Trusts (Capital and Income) Bill

Response to Consultation

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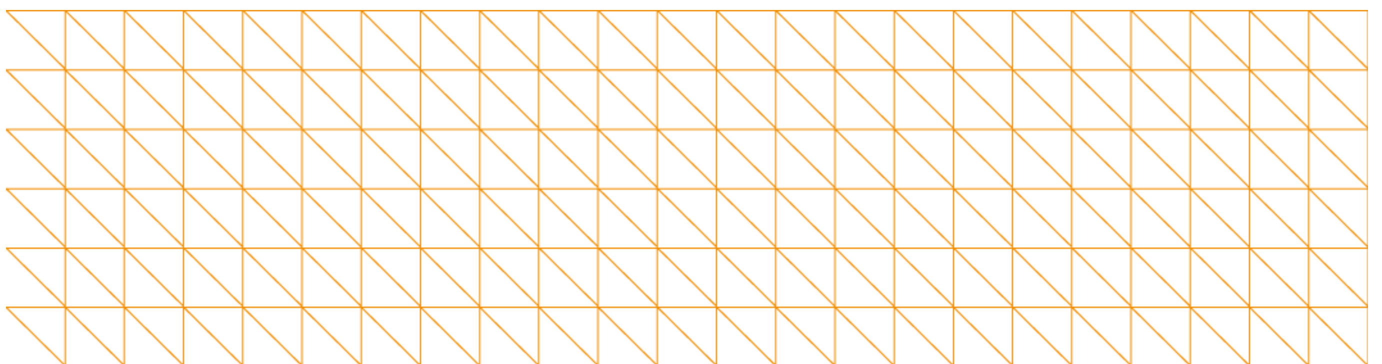

Trusts (Capital and Income) Bill

Response to consultation carried out by the Ministry of Justice.

This information is also available on the Ministry of Justice website: www.justice.gov.uk

About this consultation

To:	Any business, organisation or member of the public who has an interest in trust law
Duration:	From 22 March 2010 – 14 June 2010
Enquiries (including requests for the paper in an alternative format) to:	Lisa Levy, Post Point 6.38 Ministry of Justice 102 Petty France London SW1H 9AJ Tel: 020 3334 5313 Email: lisa.levy@justice.gsi.gov.uk

Executive Summary

This document is the response document to the Ministry of Justice consultation paper Trusts (Capital and Income) Bill published in March 2010. There were 20 responses from a range of interested parties. The department is grateful to all those who responded for their comments. Although some points of detail were raised, the response was overwhelmingly supportive. In the light of the comments made we propose making a number of amendments to the draft Bill. When this work is complete the Bill will be introduced into Parliament when parliamentary time permits.

Contents

Executive Summary	1
Introduction and contact details	5
Background	6
Summary of responses	8
Responses to specific questions	9
Conclusion and next steps	19
The consultation criteria	22
Annex A – List of respondents	23
Annex B – draft Bill as published in the consultation paper	25
Annex C – revised impact assessment	29

Introduction and contact details

This document is the post-consultation report for the consultation paper, Trusts (Capital and Income) Bill.[1]

It will cover:

- the background to the consultation paper;
- a general summary of the responses to the consultation paper;
- a detailed summary of the response to the specific questions raised in the consultation paper and an indication of the Government's response to the comments made;
- the Government's conclusion and details of the next steps following this consultation.

Further copies of this report and the consultation paper can be obtained by contacting **Lisa Levy** at the address below:

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This report is also available on the Ministry's website: www.justice.gov.uk.

Alternative format versions of this publication can also be requested from the above contact.

[1] http://www.justice.gov.uk/consultations/trusts-capital-income-consult.htm

Background

The consultation paper 'Trusts (Capital and Income) Bill' was published by the Ministry of Justice on 22 March 2010. It invited comments on the draft Bill and impact assessment published in the consultation paper.

The draft Bill proposes to amend three areas of trust law relating to the classification and apportionment of income and capital in trusts. The proposed reforms implement the Law Commission's three legislative recommendations in its report "Capital and Income in Trusts: Classification and Apportionment" (LC Report No. 315).[2] The draft Bill will:

- abolish certain rules of apportionment, which are no longer generally regarded as useful in the context of modern trust administration, while giving settlors the option to reproduce them by express provision if they wish to do so (clause 1);
- change the classification – from income to capital – of receipts from certain tax-exempt corporate demergers (clause 2);
- give trustees a discretion to compensate an income beneficiary in cases where the classification achieved by clause 2 would prejudice the income beneficiary (clause 3); and
- enable charity trustees to operate total return investment without obtaining an order from the Charity Commission (clause 4).

The purpose of these reforms is to simplify and modernise trust law rules that create unnecessary expense, litigation and difficulty to trustees of both private and charitable trusts, to decrease the regulatory burden on the Charity Commission and to facilitate total return investment by charities. The Bill is not intended to have any tax implications.

The consultation period closed on 14 June 2010.

This report summarises the responses both generally and by reference to the specific questions asked in the consultation paper. The report also sets out the Government's conclusions on the issues raised and how the Government proposes to take the reforms forward.

A list of respondents is at Annex A, which also contains the abbreviations used to describe some of the respondents in the text of this response document. References to percentages of respondents are to the respondents who replied to the question under consideration.

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[2] http://www.lawcom.gov.uk/citcat.htm

The text of the draft Bill published in the consultation paper is at Annex B and a revised impact assessment is at Annex C.

References in this response document to "the Law Commission Report" are to the Commission's report "Capital and Income in Trusts: Classification and Apportionment" (Law Com 315) and references to "the Bill" and to particular clauses are to the draft Bill published in the consultation paper and reproduced at Annex B and the clauses of that draft Bill respectively.

Summary of responses

There were 20 responses to the consultation paper. Of these, over half (11) were from associations, some of which represent many thousands of professionals. The remaining respondents consisted of four individuals, a firm of solicitors, a high street bank, an accountancy firm, the Charity Commission (a regulator of registered UK charities) and the judges of the Chancery Division of the High Court.

The consultation paper sought the views of respondents on the proposed reforms. Responses were analysed to see whether respondents agreed to the proposed reforms and whether there were any issues which needed to be addressed (Questions 1–3). Question 4 sought further evidence on the potential impacts of the proposals.

The overall response was strongly supportive of the provisional proposals and did not raise any significant doubts about the accuracy of the impact assessment. However, in relation to each proposal an important minority of consultees raised a number of different issues about aspects of the draft Bill. We discuss these below.

Responses to specific questions

1. Do you agree that corporate receipts from all tax-exempt demergers should be classified as capital, with a power to make payment where this classification is to the detriment of the income beneficiary?

1.1 There were 16 replies to this question. 15 (93%) agreed with the proposal that corporate receipts from all tax-exempt demergers should be classified as capital. 14 (87%) agreed that the trustees should have a power to make payment where this classification is to the detriment of the income beneficiary, but two (12%) disagreed: the Law Society (LS) considered that the beneficiaries should accept the consequences of the classification and that no power was necessary and an individual considered that giving trustees discretionary powers would disadvantage the beneficiaries. In addition, 14 of the respondents to this question noted a number of specific issues in relation to this proposal and the drafting of clause 3.

1.2 **Classification of payments to income beneficiary.** Four (three Associations and one individual) out of the 16 respondents (25%) who replied to this question sought clarification as to whether a payment made under clause 3 (power to compensate income beneficiary) would be capital in the income beneficiary's hands, or income. One association considered that it should be capital, and another income. Consultees linked this classification with the tax treatment of such payments. There is legal authority for the proposition that payments made to income beneficiaries from capital in the trustees' discretion may be liable to income tax.[3] However, there is also authority that payments from capital are not necessarily income in the hands of the recipient simply because they are periodic or for personal maintenance or both.[4] The Bill cannot specify the tax treatment of a clause 3 payment but it can make clear that such a payment will be capital in the beneficiary's hands for trust purposes. We intend to amend the Bill to this effect.

1.3 **Other corporate receipts.** Five (three associations, an accountancy firm and an individual) respondents considered that clause 2 should apply to a wider range of corporate distributions, including receipts from taxable demergers. These respondents argued that all receipts from corporate demergers should be treated alike in their classification for trust law purposes, regardless of their tax status. Given the Bill is not intended to have tax law consequences we do not consider that such an extension to non-tax-exempt demergers is appropriate.

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[3] *Brodie v Commissioners of Inland Revenue* (1933) 17 TC 432, *Williamson v Ough* [1936] AC 384, *Lindus v Commissioners of Inland Revenue* (1933) 17 TC 442.

[4] *Stephenson v Wishart* [1987] 2 All ER 428.

1.4 **Corporation Tax Act 2010.** One respondent noted that sections 213(2) and 213A of the Income and Corporation Taxes Act 1988, to which Clause 2(3)(a) refers, are now contained in sections 1075 to 1085 of the Corporation Tax Act 2010. We intend to update the Bill to reflect the current legislation.

1.5 **Index linking and indexation allowances.** One individual respondent suggested that clause 2 should be extended to classify as capital any indexation allowance or other compensation for the effects of inflation on an investment. *Martin v Triggs Turner Bartons*[5] was cited; in that case it was decided that the index linked elements received on the maturity of the National Savings Certificates in which the trustees had invested should be classified as income. The respondent suggested that many trustees would probably regard this as an accretion to capital, on the basis that its function is to protect the value of the capital. In *Martin* the judge indicated that these classifications would depend on the terms and conditions of particular investments. We are concerned that it might prove inappropriate to establish a fixed statutory rule for all investments. We do not propose any change to the law.

1.6 **Changes in the nature of distribution.** The Society for Trust and Estate Practitioners (STEP) raised a concern that a distribution on a demerger which was initially thought to be tax-exempt might lose that status due to a subsequent "disqualifying event" (which results in the exempt distribution treatment being withdrawn), and asked whether this would cause a receipt of capital to be reclassified as income. We have considered this point further and do not envisage that this will create any significant issues. If, in time, it proves that one of the conditions for exemption was not met at the time of the demerger, then the payment may have to be reclassified as income, and paid over to the income beneficiary. We believe that the existing legal remedies for beneficiaries, and protection for trustees, will be sufficient to deal with the consequences of such a reclassification.

