to check whether there has been an error.

Technical guidance and operational process guidance on HMRC's powers are available in the Compliance Handbook **www.hmrc.gov.uk/manuals/chmanual/index.htm**, while guidance on enquiries can still be found in the Enquiry Manual at **www.hmrc.gov.uk/manuals/emmanual/index.htm**.

Information and inspection powers – FA 2008, Sched.36

From 1 April 2009 the old information powers were repealed and the new powers contained in FA 2008, Sched.36 came into effect, in so far as they affect income tax and CGT. These were extended to IHT by FA 2009, s.96 and Sched.48 with effect

from 1 April 2010. These powers represent the consolidation and modernisation of previous powers. HMRC can still ask for information informally rather than issue an information notice but can also issue a formal notice under Sched.36 for information or documents 'reasonably required' for the purpose of checking the taxpayer's liability. Schedule 36 runs alongside the formal enquiry process in Taxes Management Act 1970, s.9A.

There is a right of appeal against an information notice but not against any requirement to produce statutory records since it is a statutory obligation to keep tax records.

Schedule 36 powers have been somewhat controversial since they include the power to undertake inspections at business premises (which can include personal residences with a business element). Homes which have no business use cannot be visited without permission from the taxpayer but where a home is the VAT registered address it may have business use. However, an officer of HMRC cannot insist on inspecting at someone's home unless there is a real need to do so.

These visits can be undertaken with the taxpayer's agreement on seven days' notice but if HMRC believes there is sufficient risk and good reason, an unannounced visit can be made, on receipt of the authorisation of an authorised officer. There is no right of appeal against the inspection. Further information on visits may be found in HMRC's factsheets CC/FS3, FS4 and FS5.

Record keeping – FA 2008, Sched.37

The new record-keeping provisions are similar to the legislation already in existence. For income tax, CGT and corporation tax the law says that records must be kept in order to enable a complete and correct tax return or claim to be made. These include records of receipts and expenditure and sales or purchases of goods where relevant. For VAT, business and accounting records must be kept plus any specified records. The guidance on this area is contained in HMRC's Compliance Handbook, see above.

The time limits for keeping records are currently:

- The sixth anniversary of the accounting period for corporation tax. For example the records for the accounting period ended 31 March 2016 must be kept until 31 March 2022.
- Five years and 10 months after the tax year for income tax and CGT for businesses and landlords. For example, for the tax year 2017/18, until 31 January 2024.
- One year and 10 months after the tax year for income tax and CGT where there is no business. For example, for the tax year 2017/18, until 31 January 2020.

Taxpayers can keep information instead of records but need to be able to show that a complete and correct tax return has been made. The information must be able to be provided in a readable form on request – i.e. no bad handwriting! In practice, taxpayers will already keep their records in electronic format and this will be

increasingly so once the digital uploading required under MTD is codified. It is anticipated that MTD legislation will stipulate the length of time digital records must be retained.

Penalties for failing to keep records may be charged at £3,000 per failure. The relevant guidance is in HMRC's Enquiry Manual at EM4650.

Time limits for claims and assessments – FA 2008, Sched.39

The normal time limit for claims and the making of assessments by HMRC for income tax and CGT is four years from the end of the tax year, so for 2017/18, this will be 5 April 2022. The time limit is extended to six years where behaviour has been 'careless'. HMRC can make assessments going back 20 years where there has been 'deliberate' or 'deliberate and concealed' behaviour.

The definitions of 'careless', 'deliberate' and 'deliberate and concealed' are the same as those used for penalties for an inaccurate return contained in FA 2007, Sched.24 (see **10.5**).

Section 99 of and Sched.51 to FA 2009 amended time limits for assessments and claims in respect of IHT, with effect from 1 April 2011.

Time limits

NOTIFICATION OF CHARGEABILITY TO INCOME TAX OR CGT

Trustees must advise HMRC if there is any chargeability in the trust within six months of the end of the tax year where a notice to file a self-assessment return has not been issued. For the tax year 2017/18, this would mean notifying HMRC of chargeability by 5 October 2018 and requesting an SA900 by that date. (See **10.5.4**.)

AMENDMENTS AND ENQUIRIES

Amendment of a self-assessment can be made at any time up to 12 months following the filing due date of the return but not if the return is already under enquiry. Changes outside this period should always be notified to HMRC but settlement may not always be agreed without a sanction applying.

HMRC can open a formal enquiry into the return within 12 months of the date on which the return was filed. Where an amendment is submitted the 12-month enquiry period is extended to the quarter day following the first anniversary of the day on which the amendment was made. So, for example, for a 2016/17 tax return, on amendment in August 2018, the enquiry window would be extended to 31 October 2018.

TAX IS PAYABLE ON TWO DATES

1. 31 January each year, when the money due comprises:

(a) final (balancing) payment for the previous tax year for income tax;
(b) the whole of any CGT for that year; and
(c) the first payment on account of income tax due for the current tax year (50 per cent of the previous year's tax).

2. 31 July each year, when the money due comprises the second payment on account of income tax due for the previous tax year (50 per cent of the tax of the previous tax year).

For example:

31 January 2018	*31 July 2018*
Any outstanding income tax for 2016/17 Any CGT for 2016/17 50% of income tax of 2016/17 as first payment on account of income tax for 2017/18	50% of income tax of 2016/17 as second payment on account of income tax for 2017/18

There is a *de minimis* test – no payments on account need be made if the previous year's tax is less than £1,000 or the proportion of the previous year's tax which was deducted at source was more than 80 per cent of the total tax for that year.

The above dates are subject to amendment as MTD is phased in, replacing the self-assessment tax return.

10.4.4 Full disclosure

The professional bodies advise practitioners to follow a policy of full disclosure to HMRC.

HMRC is assumed to have knowledge of:

(a) information contained in the tax return and its enclosures;
(b) information in a claim made on behalf of the taxpayer and the enclosures accompanying it; and
(c) information, the existence and relevance of which are notified to HMRC or could reasonably be expected to be inferred from the information in the return, enclosures and claims.

Information is available to HMRC if it is contained in the return for the current tax year or the two preceding chargeable periods. It therefore follows that if you wish HMRC to rely on an understanding of the particular treatment of the estate or trust based on documents provided initially, these documents may need to be resubmitted every three years to enable this assumption to apply.

