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POLITICAL SHIFT SPELLS TAX THREAT AND EMPHASISES THE NEED FOR PLANNING

by Drummond Kerr and Jon Croxford, partners at private client law firm Meridian Private Client LLP

Drummond Kerr

The political shift earlier this year probably means that it is more likely that inheritance tax (IHT) will rise, reliefs may be squeezed and more perceived 'tax loopholes' closed.

As an illustration of that last point, even before the political upheaval, the restrictions on non-domicile status were well under way and are finally to be enacted this autumn - we look at some of these on page 4.

Perhaps in tune with the shifting political sands, earlier this year, Chancellor Philip Hammond hinted that tax rises are not out of the question. It would indeed be no surprise if IHT, along with capital gains tax, were to be in the firing line rather than the more politically sensitive income and corporation taxes.

With these hints and the continuing high level of public debt and public spending, there is an obvious threat. Even without this, higher asset prices, including house price inflation, are bringing more and more families into the IHT net despite the extra relief where family homes are left to children or grandchildren - considered in more detail on page 2.

While this relief is much more restrictive than the headlines would suggest, it will be useful for some families. However, others will benefit more from other IHT reliefs which, in our experience, are not utilised as widely as they should be.

Gifts out of income or where the donor survives for seven years are well known IHT breaks but other reliefs have been introduced in recent years including beneficial treatment for individual savings accounts (ISAs). Now, investment returns (income and capital gains) can continue to be tax free where a husband, wife or civil partner inherits them.

There have been a myriad of changes involving personal pension funds in recent years and these offer many planning opportunities. This is a complex matter on which professional advice should be taken but, in principle, where someone dies under the age of 75, the fund is excluded from the IHT calculations and the recipients of the legacy will not have to pay any tax.

Where the individual passing away is older than 75, those who inherit will have to pay tax at their own highest rate of income tax - but there will be no IHT.

So significant are the pension planning options that some people in 'gold plated' final salary pension schemes have been persuaded to transfer their funds to private pensions in spite of the additional risks.

Another key area of IHT planning is for private business owners or shareholders - here there are valuable capital gains tax and IHT reliefs for business assets – where ongoing planning is needed to ensure that these potential reliefs are secured and maintained.

Planning goes beyond the tax aspects as well. For example, trusts, which can help with the protection of family assets from events such as divorce as well as mitigating IHT bills, should always be considered as an option.

Specialist legal and tax advice at an early stage should be at the heart of this planning.

Jon Croxford

EFFECTIVE WAYS OF HELPING SONS AND DAUGHTERS CLIMB THE PROPERTY LADDER

by Vicki Bennett, associate at Meridian Private Client LLP

Vicki Bennett

As a result of house price increases, younger generations are often unable to afford to purchase a home, leading to the rise of "the bank of mum and dad". Generous parents may be willing to help but will often have concerns in making such significant gifts to their children.

One common concern is where their child intends to live with a partner but a substantial amount of the equity in the property will be the parents' financial contribution. In such cases, parents often wish to ensure that, in the event of the breakdown of the relationship, their financial contribution is protected. Parents may have other practical concerns about passing significant funds to their children.

One option is for parents to purchase all or part of the property and hold it in their own names. However, whilst this gives parents some reassurance as to the security of their investment, it is not efficient from a capital gains tax perspective and parents may not want their child to feel dependent on living in a property owned by them.

We therefore advise parents to consider alternatives that are more tax efficient but which allow them to retain an element of control over the funds they are advancing. One relatively simple solution is to lend funds to the son or daughter, potentially securing the loan against the property.

This allows the child to own the property and qualify for the exemption from capital gains tax applicable to main residences on a future sale. If the child finds him or herself in difficulty, in terms of his or her relationship, the parents can recall the loan. Parents may also decide to write the loan off over time or at an appropriate stage in their child's life, bringing potential inheritance tax (IHT) advantages.

Another option is for the parents to establish a family trust of which they can be the trustees to assist with the property purchase. Apart from enabling the parents to retain an element of control, this has significant tax advantages provided the parents cannot benefit from the trust. In particular, a future disposal of the property can qualify for the capital gains tax exemption for main residences. The funding of the trust, within the available IHT allowances and exemptions, can also form a part of the parents' estate planning.

Parents should therefore consider carefully the manner in which they wish to make funds available to assist children with property purchases.

John Padget

ADDITIONAL INHERITANCE TAX RELIEF FOR THE FAMILY HOME NOT ALL IT SEEMS

by John Padget, solicitor at Meridian Private Client LLP

Rising house prices have been a story of the last few years. One consequence of this increase is that it has dragged more and more people into the inheritance tax (IHT) net. This has mainly been as a result of the basic threshold at which IHT becomes payable being frozen at £325,000 since 2009, with no increase scheduled until April 2020 at the earliest.

In April 2017, the government introduced a new allowance increasing the threshold at which IHT becomes payable in circumstances where the family home is left to children or grandchildren. This new allowance is called the 'additional nil rate band', and is potentially worth £100,000 in relief per person. The government plans to increase this new allowance by £25,000 per year until 2020-2021 when it will be worth a total of £175,000 per person.

