Bare Trusts—Outside the Tax Door?

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Abstract

For tax purposes, bare trusts are effectively ignored—they are transparent, the beneficiary is treated as the real owner of the trust asset with any income arising therefrom taxed upon them. However, it is still a trust; whilst discretionary and interest in possession trusts (which I shall call "ordinary express trusts") are subject to special rules with trustees subject to tax, these rules do not apply to bare trusts when, in many cases, the trustees may have similar custodial duties. Also, bare trusts are subject to anti-money laundering regulations and, for tax purposes, adopt other guises such as partnerships and implied trusts. There is thus some disparity between bare trusts and ordinary express trusts, but this disparity may be what makes the bare trust unique. An option to break the transparency and offer settlors a halfway house between transparent tax treatment and greater opaqueness of ordinary express trusts might be a useful feature.

Keywords: bare trust; beneficial ownership; transparent; sham; opaque; express trust; vulnerable persons.

[A] INTRODUCTION

Bare trusts, often referred to as "nominee", "simple" or "naked" trusts—unlike ordinary express trusts—are still trusts but are transparent for income tax, capital gains tax (CGT) and inheritance tax (IHT) purposes—in other words they don't exist as far as HM Revenue and Customs (HMRC) is concerned as the beneficiary is deemed to own the trust asset personally. The bare trustees have no obligation other than to hold the asset for the beneficiary and pass the legal title of the asset to the beneficiary upon demand. They are not treated the same as ordinary express trusts which have their own trust returns for trusts and tax credits for income distributions to beneficiaries. Bare trusts are not a new creation[1] and their trustees have the same legal obligations and responsibilities under trust law as with any other trust but are on the outside of trust tax law. Should they not be brought into the fold and treated as "settlements" for tax purposes?

Kenney and O'Brien (2007) give an interesting analysis of bare trusts and go so far as to state that bare trusts are not actually trusts at all. Nitikman discusses the approach to the Canadian authorities' treatment of bare trusts, whereby the Revenue Authority has recognized that bare trustees can be equated with agents; however, as he also points out:

> it appears to view a bare trust as being automatically an agent for the beneficiaries. That is not correct. The fundamental principle of agency is that the principal can direct the activities of the agent due to a contract between them. A trust is not a contract, so a bare trust cannot per se be an agency (2024: 445).

What are bare trusts?

For UK income tax purposes, bare trusts are defined within section 466 Income Tax Act 2007 as:

> (2) "Settled property" means any property held in trust other than property excluded by subsection (3).
>
> (3) Property is excluded for the purposes of subsection (2) if:
>
> > (a) it is held by a person as nominee for another person,
> >
> > (b) it is held by a person as trustee for another person who is absolutely entitled to the property as against the trustee, or
> >
> > (c) it is held by a person as trustee for another person who would be absolutely entitled to the property as against the trustee if that other person were not an infant or otherwise lacking legal capacity.

"[A]bsolutely entitled to property as against a trustee" is defined in section 466(5) as:

> A person is absolutely entitled to property as against a trustee if the person has the exclusive right to direct how the property is to be dealt with (subject to the trustees' right to use the property for the payment of duty, taxes, costs or other outgoings)

For CGT purposes, a similar transparency provision exists within section 60(1) Taxation of Chargeable Gains Act 1992:

[1] Their being mentioned in the case of *William Aikman v John Aikman of Cairnie* (1677), as referenced by Nitikman (2024: 439).

> In relation to assets held by a person as nominee for another person, or as trustee for another person absolutely entitled as against the trustee, or for any person who would be so entitled but for being an infant or other person under disability (or for 2 or more persons who are or would be jointly so entitled), this Act shall apply as if the property were vested in, and the acts of the nominee or trustee in relation to the assets were the acts of, the person or persons for whom he is the nominee or trustee (acquisitions from or disposals to him by that person or persons being disregarded accordingly).

For IHT purposes, the definition of a "settlement" is contained within section 43 Inheritance Act 1984:

> "Settlement" means any disposition or dispositions of property, whether effected by instrument, by parol or by operation of law, or partly in one way and partly in another, whereby the property is for the time being—
>
> (a) held in trust for persons in succession or for any person subject to a contingency, or
>
> (b) held by trustees on trust to accumulate the whole or part of any income of the property or with power to make payments out of that income at the discretion of the trustees or some other person, with or without power to accumulate surplus income, or
>
> (c) charged or burdened (otherwise than for full consideration in money or money's worth paid for his own use or benefit to the person making the disposition) with the payment of any annuity or other periodical payment payable for a life or any other limited or terminable period.

Bare trusts are therefore outside the definition of a "settlement" under the tax rules and treated the same as a transfer to an individual directly, namely a potential exempt transfer rather than a chargeable lifetime transfer (which is a transfer into a relevant property, ie a separate and ordinary express trust).

