Low Incomes Tax Reform Group

A voice for the unrepresented

**Trusts with vulnerable beneficiary**
**HM Revenue & Customs consultation response document and draft legislation for inclusion in Finance Bill 2013**

**Response from the Low Incomes Tax Reform Group ('LITRG')**

## 1 Executive Summary

1.1 We welcome the decision to open up vulnerable beneficiary status to all who will receive the care component of personal independence payment (PIP) or the Armed Forces independence payment, but are disappointed that our suggestion of a three-step definition – which would have ensured that nobody who might need the protection of such trusts would be left out of the statutory definition – has not been taken up.

1.2 We are content with the proposal to retain the mental disorder test in the Mental Health Act 1983.

1.3 We agree in principle that there should be a limit on the extent to which trust capital and income can be used for the benefit of anyone other than the disabled or vulnerable beneficiary. However, the limit proposed – the lower of £3,000 or 3% of the trust fund in any year – is too inflexible and could fetter the trustees from acting in what they see as the best interests of the beneficiary.

1.4 We welcome the grandfathering provisions such that if property is added on or after 8 April 2013 to a trust that fulfilled the criteria in force when it was set up, the added property will still qualify for vulnerable/disabled trust status.

1.5 We regard it as a missed opportunity that more extensive alignments and simplifications between the different tax regimes affecting vulnerable/disabled trusts – apart from harmonising the definitions of vulnerable/disabled beneficiaries – are not to be made. Instead, the rules and their interactions are to remain as complex as ever.

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## 2 About Us

2.1 The Low Incomes Tax Reform Group (LITRG) is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998 LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes. Everything we do is aimed at improving the tax and benefits experience of low income workers, pensioners, migrants, students, disabled people and carers.

2.2 LITRG works extensively with HM Revenue &Customs and other government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.

2.3 The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

## 3 Main comments

3.1 We are pleased to respond to the draft Finance Bill clauses on vulnerable and disabled trusts and their beneficiaries, and welcome the constructive and open nature of the consultation that preceded it.

3.2 ***Definition of vulnerable or disabled beneficiary***

3.2.1 In responding to the consultation in the summer, our starting point was that no vulnerable beneficiary should be taxed any more adversely than if they owned the trust property themselves.

3.2.2 To achieve that objective, it was necessary to establish who actually benefits from such trusts, in other words which categories of individual have a disability or vulnerability that may require the use of trusts or make their use desirable. The definition of 'vulnerable beneficiary' should then be framed sufficiently widely to cover all those who need that protection. Nobody who could benefit from such a trust should be barred from doing so by any inadequacy in the legal definition. In particular, all who are at risk of any form of abuse, exploitation, coercion or persuasion if left to manage their own property should be entitled to the protection a trust can give without suffering a tax disadvantage, and should be capable of being embraced within the definition of 'vulnerable beneficiary'.

3.2.3 With that in mind our response to the consultation proposed a three-step approach to defining a vulnerable, or disabled, beneficiary:

- Anyone in receipt of the daily living component of PIP at either rate should automatically qualify, as should anyone in receipt of attendance allowance;
- A secondary qualification would be a diagnosis of one of a list of conditions specified in a statutory instrument; and
- If neither of the above applied but an individual was clearly vulnerable in the sense of needing the protection of a trust, certification by a lawyer or doctor should suffice.

3.2.4 The draft legislation now proposed limits the definition of vulnerable beneficiary to those in receipt of the daily living component of PIP, or the Armed Forces Independence Payment. While we welcome the recognition that limiting it to those in receipt of the enhanced rate of the daily living component of PIP, as was initially proposed, would have been too narrow, we are disappointed that the other two elements of our suggested definition are not to be included.

3.2.5 Thus, our concerns remain for the minority of people who will not be claiming PIP (or would be ineligible if they did claim), and who do not fall within the scope of mental disorder under the Mental Health Act 1983, but for whom outright ownership or a bare trust would not be a reliable alternative. In short, those who fall outwith the statutory test, but nevertheless have the characteristics listed at paragraph 4.1.2 of our response. We worry, in particular, that some for whom trust arrangements have been set up by a court – for example as a receptacle for interim awards of personal injury damages – may be left out.

3.2.6 As for retaining the mental disorder test derived from the Mental Health Act 1983, this seems acceptable provided the full extent of the test (as set out in paragraph 4.7.1ff of our response) is contained in official guidance and available to trustees or would-be trustees.

### 3.3 *Limits to application of trust property and income*

3.3.1 The draft clauses deal in the main with how much of a trust's income or capital should be spent on persons other than the disabled or vulnerable beneficiary.

3.3.2 It is entirely reasonable that in order to qualify for privileged status, there should be a limit on the extent to which trust capital and income can be used for the benefit of anyone other than the disabled or vulnerable beneficiary. However, the limit proposed – the lower of £3,000 or 3% of the trust fund in any year – is too inflexible. If, for example, the trustees saw fit to provide necessary accommodation or a break to a carer, they would be unable to do that without breaching the vulnerable trust status. In short, they would be fettered from acting in what they saw as the best interests of the beneficiary by the very rules that seek to protect the interests of that beneficiary.

3.3.3 Arguably, if expenditure on another person were in fact in the best interests of the vulnerable beneficiary, and the trust funds could be said to be applied for the benefit of the vulnerable beneficiary in that sense, the limit would not apply – but the point might still have to be argued and HMRC's agreement obtained if only for the trustees' protection.

3.3.4 We feel the object of the draft legislation would be better achieved by specifying the purpose for which any trust property or income may or may not be applied for the benefit of anyone other than the vulnerable beneficiary. That would be preferable to leaving the purpose unspecified but instead stipulating an amount which is almost certain to prove inadequate. If however there has to be a limit, we note that it will be subject to review by secondary legislation and we trust the review will be an active one, and sufficiently flexible and timely to respond quickly to evidence of need.

3.4 ***Additions to pre-existing trusts***

3.4.1 We welcome the grandfathering provisions such that if property is added on or after 8 April 2013 to a trust that fulfilled the criteria in force when it was set up, the added property will still qualify for vulnerable/disabled trust status. This will enable (for example) a beneficiary who qualified because they were in receipt of (say) the highest or middle care component of disability living allowance to continue to qualify in respect of added property, even though they may no longer be entitled to claim PIP.

## 4 Decision not to harmonise rules between the different taxes

4.1 We pointed out in paragraphs 3.2 to 3.8 of our response that the different and sometimes conflicting rules that applied to the vulnerable beneficiaries tax regime for income tax and capital gains tax, and yet more differences in the disabled trust regime for inheritance tax, were contrary to the interests of the beneficiaries of those trusts. The unnecessary complexities and unfairness that result are a strong disincentive for people to make vulnerable beneficiary elections, which is regrettable since the concept of allowing the trust income and property to be taxed as though it were the beneficiaries' own is equitable and sound. The added complexity is unnecessary considering that we have never seen a case in which tax avoidance was a motive for setting up such a trust.

4.2 We therefore regard it as a missed opportunity that more extensive alignments and simplifications – apart from harmonising the definitions of vulnerable/disabled beneficiaries – are not to be made. Instead, the rules and their interactions are to remain as complex as ever.

LITRG
8 February 2013