The assumption is based on the test that HMRC is deemed to know what a reasonably competent officer of HMRC would be expected to conclude on the basis of the information available. This means the information must be reasonably clear

in the return, so the onus is on the trustees to draw attention to any important information that is relevant to a tax liability, especially if there is some doubt as to how a particular piece of information might be interpreted. The final decision on any particular matter to be disclosed will rest with the trustees, but the professional should query an instruction not to disclose something that best practice suggests is required to be disclosed.

There is no definition of what would constitute 'full disclosure'. Most taxation practitioners believe that it is a level of disclosure that is sufficient to ensure that 'discovery' could not be made by HMRC using the wide-ranging powers of Taxes Management Act 1970, s.29. This means that HMRC must receive sufficient detail to be able to understand the position taken by the tax practitioner.

You will have to consider, with the trustees, the appropriate level of disclosure in any particular case. Too much disclosure may attract unnecessary and potentially costly enquiries by HMRC that will give rise to fees that may be difficult to justify. Insufficient disclosure will mean that the return can be challenged by HMRC after the normal time limit for enquiries has passed.

For trusts, consider submitting:

(a) a copy of the trust deed to support the reported income tax treatment (although this may not be required following registration of the trust); and
(b) income account details where these provide additional information in support of the tax treatments reported.

10.4.5 Estimates, provisional figures and valuations

HMRC accepts that in some circumstances it may be necessary to enter a figure on a tax return that is not completely certain in order to complete the return by the statutory deadline.

Provisional figures

Where trustees expect to be able to provide a more accurate figure later, provisional figures will be entered and the relevant box on the tax return must be ticked in order to indicate that the figures are provisional. Supporting information should be supplied using the 'Additional Information' box of the tax return. The onus is then on the taxpayer to amend the return once the final figure is known. Do not delay notifying the final figure as penalties may arise.

Estimates

Where there is no way of arriving at a more accurate figure (for example where there is only a proportion of an expense which is deductible for tax) then this figure will be an estimate and HMRC's attention should be drawn to it, otherwise there might be a future dispute over whether or not there has been full disclosure. The tax return

guidance for the form SA900 tax return states that if you are including an estimate which, while not a precise figure, is sufficiently reliable to enable you to make an accurate tax return, there is no need to make specific reference to it.

Valuations

Some figures are a judgement and, in the case of professional valuations, have probably been arrived at through a detailed process of valuation by professionals such as a land agent or specialist accountant.

In general terms, HMRC treats valuations in the same way as estimates so trustees must make a specific disclosure if the figure provided is not sufficiently reliable for the tax return to be treated as accurate.

For CGT purposes, even if a professional has produced the valuation, HMRC must be notified that it is a valuation. HMRC has said that it will not challenge proper professional valuations that fall within the range of possibilities for negotiated valuations between fully briefed professionals.

Avoid making 'stabs in the dark'. HMRC views a failure to take professional valuation advice as constituting neglect, which gives it the opportunity to reopen enquiries after the due dates. Negligently inserting an inadequate estimate or valuation will expose the trust to possible tax avoidance.

The requirement to make sufficient disclosure was considered in the case of *Langham* v. *Veltema* [2004] STC 544. There was much comment following the outcome of this case and whether it increased HMRC's powers to claim discovery and a number of cases have since been heard on the discovery aspect. It is essential to draw attention to any valuation submitted by setting out the details in the 'Additional Information' box at the end of the tax return and ensuring that HMRC is aware that any valuation was made on the relevant basis by an independent and suitably qualified valuer.

10.5 PENALTY REGIME

Penalties have long been part of HMRC's strategy for the deterrence of tax avoidance, compliance failure and inaccuracy. One of the aims of HMRC's wide-ranging Review of Powers, Deterrents and Safeguards carried out between 2005 and 2012 was to be able to 'come down hard on those who seek an unfair advantage through failing to calculate, return or pay the right amount of tax'. The review led to the modernising and alignment of the existing penalty regime. FA 2007 and FA 2008 brought in new regimes for penalties, information and inspection powers and in FA 2009 these were broadened to cover IHT.

The body of trustees as taxpayer should be aware of the penalties associated with late or incorrect compliance, or they may find themselves becoming liable to a range of penalties.

10.5.1 Penalties for tax returns – late filing

Self-assessment returns: income tax and CGT

The self-assessment filing regime for income tax and CGT introduced the first automatic late filing penalty system. A fixed penalty of £100 was automatically incurred on a late filed return, with a further £100 levied if the return was still unfiled after six months. The penalty was capped at the level of outstanding tax at the deadline, subject to the maximum £100.

HMRC also had the power to charge a daily penalty of £60 per day on the direction of the tax tribunal, until such time as the return was submitted.

FA 2009 built on this regime, with effect from the tax return for the year ended 5 April 2011, due for filing in January 2012. The initial £100 was retained but is no longer capped if the tax is less than that amount. If the return is not filed within three months of the filing date a daily penalty of £10 is charged subject to a maximum of £900 over three months. After six months there is a range of penalties between £300 and 5 per cent of the tax and there is a similar, but behaviour-related charge after 12 months.

There is a right of appeal against late filing penalties, based on the concept of reasonable excuse. This is defined by HMRC as 'something that stopped you from meeting a tax obligation on time which you took reasonable care to meet. It might be due to circumstances outside your control or a combination of events' (Self Assessment Manual 10090).

Reasonable excuse will be denied if the taxpayer does not remedy the compliance failure without delay after the excuse has ceased.

HMRC may also consider cancelling or postponing the penalty where there are special circumstances, known as 'special reduction'. Such circumstances would include where 'application of penalty law produces a result that is contrary to the clear compliance intention of that penalty law' (HMRC Compliance Handbook at CH170600).

IHT returns

A late-filed IHT return incurs a penalty of £100, with a further charge of £100 where the account is more than six months late. A return filed more than 12 months late can give rise to a penalty of up to £3,000.

10.5.2 Penalties for tax returns – late payment

Penalties are also charged on late paid balancing payments of income tax and CGT assessed through the tax return, at the rate of 5 per cent of the unpaid tax on three trigger dates: 30 days, six months and one year after the due date (normally 31 January).

Appeal and special reduction are available as recourse (see **10.5.1**).

10.5.3 Penalties for inaccuracies

HMRC has developed a one penalty regime for inaccuracies in tax returns and other tax documents. FA 2007, Sched.24 introduced this new regime for income tax, CGT and some other major taxes with effect from 1 April 2009.

FA 2008, Sched.40 extended the regime to many other taxes including IHT for chargeable events for IHT that occur on or after 1 April 2009.