1.7 **Clause 3: payments to income beneficiaries following receipts classified as capital under clause 2.** Four respondents (three associations and a firm of solicitors), raised concerns in relation to clause 3. If trustees have received a distribution which is classified as capital under clause 2, clause 3 enables them to make a payment (or transfer property) to an income beneficiary, if the following condition is satisfied: *"the trustees are satisfied that it is likely that, but for the distribution, there would have been a receipt from the body corporate that would have been a receipt of income for the purposes of the trust"* (clause 3(1)(b)). The payment must be made *"with a view to placing the [income] beneficiary in the position in which the beneficiary would have been had there been the receipt of income mentioned in subsection (1)(b)"* (clause 3(2)).

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5 [2009] EWHC 1920 (Ch), [2009] WTLR 1339.

1.8 The LS suggested that clause 3 was not required and that income beneficiaries should accept the outcome of the classification imposed by clause 2. We appreciate the concern that granting trustees a discretion may disproportionately complicate their role, but do not consider that the classification rules for demergers should be reformed in such a way that significant prejudice to income beneficiaries cannot be remedied, even if it occurs only on rare occasions. We have therefore concluded that it is appropriate to retain clause 3.[6]

1.9 **Effect on other powers to advance capital.** STEP expressed concern that the power in clause 3 might prejudice trustees' other powers to pay capital to beneficiaries, in particular the statutory power of advancement under section 32 of the Trustee Act 1925, citing *Re Evans*.[7] We have considered this point but do not agree that the statutory power of advancement would be affected. The power conferred by section 32 can be exercised only in favour of the capital beneficiary, whereas the power in clause 3 of the Bill is exercisable in favour of the income beneficiary.

1.10 **The condition for the exercise of the power.** Two respondents were particularly concerned about the condition in clause 3(1)(b) for the exercise of the power. The Chancery Bar Association (ChBA) suggested that *'likely'* should be clarified as *'sufficiently likely to make it unfair not to compensate the income beneficiary in respect of the income receipt in question'*. The LS considered that the condition should be reformulated so that the power would be exercisable at the trustees' absolute discretion, if they believed that it was *'appropriate to do so in order to maintain a fair balance between the income and capital beneficiaries'*. We have looked at these issues but consider that it is sufficient to leave this matter to the trustees' judgment of what is "likely", and that it would not be proportionate to give them a general power to readjust the beneficiaries' respective entitlements on the grounds of "maintaining a fair balance".

1.11 **Trustees' decision to exercise the power.** Three respondents (two associations and a firm of solicitors) were concerned that giving the trustees the power to make such a payment may prove contentious in practice. The LS argued that it would not be possible for a trustee to work out with certainty whether there would have been an income distribution, or how much it would have been, and suggested that specific protection for trustees regarding liability would be necessary. STEP suggested that the power should be more flexible, enabling the trustee to make a payment with a view to *"wholly or partially placing the beneficiary in the position the beneficiary would have been [if] he had received the income"*, rather than requiring an *"all or nothing"* approach.

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[6] For a consideration of the issues see paragraphs 5.88 to 5.92 of the Law Commission Report.

[7] [1967] 1 WLR 1294.

1.12 We agree that the new power should be drafted in such a way as to minimise the potential for disputes between trustees and beneficiaries. As explained above, it is a matter for the trustees whether they consider that the condition for the exercise of the power is met, or not. We intend to amend the draft Bill to make clear that the amount of the payment is a matter within the trustees' subjective judgment, according to their view of the facts at the relevant time.

2. Do you agree that the common law and statutory apportionment rules should be disapplied for trusts created after the draft Bill comes into force, unless specifically incorporated by the settlor?

2.1 18 respondents responded to this question. 17 (94%) agreed with the proposal that the common law and statutory apportionment rules should be disapplied for trusts made or arising after the draft Bill comes into force, unless specifically incorporated by the settlor. Eight respondents (44%) noted a number of specific issues in relation to this proposal and the drafting of clause 1 (disapplication of apportionment etc rules).

2.2 **Disapplying the rules in *Re Atkinson* and *Re Bird*.**[8] The ChBA suggested that there might be good reason to retain the rules in *Re Atkinson*[9] and *Re Bird*:[10] *Re Atkinson* because the calculations are *"straightforward"* and in practice the rule generally achieves fairness between the beneficiaries, and *Re Bird* because although the calculations are more difficult, the rule is *"unlikely to apply nowadays [as] it is unusual for any investment to be unauthorised".* The Association pointed out that in the absence of any general power of allocation it would be difficult to achieve that fairness between beneficiaries and considered that the consequences of disapplying these rules are more serious.

2.3 The ChBA also argued that, if these rules are disapplied, clause 1 should expressly state how trustees should deal with such receipts. According to their research there is no authority on the effect of excluding these rules. They considered that the proceeds of realising an investment to which these rules would have applied should be applied

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[8] The rule in *Re Atkinson* [1904] 2 Ch.160 is intended to divide between the income and capital beneficiaries any loss resulting from a shortfall in the return of an authorised investment; where the rule applies the loss is divided in proportion with a calculation based upon what portion of the debt was principal and what portion of the debt was interest due. *Re Atkinson* specifically deals with a mortgage; however, a similar rule has been applied in relation to other authorised investments where there is capital and income owed. In *Re Bird* [1901] 1 Ch.916 the rule in *Re Atkinson* was extended to include losses incurred by unauthorised investments, such that the shortfall is divided between the income beneficiary and the capital beneficiary according to the proportion of total income and capital that would have been received.

[9] [1904] 2 Ch.160.

[10] [1901] 1 Ch.916.

first to capital and then only to arrears of income once that capital has been paid in full. The ChBA argued that this is more likely to protect the trust fund because it gives the income beneficiary, who is more likely to be aware of the problematic investment, more of an incentive to act quickly.

2.4 The Trust Law Committee (TLC) agreed with the ChBA that there should be an express statement of the legal position after removal of these apportionment rules and that this should involve the application of the proceeds to capital first.

2.5 We have considered these concerns. Removing the rules in Re *Atkinson* and *Re Bird* will only reverse the default position; it will be open to testators and settlors of express trusts to incorporate these rules specifically if they want them to apply to the trust. We accept, however, that it would be desirable to clarify the legal position after they are disapplied. We therefore propose to address this in the drafting of the Bill by specifying that the proceeds of realising such investments should be applied first to the amount due in respect of the capital debt.

2.6 **Expand clause 1 to disapply all branches of the apportionment rules.** One individual and the Association of Corporate Trustees (TACT) suggested that the wording in clause 1 should be expanded to disapply all branches of the apportionment rules. The concern of these respondents was that if the statute does not specifically disapply all such branches of these rules this could lead to litigation. We consider that the draft Bill is effective in disapplying the relevant apportionment rules. Various authorities as to how those rules are applied (either generally or in specific situations) have emerged, but these will fall away together with the rules on which they rely.[11]

2.7 **Further application of the rules.** In addition STEP expressed concern that specifying in clause 1 the rules to be disapplied might leave it open to the courts to uphold some further application of the apportionment rules in the future. STEP and the LS suggested that the Secretary of State should be able to make further provision by order if this should occur. However the LS acknowledged that the likelihood of this eventuality is low, as all of the relevant cases in relation to apportionment rules were decided over 100 years ago. Given this we are not convinced that it is appropriate for a delegated power to be provided to the Secretary of State to make provision for some remote possibility of further application of the apportionment rules.

2.8 **Existing trusts.** Three respondents (two associations and an individual) (16%) suggested that the disapplication of the apportionment rules

[11] For example, the "rule in *Re Perkins*" [1907] 2 Ch 596, which relates to the apportionment of annuity payments which the testator covenanted during his lifetime to make, is an application of the rule in *Allhusen v Whittell* (1867) LR 4 Eq 295; see *Re Darby* [1939] Ch 905, 915–6, by Sir Wilfrid Greene MR.

should have some effect for existing trusts. TACT, for example, said that the removal of the apportionment rules would speed up the distribution of the trust fund. It was suggested that trustees of existing trusts should be able to elect (in writing) to disapply the apportionment rules, and that the current approach is too limited. We have considered this point but are concerned that such a power to elect could undermine the expectations of the original settlor or testator of such a trust. Given this we do not intend to make any general provision for the disapplication of apportionment rules for existing trusts.

2.9 **Trusts created by advancement or appointment.** The Institute of Chartered Accountants in England and Wales (ICAEW) asked for clarification as to the position of new subsidiary trusts that come into being by the exercise of a power of advancement or appointment created by the original settlor of a trust established before the commencement of this Bill. STEP considered that the words *"created or arising"* in clause 1(1) include trusts created by the exercise of such powers under a pre-existing trust and felt that this should be clarified by a transitional provision.

2.10 The ChBA also considered that this issue should be clarified (either in clause 1 or under the power in clause 5(3) for the Secretary of State to make provision for "transitory, transitional or saving purposes"). They argued that if, as is usually the case, the trustees could have excluded the apportionment rules in the appointment or advancement those rules should not apply to the subsidiary trusts. We agree that it should be clear whether the Bill applies. We propose that clause 1 should apply also to trusts created by the exercise of a power of advancement or appointment out of existing trusts, if the terms of the "parent" trust give the trustees express powers to prevent the apportionment rules from applying to the trusts so created.

3. Do you agree that charities should be given the power to make a resolution to spend their permanent endowment for the purposes of undertaking total return investment, subject to compliance with Charity Commission regulations?

3.1 14 respondents responded to this question. 13 (92%) of them agreed that charities should be given the power to make a resolution to spend their permanent endowment for the purposes of undertaking total return investment, subject to compliance with Charity Commission regulations. Five respondents (35%) noted a number of specific issues.

3.2 **Endowment funds of charitable bodies corporate.** The new section 75BA of the Charities Act 1993 to be inserted by Clause 4 of the Bill *"applies to any available endowment fund of a charity which is not a company or other body corporate".* This wording is the same as that in sections 75 and 75A of the Charities Act 1993, inserted by the Charities Act 2006. The Charity Law Association (CLA) stated that it is uncertain what funds are excluded by these words and for what purpose, since a company may only hold permanent endowment as a trustee, and not

beneficially. The CLA noted that when these provisions were discussed during the Committee stages of the Act's passage through the House of Commons the then Minister confirmed that charitable companies could use the power in those sections to spend the permanent endowment of which they were a corporate trustee.[12]

3.3 The CLA queried in particular how the new section 75BA would apply to Royal Charter corporations, due to conflicting statements and authorities as to whether Royal Charter bodies can hold their property beneficially, or whether they must always hold it on trust. The CLA expressed concern that if the latter is the case, such bodies would not be able to use the power in the draft Bill.