Kessler (2012-2013: 68) gives a detailed outline of a bare trust (which he also calls a "nomineeship") and distinguishes them from (what he calls) "substantive" trusts:

> In classifying an entity as a bare or a substantive trust, three rules of trust law (or succession law) are particularly relevant:
>
> (1) A substantive trust must confer rights on more than one person [but not a minor, per section 466 Income Tax Act 2007]. If a trust has only one beneficiary, it can only be a bare trust.

> (2) A testamentary disposition has no effect during the life of the testator/settlor, so if a disposition is classified as testamentary, it can only be a bare trust during the lifetime of the testator/settlor.
>
> (3) A trust which is a sham is generally a bare trust.

[B] SHOULD BARE TRUSTS BE TREATED AS ORDINARY TRUSTS FOR TAX PURPOSES?

Sham

Kessler's third point is possibly the first reason why bare trusts should have their transparent tax status removed; the suggestion is that a bare trust simply is not a trust but rather a mechanism pretending to be one when actually the trustees have no power whatsoever and are merely nominees of the settlor. This proposal is supported by Kenney and O'Brien (2007) and Adams (2022) who point out bare trusts' employment as a means for settlors to escape their creditors. However, the type of arrangements often utilizing bare trusts are regarded as shams only because the settlor retains complete control over the asset and over the trustee (who is merely a nominee[2])—they have not really given up the asset, yet strictly (and legally) they have done so through a bare trust. Were a bare trust to exist, the settlor would either be required to dispose of the asset to another individual or place it into an ordinary express trust (if not another entity like a company), in which case the trustees' first duty would be toward the beneficiary. Kenney and O'Brien's view is that a settlor-interested trust, by definition, is a bare trust and therefore a sham:

> The simple rule remains that the trust is but a sham, or an "illusion", if the whole of the equitable ownership of the trust property remains in the settlor.
>
> There is not a true trust (as opposed to a bare trust) if the equitable ownership remains wholly in the settlor, whether as a matter of form or as a matter of substance (where the form is a sham), so that the settlor can freely dispose of the capital and income by directing the trustees to act as his nominee (2007: 61).[3]

However, an ordinary express trust can also be settlor-interested, so for tax purposes the asset would be regarded as belonging to the settlor; it does not automatically follow that bare trusts and settlor-interested trusts are one and the same, nor that a settlor-interested trust is automatically

[2] HMRC refers to bare trustees as "dummies" and "names" in Manual TSEM6360.

[3] Citing an abstract from Hayton (1992: 3).

a sham. Conaglen (2008: 177) reminds us that a sham trust does depend on there being an intention to disguise the true ownership of the assets and to mislead with dishonesty. The "canonical"[4] case of *Snook v London and West Riding Investments Ltd* (1967: 802) defines the doctrine of the sham trust:

> it means acts done or documents executed by the parties to the "sham" which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create.

So, a bare trust need not be the tool of any malicious intent to disguise the settlor's identity and ownership of an asset. As I will consider below, implied trusts are bare trusts for tax, a means of bringing parties' intentions to fruition and of restitution. Nominee arrangements are also often used for commercial reasons and executors act as bare trustees for certain legatees of a deceased's estate. Whilst bare trusts undoubtably can be used by individuals to hide their true ownership over assets, they are just as susceptible as limited companies to hide the true owner; ordinary express trusts were also sometimes used to hide the true beneficiary as secret or semi-secret trusts. What is significant is that HMRC's Trust Registration Service (TRS), which helps enforce the anti-money laundering (AML) Directives, ensures that bare trust settlors and beneficiaries are properly identified alongside all other trusts—there is now a more level playing field.

The Trust Registration Service

The creation of HMRC's TRS stems from the requirement under the Fourth (and now Fifth)[5] AML Directive that the details of all express trusts' constituent parties, irrespective of any tax liability, be disclosed—including those of bare trusts. Whilst bare trusts do not exist as separate trusts for HMRC, they are subject to the same AML Directive as ordinary express trusts. The logic behind the TRS is to combat the very thing that bare trusts can facilitate—fraud. The application of the TRS to bare trusts has therefore effectively negated the arguments that a bare trust is a sham—the parties' details are reported and the existence of the trust is made available to HMRC, thus (ideally) nullifying their effectiveness as malicious vehicles.

4 This description was given to Snook (1967) in the case of *A v A* (2007: 32).

5 Which took effect on 10 January 2020 as Directive (EU) 2015/849.

Saunders v Vautier (1841)

Under this rule, beneficiaries of majority age may require trustees to transfer the legal title of the trust assets to them absolutely and thus terminate the trust—this rule applies to any ordinary express trust and was extended to discretionary trusts per *Stephenson v Barclays Bank* (1975). Bare trustee beneficiaries can insist that the legal title of the trust asset reverts to them absolutely; so beneficiaries, collectively, have the same potential powers over the trustees whether it is a bare trust or not.