The penalties may apply where there have been careless or deliberate inaccuracies leading to potential lost revenue, or a failure to notify HMRC of an underassessment. Maximum penalties for UK sources are 100 per cent of the tax and this can be up to 200 per cent for offshore sources. The maximum penalties can then be reduced depending on:

- The nature of the disclosure – whether 'prompted' by HMRC or 'unprompted', for example where there is a voluntary disclosure.
- The underlying behaviour, from:
  - a mistake, where no penalty is chargeable; through
  - careless inaccuracy, due to a lack of 'reasonable care';
  - deliberate understatement, such as intentionally sending incorrect information; and
  - the most serious, deliberate understatement with concealment, for example deliberately sending incorrect information and taking steps to hide it.
- The assistance the taxpayer gives to HMRC in identifying and quantifying the omission.

It is possible to seek a suspended penalty for up to two years, where there has been a careless inaccuracy; the penalty will be cancelled on satisfying conditions agreed with HMRC.

There is a right of appeal to the First-tier Tribunal against the penalty imposed, or where there is a failure to agree, a suspension and special reduction may also be sought (see **10.5.1**).

10.5.4 Failure to notify chargeability

There is an obligation for any person (including trustees) who is chargeable to income tax or CGT to notify chargeability to HMRC for any year of assessment where a tax return filing notice has not been issued. This must be done within six months of the end of that year, i.e. 5 October.

There is no requirement to notify chargeability where there is no liability to income tax or CGT or where sufficient tax has been deducted at source to meet the net liability for the year. Trustees should be aware that with interest and dividend income being paid gross, this obligation may have become more relevant with effect from 2016/17 (notification by 5 October 2017).

There is a penalty for failure to comply with this deadline, based on the amount of net tax due but unpaid at 31 January following the tax year for which the liability arises. Thus, if a taxpayer fails to notify chargeability by 5 October, but all tax is paid in full by the following 31 January, there will be no penalty.

The penalty structure is as described at **10.5.3** for inaccuracies.

10.5.5 Penalties in compliance checks

Schedule 36 penalties may be charged for failing to comply with an information notice, obstruction at an inspection, concealment or destruction of documents or providing inaccurate documents. The basic penalty is £300 and the maximum penalty for continuing failure is £60 per day until the information is provided. In some cases normal penalties are seen to be ineffective (e.g. where large amounts of unpaid tax are at stake), and in these circumstances a penalty related to the likely amount of improper tax advantage gained by not providing the required information can be authorised by the Upper Tribunal.

A penalty for obstructing an inspection can be charged where the First-tier Tribunal has approved the inspection; that approval will only be given if HMRC can demonstrate that the inspection is reasonable.

10.6 MAKING TAX DIGITAL (MTD)

This fundamental change to the UK tax compliance system was first announced in the March 2015 Budget which was followed in August 2016 by a series of consultations. Legislation initially drafted for inclusion in the Finance (No.2) Act 2017 was shelved prior to the 2017 General Election. The Finance Bill 2017-18 was published on 8 September 2017 and includes provisions which allow HMRC to introduce MTD via statutory instrument, which will therefore not be scrutinised by parliament.

The proposed mandatory commencement dates which would have brought unincorporated businesses and landlords into MTD from April 2018 (turnover above VAT threshold) and 2019 (turnover below VAT threshold) have been deferred until at least April 2020 and only VAT will be brought into this new system with effect from 6 April 2019. Corporates and large partnerships (turnover above £10m) will adopt MTD from April 2020.

The key features of MTD are:

- Businesses and landlords will be required to maintain records digitally and submit online quarterly updates of income and expenditure to HMRC.
- The business owner submits an online end of period account to HMRC with the final figures for the accounting period including any accounting adjustments.
- The figures are shown on the business's digital tax account giving the final figure of tax.

worth. This will most obviously be any money paid for the land or interest, but can also include the release or assumption of a debt, goods, works and services, and the value of other property transferred.

Specific provision is made in Sched.4, para.8 for the treatment of debt. It is made clear that where a debt is secured on the land being transferred, and the rights or liabilities in relation to that debt of any party to the transaction are changed as a result of or in connection with the transaction, then there will be an assumption of debt by the purchaser which will be chargeable consideration for SDLT purposes. As a general rule, any non-monetary consideration (other than debt) should be valued at its market value, unless otherwise provided for under FA 2003, Sched.4, para.7.

Schedule 4, paras.16A and 16B deal with IHT and CGT becoming payable as a result of a land transaction. In many cases, the purchaser taking on responsibility for paying the tax will not be regarded as chargeable consideration. This would be relevant, for example, where property is transferred to the 'purchaser' under the terms of a will and they bear the IHT on it, or where the transfer is a CGT disposal made otherwise than at arm's length and the CGT burden is met by the 'purchaser'.

The purchaser is liable to pay the tax on a chargeable transaction (FA 2003, s.85). They are responsible for making a land transaction return (SDLT1–4, as appropriate) and paying the SDLT within 30 days of the effective date of the transaction. An SDLT1 is not required where the consideration is not greater than £40,000. Late payment will give rise to an interest charge. Where trustees of a settlement are liable for SDLT, payment may be made by any one or more of the responsible trustees (see **17.4.2**).

The general anti-abuse rule (GAAR) introduced by FA 2013 applies to SDLT.

17.2 RATES OF TAX

The rate of SDLT is a percentage of the chargeable consideration. If a transaction is linked to another chargeable transaction, the rate will be determined by reference to the total of all the linked transactions, unless multiple dwellings relief can be claimed. The purchase of additional residential properties is now often subject to higher rates of SDLT (see **17.5**).

The rates differ depending on whether the land concerned is entirely residential, or wholly or partly non-residential.

