Representation from the Chartered Institute of Taxation
for Finance (No 2) Bill 2022-23 Public Bill Committee

Chartered Institute of Taxation.

Low Income Estates in Administration and Trusts Clause 29 and Schedule 2

Executive Summary

This clause and schedule provide that (a) estates of people who have died and (b) trusts, with annual income not exceeding £500, will not be subject to income tax on that income.

The legislation represents a practical approach to the issue in respect of estates, and will be of benefit to both the personal representatives of the deceased and their beneficiaries.

However there is far less simplification in respect of trusts with low levels of income – and for some people it will increase their administrative burden. The measure fails to address the particular difficulties faced by some very small trusts with tiny amounts of income, often with minor or vulnerable beneficiaries; it does not fulfil the stated policy objectives of simplifying the administration of such trusts, acknowledging that achieving this within the current framework is more challenging than in the case of estates.

1 Income from Estates in the course of Administration

1.1 This clause and schedule extend the scope of an existing concession to cover all forms of income from a deceased's estate (potentially therefore including, for example, rental income and dividends rather than just interest) provided the total income over the course of a year is not more than £500.

1.2 Such income will be exempt from income tax, so that neither the personal representatives nor the estate's beneficiaries will have any income tax liability. Where estate income exceeds the threshold, all of it is taxed so that the normal rules apply. Although an exemption inevitably introduces a cliff-edge at borderline, this is a sensible reform that will genuinely simplify the position for small estates with family members often acting as personal representatives. In these limited circumstances this modest exemption is justified.

See Appendix, Example 1 for a comparison of the old and new positions in relation to estates in the course of administration.

2 Trusts

2.1 The simplicity for estates has not been carried through to small trusts. This recognises the different position of trusts, which unlike the estate of a deceased person are not a one-off event and may carry a risk of avoidance. However, given that trusts with the smallest income are generally those used to protect the vulnerable (take for example the small will trust set up by Jennifer Archer recently in the BBC Radio 4 Archers programme for her grandchild), it is desirable to provide some simplification for these trusts especially given the increased regulatory burden on all trusts in recent years in the form of the Trusts Register and other reporting requirements.

2.2 The difficulty is that although a similar £500 threshold[1] is applied to the income arising to the trustees of a settlement, it does not exempt the income in the hands of the beneficiaries. Indeed the measure will actually increase compliance issues for some beneficiaries. (Trust income is currently taxed in a two stage process: first, the trustees report income coming into the trust and pay tax on it; secondly, when income is distributed to beneficiaries, they also must report the income and pay any tax still due, after credit for tax at the first stage. Unlike the proposed estates exemption, the new trusts exemption will only apply at the first stage.)

2.3 Beneficiaries of interest in possession trusts (ones where the beneficiary is entitled to the trust income – often the case in relation to trusts set up by will for the surviving spouse of a second marriage who is the life tenant) [2] will receive the trust income (up to £500) gross i.e free of any tax. The trustees will have no liability to report or pay. This will help a life tenant who is a non-taxpayer as they will no longer need to submit repayment claims. However it also means that basic-rate taxpayers will have to pay the basic rate tax due on their income from the trust. Currently they may often not be filing a tax return at all as their basic rate liability will have been met by the tax deducted by the trustees. This measure means that they will now have to file.

2.4 Indeed this measure could increase the number of tax returns required. If there are five basic rate beneficiaries all entitled to the trust's income in equal shares of £100 each, five tax returns will be necessary where previously the trustees would have just filed one. The same point is relevant to higher rate taxpayers although here at least they are more likely to be filing tax returns already. But they will now have to remember to report very small amounts of trust income.

2.5 HMRC estimates that this measure will affect 37,000 individuals overall but it is possible that the effect could be greater and more adverse – for them, this will be the reverse of a simplification.

See Appendix, Example 2 for a comparison of the old and new positions in relation to an interest in possession trust.

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[1] Where a settlor has a number of current trusts, the £500 limit will be proportionately reduced for accumulation and discretionary trusts, by the total number of the current trusts to a minimum of £100. This anti-avoidance provision addresses the risk of multiple trusts being created to take advantage of the exemption, and mirrors the approach adopted in relation to the CGT annual exemption for trusts. Interest in possession trusts, settlor-interested trusts, vulnerable beneficiary trusts and heritage maintenance trusts are not taken into account.

[2] The same applies to settlors of settlor-interested trusts (where, broadly, the settlor has not been excluded from benefit).

2.6 The position for discretionary trusts (ones where no one is entitled to income – such as Jennifer Archer's will trust for her granddaughter) is even more complicated. The trustees will not have to report income under £500 but any distribution made to a beneficiary will still involve the trustees in complex computations (incomprehensible to many lay trustees) to determine the amount of tax payable on the income distributed.

See Appendix, Example 3 for a comparison of the old and new positions in relation to an accumulation or discretionary trust.

2.7 Our concern therefore is that this measure, while described as simplification, could actually increase levels of confusion for trustees of small trusts. This in turn will impact upon often vulnerable beneficiaries receiving modest amounts of income who will now have greater compliance burdens.

2.8 A separate exercise of simplification in relation to disabled beneficiaries still needs to be undertaken. The problem with this limited measure is that it is not a simplification at all for many, maybe most, beneficiaries of small trusts.

3 The Chartered Institute of Taxation

3.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT's comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

The CIOT's 19,000 members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

For further information, please contact:
George Crozier, CIOT Head of External Relations
gcrozier@tax.org.uk 020 7340 0569

The Chartered Institute of Taxation
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APPENDIX

EXAMPLE 1: Estate in the course of administration

Personal Representatives of deceased's estate receive £60 dividends and £20 interest.