3.4 We have discussed this point with the Charity Commission in relation to the interpretation of the wording in sections 75 and 75A of the Charities Act 1993. They have confirmed that in their view the reference to a company or other body corporate in those sections includes a charity established as a limited company, industrial and provident society or by Royal Charter.

3.5 Although the matter is not beyond doubt, the Charity Commission's view is that charities incorporated by Royal Charter can hold their property as beneficial owner but would hold an endowment on trust. In principle the Charity Commission would consider a section 75 (or 75A) resolution passed by a Royal Charter body in respect of endowment funds of which it is trustee to be valid.

3.6 The same result is intended in relation to the new section 75BA inserted by clause 4 of this Bill. We do not consider it desirable to depart from the existing formulation in sections 75 and 75A of the Charities Act 1993.

3.7 **Spending the permanent endowment.** The new section 75BA(2) of the Charities Act 1993, inserted by clause 4 of the Bill, describes the resolution which the charity trustees may make: *"that the fund, or a portion of it, ought to be freed from the restrictions with respect to expenditure of capital that apply to it".* The CLA suggested that this is too wide because it could enable trustees to spend the whole of the permanent endowment itself, not just capital growth. They expressed concern that intending donors might be put off because of the risk that their intention of a durable endowment would be undermined. The CLA anticipated that this power will be cut down by the regulations to be made by the Charity Commission under the new section 75BB (also inserted by clause 4) but argued that it is inappropriate for the scope of the power to spend the permanent endowment to be left to regulations. They considered that the Bill should allow the trustees to invest permanent endowment without needing to balance capital growth and income and, subject to regulations, to decide what part of the capital gains should be treated as income.

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[12] Ed Miliband, Hansard 11 July 2006, Column 241.

3.8 We agree that the current drafting of the new sections gives the trustees power to make a resolution in wide terms and the Charity Commission a wide power to regulate the adoption of total return investment by resolution. The detail of the regulation is to be set out in the Charity Commission's regulations. On reflection, whilst we think it appropriate that the detail should be set out in the Charity Commission's regulations – on which there will be separate consultation and which can be amended from time to time in the light of experience – we are persuaded that by emphasising the freedom of trustees not to maintain a balance between capital and income, the drafting approach taken in clause 4 may not have clearly expressed the spirit of the new power. Trustees are always required to make decisions about retention and expenditure responsibly with a view to balancing present and future needs. To remedy this we intend to make specific reference to the possibility that the regulations may specify limits on total return investment, such as the extent to which the fund must remain unspent. We hope that these amendments will address the concerns expressed by consultees.

3.9 **Section 75BA(3) of the Charities Act 1993.** The new section 75BA(3) of the Charities Act 1993, inserted by clause 4 of the Bill, describes the first condition which must be met in order for trustees to be able to make a resolution to free the fund, or part of it, from the restrictions on expenditure of capital. It states that the charity trustees must be 'satisfied that it is likely that the total return from the fund or portion would be greater if it could be invested without the need to maintain a balance between capital and income returns'.

3.10 STEP and the LS both questioned whether section 75BA(3) is necessary and whether the requirements of subsection (4) would be sufficient. The CLA commented that the wording of section 75BA(3) is prospective only, and we note that trustees may find it difficult to be satisfied that the condition is fulfilled on the basis only of possible future increases in returns.

3.11 As part of our reconsideration of the drafting of the new sections to be inserted by clause 4 we will consider further whether those provisions could be merged to provide an improved description of the points on which charity trustees have to be satisfied. In particular we intend to make clear that the trustees may make the resolution if they are satisfied that it is in the interests of the charity that the fund or part of it should be subject to the regulations made by the Charity Commission to facilitate its investment on a total return basis.

3.12 **Historic Capital Gains.** The CLA also queried whether trustees would be able to spend historic capital gains under a resolution. Since historic capital gains are subject to a restriction on being expended for the purposes of the charity, we take the view that they are included within the permanent endowment (as defined at section 96(3) of the Charities Act 1993) and thus part of the available endowment fund for the purposes of new section 75BA. This means that they will be available for expenditure under the scheme of the Bill.

3.13 **Accumulating income.**[13] The CLA expressed concern that section 14 of the Perpetuities and Accumulations Act 2009 would prevent charities from implementing a complete form of total return investment in accordance with the regulations made under the new section 75BB. Section 14 limits the effect of any provision to accumulate income in an instrument providing for property to be held on trust for charitable purposes to a fixed period of 21 years, or the period which ends with the death of the settlor, or one of the settlors if more than one, unless the provision is made by a court or the Charity Commission. The concern is that regulations under section 75BB will not be a provision made by the Charity Commission for the purposes of section 14. It would clearly be unsatisfactory if this was the case because accumulation is an integral part of total return investment. To overcome this uncertainty we propose making clear that the restrictions in section 14 will not apply where trustees have resolved to make a fund or part of it subject to regulations under section 75BB.

4. The Impact Assessment indicates that the draft Bill will result in moderate fiscal benefits for businesses, charities or the voluntary sector, and the public sector. Do you agree and do you have any evidence to support your view? Please give as much detail as you can about you, your organisation or those you represent and address the following:

a) exactly how you or your organisation would be affected; and

b) what the cost (monetary or otherwise) to you, your organisation, or those you represent would be, explaining how this has been quantified where possible.

4.1 Four respondents (two associations, a firm of solicitors and an individual) responded to this question. Two associations (50%) expressly agreed that the Bill would result in moderate fiscal benefits providing anecdotal evidence.

4.2 **How will organisations be affected?** Three consultees commented on the limited impact of the proposals. One law firm specialising in trusts and estates suggested that these changes will only affect them marginally, given that the apportionment rules have been routinely excluded from the majority of trusts. The CLA stated that the changes will be beneficial to charities, but that the extent of that benefit will depend on the subsequent regulations made by the Charity Commission. They indicated that if the regulations impose terms and conditions which are similar to those currently imposed by an Order from the Charity Commission, then the use of the new statutory power is likely to be less administratively burdensome than applying to the Commission for an Order and the cost of taking professional advice for that purpose (estimated at £1,000 on average) will be saved. However it should be

[13] Accumulation in this context is the conversion of income from trust property into capital. It should be distinguished from the administrative retention of income.

noted that some legal advice would still be required at a lower cost. TACT noted that excluding existing trusts from clause 1 (removal of apportionment rules) would restrict the impact of the reform.

4.3 We have included reference to these points in the impact assessment. A copy of the revised assessment is at Annex C.

5. Further comments by respondents

5.1 **The use of orders.** ICAEW expressed concern as to the use of Orders rather than primary legislation to amend Acts, stating concern that this process curtails the opportunity for public debate in Parliament. They specifically requested that an undertaking be made in relation to clauses 2 (orders to define further tax-exempt corporate distributions) and 4 (regulations under section 74BB of the Charities Act 1993) that any proposed changes be subject to public consultation before being presented to Parliament. These orders and regulations will be made subject to a negative resolution procedure and will in practice usually be the subject of public consultation before they are made. We consider that this provides for an appropriate level of scrutiny. The procedure applied to the section 75BB regulations is the same as applies to other similar measures under the Charities Act 1993 and the changes that might be made by orders under clause 2 are likely to be highly technical.

5.2 **Delegated Powers**. ICAEW requested clarification in clause 5 as to why the Secretary of State is to be given the power to delay, potentially indefinitely, the coming into effect of this Bill. The commencement provision in clause 5 provides for the Bill to come into force on a date to be fixed. The Secretary of State is under a duty to keep the setting of this date under review. This is a usual provision where the timing of commencement is flexible. It allows time for any necessary preparations, including publicity of the impending changes, to be made over an appropriate period. In the case of the Bill, it may be desirable to link the coming into force of clause 4 with the making of the regulations under section 75BB. This may lead to separate commencement dates for different purposes. We do not propose any change to the Bill.

Conclusion and next steps

We are very grateful to everyone who responded to the consultation paper. Although some respondents had some concerns about some points of detail, the overall response to the consultation was overwhelmingly supportive and confirmed the assessment we had made of the impact of our provisional proposals. We have considered all the points made and, as we have described, have decided to make several amendments to the Bill in response to the points raised. References to paragraphs are to paragraphs of this response document.

Amendments

We will consider making the following amendments to the Bill given the responses that we received. These are as follows:

Clause 1 – Disapplication of apportionment etc. rules

- **Clause 1 – Trusts created by advancement or appointment.** We propose that clause 1 should apply also to trusts created by the exercise of a power of advancement or appointment out of existing trusts, if the terms of the "parent" trust give the trustees express powers to prevent the apportionment rules from applying to the trusts so created (paragraph 2.10).
- **Clause 1(2) – Disapplication of the rule in *Re Atkinson* and the rule in *Re Bird*.** We propose to clarify the legal position after disapplication of these rules by providing that the sale proceeds of the relevant investments are to be applied first to the amount due in respect of the capital debt (paragraph 2.5).

Clause 2 – Classification of certain corporate distributions as capital

- We intend to update the references in the draft Bill to sections 213(2) and 213A of the Income and Corporation Taxes Act 1988 to the corresponding provisions of the Corporation Tax Act 2010 (paragraph 1.4).

Clause 3 – Power to compensate income beneficiary

- **Clause 3(2) – Classification of payment to income beneficiary.** We intend to make clear in the Bill that a clause 3 payment will be capital in the beneficiary's hands for trust purposes (paragraph 1.2).
- **Clause 3(2) – Payment to income beneficiary.** We intend to amend the draft Bill to make clear that the amount of the payment is a matter within the trustees' subjective judgment, according to their view of the facts at the relevant time (paragraph 1.12).