17.2.1 Residential property rates (applicable from December 2014)

Transfer value	SDLT rate
Up to £125,000	Zero
The next £125,000 (portion from £125,001 to £250,000)	2%

Transfer value	SDLT rate
The next £625,000 (portion from £250,001 to £925,000)	5%
The next £575,000 (portion from £925,001 to £1.5 million)	10%
The remaining amount (portion above £1.5 million)	12%

Example

A buys a house for £375,000. The SDLT is calculated as follows:

- 0% on the first £125,000 = £0
- 2% on the next £125,000 = £2,500
- 5% on the next £125,000 = £6,250
- Total SDLT paid by A = £8,750

17.2.2 Non-residential and mixed-use land and property rates (applicable from December 2014)

Transfer value	SDLT rate
Up to £150,000	Zero
The next £100,000 (portion from £150,001 to £250,000)	2%
The remaining amount (portion above £250,000)	5%

Example

B buys a freehold commercial property for £375,000. The SDLT is calculated as follows:

- 0% on the first £150,000 = £0
- 2% on the next £100,000 = £2,000
- 5% on the final £125,000 = £6,250
- Total SDLT paid by B = £8,250

Where the purchase is of a new non-residential lease, there are two components to the SDLT charge. The first is the charge on the premium paid. The second is the charge on the 'net present value', being the value of the annual rent paid, based on the total rent over the life of the lease. The two amounts are added together to form the SDLT payment due. There are separate rates for the 'net present value'.

Net present value of rent	SDLT rate
£0 to £150,000	Zero
The portion from £150,001 to £5 million	1%
The portion above £5 million	2%

From March 2012, where specific conditions are met, acquisitions of residential property by certain 'non-natural' persons are liable to a higher rate of SDLT of 15 per cent above a certain value threshold for the property (FA 2003, s.55 and Sched.4A). One must therefore consider whether trust companies acting as trustees will be caught by these provisions. By Sched.4A, para.3(4) references in this legislation to a company specifically 'do not include a company acting in its capacity as trustee of a settlement'.

HMRC's commentary on this section, at SDLTM09550 confirms that this is the case whether the company is acting as a corporate trustee for many settlements, or acting as trustee of a single settlement. Bare settlements are excluded from this provision by virtue of the definition of settlement for these purposes (see **10.3**). It can be noted, however, that as HMRC looks through a bare trust to its beneficiary as the person liable to pay the SDLT, the higher rate provisions are unlikely to be relevant on the basis that the beneficiary will usually be an individual not a company.

17.3 MULTIPLE DWELLINGS RELIEF

Sometimes a transaction is for freehold or leasehold interests in more than one property, and on other occasions a number of transactions might be linked. Multiple dwellings relief was introduced in 2011 (now contained in FA 2003, Sched.6B) to reduce barriers to investment in residential properties.

Where certain conditions are met, it may be used to reduce the amount of SDLT payable. If, for example, five dwellings each valued at £200,000 were bought, the amount of SDLT payable on each if bought separately would amount to less than the SDLT payable on linked transactions totalling £1 million, because of the stepped rates of tax payable on larger sums.

In these circumstances, the purchaser is permitted to divide the total consideration paid in the linked transactions by the number of properties bought to find the average purchase price. SDLT is calculated on that average figure, and is then multiplied by the number of properties to reach the total SDLT payable. The minimum rate of tax allowable under the relief is 1 per cent of the amount paid for the dwellings. Responsibility for doing the calculations and deciding whether the relief should be claimed lies with the purchaser(s).

17.4 SDLT IN TRUSTS

17.4.1 Introduction

The SDLT legislation distinguishes between bare trusts and other settlements. FA 2003, Sched.16, para.1 defines a settlement – to which the SDLT provisions for trusts apply – as a 'trust that is not a bare trust'.

- Where a person acquires property as a bare trustee the SDLT provisions apply as if it were vested in the beneficiary or beneficiaries for whom the property is acquired, and as if the acts of the trustees are the acts of the person for whom the interest is held (Sched.16, para.3). The SDLT rules apply as if the beneficiary is the legal owner of the property, and it is therefore the beneficiary who is responsible for the payment of SDLT and for submitting the land transaction return.
- FA 2003, s.105 and Sched.16 govern how SDLT applies to trusts and trustees of all other settlements.

17.4.2 Liability of trustees of a settlement

Where persons acquire property as trustees of a settlement (as opposed to a bare trust) they are treated for SDLT purposes as the purchasers of the interest acquired (Sched.16, para.4). Therefore, all the normal obligations regarding notification and payment of SDLT will fall to them.

Settlements for these purposes include interest in possession trusts, discretionary trusts, A&M trusts and any other trust arrangement which is not a bare trust. The nature of the beneficiaries' interests within the trust structure will not usually be relevant. The exception to this is where the rules relating to the purchase of additional residential properties are applicable, as in those circumstances certain beneficial interests will give rise to a higher rate of SDLT (see **17.5.7**).

Payments of the SDLT and any related interest and penalties may be claimed from any one or more of the 'responsible trustees', but cannot be recovered from any later trustee who is not a 'responsible trustee' in relation to the acquisition at issue. The 'responsible trustees' are those who are trustees at the effective date of the land transaction and anyone who subsequently becomes a trustee. A later appointed trustee will not, however, be liable for any penalty, or interest on that penalty, when the act or omission that caused the penalty occurred before they became a trustee (Sched.16, para.5). A land transaction form may be submitted by any one or more of the responsible trustees (para.6(1)).

17.4.3 Creation of a trust

When a trust is created, property is put into the hands of the trustees who will become its legal owners. This trust property may include land, and its legal transfer into their names will be a land transaction for SDLT purposes. Nevertheless, in

many, if not all, situations the transfer will be for no value, and no land transaction form will be needed. By the terms of FA 2003, Sched.4, para.1, the chargeable consideration for a transaction is, usually, any consideration given in money or money's worth, either directly or indirectly by the purchaser or a person connected with the purchaser. For these purposes, a settlor would be connected with a trustee of his settlement.

Any straight transfer of property to the trustees, by way of gift, would have no chargeable consideration and therefore no SDLT consequences. If, however, either the settlor pays for the property being transferred, or there is consideration in some other form, the situation will be different. This applies not only to a purchase price paid for the property being transferred – for example if the settlor specifically arranged for its purchase for the trust – but also to consideration in money's worth such as the satisfaction, release or assumption of a debt on the property (Sched.4, para.8).

Where no consideration is given for the transfer, no SDLT form need be submitted. This applies equally for any minimal consideration, below £40,000. It should be noted that as the SDLT rate is 0 per cent up to at least £125,000, there will be occasions where trustees are required to submit a land transaction form even where no SDLT is payable.

17.4.4 Specific situations

Although the transfer of property into a trust on its creation will often be a straightforward matter of the settlor gifting the property to the trustees, there are occasions where trusts are created by specific events. Are any of these treated any differently?

