TRUST TAXATION

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CONTENTS

PART I: GENERAL

1. THE TRUST

Anatomy of a trust 1.01
Trustees' powers 1.09
The settlor 1.14
The trustees 1.15
Sham trusts 1.18
Taxation issues 1.20
Hastings-Bass and mistake 1.22
Accumulation and perpetuity issues 1.39

2. CATEGORISATION OF FOREIGN ENTITIES AND TRUSTS

Introduction 2.01
Foundations 2.09
Establishments 2.18
US Grantor trusts 2.19
Usufructs 2.29
Delaware LLCs 2.29

3. RESIDENCE AND DOMICILE STATUS OF INDIVIDUALS

Introduction 3.01
The current statutory rules 3.07
Problems in determining residence status under current case law 3.16
HMRC practice and judicial review 3.38
Ordinary residence 3.54
Practical points for those wishing to become non-UK resident 3.63
The proposed statutory residence test 3.67
Domicile 3.87

4. RESIDENCE OF TRUSTEES AND COMPANIES

Trustee residence 4.01
Exporting UK trusts 4.13
Importing a trust 4.40
Corporate residence 4.43

16. ENTERPRISE INVESTMENT SCHEME (EIS) DEFERRAL« RELIEF

The scope of the relief 16.01
Qualifying conditions" 16.10
ETS relief and trusts 16.14
Transitional provisions—interaction with entrepreneurs' relief 16.18

17. SHARE SALES AND DEFERRED CONSIDERATION; EARN-OUTS; SHARE BUY-BACKS; PRIORITY OF RELIEFS

Introduction 17.01
Share exchanges 17.04
Sales of shares for ascertainable consideration in cash 17.08
Sale for deferred consideration in shares or'loan notes 17.10
Earn-outs 17.25
Share buy-backs 17.34
Conclusions and comments on priority of reliefs 17.40

18. CGT HOLD-OVER RELIEF

Background 18.01
Gifts of business assets (s. 165 relief) 18.20
Gifts subject to an immediate IHT charge (s.260 relief) 18.48
Disposals to a settlor-interested trust 18.61
Payment of tax by instalments on gifts and sales at an undervalue 18.67
Principal private residence relief and s.260 hold-over.* 18.71
Double charges: relief for IHT against CGT 18.76
Tax planning and hold-over relief 18.78

19. OFFSHORE TRUSTS

Background 19.01
UK domiciled and resident settlors 19.13
Foreign domiciled settlors 19.26
Taxation of UK resident and'domiciled beneficiaries 19.27
Taxation of foreign domiciled UK resident beneficiaries 19.49
Anti "flip-flop" legislation and Schs 4B and 4G 19.69
Information requirements for offshore trusts 19.79
Conclusions 19.80

20. THE DISPOSAL OF A BENEFICIAL INTEREST

The basic rule 20.01
Disposal of an interest in a non-UK resident settlement or in a settlement which was at any time non-resident or which has received properly from such a settlement 20.06
Sale of an interest in a settlor-interested trust 20.19
Tax planning issues 20.29

21. LOSS RELIEF

Basic principles 21.01
Anti-avoidance 21.07
Losses of UK resident settlor-interested trusts 21.12
Loss relief when a beneficiary becomes absolutely entitled 21.21

Other restrictions on set-off of UK resident trust losses 21.26
Offshore trusts and losses 21.28
Losses of offshore trusts within s.86' 21.34
Losses in an underlying offshore company 21.38

PARTilV: INHERITANCE TAX

22. INHERITANCE TAX, RESERVATION OF BENEFIT AND PRE-OWNED ASSETS INCOME TAX—AN INTRODUCTION
Potentially exempt transfers (PETs) 22.02
Gifts from companies 22.06
The charge on death 22.08
Reservation of benefit 22.10
Ingram and *Eversden* 22.17
Application of the reservation of benefit provisions generally 22.21
Avoiding the reservation of benefit rules 22.30
Impact of the pre-owncd assets charge 22.38

23. THE 2006 IHT RULES—AN OVERVIEW
Background to the changes 23.02
The IHT treatment of settlements set up on and after March 22,-2006 23.08
Exceptional cases: new settlements which are not taxed under the relevant property regime 23.12
Will drafting options 23.19
Existing settlements 23.25
Comments and conclusions 23.31

24. IHT DEFINITIONS AND CLASSIFICATIONS
Meaning of "settlement" and related terms 24.01
When is there a disposition creating a settlement? 24.11
Who is the settlor? 24.18
Additions by the settlor including loans to trusts and the implications of borrowing by interest in possession trusts 24.26
Classification of settlements 24.35