Clause 4 – Total return investment by charities

- **Clause 4 – new section 75BA(2) of the Charities Act 1993 – spending the permanent endowment**. We intend to amend the Bill to make clear that the trustees may make the resolution if they are satisfied that it is in the interests of the charity that the fund or part of it should be subject to the regulations made by the Charity Commission to facilitate its investment on a total return basis (paragraph 3.8). We also intend to make specific reference to the possibility that the regulations may specify limits on total return investment, such as the extent to which the fund must remain unspent (paragraph 3.8).
- **Clause 4 – new section 75BA(3) of the Charities Act 1993**. We will consider further whether subsections (3) and (4) of the new section 75BA(3) should be merged to provide an improved description of the points on which charity trustees have to be satisfied before they can resolve that the fund or portion and income arising from it should be subject to regulations enabling total return investment (paragraph 3.11).
- **Clause 4 – Accumulating income**. We propose making clear that the restrictions in section 14 of the Perpetuities and Accumulations Act 2009 will not apply where trustees have resolved to make a fund or part of it subject to regulations under section 75BB (paragraph 3.13).

Next steps

The next step is to draft the Bill incorporating the proposed amendments. The Bill will then be introduced into Parliament when parliamentary time permits.

Consultation Co-ordinator contact details

If you have any complaints or comments about the consultation **process** rather than about the topic covered by this paper, you should contact Sheila Morson, Ministry of Justice Consultation Co-ordinator, on 020 3334 4498, or email her at consultation@justice.gsi.gov.uk.

Alternatively, you may wish to write to the address below:

Sheila Morson
Consultation Co-ordinator
Ministry of Justice
102 Petty France
London SW1H 9AJ

If your complaints or comments refer to the topic covered by this paper rather than the consultation process, please direct them to the contact given under the **How to respond** section of this paper at page 5.

The consultation criteria

The seven consultation criteria are as follows:

1. **When to consult** – Formal consultations should take place at a stage where there is scope to influence the policy outcome.

2. **Duration of consultation exercises** – Consultations should normally last for at least 12 weeks with consideration given to longer timescales where feasible and sensible.

3. **Clarity of scope and impact** – Consultation documents should be clear about the consultation process, what is being proposed, the scope to influence and the expected costs and benefits of the proposals.

4. **Accessibility of consultation exercises** – Consultation exercises should be designed to be accessible to, and clearly targeted at, those people the exercise is intended to reach.

5. **The burden of consultation** – Keeping the burden of consultation to a minimum is essential if consultations are to be effective and if consultees' buy-in to the process is to be obtained.

6. **Responsiveness of consultation exercises** – Consultation responses should be analysed carefully and clear feedback should be provided to participants following the consultation.

7. **Capacity to consult** – Officials running consultations should seek guidance in how to run an effective consultation exercise and share what they have learned from the experience.

These criteria must be reproduced within all consultation documents.

Annex A – List of respondents

Judiciary

1. The Hon Mrs Justice Proudman DBE representing the judges of the High Court, Chancery Division

Associations

2. Association of Corporate Trustees (TACT)
3. Association of Pension Lawyers
4. Chancery Bar Association (ChBA)
5. City of Westminster and Holborn Law Society
6. Law Reform Committee of the Bar Council of England and Wales
7. Law Society (LS)
8. British Bankers' Association
9. Society of Trust and Estate Practitioners (STEP)
10. Trust Law Committee (TLC)
11. Institute of Chartered Accountants in England and Wales (ICAEW)
12. Charity Law Association (CLA)

Firms of Solicitors

13. Lane Smith and Shindler

Accountancy firms

14. Baker Tilly accountants

Banks

15. Royal Bank of Scotland

Regulator of Charities

16. Charity Commission

Individuals

17. Mark Herbert QC
18. Richard Williams
19. Paul Saunders
20. Tim John Smith

DRAFT

OF A

B I L L

TO

Amend the law relating to capital and income in trusts.

BE IT ENACTED by the Queen's most Excellent Majesty, by and with the advice and consent of the Lords Spiritual and Temporal, and Commons, in this present Parliament assembled, and by the authority of the same, as follows:—

1 Disapplication of apportionment etc. rules

(1) Any entitlement to income under a trust created or arising after this section comes into force is to income as it arises (and accordingly section 2 of the Apportionment Act 1870 (c. 35), which provides for income to accrue from day to day, does not apply in relation to the trust). 5

(2) The following do not apply in relation to a trust created or arising after this section comes into force—

(a) the first part of the rule known as the rule in *Howe* v. *Earl of Dartmouth* (which requires certain residuary personal estate to be sold);

(b) the second part of that rule (which withholds from a life tenant income arising from certain investments and compensates the life tenant with payments of interest); 10

(c) the rule known as the rule in *Re Earl of Chesterfield's Trusts* (which requires the proceeds of the conversion of certain investments to be apportioned between capital and income); 15

(d) the rule known as the rule in *Allhusen* v. *Whittell* (which requires a contribution to be made from income for the purpose of paying a deceased person's debts, legacies and annuities);

(e) the rules known as the rule in *Re Atkinson* and the rule in *Re Bird* (which require losses on certain investments to be apportioned between capital and income). 20

(3) Trustees have power to sell any property which (but for subsection (2)(a)) they would have been under a duty to sell.

(4) In a case where there is a trust instrument, subsections (1) to (3) have effect subject to any contrary provision in the instrument. 25

2 Classification of certain corporate distributions as capital

(1) A receipt consisting of a tax-exempt corporate distribution is to be treated for the purposes of any trust, whether created or arising before or after this section comes into force, as a receipt of capital (even if it would otherwise be treated for those purposes as a receipt of income). 5

(2) In a case where there is a trust instrument, subsection (1) has effect subject to any contrary provision in the instrument.

(3) The following are tax-exempt corporate distributions for the purposes of this section and section 3—

(a) a distribution that is an exempt distribution by virtue of section 213(2) or 213A of the Income and Corporation Taxes Act 1988 (c. 1), and 10

(b) any other distribution of assets (in any form) by a body corporate, where the distribution is of a description specified by an order made by the Secretary of State by statutory instrument.

(4) An order under subsection (3)(b) may specify a description of distribution only if neither income tax nor capital gains tax is chargeable in respect of a distribution of that description. 15

(5) The making of an order under subsection (3)(b) requires the consent of the Treasury.

(6) A statutory instrument containing an order under subsection (3)(b) is subject to annulment in pursuance of a resolution of either House of Parliament. 20

3 Power to compensate income beneficiary

(1) Subsection (2) applies in any case where—

(a) by virtue of section 2 a tax-exempt corporate distribution made by a body corporate is treated for the purposes of a trust as a receipt of capital, and 25

(b) the trustees are satisfied that it is likely that, but for the distribution, there would have been a receipt from the body corporate that would have been a receipt of income for the purposes of the trust.

(2) Where this subsection applies, the trustees may make a payment out of the capital funds of the trust, or transfer any property of the trust, to an income beneficiary with a view to placing the beneficiary (so far as practicable) in the position in which the beneficiary would have been had there been the receipt of income mentioned in subsection (1)(b). 30

(3) In subsection (2) "income beneficiary", in relation to a trust, means a person entitled to income arising under the trust, or for whose benefit such income may be applied. 35

4 Total return investment by charities

After section 75B of the Charities Act 1993 (c. 10) insert—

"75BA Investment of endowment fund on total return basis 40

(1) This section applies to any available endowment fund of a charity which is not a company or other body corporate.

(2) Where the following conditions are met, the charity trustees may resolve for the purposes of this section that the fund, or a portion of it, ought to be freed from the restrictions with respect to expenditure of capital that apply to it.

(3) The first condition is that the charity trustees are satisfied that it is likely that the total return from the fund or portion would be greater if it could be invested without the need to maintain a balance between capital and income returns. *5*

(4) The second condition is that the charity trustees are satisfied that it is in the interests of the charity that the fund or portion, and income arising from it, should be subject to regulations under section 75BB(1)(b). *10*

(5) While a resolution under subsection (2) has effect—

(a) the fund or portion is not subject to the restrictions mentioned in that subsection, but

(b) the fund or portion, and income arising from it, is subject to regulations under section 75BB(1)(b). *15*

(6) In this section "available endowment fund" has the same meaning as in section 75.

75BB Total return investment: regulations

(1) The Commission may by regulations make provision about— *20*

(a) resolutions under section 75BA(2), and

(b) the investment of a relevant fund without the need to maintain a balance between capital and income returns, and expenditure from such a fund.

(2) Regulations under subsection (1)(a) may, in particular— *25*

(a) specify steps that must be taken by charity trustees before passing a resolution under section 75BA(2),

(b) make provision about the variation and revocation of such a resolution,

(c) require charity trustees to notify the Commission of the passing, variation or revocation of such a resolution, and *30*

(d) specify circumstances in which such a resolution is to cease to have effect.

(3) Regulations under subsection (1)(b) may, in particular—

(a) make provision about the taking of advice by charity trustees in connection with the investment of, and expenditure from, a relevant fund, *35*

(b) specify circumstances in which expenditure from a relevant fund requires the Commission's consent, and

(c) require charity trustees to report to the Commission on the investment of, and expenditure from, a relevant fund. *40*

(4) Any regulations made by the Commission under this section must be published by the Commission in such manner as it thinks fit.

(5) In this section—

(a) "relevant fund" means a fund, or portion of a fund, in respect of which a resolution under section 75BA(2) has effect, and *45*

(b) references to expenditure from a relevant fund include references to expenditure of income arising from such a fund.”

5 Short title, commencement and extent

(1) This Act may be cited as the Trusts (Capital and Income) Act 2009.

(2) This section comes into force on the day on which this Act is passed, but otherwise this Act comes into force on such day as the Secretary of State may by order made by statutory instrument appoint. *5*

(3) An order under subsection (2) may—

(a) appoint different days for different purposes;

(b) make such provision as the Secretary of State considers necessary or expedient for transitory, transitional or saving purposes in connection with the coming into force of any provision of this Act. *10*

(4) This Act extends to England and Wales only.

Title: **Trusts (Capital and Income) Bill** **Lead department or agency:** Ministry of Justice **Other departments or agencies:**	Impact Assessment (IA)
	IA No: MOJ057
	Date: 01/12/2010
	Stage: Final
	Source of intervention: Domestic
	Type of measure: Primary legislation
	Contact for enquiries: paul.hughes@justice.gsi.gov.uk

Summary: Intervention and Options

What is the problem under consideration? Why is government intervention necessary?