- *Will trust* – if the executors and trustees of a will trust are different people, a transfer of assets by the executors of the estate to the trustees will be made at the end of its administration. This will again be a transfer for no consideration, and land transferred into the trust will therefore not be liable to SDLT.
- *Declaration of trust by settlor who holds the trust fund as trustee* – circumstances may vary, but if there is no transfer of legal title to the property there will be no land transaction on which SDLT could be payable. If the property is transferred into the joint names of two trustees, although there would be a land transaction, the transfer will again be a gift and give rise to no chargeable consideration (unless some element of debt release or assumption is, unusually, involved at the creation of the trust).

17.4.5 Appointment of trustees

For SDLT purposes, trustees of a settlement are treated as a single and continuing body of persons. The appointment and removal of trustees of a settlement will therefore not give rise to a land transaction even if legal title to land is transferred as

a result of the change. HMRC confirms at SDLTM31745 that there is no charge where trust property is secured by a mortgage or other borrowing.

No land transaction return need be submitted, following a change of trusteeship. If the change results in an application to the Land Registry, a covering letter should accompany the documents instead of a land transaction return.

17.4.6 Sub-fund transactions

From 6 April 2006 trustees have been permitted to elect that a particular fund comprised in, or a specific portion of, a settlement, be treated as a separate settlement. This might be appropriate where, for example, a will provided for a life interest for a widow, followed by trusts for each of the deceased's children. The fund could be divided into sub-funds for each of the children, allowing for privacy and for discretions to be exercised differently for different branches of the family. Once sub-funds have been created, they can be held by their own trustees and may cease to have a connection with the trustees of the principal fund.

Where a sub-fund election is made, there is a deemed disposal for CGT purposes (see **16.3.3**) by the trustees of the principal fund, and a deemed acquisition by the trustees of the sub fund, who are treated as having become absolutely entitled to the property comprised in the sub-fund at the time the election is effective.

The question which follows is whether there are any SDLT consequences if the assets being transferred to a sub-fund include land. HMRC's SDLT and Trusts Manuals contain no specific guidance on this point, so we must be guided by the legislation and its general provisions. If, as will usually be the case, there is no chargeable consideration for the transfer, then there will be no chargeable consideration on which SDLT can be charged, even if the transfer would form a land transaction of a chargeable interest for SDLT purposes. HMRC has made it clear that for a transfer between pension funds, the assumption of obligations to provide benefits is not chargeable consideration (SDLT31800). It follows that if separate trustees are to receive land into a sub-fund, to be held for particular beneficiaries, then their obligations in that respect are also likely not to be regarded as chargeable consideration. Caution will be needed by the trustees, however, to ensure that no additional consideration, such as the assumption or release of debts, gives rise to chargeable consideration that will be liable to SDLT.

17.4.7 Reallocation of trust property as between beneficiaries

FA 2003, Sched.16, para.8 specifically addresses how a reallocation of trust property will be treated. Where trustees reallocate trust property in such a way that a beneficiary acquires an interest in certain trust property and ceases to have an interest in other trust property, and the beneficiary consents to ceasing to have that interest, their consent is not regarded as chargeable consideration for the acquisition.

17.4.8 Exercise of powers by trustees

Most exercises of a power of appointment by trustees are undertaken without charge, and so long as there is no chargeable consideration for the exercise, the SDLT rules will have no application. Consequently, there will be no SDLT charge in relation to the vast majority of exercises of trustee powers.

There is an exception made in the legislation, however, under Sched.16, para.7, which provides that where a chargeable interest is acquired by virtue of an exercise of a power of appointment or of a discretion, *any consideration* given so to cause the power to be exercised in favour of the particular object who benefits from it will be chargeable consideration on which SDLT is paid. HMRC acknowledges that the provision will have no application to normal trust transactions: 'it is intended to deal with the unusual case where a person pays trustees, or someone else, in order that the power or discretion may be exercised in their favour' (SDLTM31760).

17.5 RULES FOR ACQUISITION OF ADDITIONAL RESIDENTIAL PROPERTY

17.5.1 Introduction

In his Autumn Statement on 25 November 2015, the Chancellor of the Exchequer announced that higher rates of SDLT would apply from 1 April 2016 to purchases of additional *residential* properties, such as second homes and buy-to-let properties. This announcement was followed by the publication of a consultation document which allowed a very small window of opportunity for response, being published on 28 December 2015 (a bank holiday between Christmas and New Year!) inviting responses by 1 February 2016.

The government's reasons for introducing this higher rate of SDLT were set out in the consultation document.

> The government believes it is right that people should be free to purchase a second home or invest in a buy-to-let property. However, the government is aware that this can impact on other people's ability to get on to the property ladder. Applying higher rates of SDLT to additional residential property purchases is part of the government's commitment to supporting home ownership and first time buyers.

The relevant provisions for the changes are contained in FA 2003, Sched.4ZA as inserted by FA 2016, s.128(3), and the government produced a comprehensive Guidance note (last updated November 2016), detailing how it envisaged the new legislation would work.

It is necessary to understand how the rules are generally applied in order to be able to assess the implications they might have for any trust-owned property. Practitioners, from the consultation stage onward, have expressed concern about the application of these rules, and some of their concerns relate very specifically to trust-owned property.

17.5.2 Rates

The higher rate has been set at 3 per cent above the standard rate of SDLT but will not apply to purchases of property under £40,000, or purchases of caravans, mobile homes or houseboats.

Where the higher rate is applicable, it will apply to the portion of the consideration that falls within each rate band as follows:

Table 17.1 SDLT rates for additional residential property

Purchase price of property	Rate paid on portion of price within each band
Up to £125,000	3%
Over £125,000 and up to £250,000	5%
Over £250,000 and up to £925,000	8%
Over £925,000 and up to £1,500,000	13%
Over £1,500,000	15%

For example, the SDLT due on a purchase of a main property bought for £300,000 would be £5,000, calculated as follows:

Charge	SDLT
0% on the first £125,000 =	£0
2% on the next £125,000 =	£2,500
5% on the final £50,000 =	£2,500
Total SDLT due =	**£5,000**

The SDLT due on an equivalent purchase of a buy-to-let property for £300,000 that is liable to the higher rates would be £14,000, calculated as follows:

Charge	SDLT
3% on the first £125,000 =	£3,750
5% on the next £125,000 =	£6,250
8% on the final £50,000 =	£4,000
Total SDLT due =	**£14,000**

17.5.3 Basic rules for when the higher rate applies

To establish how and when the higher rate of SDLT might apply to the purchase of a property to be held in trust, one must be familiar with many of the basic rules for the application of the charge. The higher rate applies to the purchase of a *major interest*

PPR relief: no election is permitted. For SDLT purposes this is purely and simply a question of fact. The considerable body of PPR case law considering what is and what is not a main residence suggests this question of fact may prove to be more difficult to establish than it might at first appear. The Guidance notes do, however, contain a checklist of points to consider in reaching a decision on this matter. The list is not regarded as exhaustive, but 'may be useful in establishing which residence is an individual's main residence':

- If the individual is married or in a civil partnership, where does the family spend its time?
- If the individual has children, where do they go to school?
- At which residence is the individual registered to vote?
- Where is the individual's place of work?
- How is each residence furnished?
- Which address is used for correspondence?
- Where is the individual registered with a doctor/dentist?
- At which address is the individual's car registered and insured?
- Which address is the main residence for council tax?

