

New reporting rules for trusts

As part of a new crackdown on money laundering, rules were introduced recently which require trustees to provide HM Revenue & Customs with detailed information about the assets held in trusts and the identities of trustees and beneficiaries.

The potential for the misuse of offshore trusts to avoid tax was highlighted in the Panama Papers affair in 2016, which embarrassed the then Prime Minister David Cameron.

The register in which the information will be held is available only to law enforcement agencies, but there is pressure from within the EU to permit public access.

It is not clear whether such an extension of the EU rules would apply to the UK post-Brexit, and this could be part of the Brexit negotiations. However, concerns have already been raised over the consequences of public disclosure for privacy, human rights and data protection.

The immediate concern is over the impact of the requirements on small family trusts, whose trustees may be unfamiliar with HMRC reporting.

The requirements will only be triggered if tax issues are involved, and this could be regarded as an additional argument for investing trust funds in investment bonds, which are already favoured for the investment of discretionary trust funds because, being structured as insurance policies, they produce no taxable income.

Meanwhile...

The Financial Times has reported that the number of UK wealth managers providing offshore investment services to their clients reduced by 20% between 2015 and 2016, though two-thirds of the major managers still offer such services.

It appears that the main reason for the decline is the increased sharing of information between tax authorities internationally. More than 100 jurisdictions now exchange data automatically, with the result that there is virtually nowhere in the world where individuals, trusts and companies can conduct financial activities without the knowledge of their host country.

How HMRC catches cheats

1. The exchange of information between tax authorities referred to above focuses on offshore tax evasion, and a new £25,000 penalty can be imposed even if there is no intent to defraud HMRC.
2. Leaks by disaffected employees of international financial institutions have implicated thousands of clients of those institutions.
3. Through its 'Connect' computer system, HMRC analyses a vast store of data from sources which include banks, credit card companies, the Land Registry, Amazon, Airbnb and PayPal.
4. HMRC's efforts to clamp down on the 'hidden economy' has focused on small businesses and particular trades and professions which might benefit from undeclared sources of income, such as plumbers, solicitors and doctors, but now the focus has extended to sources of income such as buy-to-let. The licensing of lettings by some local authorities provides a searchable register of buy-to-let landlords.
5. This year, HMRC launched a new hotline to encourage law-abiding taxpayers to report apparent cases of tax fraud and evasion and HMRC has been known to reward informants financially. Disclosures sometimes happen during the course of an acrimonious divorce.
6. Social media provides a wealth of personal information, and users lay bare their private lives at their peril. Lavish spending on weddings or home improvements may raise suspicions on the part of HMRC.
7. Banks and professional advisers are duty-bound to file 'suspicious activity reports' if they have reason to suspect that transactions may be facilitating money laundering or terrorist activities.
8. In order to encourage evaders to admit their wrong-doings, HMRC has on occasion offered reduced penalties to those who settle up. At the same time is threatens tougher penalties on those who decline to put their hands up.

The value of on-shore trusts

On-shore trusts were very popular for family wealth planning until 2006, when inheritance tax law was changed.

Until that date, the only transfers of assets into trust which incurred a charge to tax were transfers into discretionary trusts, which give trustees the right to select the beneficiaries. Now, any transfer into trust other than a bare trust, which is tantamount to a direct gift, is a chargeable event.

However, no tax will be payable if the value of the transfer is less than the £325,000 'nil rate band' for IHT and the person setting up the trust survives for seven years after doing so. Tax will only be charged if the 'settlor' dies within the seven years.

This would allow grandparents each to put into trust money or financial assets worth £325,000, for example for their grandchildren's education. In addition, if they had not used their annual allowance of £3,000 for the previous two years, they could top up the £650,000 transfer by £6,000 each, producing a total gift into trust of £662,000.

With IHT at 40%, this could result in a saving of £164,800 compared with the situation if the assets transferred had remained in the grandparents' estates; and if they survived the gift by seven years, they could do the same again.

There would of course be charges for administering a trust, which might amount to £3,000 per year, but the trustees might be able to claim income tax relief on this expenditure.

The greatest advantage would be gained from gifts into trust if these were made by grandparents, but it would be equally possible for parents to make the gifts, subject to the important caveat that they should not access the trust funds for the benefit of their children before the children reach the age of 18. To do so would result in a tax charge on the parents.

Tax advantages are not the only reason for setting up a trust. Importantly, trusts provide the means of protecting beneficiaries against themselves. Young beneficiaries have often been led astray when entrusted with money at a time when they are ill-equipped to make responsible financial decisions. Settlers may also wish to avoid the consequences of beneficiaries becoming involved in divorce squabbles