Three aspects of trust law are under consideration: 1) the rules governing the classification of receipts from tax-exempt corporate demergers as income or capital; 2) the rules apportioning receipts between capital and income beneficiaries; and 3) the rules under which charities with permanent endowments can adopt total return investment (TRI).
Government intervention is necessary because: 1) the classification rules are problematic, and cause unnecessary costs; 2) the apportionment rules are not fit for purpose, and cause unnecessary costs; and 3) the cost of administering the rules for adopting TRI can be reduced to the benefit of charities and the Charity Commission.

What are the policy objectives and the intended effects?

Policy objectives are to: 1) create a consistent and appropriate rule governing the trust law classification of receipts from tax exempt corporate demergers; 2) remove unnecessary and burdensome rules of apportionment; and 3) streamline the process by which charities can obtain authorisation to adopt TRI.

The effect will be to decrease the cost of administering private and charitable trusts, reduce litigation, decrease the regulatory burden on the Charity Commission and encourage the take-up of TRI (bringing better returns on investments to charities).

What policy options have been considered? Please justify preferred option (further details in Evidence Base)

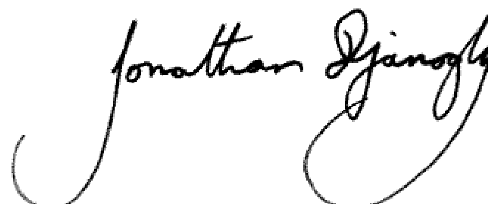
Option 0: Do Nothing

Option 1: Enact the Trusts (Capital and Income) Bill. It contains a targeted tax-neutral reform package, reducing administrative costs and facilitating the use of TRI This option is preferred. It offers tax-neutral improvements to trust administration and investment by reducing costs and facilitating access to higher investment returns under TRI.

When will the policy be reviewed to establish its impact and the extent to which the policy objectives have been achieved?	It will be reviewed 01/2017
Are there arrangements in place that will allow a systematic collection of monitoring information for future policy review?	No

Ministerial Sign-off For final stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) the benefits justify the costs.

Signed by the responsible Minister:  Date: 13 January 2011

Summary: Analysis and Evidence

Policy Option 1

Description:

Enact the Trusts (Capital and Income) Bill.

Price Base Year N/A	PV Base Year N/A	Time Period Years N/A	Net Benefit (Present Value (PV)) (£m)		
			Low: Optional	**High:** Optional	**Best Estimate:** N/Q

COSTS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	Optional		Optional	**Optional**
High	Optional		Optional	**Optional**
Best Estimate				**Not Quantfied**

Description and scale of key monetised costs by 'main affected groups'

Other key non-monetised costs by 'main affected groups'

Minor and negligible one-off awareness and familiarisation costs

BENEFITS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	Optional		Optional	**Optional**
High	Optional		Optional	**Optional**
Best Estimate				**Not Quantfied**

Description and scale of key monetised benefits by 'main affected groups'

Other key non-monetised benefits by 'main affected groups'

Ongoing benefits relating to trust investment management also expected to be broadly moderate in size. Benefits in terms of irritant reduction from removing rules which have unintended and distortionary impacts.

Key assumptions/sensitivities/risks **Discount rate (%)** N/A

For proposal 3: The extent of the benefit of the new scheme will depend on the detail of the new regulations. If it is too restrictive charities will be unnecessarily limited in undertaking total return investment but if it is too permissive the risk of inappropriate total return investments increases. We understand that the Charity Commission intends to consult on proposed regulations to assist it in striking the right balance.

Impact on admin burden (AB) (£m):			Impact on policy cost savings (£m):	In scope
New AB: N/Q	**AB savings:** N/Q	**Net:** N/Q	**Policy cost savings:**	No

Enforcement, Implementation and Wider Impacts

What is the geographic coverage of the policy/option?			England and Wales		
From what date will the policy be implemented?			01/09/2011		
Which organisation(s) will enforce the policy?			Beneficiaries for Clauses 1 - 3 and Charity Commission for Clause 4		
What is the annual change in enforcement cost (£m)?			Insignificant		
Does enforcement comply with Hampton principles?			Yes		
Does implementation go beyond minimum EU requirements?			No		
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:** N/A	**Non-traded:** N/A	
Does the proposal have an impact on competition?			No		
What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable?			**Costs:**	**Benefits:**	
Annual cost (£m) per organisation (excl. Transition) (Constant Price)	**Micro** n/q	**< 20** n/q	**Small** n/q	**Medium** n/q	**Large** n/q
Are any of these organisations exempt?	No	No	No	No	No

Specific Impact Tests: Checklist

Set out in the table below where information on any SITs undertaken as part of the analysis of the policy options can be found in the evidence base. For guidance on how to complete each test, double-click on the link for the guidance provided by the relevant department.

Please note this checklist is not intended to list each and every statutory consideration that departments should take into account when deciding which policy option to follow. It is the responsibility of departments to make sure that their duties are complied with.

Does your policy option/proposal have an impact on…?	Impact	Page ref within IA
Statutory equality duties[1] Statutory Equality Duties Impact Test guidance	Yes	16
Economic impacts		
Competition Competition Assessment Impact Test guidance	No	16
Small firms Small Firms Impact Test guidance	Yes	16
Environmental impacts		
Greenhouse gas assessment Greenhouse Gas Assessment Impact Test guidance	No	16
Wider environmental issues Wider Environmental Issues Impact Test guidance	No	16
Social impacts		
Health and well-being Health and Well-being Impact Test guidance	No	16
Human rights Human Rights Impact Test guidance	No	16
Justice system Justice Impact Test guidance	Yes	16
Rural proofing Rural Proofing Impact Test guidance	No	16
Sustainable development Sustainable Development Impact Test guidance	No	16

[1] Race, disability and gender Impact assessments are statutory requirements for relevant policies. Equality statutory requirements will be expanded 2011, once the Equality Bill comes into force. Statutory equality duties part of the Equality Bill apply to GB only. The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland.

Evidence Base (for summary sheets) – Notes

Use this space to set out the relevant references, evidence, analysis and detailed narrative from which you have generated your policy options or proposal. Please fill in **References** section.

References

Include the links to relevant legislation and publications, such as public impact assessment of earlier stages (e.g. Consultation, Final, Enactment).

No.	Legislation or publication
1	Law Commissioners report "Capital and Income in Trusts: Capital and Apportionment" (LC Report No. 315) www.lawcom.gov.uk/citcat.htm
2	Trusts (Capital and Income) Bill Consultation Paper CP07/10 (Published on 22 March 2010)
3	
4	

+ Add another row

Evidence Base

Ensure that the information in this section provides clear evidence of the information provided in the summary pages of this form (recommended maximum of 30 pages). Complete the **Annual profile of monetised costs and benefits** (transition and recurring) below over the life of the preferred policy (use the spreadsheet attached if the period is longer than 10 years).

The spreadsheet also contains an emission changes table that you will need to fill in if your measure has an impact on greenhouse gas emissions.

Annual profile of monetised costs and benefits* - (£m) constant prices

	Y_0	Y_1	Y_2	Y_3	Y_4	Y_5	Y_6	Y_7	Y_8	Y_9
Transition costs										
Annual recurring cost										
Total annual costs										
Transition benefits										
Annual recurring benefits										
Total annual benefits										

* For non-monetised benefits please see summary pages and main evidence base section

Microsoft Office Excel Worksheet

Evidence Base (for summary sheets)

1. Introduction and Background

1. Trusts are an important mechanism for the management of property by individuals and businesses. They can be viewed individually as an arrangement established by one person (a settlor) whereby another person (the trustee) is given the power to manage property (money, land, investments, etc.) on behalf of another person (the beneficiary). The beneficiary enjoys the benefit of the property, while the trustee has the obligation to manage it. These arrangements can be very simple or very complicated.
2. Very large trusts may be used as investment vehicles, and small trusts may be used to ensure that property is shared fairly. It is impossible to say how many trusts are governed by the law of England and Wales, because trusts are private arrangements and there is no central registration requirement. However, in 2008, 195,000[2] trusts returned the relevant income tax self assessment forms to HM Revenue & Customs and 55,552[3] charities were structured as trusts. It is reasonable to conclude that trusts are commonplace and play an important role in families, society and the economy.
3. Some aspects of trust law cause difficulty and expense to trustees. Many larger tax paying trusts are able to pay for expert legal advice to address these issues. Many smaller trusts do not usually have the benefit of such legal advice. The technical complexity of some areas of trust law can cause confusion and frustration, particularly where the amount of money at stake does not warrant expensive specialist legal advice. When the Trustee Act 2000 passed through Parliament, concerns were expressed about the complicated and difficult rules relating to the distinction between capital and income in trusts, leading to these rules being referred to the Law Commission for consideration.
4. The proposed Trusts (Capital and Income) Bill is the result of the Law Commission's work. It would reform three problematic areas of trust law, all of which concern the situation where a trustee holds investments on behalf of different classes of beneficiaries and has to determine whether a receipt generated by the investment is capital or income. These problems affect lay trustees and specialists, private trusts and charitable trusts.
5. The Bill implements the Law Commission's three legislative recommendations in its May 2009 report "Capital and Income in Trusts: Capital and Apportionment"[4]. These recommendations, which are intended to be tax-neutral, are –
    a. to abolish certain rules of apportionment, which are no longer generally regarded as useful in the context of modern trust administration, while giving settlors the option to reproduce them by express provision if they wish to do so (clause 1);
    b. to change the classification – from income to capital – of receipts from certain tax-exempt corporate demergers (clause 2);
    c. to give trustees a discretion to compensate an income beneficiary in cases where the classification achieved by clause 2 would prejudice the income beneficiary (clause 3); and
    d. to enable charity trustees to operate total return investment without obtaining an order from the Charity Commission (clause 4).

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[2] HM Revenue and Customs, Table 13.1 – Trusts and Estates which make a Full Self Assessment Return. Available at www.hmrc.gov.uk/stats/trusts/table-13.1.pdf. Because some returns are filed late, statistics for this year in the published table may be less complete than for other years.

[3] Information provided by the Charity Commission – charities registered with the Charity Commission according to governing document as at 06.08.2008.