Old position

Personal representatives must inform HMRC (an informal procedure):

£60 dividend x 8.75% =	£5.25
£20 interest x 20% =	£4.00
Income Tax due =	£9.25

HMRC issue reference number.
Personal representatives pay £9.25 to HMRC.

Personal representatives pay the net income to beneficiary:

Net dividend of	£54.75
Net interest of	£16.00

Personal Representatives should also supply the beneficiary with a form R185(Estate Income) setting out:

	£ Net	£ Tax Paid
Dividend	54.75	5.25
Interest	16.00	4.00

The beneficiary should report this income to HMRC, particularly if they wish to reclaim the tax already paid and it is covered by their dividend and savings allowances, or if they are liable to higher rates of tax. The Trust and Estates Income pages for a paper tax return must be submitted by 31 October following the relevant tax year. Commercial software must be bought if the beneficiary wishes to file online as HMRC's system does not provide free software for trust and estate income.

New position

The Personal Representatives are spared the burden of reporting the income and paying the small amount of tax due.

The beneficiary receives the income without any tax deduction and, whether or not they pay tax, is similarly spared the burden of reporting the income and claiming a refund or paying any further tax due – a real simplification.

HMRC no longer bear the administrative costs of processing small amounts of Personal Representatives' and beneficiaries' income.

If the estate income were, say, £580 (rather than £80) the steps taken under the 'old position' will still be necessary as this is the normal process.

EXAMPLE 2: interest in possession trust

This is a trust where the beneficiary is entitled to the income arising, e.g. a will trust where a husband in his second marriage leaves the income of his estate to his widow for life, and after her death the capital passes to the children of his first marriage. The tax consequences are similar to those for the estate in the course of administration, Example 1.

Trustees receive £60 dividends and £20 interest.

Old position

Trustees must file an annual tax return and pay income tax:

£60 dividend x 8.75% =	£5.25
£20 interest x 20% =	£4.00
Income Tax due =	£9.25

Trustees pay the net income to beneficiary:

Net dividend of £54.75
Net interest of £16.00

Trustees should also supply the beneficiary with a form R185(Trust Income) setting out:

	£ Net	£ Tax Paid
Dividend	54.75	5.25
Interest	16.00	4.00

The beneficiary should report this income to HMRC. The Trust and Estates Income pages for a paper tax return must be submitted by 31 October following the relevant tax year. Commercial software must be bought if the beneficiary wishes to file online as HMRC's system does not provide free software for trust and estate income.

New position

The Trustees are spared the burden of reporting the income and paying the small amount of tax due.

The beneficiary receives the income without any tax deduction. A non-taxpayer is spared the burden of reporting the income and claiming a refund; however all tax-paying beneficiaries will now have to file a return and pay the further tax due – which is not a simplification.

HMRC no longer face the administrative costs of processing small amounts of trustees' income and issuing refunds to non-taxpaying beneficiaries. However there will be additional returns to process where the liability of tax-paying beneficiaries had previously been met by deductions made by the trustees.

If the trust income were, say, £580 (rather than £80) the steps taken by the trustees under the 'old position' will still be necessary, as this is the normal process.

EXAMPLE 3: accumulation or discretionary trust

This is a trust where the beneficiary is not entitled to the income arising, e.g. Jennifer Archer's will trust where the trust fund is held by the trustees for her grandchild, Martha, until she reaches the age of 18. The income will be accumulated unless the trustees have discretion to pay it for the child's benefit.

Trustees receive £60 dividends and £20 interest.

Old position

As the trust's income is less than £1,000 special rules mean that the same basic trust rates as in Example 2 apply. [If the trust income were greater than £1,000 the excess is subject to additional trust rates of 39.35% on dividends and 45% on other income.]

Trustees must file an annual tax return and pay income tax:

£60 dividend x 8.75% =	£5.25
£20 interest x 20% =	£4.00
Income Tax due =	£9.25

This £9.25 tax goes into a 'tax pool' and can be used as a credit against the trustees' liability to pay further tax when they make a distribution.

Trustees exercise discretion to pay income to beneficiary; a 45% 'distribution' charge is applied on the grossed-up amount paid, with credit for any tax in the tax pool:

Net discretionary payment of	£44.00	
Tax at 45% on £80.00 =	£36.00	(£9.25 is met by the tax pool and £26.75 is due to HMRC)

Trustees should also supply the beneficiary with a form R185(Trust Income) setting out:

	£ Net	£ Tax Paid at 45%
Payment	44.00	36.00

The beneficiary should report this income to HMRC and if they are a non-taxpayer (such as Martha) will claim a £36.00 refund. The Trust and Estates Income pages for a paper tax return must be submitted by 31 October following the relevant tax year. Commercial software must be bought if the beneficiary wishes to file online as HMRC's system does not provide free software for trust and estate income.

New position

If the trustees do not distribute the £80 income they do not suffer tax on it initially, and do not have to report it – a slight easing in their administrative burden.

However if they decide to pay it to the beneficiary, the 45% 'distribution charge' described above is applied, and the beneficiary is in the same position as before. The new system operates as a deferral of liability. The complexities in the system of trust taxation remain.

If the trust's income were, say, £580 (rather than £80), as the old '£1,000 basic rate band' has been abolished the steps taken under the 'old position' will be necessary, save that a 39.35% trust rate is applied to dividends and a 45% trust rate to other forms of income.