Where a death occurs after 6 April 2020, an individual could now potentially have a total IHT tax free allowance of £500,000 or £1m for a couple as unused allowances can be transferred between husbands, wives and civil partners.

However, this additional nil rate band relief is not as good as it at first seems.

Firstly, the rules only cover gifts of property to direct descendants including children, adopted children, stepchildren and grandchildren. The new relief does not apply to trusts unless specific measures are used.

Secondly, the relief is gradually removed where the value of a person's estate exceeds £2m. If the total value of a gross estate for a death after 5 April 2020 exceeds £2.35 million, the relief will not apply.

Thirdly, the new rules discriminate against childless individuals or couples who may want to leave their estates to indirect family or friends. They will be limited to the usual threshold of £325,000 per person and may end up with a significantly higher IHT liability as a result.

As is often the case with new tax legislation, the application of the rules can be complicated and specialist legal advice should be obtained to ensure that the benefit of the new relief is maximised.

TAX PLANNING CAN ADD MORE TO DEVELOPMENT PROFITS

by Jon Croxford, partner at Meridian Private Client LLP

Jon Croxford

With the relaxation of planning rules and the need for more housing generally, there are increasing opportunities for land to be sold for property development.

But without careful tax planning, a substantial proportion of the development profit can be swallowed up in tax bills.

The tax treatment of the sale of land for property development is complex but can be broken down into a few rules of thumb.

Firstly, it is generally preferable if any gain realised on selling land for property development is subject to capital gains tax ('CGT') as opposed to income tax. This is for the simple reason that CGT is now charged at a top rate of 20% (other than for gains on residential property itself, which are taxed at 28%). In comparison, income tax is charged at a top rate of 45%.

Secondly, if at all possible, the sale of land should not only attract CGT treatment but it should qualify for entrepreneurs' relief and a 10% rate of tax. This is only possible if the land is used in a business and if certain stringent conditions are met.

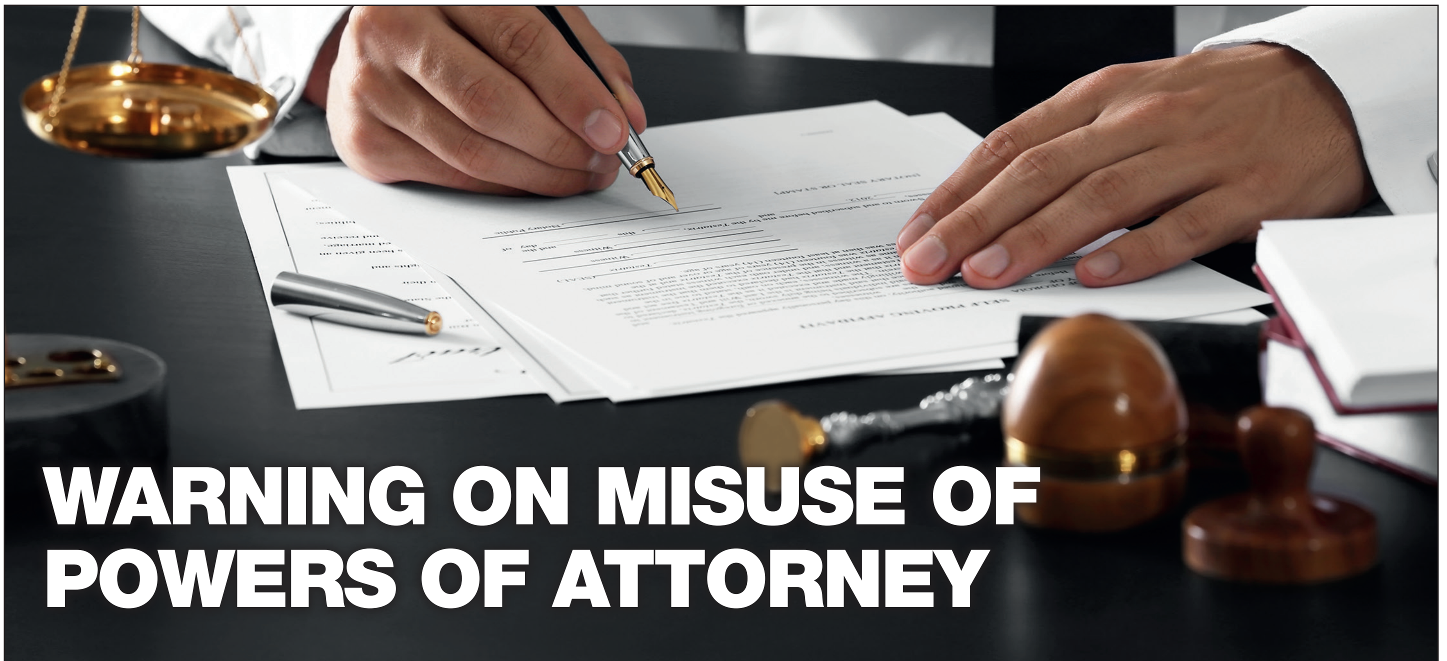
In broad terms, HMRC will want to tax as income any gain realised on a sale of land where either the land was acquired with the intention of selling it on at a profit (in which case HMRC may simply argue that the transaction is in the nature of a trade) or where the land is developed with the intention of realising a profit. In the latter case, HMRC may resort to anti-avoidance legislation commonly referred to as the "transactions in land" legislation.