[4] http://www.lawcom.gov.uk/citcat.htm

6. The Law Commission initially consulted interested parties in 2004 and this consultation formed the basis of the proposals set out above. The proposals were strongly endorsed on publication by the Trust Law Committee and the Society of Trust and Estate Practitioners.
7. To ensure that these proposals were still supported a further consultation was undertaken by the MoJ in March 2010. The consultation paper sought views on the draft Bill and asked the specific questions about the proposed reforms to establish whether respondents agreed with them and whether there were any issues which needed to be addressed. We also sought further evidence on the potential impacts of the proposals.
8. 20 responses were received to the consultation paper. Of these, over half (11) were from associations, some of which represent many thousands of professionals. The remaining respondents consisted of 4 individuals, a firm of solicitors, a High Street bank, an accountancy firm, the Charity Commission (a regulator of registered UK charities) and the Judges of the Chancery Division of the High Court.
9. The vast majority of the respondents agreed with all three legislative recommendations. However, one, the Law Society, disagreed with the proposed power to make compensatory payments (clause 3) and several criticised certain points of detail in the Bill.
10. Only four consultees commented specifically on the Impact Assessment, but some of the comments made on other topics related to its content. We have taken all these comments into account in updating this assessment. In general, the comments made agreed with the assessment.
11. As a result of the consultation we intend to make some minor changes to the Bill. These changes should create greater clarity and certainty and should reduce the potential for disputes and other adverse consequences.

2. Scope of the Impact Assessment

12. The proposals affect all trusts which are required to deal differently with income and capital.
13. Two sorts of trusts will be particularly affected by reform. First, trusts set up for a number of beneficiaries in succession. For example, a settlor may include in his will a gift of property (£5,000) to a trustee on terms that it is to be enjoyed by his wife during her lifetime and then passed to their children after his wife's death. The £5,000 cannot be given to the wife outright, because if it is spent then the children will have nothing. Instead, the wife will have the right to the income from the £5,000 during her lifetime, and the children will be entitled to the £5,000 fund upon their mother's death. There is therefore a difference between the person entitled to the income (money generated from an investment) and the person who is entitled to the capital (the property used to generate income).
14. Secondly, the distinction between capital and income is also relevant to charities that are established as trusts. The number of such trusts is not known but Charity Commission records indicate that 55,552[5] charities were structured as trusts in 2008. A charitable trust does not have named beneficiaries, but instead benefits a charitable purpose. Instead of balancing the interest of different beneficiaries, the distinction between capital and income arises because the charity trustees are required to be even-handed between the interests of present and future recipients of charitable expenditure. Some settlors giving money to charity specify that the capital fund they donate is not to be spent on the charitable purpose, but invested. This fund is the permanent endowment of the charity. In such cases the income from the investment is the only money that can be applied to the charitable purpose. Such arrangements are intended to ensure that the charity can continue to provide a benefit long into the future, and not be exhausted in the short-term. In December 2008 almost

[5] Information provided by the Charities Commission – charities registered with the Charities Commission according to governing document as at 06.08.2008.

14,000 charitable trusts were registered with the Charity Commission with a permanent endowment.

15. The proposed reforms in the Bill to the apportionment of capital and income will affect all new trusts; those relating to the classification of tax-exempt corporate distributions will affect all trusts, irrespective of when they were created; and those relating to charities will be available for all charitable trusts with a permanent endowment. People creating new trusts will be able to replicate the apportionment rules and exclude the effect of the new classification rules if they so wish.
16. Aside from affecting all parties involved in a trust these proposals will also affect the professionals involved in establishing and administering trusts. Where actions are taken in respect of how trustees are managing the trust, legal and other advisers and the judicial system may be involved.
17. In so far as the current position and the proposed reforms affect how trusts manage their investments then the financial services sector and the entities in which trusts invest might also have an interest at the margin in these proposals.
18. The features of the present law therefore potentially affect large numbers of trusts, but in practice their effect can be excluded.

3. Problem under consideration

Classification of corporate receipts on a demerger

19. This reform applies to all trusts, new and old, charitable and non-charitable. The reform relates to demergers which are subject to a specific tax treatment.[6] The reform amends the way in which shares received by trustees on such demergers are classified – that is, treated as income or capital – for trust law purposes.
20. A corporate demerger occurs when a part of an existing company is split off to become a separate new company, which operates independently from the original company. Shareholders of the original company are usually given an equivalent stake of ownership in the new company. Demergers are often undertaken to enable the separate corporate parts to operate more smoothly, to enable a company to sell off a portion of its business, or to return value to shareholders who may then sell the shares they receive. Trustees receive the shares in demerged companies as part of trust assets. In the cases we are concerned with the distribution by the company will be tax exempt. This is referred to as a tax exempt corporate distribution.
21. Financially the effect of a demerger is to split one lump of capital into two. However, under current trust law some demerged shares are classified as income and some are classified as capital. This depends on whether the demerger is structured by the company as a “direct” demerger or an “indirect” demerger. In a direct demerger, a company (A) transfers part of its business to a new company (B). The shareholders of A get shares in B distributed by way of a dividend from Company A. In an indirect demerger, a company (A) transfers shares in a subsidiary company (B) to a separate holding company (C). The shareholders of A get shares in C by way of dividend declared by Company A and satisfied by the issue of shares by Company C.
22. Where a demerger is “direct” the shares received are classified as income. Where it is “indirect” they are classified as capital.

[6] Income tax is not payable on a share distribution on demerger where that distribution falls within section 213(2) or section 213A of the Income and Corporation Taxes Act 1988; such distributions are defined in section 218 as ‘exempt distributions’. The corresponding provisions in the Corporation Tax Act 2010 are sections 1075 to 1085 and we intend to update the Bill to reflect the current legislation.

23. For example:

    A settlor gives property (£5,000) to a trustee to be enjoyed for the lifetime of one person (A), then given to another person (B) after A's death. A has the right to the income from the property during A's lifetime, and B will be entitled to the £5,000 fund upon A's death.

    Under the current rules, if the £5,000 was used to buy shares in a company which then demerged by means of a direct demerger, the part of the shareholding representing the shares in the demerged company would be reclassified as income and distributed to A. As a consequence upon A's death B would inherit in value less than £5,000, contrary to the intention of the settlor.

    If, on the same facts, the demerger was structured as an indirect demerger, the shares received as a result of the demerger would be treated as capital and remain the entitlement of B.

24. The treatment as income of a receipt of shares from a direct demerger therefore provides a windfall to the beneficiary entitled to income at the expense of the beneficiary interested in capital. The treatment from an indirect demerger is preferable, but is based on a decision of the lower court which does not bind more senior courts and so might be subject to challenge at a later date.
25. The current law on classification of receipts of tax-exempt corporate distributions gives rise to a range of problems:
    - The fact that different sorts of demerger give rise to different classifications might lead to trusts needing to obtain advice about the treatment of demerger receipts. This requires investigation into the technicalities of the demerger. Costs may be incurred by trustees and time spent in establishing the correct analysis of the demerger.
    - Trusts may not work as intended by the settlor who established them. For example, where children are capital beneficiaries of a trust their childcare may be funded out of advancements of capital, which could be jeopardised if the capital fund was eroded by a large unexpected payment of income out of the trust. In the case of a charitable trust, the income arising might have to be spent on current charitable purposes rather than being held for use in the future. In both cases, value could be stripped from the trust which could compromise its ability effectively to serve its purposes.
    - Trustees might take avoiding action, in particular disposing of the corporate shares in question prior to the corporate demerger and acquiring other shares. Transaction costs may be incurred in taking this action and there might also be costs in terms of reduced share performance.
    - Capital beneficiaries might consider pursuing legal action against the trustees for failure to take steps to avoid the implications of a direct corporate demerger.
    - Litigation might also be generated by attempts to counteract the effect of the corporate demerger. Trustees might decide to apply to the court to vary the terms of the trust to overcome the unwanted consequences of the demerger, generating legal costs.

26. The response to the MoJ consultation supported the proposal to change the classification – from income to capital – of receipts from certain tax-exempt corporate demergers. Some consultees wanted the reform to go further but this would have raised tax issues. No new problems were identified, but some consultees were concerned that the power in Clause 3 to make compensatory payments to the income beneficiary might cause some problems for trustees. As a result we intend amending the Bill to make clear that the amount of a payment under Clause 3 (as well as the decision as to whether a payment should be made) is a matter within the trustees' subjective judgment.

Reform of the Apportionment Rules

27. Apportionment rules are legal rules that developed in the 19th century to divide income and capital between beneficiaries in what was thought to be a fair way in particular circumstances. Five of the rules stem from court rulings where the court considered that the default distribution caused inequalities. There is also a statutory rule of apportionment governing the allocation of income that accrues over a period. These six rules are only applied in defined circumstances which recent changes in trust law have made less likely to occur. The motivation behind the rules was that because a trustee has a duty to balance the interests of the beneficiaries, the interests of the 'income beneficiary' and the 'capital beneficiary' should be evened out. The apportionment rules apply to all trusts by default but may be expressly excluded from the trust deed by the settlor.
28. The apportionment rules aim at providing balance between trust beneficiaries either by requiring the trustee in specific circumstances to sell certain property and invest it differently or by requiring a specified compensating payment to be made either to the income beneficiary or the capital beneficiary.
29. There is no general rule achieving fair apportionment between the income beneficiary and the capital beneficiary, although there is of course a general duty on trustees to balance their respective interests in administering the trust.
30. Currently almost all professionally drafted trusts specifically exclude the apportionment rules as they are technical and inflexible, requiring complex calculations to establish transfers between beneficiaries of what are often very small amounts of money, i.e. the costs of applying the rules is often disproportionate in relation to the sums of money involved. Legal costs are incurred at the outset if the rules are excluded, in drafting the exclusion and spending time explaining what the rules are and why exclusion is desirable.
31. In cases where the rules have not been excluded, for example by oversight or where trusts are created automatically by the intestacy rules (when someone dies without leaving a will), the trustees might be unaware of them, might not be applying them properly or might be choosing to ignore them. In these instances the trustees might be liable to actions from beneficiaries as a result of not applying the rules. There is value to trustees in not being exposed to this potential liability. Even where the failure to observe the rules does not result in litigation, the gap between the law and practice maintains rules that are not fit for purpose.
32. The response to the consultation supported the proposed reforms to the apportionment rules, subject to clarification of some points of detail. To meet these we propose that trusts created under a power of advancement or appointment after commencement will have the benefit of the reforms if the trustees could have disapplied the rules of apportionment in any event. This will remove any doubt as to the scope of application of the reforms. We also propose to clarify the position after disapplication of one of the equitable apportionment rules by specifying that the sale proceeds of investment which are security for both principal and interest will be applied to the capital debt first. One consultee wanted to extend the benefit of the reform to all trusts, but we consider that this would risk interfering with the intentions of the person who created the trust. Some consultees commented that the present rules are not burdensome because they are routinely excluded.