The test for the *old* dwelling is a *question of objective fact* – was the dwelling at some point the only or main residence of the individual who disposed of it?

The test for the *new* dwelling house is, however, a *question of intention* – does the purchaser intend the dwelling house to be his only or main residence?

Interests treated as being owned by an individual

These include:

- The individual has absolute beneficial ownership but the legal ownership is held by another person, e.g. bare trust, nominee arrangement.
- The individual would be absolutely entitled but for being under age or disabled in a way that prevents them from legally owning the property.
- The individual has a right to occupy the dwelling for life or has a right to the income earned in respect of the dwelling.
- Where a minor child has an absolute interest in a trust, the parents of that child are treated for the purposes of Condition C as owners of the interest.

Joint purchasers, married couples and civil partners

Where a transaction is entered into by joint purchasers the higher rates apply if the transaction would be a higher rate one for any of the purchasers considered individually. This rule applies irrespective of whether the interest in a dwelling is purchased as joint tenants or tenants in common.

It is also significant that the Guidance confirms that 'it does not matter how small the interest of a particular purchaser is, the test is applied in the same manner'.

Where an individual with a spouse or civil partner purchases an interest in a dwelling, that spouse or civil partner will be treated as a joint purchaser even if they have no part in the transaction. As a consequence, *where Conditions A to D are met by either spouse or civil partner, the transaction will be a higher rate transaction.*

This is one of the areas where concerns have been raised about the practical application of the new rules.

Individuals – special rules for particular situations

PARTNERSHIPS

A partner in a partnership will be treated as a joint purchaser of land purchased by or on behalf of the partnership. If any one partner would be liable to the higher rate then the whole purchase will be so liable. There are, however, exemptions so that, for example, an individual buying a main residence for themselves will not be caught by this partnership rule.

INHERITED PROPERTY

Where a person inherits an interest in a dwelling following the death of another – e.g. specific gift, residuary legatee – in the *three* years before a purchase of a major interest, their interest in that inherited property can be ignored, in certain circumstances, in calculating if they meet the higher rate SDLT conditions.

This will be the case if the beneficiary became a joint owner of the inherited property, and his share (and that of his spouse or civil partner) is no more than 50 per cent of the whole interest in that property. If, however, such an interest was inherited more than three years before the new purchase, then it will count as an interest that can trigger the higher rate of SDLT. The three years will run from the date the individual becomes entitled to the property, usually the date on which it is transferred to them. But note: where the interest is a gift of residue the three years may run from the earlier date of when the residue is ascertained (see CGT30700 ff).

The purchase of two or more properties by individuals

Where an individual purchases two or more dwellings in the same transaction, different tests determine whether the transaction is liable to the higher rates of SDLT. A transaction involving more than one dwelling will either be liable to the higher rates of tax or not: the rules do not allow for a single transaction to be a combination of higher and normal residential rates of SDLT.

The same Conditions A to D are used for multiple purchases on the same day, but Condition A is modified to whether the 'chargeable consideration attributable to the dwelling on a just and reasonable basis is £40,000 or more' (HMRC Guidance 'Stamp Duty Land Tax: higher rates for purchases of additional residential properties').

There are two independent tests for when the higher rates apply to a purchase of more than one dwelling on the same day:

- The higher rates of SDLT will apply if two or more of the dwellings purchased meet Conditions A and B. These are the same conditions applied to a single purchase by an individual, except that Condition A is modified to allow for consideration of the value attributable to the property under consideration.
- The second test is applicable where only one of the properties purchased on the same day meets Conditions A and B. In this scenario the transaction is only subject to the higher rates if the dwelling that meets Conditions A and B also meets Condition D and the purchaser meets Condition C.

17.5.4 Companies and other non-individuals

The higher rates will apply to the purchase of a major interest in one or more dwellings by a company if the following conditions are met in respect of at least one of the dwellings:

- the dwelling purchased is worth £40,000 or more; and
- the dwelling is not subject to a lease which has more than 21 years to run at the date of purchase.

Otherwise, the higher rates will not apply to the purchase.

17.5.5 Interaction with multiple dwellings relief

As discussed above (see **17.3**), where two or more dwellings are purchased in a single or linked transaction multiple dwellings relief can be claimed. The higher rates will apply to claims for multiple dwellings relief (MDR). When MDR applies, it works by calculating the SDLT on each dwelling by reference to the average price of all the dwellings. While this SDLT will include the 3 per cent surcharge, a saving in SDLT actually paid can arise because of the multiple use of the lower SDLT rate bands.

Where, however, six or more dwellings are purchased in a single transaction, different considerations can come into play. In these circumstances the entire purchase will count as a *non-residential* property transaction, generally leading to the application of a lower SDLT rate.

Where it is possible to claim MDR, it will frequently be better to do so, but it may be necessary to work through the various calculations to decide which way to proceed.

17.5.6 Filling in a return and making payment, claim for repayment

SDLT filing requirements

A return must be filed and payment made within 30 days of the effective date of the transaction, as with SDLT on other types of purchase.

The return filed is usually SDLT1, but the code used for the 'type of property' (04) will denote that it is a purchase of an additional property which is subject to the higher rates.

Payments can be made in exactly the same way as payments of SDLT for other purchases, and guidance can be found on gov.uk. A calculator is available on the gov.uk website which calculates the amount of SDLT due on purchases of additional residential properties.

The government announced in the Autumn Statement 2015 its intention to reduce the SDLT filing and payment window from 30 days to 14 days after the effective date of the transaction. A consultation document on the SDLT filing and payment process was published in August 2016, the closing date for comments being early in October 2016. In response to concerns expressed, the government has delayed the proposed change, which will now be introduced a year later than originally planned (during the 2017/18 tax year) in 2018/19. Implementation will not be before April 2018.