Lessons from Canada

On 29 October 2024 the Canadian Revenue Authority (CRA) announced that, for the years 2023, 2024 and 2025, bare trustees need not file an income tax return (Form T3) unless specifically requested to do so. A similar announcement[6] on 28 March 2024 had exempted bare trusts from filing T3s for 2023 on the grounds that it would have an "unintended impact on Canadians" and would "ensure the effectiveness and integrity of Canada's tax system". However, this exemption would only appear to target inter-spousal trusts; those with minor beneficiaries are still required to submit T3s.

The CRA's general requirement that *all* trusts file T3s would appear to mirror the UK's TRS desire to equate bare trusts with ordinary express trusts; however, the recent announcement concerning exemptions also acknowledges that they are clearly not the same if doing so would undermine the effectiveness and integrity of the tax system as a whole.

Vulnerable Persons' Trusts

Vulnerable Persons' Trusts (VPTs) are ordinary express trusts, made effective and brought to HMRC's attention by an election,[7] whose constitution is focused on the needs of individuals who are not capable of looking after themselves through mental disorder as defined by the Mental Health Act 1983, or are in receipt of state benefits due to a physical disability. The trustees are required to account for the tax (at rates which reflect the beneficiary's marginal tax position) but they are still ordinary express trusts whereby the income is calculated in accordance with the beneficiary's own tax position, whilst the tax is the responsibility of the trustees.

6 Government of Canada, "New – Bare Trusts Are Exempt from Trust Reporting Requirements for 2023" (28 March 2024).

7 Via Form VPE1.

The existence of the VPT might be an argument for saying that ordinary express trusts and bare trusts could be treated the same for tax purposes—the trustees would have the same duties with respect to tax and being a custodian, the beneficiaries have (to some degree) the same rights collectively, and for AML purposes they are treated as separate entities. By treating bare trusts as ordinary express trusts for tax purposes, nothing is changing in those regards, but it would help address the accusation that bare trusts are vehicles of scams. A bare trust can still place minimal obligations on the trustees (essentially keeping them as nominees—or with "passive" duties as Nitikman refers to them (2024: 443)) and near absolute rights to the beneficiary as an adult—so could bare trustees not be subject to tax in the same way as trustees of VPTs are?

[C] DON'T BARE TRUSTS HAVE A SPECIAL ROLE? SHOULDN'T THEY BE KEPT DISTINCT FROM ORDINARY EXPRESS TRUSTS?

Bare trusts are very fluid; they are not only standalone forms of trust, but can take the guise of other entities as set out below.

Partnerships

An ordinary partnership, limited liability partnership (LLP) or limited partnership (LP) are all essentially bare trusts for UK tax purposes with the legal owners holding the assets for the partners: that is, the beneficiaries. Partnerships are transparent for tax purposes, so their income profits/loss and capital gains/losses are taxable on the partners as beneficial owners rather than on the partnership itself. Whilst the legal owners of the partnership assets may also be the beneficial owners, English land can only have four legal owners, whereas a partnership may have more than four beneficial owners/partners—these scenarios may well require registration under the TRS where the legal owners are holding the assets as express trustees for the partners. Partnership law is very distinct from trust law and there cannot really be any confusion between the two, as is possible with trust and agency law. The treatment of partnerships is per the tax legislation and Statement of Practice;[8] they are not bare trusts in any other respect—indeed LLPs are separate corporate entities. LLPs, LPs and ordinary partnerships are separate entities with respect to value-added tax, and Scottish partnerships are distinct entities in Scottish law; yet for UK tax purposes, whatever their standalone status in law, they

8 SP D12, January 1975.

are all bare trusts at their core. Even in the United States, limited liability companies (LLCs) and limited liability partnerships are transparent for tax purposes; however, the partners of an LLC can elect for their partnership to be opaque (ie not transparent, rather a separate taxable entity) for tax purposes thus being treated more like a limited company.

Implied trusts

Resulting trusts are generally either fail-safe mechanisms for failed gifts/ express trusts placing beneficial ownership back onto the donor/settlor or are "common intention" trusts whereby the beneficial ownership is assigned according to the parties' intentions rather than strict recognition of legal ownership. Another type of implied trust is the constructive trust—effectively a form of restitution which imposes trusteeship upon individuals who have unjustly enriched themselves with the possession of property through dishonesty.

Implied trusts are the opposite of express trusts as the intended position, rights and responsibilities of the parties are not expressly laid out—instead they are imposed by the courts (acting as enforcers of the laws of equity). As with the bare trust, it is the beneficiary who is the taxable person, although often that person will not immediately realize they are the taxable person. As these trusts are the product of the courts which impose beneficial ownership and trusteeship, it will often not be until a dispute arises and the court has passed judgment that this will be apparent.