Charity Commission regulation and total return investment (TRI)

33. Many charitable trusts have a permanent endowment. A permanent endowment is made up of funds where there are restrictions as to how the money is to be allocated (for example, held as capital or spent as income). Generally described, if an investment return received by a trust with permanent endowment is classified as capital it must be added to the charity's capital for investment. This means it cannot be spent on the charitable purposes. If the

investment return is classified as income the charity is under an obligation to spend the income on the specified charitable purposes.

34. These formal classification rules have required charities to make investments based upon the form they take so as to try to ensure the desired balance between what is considered to be income and capital. This may restrict the choice of investments the charity can make and so may hamper the charity's ability to create an appropriate balance between risk and return. It means that a charity with permanent endowment may be unable to take the same approach to selecting an investment portfolio that would be taken by an individual, a company or a fully discretionary trust. In addition, however carefully the charity attempts to select investments that provide a balance, unexpected returns may create a windfall for income or capital. This may result in investments which were to be held for future growth being spent as income, or returns which were expected to be expendable income having to be invested.
35. Total return investment ignores the technical classification of investment returns and instead allows trustees to look at the overall investment return, and allocate funds to the charitable purposes or investment without being concerned about the form that the return takes. Removing this artificial restriction allows for more flexible and potentially profitable investment strategies.
36. The Charity Commission supports total return investment. Charities can currently apply to the Charity Commission under section 26 of the Charities Act 1993 to be authorised to pursue a total return investment strategy under a Charity Commission scheme, but as at the time of the consultation only 46 charities had done so. Anecdotal evidence suggests that the fact that an authorisation has to be given may put charities off undertaking total return investment as it adds complication, moderate cost and (as charity trustees often meet at intervals) delay. In addition, the terms on which the Charity Commission currently authorises total return investment have been criticised by charities and their advocates as overly burdensome. As a result, the current system presents some barriers to the uptake of total return investment by charities.
37. The response to the consultation was overwhelmingly in favour of the proposed reform that will allow charity trustees with a permanent endowment to operate total return investment without obtaining an order from the Charity Commission. Consultees did however raise concerns about the extent of the freedom that might be given to trustees and the width of the proposed regulatory power. One respondent stated that the costs to charities of the new power to opt in to total return investment would not be clear until the Charity Commission's regulations had been made.
38. To meet these concerns we propose amending the Bill to clarify that: trustees must look to the interests of the charitable trust as a whole before resolving to apply the Charity Commission's Total return investment regulations; the regulations may deal with various matters, including specifying limits on what may be spent; and trustees complying with the regulations may accumulate income. Charities would need to follow these regulations to effect total return investment.
39. We agree that the extent of the benefit of the new scheme will depend on the detail of the new regulations. If it is too restrictive charities will be unnecessarily limited in undertaking total return investment but if it is too permissive the risk of inappropriate total return investments increases. We understand that the Charity Commission intends to consult on proposed regulations to assist it in striking the right balance.

4. Economic Rationale for Government Intervention

40. The conventional economic approach to Government intervention is based on efficiency or equity arguments. The Government usually considers intervening if there is a strong enough failure in the way a market operates ('market failures') or in the way that the Government already intervenes ('government failures'). The Government also considers intervening for equity (fairness) reasons. In addition the proposed intervention should be effective and efficient enough to address the issue at stake without generating a further set of distortions.
41. In this instance existing rules and requirements are generating inefficiencies in the way trusts manage their investments. This includes placing restrictions on the way in which trusts would otherwise operate and creating undesirable distortions in trustee decision-making. These inefficiencies are unintentional in some cases and avoidable in other cases. The rationale for government intervention is therefore to tackle failures associated with existing restrictions. In the case of demergers, intervention will also tackle unfairness.

5. Cost Benefit Analysis

"Do Nothing" Base Case / Option 0

Description

42. The base case is that the proposed reforms would not be adopted and the situation described above would continue as now.

Costs and Benefits of the Base Case

43. Because the Base Case is necessarily compared against itself for the purposes of this Impact Assessment its costs and benefits are both zero and the overall net present value of the Base Case is zero.

Costs and Benefits of Option 1 – the package of reform

44. The three elements of the tax-neutral package of reforms are mutually independent. We shall consider each in turn.

Proposal 1 – Classification of corporate distribution after tax exempt demerger (clauses 2 and 3)

45. The effect of the reforms would be to amend the law so that all shares distributed on a tax exempt demerger would be classified as capital. This would secure a consistent, logical result that accords with the financial reality of the distribution, whether it takes the form of a direct or indirect demerger. In exceptional cases the classification of all such shares as capital would disadvantage some income beneficiaries if the income has been rolled up by the distributing company into capital prior to the demerger. In this case the Bill would give the trustees power to compensate the income beneficiary from trust capital. We expect that the power to make payments will only be rarely exercised but to overcome possible problems identified by consultees we intend to amend the Bill so that whether the trustee has properly exercised this discretion will be assessed subjectively. This should reduce the occasion for legal challenge and so keep the cost of the new power down.
46. While it is impossible to estimate how many tax-exempt demergers there are per year, broadly publicised demergers by publicly listed companies demonstrate the potential extent of the reform. Examples of publicly listed companies which have demerged in recent years include Severn Trent, WHSmith, Scottish Power, Anglo American and BT.

47. It is impossible to know with certainty how many shareholders in publicly listed companies are trustees, but anecdotal evidence confirms that many trusts invest in companies that have demerged or might demerge in the future. One London solicitors' firm reported that 150-200 trusts it was involved with were affected by the ICI/Zeneca demerger in 1993. Many of the larger cases are fairly common constituents of a lot of portfolios.

Costs of Proposal 1

48. The income beneficiary would no longer receive the benefit of the tax exempt corporate distributions on a direct demerger. This is thought to be fair. Costs attributable to this re-classification are expected to be negligible. The duty to pay under clause 3 is expected to arise infrequently and the costs should be commensurately low. There might be initial negligible familiarisation and awareness costs.

Benefits of Proposal 1

49. The capital beneficiary would receive the benefit of the tax exempt corporate distributions on a direct demerger. Reform would save trustees the cost of obtaining advice on the analysis and effects of demergers. As an illustrative example if there were one corporate demerger per year of a reasonably large public company, if 500 trusts held shares in that company, and if between one and two hours of legal advice at around £130 per hour was provided per trust in relation to the implications of that demerger, then the proposals would save around £100,000 per year in legal costs.
50. Any unfairness to beneficiaries associated with accepting the distributional consequences of the current rules for direct demergers would be avoided.
51. Reform would avoid the costs of trustees taking action to sell shares of companies that are about to demerge (and reinvesting elsewhere). The costs of buying and selling the shares would be saved. There would be no potential failure to maximise return on the original investment or possible reduced returns or increased risk from the alternative investment.
52. The costs related to beneficiaries taking legal action against the trustees for failure to avoid the effects of the current rules would be avoided. It is unclear how extensive such legal actions might be, but anecdotal evidence suggests that if there were any such actions the costs in each case would probably not be insignificant.
53. The costs that maybe currently incurred by some trusts of seeking court approval to a variation of the trust, would be saved. It is unclear how many such court applications currently take place, but anecdotal evidence suggests that if there were any such actions the costs in each case would probably not be insignificant, with costs being borne by the trust fund. In some cases the variation of a trust may be very expensive.

Net Impact of Proposal 1

54. In summary the benefits of Proposal 1 are likely to outweigh the costs. Current rules create distortions which generate disbenefits and costs. These would be avoided if the rules were changed. The new rules are not expected to generate significant further costs themselves.

Proposal 2 – Reform of the Apportionment Rules

Description

55. These reforms would result in the apportionment rules no longer being applied by default but they would remain available for inclusion in trust deeds should the settlor so wish. This reform would apply to new trusts only, not to existing trusts.

Costs of Proposal 2

56. Costs are expected to be negligible. The reform brings the law into line with existing general practice for professionally drafted trusts, which generally exclude these rules already. There might be initial familiarisation and awareness costs associated with learning about the reform.

Benefits of Proposal 2

57. In relation to new trusts which exclude the apportionment rules there would be savings in terms of settlors and beneficiaries no longer needing to incur legal costs to understand what the rules are and drafting the trust deeds in such a way as to exclude them. Anecdotal evidence suggests that although the expense incurred in drafting the exclusion is minimal, costs in the order of £300 per trust might arise where the settlor wants an explanation of the exclusions. The comments of one consultee suggest that such explanation is rarely given.
58. There may be cases where the apportionment rules may not have been excluded, either by choice, or because the settlor was unaware of them or in the case of trusts which arise without anyone having made a specific decision to create them, such as those arising on intestacy, because they are the default provision. In all such cases the rules may not be followed by trustees or not be implemented fully because they were not known about or were inappropriate given the nature of the trust. In relation to such situations the reforms would benefit trustees as they would no longer be open to legal action as a result of not applying the rules and there no longer being a gap between law and practice in this regard.
59. In relation to situations where the apportionment rules were followed, there would be savings in terms of no longer applying undesirable technical and complex rules which often relate to very small sums of money and involve disproportionately costly calculations, or attempting to agree estimates between beneficiaries where that is possible. Anecdotal evidence suggests that the cost of applying the rules is around £1,000. One solicitor's firm has reported an individual case in which costs for legal advice and negotiation amounted to £15,000.
60. It can be estimated that per year 800 – 1100 trusts for beneficiaries in succession are created where people die without leaving a valid will (intestacy), where the apportionment rules will automatically apply. Such trusts are created where the deceased left a spouse (husband, wife or civil partner) and children or other descendants. If the intestacy rules apply to more than £250,000 of the estate (other than personal items), one half of the rest passes into a trust under which the spouse is entitled to the income and the children or other descendants to the capital. Under the proposed reforms, the apportionment rules will not apply to these trusts, removing a source of complication.