Claiming a repayment

If a previous main residence is sold within three years of paying the higher rates on a new main residence a refund of the additional SDLT is available. This refund can be claimed by making an amendment to the original return. It is important to remember that the repayment needs to be claimed within three months of the sale of the previous main residence, or within one year of the filing date of the return, whichever comes later.

A repayment can be claimed by completing an SDLT repayment request form, available on the government website. This form can be completed and submitted online, or a summary printed and posted to HMRC Birmingham Stamp Office.

17.5.7 How the rules apply to trustees

Type of trust

BARE TRUSTS

As with the normal SDLT rules, a bare trustee is ignored for the purposes of determining whether a purchase is subject to the higher rates of SDLT. The absolute beneficiary or beneficiaries are treated as the purchaser(s).

INTEREST IN POSSESSION

On a purchase by trustees of an interest in possession trust the application of the higher rates will be determined by reference to the beneficiary with the IiP. Therefore, if the property and the beneficiary meet the conditions of an individual purchase above, the transaction will attract the higher rates of SDLT.

DISCRETIONARY AND OTHER TRUSTS

Where the purchase by trustees is neither by a bare trust nor an interest in possession trust it will be liable to the higher rates in the same situation as a company purchaser (see **17.5.4**).

Trust ownership – points to note

IIP TRUSTS

An IiP beneficiary will be regarded as the purchaser of a residential property for higher rate SDLT purposes. If the trustees buy a property for that beneficiary to live in, it will not attract the SDLT surcharge unless the beneficiary meets the requirements for the higher rate of SDLT to apply. Conditions A–D above will be applied to the beneficiary, not the trustees. This will remain the case no matter how many properties the remainder beneficiary might own. If the life tenant already owns a residential property at the time the trustees buy one for them, the higher rate rules apply to that trust purchase. If the trustees buy a property which is to be a replacement main residence for the IiP beneficiary, relief from the higher rate will be granted accordingly. If the IiP beneficiary benefits from a residential dwelling owned by the trust, and later decides to buy a residential property in their own name, that purchase will be of a second property and will come within the higher rate rules.

There appears to be no consideration of whether the IiP beneficiary in fact occupies a trust property in which they have a life interest. If the beneficiary is taking income from a trust property entirely unsuitable for them to live in, they still pay the surcharge on the purchase of their own, suitable, home.

DISCRETIONARY TRUSTS

No discretionary beneficiary will be regarded as having a right to live in a trust property, so the purchase of residential property will always fall foul of Condition D and be liable to SDLT higher rates if the other conditions are met.

The government has made it clear that it regards a discretionary beneficiary's interest as 'too remote or insignificant to be counted as an interest held by the beneficiary' (para.2.21 of the consultation paper), as it does that of a reversionary beneficiary.

17.5.8 Areas of concern surrounding higher rate SDLT

Determination of intention and change of intention

Questions have been raised about what should happen in the situation where someone bought a second property as e.g. a buy-to-let, and declared it to be such on the SDLT return (the higher rates of tax would apply); but then unforeseen circumstances lead to the purchaser later deciding to occupy the dwelling as his main residence, within three years of the original purchase. It appears that there is no opportunity provided in the legislation as enacted to claim a refund of the additional tax paid: when considering the new dwelling, it is the *intention at the time of the transaction* that matters (FA 2003, Sched.4ZA, para.3(6)(a)).

Neither is it clear what the consequences would be if a purchaser, having declared his intention to use the dwelling purchased as his only or main residence, then changed his mind following the purchase. It is not known if, or indeed how, HMRC would check whether a purchaser's stated intention was actually followed through.

Complications for spouses or civil partners

There are concerns about treating spouses or civil partners as 'one unit' for the purposes of establishing whether an individual already has an only or main residence. A couple who decide to marry or enter into a civil partnership, and buy a property together, could be penalised if one of the couple already owns a property. It is not an uncommon occurrence for a couple to sell one previously lived-in property, but to keep the other as a source of income and an investment. The ownership by one of the couple of the rental property could 'taint' the transaction, even if the new property is put into the sole name of the non-property-owning partner.

This could have significant cost implications for couples who decide to marry, and arguably imposes a need for estate planning, to try and mitigate these consequences, beyond that which might be expected of a couple who are soon to be married or enter a civil partnership.

Non-UK property

Property owned abroad will be brought into the equation in deciding if the 3 per cent SDLT surcharge will apply. This presents some practical difficulties:

- Determining whether a foreign property is a main residence may be difficult as a question of fact, particularly where non-residents own and occupy different homes in various countries.
- There can be situations where it is difficult to establish ownership of a property in jurisdictions where it is affected by religious or family complexities. For example, property ownership in some foreign jurisdictions may be by the whole family without distinguishing individual family members.

Main residence exemption – a potential trap

Where a purchaser who has already sold his main residence buys, within 36 months, two more properties in a single transaction – a new main residence and, say, a holiday home – he might expect to obtain relief from the higher rates of SDLT. This is not the case. The buyer will be subject to the rules for the purchase of two or more properties in one transaction. Under these, if both properties meet Conditions A and B, the higher rates will automatically apply. Condition D, dealing with the replacement of a main residence, is not taken into account.

Careful planning can alleviate this problem. The purchases should be structured as entirely separate transactions so that each can be looked at individually. The order of the transactions will also be significant where the buyer hopes to use the main residence exemption: it will not be available on the second purchase, as the buyer will already own a property by that stage.

Granny annexes

A concern raised on the legislation as originally drafted was that it would catch a house purchased with a granny annexe, as being subject to the multiple purchase rules. The government amended the legislation so that the purchase involving an annexe would be exempt from the surcharge where the main residence and the annexe are bought at the same time (Sched.4ZA, para.5). As a consequence, an annexe which is worth less than one-third of the total property value, or less than £40,000, will not qualify for the extra charge.

17.6 HIGHER RATE – IMPACT ON PLANNING

17.6.1 Use of transitional provisions

If a person's only or main residence was sold before 26 November 2015, it will be possible to buy a new main residence before November 2018 and not pay the higher SDLT rates even if the individual owned other (e.g. buy-to-let) properties at the time of the transaction. This is unlikely to have much relevance to IiP beneficiaries, but is useful for the limited occasions on which it could apply.