Importantly, HMRC do not generally consider simply obtaining planning permission as "development" for these purposes. Therefore, a land owner who obtains planning permission or sells land with consideration linked to obtaining planning permission alone, should not fall foul of the income tax rules. HMRC's stated view is that physical development is required if they are to seek income tax treatment.

HMRC will, however, seek to apply income tax treatment where a person sells land under an arrangement where he or she benefits from any future physical development e.g. sharing in the profit from future house sales. Such agreements are often called 'slice of the action' deals.

Therefore, if only for tax reasons but also sometimes for simplicity, it can be best not to become involved in the actual physical development process but simply to sell the land and benefit from the uplift in value derived from obtaining planning permission. This should allow CGT treatment to apply to any gain.

In addition, if the land is currently or can be brought into use in a trade, entrepreneurs' relief and a 10% rate of tax may be achievable. However, this may take planning steps to be undertaken at least a year in advance of sale of the land.



WARNING ON MISUSE OF POWERS OF ATTORNEY

A warning by a retired senior judge on the potential misuse of Lasting or Enduring Powers of Attorney will create concerns for many people.

However, Peter Gate, an associate at Meridian Private Client LLP said: "I believe that such arrangements are still the right course for many people, as long as caution is exercised in deciding on who to appoint and the appropriate advice is taken".

As wills have no effect until death, these are of no use in such circumstances and Lasting Powers of Attorney are designed to help where accident or illness leads to incapacity.

Though such arrangements are theoretically supervised by the courts, a retired senior judge in the Court of Protection, Mr Denzil Lush, has warned of the lack of safeguards and of many cases where the power has been abused.

Peter Gate says that many such abuses come from appointing inappropriate and untrustworthy people.

"The key to ensuring integrity and honesty is to make the appointment while you have the capacity to do so and to select the relevant individuals with care.

"The alternative procedure where the Court appoints a "Deputy" (who are equivalent to an Attorney) to manage your affairs may lead to more direct supervision from the Court but this has significant disadvantages. You have no control over who is appointed by the Court and once appointed the Deputy must not only produce a report and accounts each year for the Court, but the costs involved (including the Court's annual supervision fee) will be paid from your assets. This can quickly become very expensive.

"A professionally drafted Lasting Power of Attorney appointing the right people as attorneys remains the best way to deal with this difficult situation."

DOMICILE RULE CHANGES - AN UPDATE

by Jon Croxford, partner at Meridian Private Client LLP

Much has been written about the proposed changes to the taxation of non-UK domiciled individuals. However, despite being originally proposed in 2015, they have yet to make their way onto the statute books.

Having been pulled from the Finance Bill just prior to the General Election earlier this year, they now look likely to be enacted in a second Finance Bill this Autumn and to take effect with effect from 6 April 2017.

In outline, the main changes are as follows:

- An individual will be deemed domiciled in the UK for all tax purposes once he or she has been resident in the UK for 15 years. Individuals caught by this rule will cease to be able to benefit from the remittance basis of taxation and will therefore be taxed on worldwide income and gains. This also supersedes the current 17 year deemed domicile rule which applies for inheritance tax (IHT) purposes only.
- In compensation, certain qualifying individuals will benefit from a rebasing of their foreign assets for capital gains tax purposes to market value as at 5 April 2017.
- In addition, qualifying individuals will also be able to split out foreign "mixed funds" i.e. funds containing untaxed foreign income and gains and clean capital, into their constituent parts (something which has not previously been possible). This has been termed "account cleansing" and is helpful but may be difficult to apply in practice.
- Offshore trusts established prior to an individual becoming deemed domiciled will retain their tax benefits provided they are not "tainted" by an addition of funds to the trust. There appears also to be a new advantage in that the normal "look through" rules for income tax purposes will be switched off so that foreign source income can be rolled up tax free within such a trust.
- UK residential property held through an offshore company will, for IHT purposes, be treated as owned by the ultimate beneficial owner. This will create an exposure to IHT for non-UK domiciled individuals and for certain trusts established by such individuals.

Individuals and trusts affected by these changes should take specialist advice if they have not done so already.

NEW RECRUITS BOOST FOR MERIDIAN

The Meridian team has been strengthened by the recruitment of two new solicitors, Harpreet Talwar and John Padget.

Both are private client lawyers, with extensive experience of wills and probate, trusts, estate planning, long-term tax planning, powers of attorney and assisting the elderly and with bereavement.

Partner Drummond Kerr said: "The recruitment of Harpreet and John has strengthened our team and will help us with our business development.

"We are planning further expansion and expect to announce further recruitments soon".

At Meridian Private Client LLP, we are used to working alongside clients' other advisers and we are willing to hold initial consultations on a 'no commitment' basis. This newsletter is not a detailed statement of all the law on the matters referred to. Specialist advice from ourselves should be taken in all cases.