25. CREATION OF SETTLEMENTS
Background 25.01
Charge to tax in respect of settlements created on or after March 22,2006... 25.02
Reservation of benefit on setting up a trust 25.06
Impact of the pre-owned assets charge 25.10
The importance of the 2006 changes 25.11

26. THE TAX TREATMENT OF QUALIFYING AND NON-QUALIFYING INTERESTS IN POSSESSION AND REVERSIONARY INTERESTS INCLUDING VALUATION ISSUES, LEASES, RELIEFS, *MELVILLE* SCHEMES AND SALES
Background 26.01

36. TRUSTS FOR VULNERABLE AND DISABLED BENEFICIARIES

Background matters 36.01
Income tax rules 36.06
CGT treatment 36.22
Inheritance tax: disabled trusts under s.89 36.30
THT: "disabled persons' trusts" after March 21, 2006 36.42
Dispositions for the maintenance of family including a dependent relative 36.56

37. REVERTER TO SETTLOR TRUSTS

Tax treatment of a revertor.to settler trust before the FA 2006 changes 37.02
The IHT position from March 22, 2006 37.19
The POA position from December 5, 2005 37.28
Comments and conclusions 37.34

38. TAX EFFICIENT WILL DRAFTING

Use of IHT nil rate band before October 9, 2007 38.02
The transferable nil rate band 38.08
Impact on drafting of **IHT** efficient-wills 38.17
The Nil Rate Band Discretionary Trust 38.24
BPR/APR and nil rate gifts 38.46
Dealing with residue with surviving spouse 38.49
Dealing with residue—no surviving spouse 38.56
Wills for cohabitees 38.57
Proposed changes for charitable legacies 38.59

39. DEEDS OF VARIATION, DISCLAIMERS AND OTHER POST-DEATH REARRANGEMENTS

Variations: inheritance tax treatment 39.04
Variations: CGT treatment 39.33
Variations: income tax 39.41
Variations: impact of the POA charge 39.44
Variations: stamp duty and SDLT 39.45
Disclaimers 39.47
Section 144: discretionary will trusts 39.55

40. CAPITAL TAX ISSUES FOR PERSONAL REPRESENTATIVES

General 40.01
Valuation of assets at death 40.07
CGT losses of the deceased 40.12
Sales by PRs 40.13
Losses of the PRs 40.19
Transfers to legatees 40.20

41. PILOT TRUSTS

What is a pilot trust? 41.02
Related settlements 41.04
The attraction of pilot trusts 41.06

Adding property 41.07
Merging the trusts 41.16
Typical uses of pilot trusts 41.17
Miscellaneous technical points and traps 41.25

42. BARE TRUSTS
General points 42.01
Uses 42.04
Taxation of a bare trust 42.06
Deferring absolute entitlement 42.16

43. TRUSTS AND HOUSES: CAPITAL GAINS TAXAND INHERITANCE TAX CONSIDERATIONS
Capital gains tax—principal private residence relief 43.01
Inheritance tax planning: some general considerations 43.29
The fate of past schemes 43.37
Current planning options^carve-out schemes including reversionary lease schemes 43.85
Co-ownership/sharing arrangements (including let property) 43.94
Cash gifts 43.116
Selling the family home 43.126
Foreign domiciliaries and the family home—inheritance tax and capital gains tax considerations 43.137

44. CHATTEL SCHEMES
Chattel arrangements 44.01
Foreign domiciliaries and chattel schemes 44.17

45. **BUSINESSES: BPR**
Overview 45.01
Relevant business property 45.08
Restrictions on BPR 45.12
What must be transferred? 45.35
The value of the business 45.37
How the reliefs work for settled property. 45.48
Application of the reservation of benefit rules 45.66
Impact of the pre-owned assets charge 45.73

46. FARMS: AGRICULTURAL PROPERTY RELIEF
Basics of the relief 46.01
"Agricultural value" and liabilities 46.06
The "character appropriate" test 46.13
What is a farmhouse? 46.20
When is agricultural property "occupied for the purposes of agriculture"? 46.22
Getting 100 per cent relief on let property 46.24
Planning points 46.25

47. LIFE POLICIES AND OTHER INSURANCE PRODUCTS HELD IN TRUST
Background 47.01

Existing trusts 47.03
Family protection policies 47.13
Loan trusts 47.21
Discounted gift plans (DGPs) 47.23
Flexible reversionary trusts 47.34
The chargeable event legislation 47.39