For illustrative purposes, it can be estimated that there are 800 – 1,100 trusts created by the law of intestacy per year. Even if only 25% of trustees of these trusts are required to apply the apportionment rules (approximated at £1,000) this would cost a minimum of £200,000 under the above assumptions.

Even if only 100 settlors per year require advice on the apportionment rules (estimated at £300) this would cost £30,000 per year under the above assumptions.

Net Impact of Proposal 2

61. In summary the benefits of Proposal 2 are likely to outweigh the costs. The costs are one-off and negligible and the benefits are likely to be greater than this and ongoing.

Proposal 3 – Charity Commission regulation and total return investment

Description

62. At present very few charities apply to the Charity Commission for approval to adopt total return investment. At the time of the consultation there were 46 charities with total return orders out of around 14,000 charitable trusts with a permanent endowment registered with the Charity Commission. 10 of these orders were granted by the Charity Commission in 2008/09.
63. The effect of the reforms would be to allow charitable trusts with a permanent endowment to opt-in to total return investment without making a prior application to the Charity Commission. Instead they can resolve that they wish to adopt this form of investment. The resolution will replace the application. This will clearly be less burdensome.
64. The Trustees will need to assess the merits of adopting total return investment as at present, and, which is new, ensure that they comply with the scheme of total return investment offered by the Charity Commission regulations and the conditions in the Bill. These are that total return investment is likely to increase the total return from the relevant assets and that it is in the interests of the charity to adopt that approach under the regulations.
65. The Charity Commission regulations have not yet been formulated, so the costs of compliance with them cannot yet be estimated. It is however expected that a standard form scheme for adoption by resolution will be less costly to use and comply with on a case by case basis than a stand alone application process as at present.
66. The ability to opt into the scheme by resolution rather than by application might encourage uptake at the margin as application costs would be avoided. The Charity Commission does not charge an application fee. The application procedure is relatively light touch and its removal is not expected to reduce protections as it is more akin to an administrative registration procedure than to a gateway procedure. Nonetheless, anecdotal evidence has estimated the cost of each application as £1,000 or more.

Costs of Proposal 3

67. For charitable trustees the Bill will reduce the overall cost of adopting total return investment. The cost of making the resolution itself will be negligible. Trustees will need to consider the terms of the regulations and ensure that they can satisfy the conditions specified in the Bill but this should almost invariably be less difficult and expensive than making an application to the Charity Commission under the present system. There might be initial familiarisation and awareness costs associated with learning about the reform. For the Charity Commission there may be costs in implementing this one-off change, such as creating the regulations and associated guidance and publicity**.**

Benefits of Proposal 3

68. Removing the application requirement and enhancing the Charity Commission's total return investment scheme will facilitate total return investment by charities at the margin. It is unclear whether the removal of this minor barrier might increase the number of charities investing in this way, nevertheless there would be a saving for those which already would like to engage in total return investment.
69. It is generally accepted that a total return investment strategy yields increased investment returns (without increasing risk), on the basis that investment choices are no longer restricted by the requirement to generate returns in a particular form. For purely illustrative purposes only, if total return investment led to a 0.5% increase in returns, a higher value charitable trust[7] with permanent endowment would benefit from increased annual revenue of

[7] The Charity Commission records charitable trusts with permanent endowment as either 'higher value' with a yearly income over £500,000 or "lower value" with an income of less than £500,000.

£150,000.[8] A lower value charitable trust with permanent endowment would benefit from increased annual revenue of between £1,250 and £3,750.[9]

70. Enabling Total return investment by resolution rather than application would have direct benefits to charities wanting to undertake total return investment as they would no longer have the minor complication, cost and, delay of submitting an application. There would also be no need for ongoing correspondence.
71. The Charity Commission would gain from no longer processing applications. Given the current annual volume of applications the total administrative cost savings per year to the Charity Commission are likely to be of the order of £9,000. For example:

Savings from the new process: if there are **15** applications per year, which each take 15 hours of work (**£34.50** per hour) plus 1.5 hours of an accountant's time (**£54** per hour), the reforms could amount to a minimum **£9,000** saving per year.

Net Impact of Proposal 3

72. In summary the benefits of Proposal 3 are likely to outweigh the costs. The costs are one off and negligible but the benefits are ongoing and might be significant. It is important to note that based on consultation responses received in March 2010 there was a general concern as to what the impact of this proposal would be given that it depends on the development of regulations by the Charity Commission.

Enforcement and Implementation

73. In relation to private trusts the enforcement of the reformed law relating to apportionment and classification will be responsibility of the beneficiaries. Trustees who breach their duties will be at risk of being sued and made liable for breach of trust. This follows the usual policy of the law in relation to trusts. The Act will be brought into force at such time as the Secretary of State thinks appropriate.
74. The decision by trustees of charitable trusts with permanent endowment to exercise the new power to adopt total return investment is a matter within their discretion**.**
75. It is a condition of the adoption of total return investment under the new provision that the fund or portion and income arising from it should be subject to the Charity Commission's regulations. The Charity Commission can take regulatory action if it appears that the trustees have committed a breach of trust or duty. Whilst the main regulatory body for charities is the Charity Commission, the Attorney General also has powers, when acting in the public interest as protector of charity, to commence proceedings for breach of trust. This is only one example of the broad range of powers the Attorney General holds in respect of charity matters and it is not expected that these proposals will have any significant impact on the exercise of those powers by the Attorney General. It is also possible for a trustee to take action against the other trustees, but in all likelihood such a trustee would complain to the Charity Commission in the first instance.
76. The reforms will be brought into force on a date to be fixed by order. The timing has not yet been settled. It is possible that the reforms may be brought into force at different times.

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[8] Assuming the average asset value of a higher value trust is £30.5 million, based on figures provided by the Charity Commission, giving the average asset value as at 29 April 2009 based on completed accounts for 2007 and 2008 of 786 higher value trusts which are registered charities.

[9] It has not been possible to find any statistics on the average size of lower value charitable trusts with permanent endowment. Therefore we consider the likely effects of reform on a range of asset values for these trusts from £250,000 to £750,000. As at 18 December 2008 there were 13,884 charitable trusts with permanent endowment (Charity Commission figures); deducting the 786 higher value trusts leaves approximately 13,000 lower value charitable trusts with permanent endowment.

Specific Impact Tests

Competition Assessment

77. These proposals are not expected to directly or indirectly limit the number or range of suppliers. They are not expected to limit the ability of suppliers to compete. They are not expected to limit suppliers' incentives to compete vigorously.

Small Firms Impact Test

78. Businesses with fewer than 50 employees may be affected by the Bill if they are small legal or trust services suppliers. They may be affected by a reduction in trust related business at the margin as a result of the simplifications of procedure made by the Bill. However there may be new business opportunities in relation to total return investment.

Justice Impact Test

79. Impact to the justice system from these proposals is expected to be minimal. There is a possible risk of litigation under proposal one in relation to the compensating payment made to the income beneficiary. However this payment is expected to be made rarely. In any case civil court fees should be set on a cost recovery basis.

Sustainable Development

80. The Government is committed to five principles of sustainable development; (i) living within environmental limits; (ii) ensuring a strong, healthy and just society; (iii) achieving a sustainable economy; (iv) promoting good governance; and (v) using sound science responsibly. The proposals in this Impact Assessment are not expected to have a significant impact on these principles.

Carbon Assessment and other Environmental tests

81. No significant direct impacts are expected.

Health Impact Assessment

82. No significant direct impacts are expected.

Race Equality, Disability Equality, Gender Equality

83. An Equality Impact Assessment (EIA) has been completed. At this stage it is not anticipated that the proposals would have any positive or adverse implications for race equality, disability equality or gender equality. See attached EIA.

Human Rights

84. No impacts are expected.

Rural proofing

85. A differential impact on rural areas is not expected.

Annexes

Annex 1 should be used to set out the Post Implementation Review Plan as detailed below. Further annexes may be added to provide further information about non-monetary costs and benefits from Specific Impact Tests, if relevant to an overall understanding of policy options.

Annex 1: Post Implementation Review (PIR) Plan

A PIR should be undertaken, usually three to five years after implementation of the policy, but exceptionally a longer period may be more appropriate. A PIR should examine the extent to which the implemented regulations have achieved their objectives, assess their costs and benefits and identify whether they are having any unintended consequences. Please set out the PIR Plan as detailed below. If there is no plan to do a PIR please provide reasons below.

Basis of the review: [The basis of the review could be statutory (forming part of the legislation), it could be to review existing policy or there could be a political commitment to review]; The basis of the review is to review existing policy.
Review objective: [Is it intended as a proportionate check that regulation is operating as expected to tackle the problem of concern?; or as a wider exploration of the policy approach taken?; or as a link from policy objective to outcome?] The objective of the review will be to carry out a proportionate check that the new law is operating as expected.
Review approach and rationale: [e.g. describe here the review approach (in-depth evaluation, scope review of monitoring data, scan of stakeholder views, etc.) and the rationale that made choosing such an approach] To ensure the review is proportionate, given the infrequency with which the new law is expected to apply, the approach of the review will be to scan information relating to the effect of the reforms. This will be derived from stakeholder views, legal case reports and academic and other writing.
Baseline: [The current (baseline) position against which the change introduced by the legislation can be measured] The baseline is the current situation. For proposal 1 this is that receipts have to be classified on a case by case basis. The clause 3 duty is new. For proposal 2 the apportionment rules are routinely excluded in express trusts but still apply in other trusts where they result in complicated calculations. For proposal 3 charities have to apply to the Charity Commission to adopt total return investment and at present few do so.
Success criteria: [Criteria showing achievement of the policy objectives as set out in the final impact assessment; criteria for modifying or replacing the policy if it does not achieve its objectives] Proposals 1,2 and 3 - Reforms implemented as planned, postive stakeholder view of reforms and absence of complaints from interested parties about the effect of the reforms. Absence of any significant litigation in relation to the changes. Proposal 3 -An increase in the take up of total return investment.
Monitoring information arrangements: [Provide further details of the planned/existing arrangements in place that will allow a systematic collection systematic collection of monitoring information for future policy review] There are no readily available means of collecting information on the effect of the reforms systematically and to create a new system would be disproportionate. However, interested parties can be expected to bring complaints about the law to our attention. We can also survey case reports and other literature.
Reasons for not planning a PIR: [If there is no plan to do a PIR please provide reasons here] Not applicable.

Add annexes here.

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