So, what would happen if bare trusts were equated with ordinary express trusts as far as tax is concerned? Partnerships and implied trusts need not change their rules—they are still distinct (transparent) entities, but they would simply not be equated to bare trusts anymore.

[D] WHY SHOULD BARE TRUSTS BE RETAINED AS TRANSPARENT ENTITIES FOR TAX?

The argument in favour of retaining the bare trust's transparency for tax purposes is largely bolstered by two factors: first, the TRS, which has addressed the "bare trust=sham" assertion and made it redundant; second, it is simply not right or just to impose an opaque settlement when one individual intends to make an absolute gift to another. A parent may want their children to have an asset, or cash in a bank account which they can utilize when they are older; children (under 18s in England and

Wales, under 16s in Scotland) cannot own property in their own name; the only way they could do so without any restrictions as to income and/or access to capital is through a bare trust, so this is one of the obvious advantages of retaining its transparent nature. To quote the Government's own guidance:

> Bare trusts are often used to pass assets to young people – the trustees look after them until the beneficiary is old enough.[9]

Likewise, when a life tenant of a trust dies, the trustees hold the assets on bare trust for the remaindermen until the legal title passes over—that was the settlor's intention and there should be no reason why the property should essentially remain settled property. Until the legal title of a deceased's asset is assented to a beneficiary, an executor will hold that asset on bare trust—the beneficiary will be deemed to have owned the asset from death, in accordance with the deceased's wishes.

Bare trusts are therefore more of a mechanism to facilitate absolute and direct ownership—not just a means to defrauding the authorities and concealing the real owner's identity. Sometimes the intended recipient simply cannot have the legal ownership due to age or probate; the possibility that some malevolent individual might use a nominee arrangement to disguise their ownership is no reason to think all bare trusts are shams.

LLPs are bare trusts for tax purposes, as alluded to above, but they are analogous to each other insofar as they are one thing legally and another thing for tax purposes. In a previous article (Thorpe 2024), I suggested that any members of an LLP might want the option to treat their partnership as an opaque entity if they so choose, like partners of LLCs are able to. But what if bare trustees could do the same? What if the trustees could elect to treat the trust as opaque for tax purposes? This would not mean that partnerships or even implied trusts would suddenly be treated as ordinary express trusts, but bare trusts could be so treated to a greater extent.

[E] AN OPAQUE BARE TRUST?

Why would bare trustees want to do this? Prior to the application of the TRS, a government might have wanted opaque bare trusts to clamp down on any fraudulent activity, but this would now seem unnecessary. There may be income tax reasons for taxing the trustees rather than the beneficiary, but that depends largely upon the beneficiary's marginal tax

9 Gov.uk, "Trust and Taxes".

position—very often children, who receive no other taxable income, are beneficiaries of these trusts and so have a personal allowance and basic rate tax band available. This then begs the question: at what rate would trustees pay tax—the basic rate of an interest in possession trust or the additional rates of a discretionary trust with beneficiaries being able to claim a tax credit?

A better option, if the trustees and/or beneficiaries so choose, might be equating bare trusts to VPTs as ordinary express trusts, whereby the trustees account for the income tax but according to the beneficiary's own marginal tax rate. This would combine the benefits of taxing a bare trust's beneficiary with all the integrity of a "substantive" trust comprising of trustees with duties beyond the mere passive. Partnerships and implied trusts would retain their own identities through their respective legal and equitable regimes.

[F] CONCLUSION

The bare trust is not an ordinary express trust, nor can it be equated as such—it is a form of nomineeship or mechanism for holding onto an asset for those who cannot do so themselves. The criticism over bare trusts as shams and vehicles for fraud are largely redundant by the onset of AML regulations treating bare trusts like any other trust, but the possibility still exists; the issue about the tax anomaly is worth addressing.

As with the LLP, we have an entity which is one thing in law and another for tax. However, that is not necessarily a bad thing as it offers great flexibility which allows individuals to be treated as owners of assets for tax without being so in law. Not all nominee arrangements are malicious. However, if it did not suit the parties to the trust or there remained any doubt about the integrity of bare trusts, the option could be available to give tax responsibilities to trustees, akin to those of VPTs who act as custodians for those same individuals who might be beneficiaries of a bare trust. An opaque trust, with the same income tax status as VPTs might be seen as a "bare trust plus", with the trustees having more than nominee or "passive" duties, potentially giving more substance to the "simple" trust. At the same time an election for such treatment should ensure that the chosen beneficiary still has full benefit of the assets – akin to absolute ownership. The beneficiaries of a VPT are in no better position to manage their own affairs in fact as a child is in law; the option to turn a simple nominee arrangement into an ordinary express trust, but one which simultaneously gives the "real" owner of the asset all the benefits of absolute ownership, might be an attractive possibility.

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