48. PENSION ARRANGEMENTS
Background 48.01
Pension trusts and **IHT** 48.15
Lifetime IHT issues 48.26
ABI Guidance 48.48

49. EMPLOYEE BENEFIT TRUSTS
Background—general tax treatment before December 9, 2010 49.01
Definition of an EBT 49.16
Exit charges when property ceases to be comprised in an EBT 49.33
Entry charges—general 49.36
Relief for dispositions by a close company 49.44
Relief for dispositions by individuals 49.53
Business and agricultural property relief 49.56
Disguised remuneration—position from December 9, 2010 49.59

50. TRUSTS AND DIVORCE
Claiming trust assets on a divorce 50.03
Nuptial settlements 50.04
Trusts as a financial resource 50.19
Pre- and post-nuptial agreements 50.24
Inherited and pre-marital wealth 50.34
Anti-alimony and no contest clauses 50.38
Tax position on divorce 50.41
Trusts,and remittance issues for foreign domiciliaries 50.54

51. STAMP DUTY LAND TAX AND STAMP DUTY
Stamp Duty Land Tax—an overview 51.01
Typical transactions encountered by trustees 51.09
Stamp Duty 51.24

52. PARTNERSHIP STRUCTURES
Introduction 52.01
Tax treatment of partnerships 52.17

53. OFFSHORE INCOME GAINS
Introduction 53.01
What is an offshore fund? 53.04
Taxation of offshore non-reporting funds (OIGs) 53.08
Taxation of UK resident trusts 53.14
Non-resident trusts 53.17

54. TAXATION OF NON-RESIDENT COMPANIES

Introduction 54.01
Taxation of an individual owning an interest in an offshore company » 54.04
Trustees owning non-resident companies 54.24
Summary of tax advantages and disadvantages of incorporation ..54.34

55. CHECKLIST FOR PRIVATE CLIENTS AND TRUSTS: PLANNING IDEAS

Points to consider when lirst receiving instructions in relation to an existing trust • ' 55.02
Points to consider when advising foreign domiciliaries (including rental properties) 55.22
Capital gains tax regime for beneficiaries receiving capital •payments'from offshore trusts 55.33
CGT'and offshore trusts generally 55.40
Importing an offshore trust 55.45
Residence—emigration and immigration 55.50
Advantages and disadvantages of holding assets through an "offshore holding company 55.64
Tax issues to consider on setting up a settlement 55.65
Making capital distributions to beneficiaries/hold-over relief/ absolute entitlement at specified age such as 25- 55.70
Resettlements vs variations _» '55.82
Business reliefs and use of trusts 55.90
Private residence relief—CGT 55.108
Disposals of beneficial interests in trusts 55.113
Losses' 55.118
Lifetime inheritance tax planning—avoiding reservation of benefit 55.119
Death bed planning ' 55.123
, Minimising charges under the relevant property regime 55.130
Will drafting * 55.131
Excluding the settlor from settlor-interested trusts—traps to Swatch 55.136

56. DISCLOSURE, COMPLIANCE, REPORTING AND ENFORCEMENT OF TAX LIABILITIES

HMRC's approach to tax schemes 56.01
How DOTAS works in relation to direct taxes other than IHT 56.10
DOTAS and IHT 56.32
'Reporting transfers into and out of trusts 56.43
Excepted estates 56.61
Inheritance tax and the penalty regime—liability and reporting 56.65
Jurisdiction and enforcement issues against non-resident trustees 56.82

Trusts are subject to different taxation than ordinary investment accounts. Trust beneficiaries must pay taxes on income and other distributions that they receive from the trust, but not on returned principal. IRS forms K-1 and 1041 are required for filing tax returns that receive trust disbursements. Understanding Trusts and Beneficiaries. What is taxation of trusts and estates? A trust is created when you (the grantor) transfer property to a trustee for the benefit of a third person (the beneficiary). An estate is the assets and liabilities left by a person at death. Both a trust and an estate are separate, legal, taxpaying entities, just like any individual. Income earned by the trust or estate property (e.g., rents collected from real estate) is income earned by the trust or estate. Two questions necessarily arise out of these situations. Revocable Trusts If you are the trustee of your own revocable trustÂ Irrevocable trusts are divided into two types for tax purposesâ€”grantor trusts and non-grantor trusts. Grantor trusts are those in which the creator of the trustâ€”the grantorâ€”retains significant benefits or rights, such as the right to receive all the trust income or change trustees. Grantor trusts file their own informational returns, reporting the trust income, but do not pay any income tax. Because trusts are not subject to double taxation, either principal or income on which the trust paid taxes can be distributed tax-free to the beneficiaries. Likewise, any taxable distribution to beneficiaries is deductible by the trust. Gift taxes may also apply to either property transfers to a trust or distributions to beneficiaries.