17.6.2 Replacement of main residence – potential difficulties

Letting out the old main residence

The replacement main residence exception to the new rules applies, among other things, where the old residence was the only or main residence within the three years leading up to the purchase of the new home. The consequences of *letting out* a previous main residence for a while could be expensive if that prevented the property from meeting this condition.

Buying two replacement properties in a single transaction

See 'Main residence exemption – a potential trap' above.

17.6.3 Trust property

Discussion by STEP practitioners has raised the possibility of granting a young beneficiary, who owns no property yet, a short-term interest in possession. Where a beneficiary has an IiP, the new rules apply as if they are the purchaser of a new property. Would the trustees then be able to buy/sell property using the lower SDLT rates on the back of that interest in possession? Would GAAR prevent this from being done?

17.7 ANNUAL TAX ON ENVELOPED DWELLINGS

17.7.1 Introduction

On 1 April 2013 the annual tax on enveloped dwellings (ATED) came into effect. ATED is a tax payable by companies and other non-natural persons (NNPs), who own high value UK residential property. (UK for the purposes of this part of the chapter has its usual meaning.) ATED does not apply to individuals who directly own property but does apply to companies and other collective investment vehicles that, in effect, wrap or envelope the ownership of the property within a corporate structure.

ATED represents one of three changes implemented by the government to discourage high value residential property from being bought and sold through corporate structures to avoid paying tax. The other two changes are the introduction of a 15 per cent rate of SDLT for certain residential purchases by non-natural persons (see **17.2** which notes that this does not apply to trust companies) and a CGT charge on such properties.

ATED applies to a 'single-dwelling interest'. The term 'single-dwelling interest' is a fundamental principle of ATED and a full definition can be found in FA 2013, s.108. Some properties are not classed as dwellings for the purposes of the ATED regime, including hotels, guest houses, boarding school accommodation, hospitals, student halls of residence, military accommodation, care homes and prisons.

Effectively, single dwellings have to be located in the UK to be caught within the ATED regime. The definition of a dwelling includes part of a residential or mixed-use property and incorporates properties 'capable of being a dwelling'. A dwelling can include gardens and grounds and any buildings within them. If, however, a building is being used for a purpose within the relief criteria then the building will be outside ATED.

If a dwelling is part of a mixed-use property that includes sections which are not used for residential purposes, only the residential part of the property will be within

the ATED regime. Additionally, if a dwelling incorporates a number of self-contained flats, each self-contained flat will be valued on an individual basis.

If a company or a person connected with a company owns more than one dwelling in a property, the multiple dwellings are added together and considered as a single dwelling if there is internal access between the dwellings. Furthermore, if there are two dwellings with internal access between them in adjoining buildings, they will be treated as one dwelling. In these circumstances the values of the dwellings will be aggregated and ATED paid on the total.

There may also be an aggregation for valuation purposes if a company and individuals connected to that company own a number of interests in a dwelling. For example, this could include the shareholders of a company, their relatives and the beneficiaries of a trust, where the dwelling is owned by a company and the company is owned by the trustees. This aggregation will only apply, however, if certain conditions and thresholds are met. Where one of the connected persons is an individual the property is only valued as a single-dwelling interest if:

- The property value is more than £2 million and the company's interest is worth more than £500,000.
- The property value is £2 million or less and the company's interest is worth more than £250,000.

17.7.2 The ATED charge in relation to trusts

Liability to pay ATED arises if the following conditions are met:

1. *Ownership condition* – the property is owned wholly or partly by a company, a partnership where at least one partner is a company, or a collective investment scheme.
2. *Beneficial entitlement*, alone or with others, to a single-dwelling interest.
3. *Value of property £500,000 or more* for years commencing April 2016 onwards.
4. *No exemption or relief applies*.

For trustees, the most important of these conditions is that the company must have beneficial entitlement to the property. The ATED provisions were implemented in FA 2013, and FA 2013, s.95(2) states:

> (2) References in this Part to entitlement to a single-dwelling interest (or any other chargeable interest) do not include –
>
> (a) entitlement in the capacity of a trustee or personal representative, or
> (b) entitlement as a beneficiary under a settlement.

It is therefore clear that corporate trustees who own property as trustees of interest in possession or discretionary trusts will *not* be caught by these provisions. FA 2013, s.95(4) specifically provides that 'settlement' should have the same meaning as in the SDLT provisions of FA 2003, so does not encompass a bare trust. A trustee,

whether corporate or not, who holds property as bare trustee for a company who would meet the ATED conditions might therefore need to be aware of these provisions, a brief outline of which follows.

17.7.3 Reliefs and exemptions

A number of reliefs and exemptions from ATED have been introduced due to concerns being raised with the government during the consultation process of the possible detrimental effects of ATED on residential property related businesses. FA 2013, ss.133–150 set out certain reliefs that can be claimed from ATED. In the first instance, an ATED return must be completed and returned and the full amount of ATED paid. Reliefs must be claimed on the ATED return and are worked out on the basis of 'relievable days'. A relievable day is one on which the conditions of the relief are met.

Relief may be claimed for the following:

1. Property rental businesses and letting to unconnected parties for rent on a commercial basis (FA 2013, s.133).
2. Property developers, where dwellings are held for the purposes of a property development trade (FA 2013, s.138).
3. Property developers, in relation to a qualifying exchange of dwellings (FA 2013, s.139).
4. Property traders, where dwellings are held for the purpose of a trade of buying and selling dwellings (FA 2013, ss.141 and 142).
5. Financial institutions acquiring dwellings in the course of lending, which are held with the intention of sale in the course of that business without delay (FA 2013, ss.143–144).
6. Unoccupied rental property being prepared for sale, demolition and rebuilding or conversion for use in a way that qualifies for relief (FA 2013, s.134).
7. Dwellings open to the public. A company may be able to claim relief from ATED if, for example, it owns an historic house that is open to the public for at least 28 days of the year; or if it provides access to the dwelling as part of its services, for example as a wedding venue. Access must be to a significant part of the property. The activities of the company in relation to the house must be carried out on a commercial basis and with a view to profit, even if the profit does not pay for the full costs of the house (FA 2013, s.137).
8. If a farmhouse is owned by a company and the company carries on a trade of farming on a commercial basis and with a view to profit, it may be able to claim a relief that reduces an ATED charge by 100 per cent. The criteria to qualify are set out at FA 2013, ss.148–149 and specify:

   (a) a farm-worker (or a former long-serving farm-worker or their surviving spouse or civil partner) must occupy the property;
   (b) the relief will be available where a person connected to the owner