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Summer 2016

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Pictured at an event celebrating a decade of successful private client advice: Meridian Private Client partners Jon Croxford, Drummond Kerr and Philip Harrison.

TAX AND ASSET PROTECTION SET TO BE MORE IMPORTANT THAN EVER

By Philip Harrison, partner at Meridian Private Client LLP

Inheritance tax (IHT) hit the headlines earlier this year when newspapers sensationally described a total of £200,000 of lifetime gifts to Prime Minister David Cameron from his mother as a 'tax dodge'.

Such indignation was unjustified because these gifts are within the law, being exempt from IHT where the donor survives for seven years after making them.

Though such lifetime gifts remain a legitimate part of IHT planning, politicians may take the misguided press indignation that resulted as a green light to allow the amount of IHT collected to rise further. This has been already happening. IHT collected in the tax year 2015/6 is expected to be around £4.6 billion compared with £3.8 billion in 2014/5.

The Office of Budget Responsibility (OBR) says that the number of estates on which IHT is payable has quadrupled since 2010 and that the number of families paying IHT will soar in the future, partly due to rising house prices.

This is despite the additional allowance for family homes being given in limited circumstances and called the Residence Nil Rate Band (see page 3). Apart from this allowance, itself set at a relatively modest amount and not fully in force until 2020/1, the current IHT threshold at which 40 per cent IHT becomes payable has been unchanged since 2009. It is not up for review until 2020/1, by which time many more families will be paying the tax.

Of even more concern is that it may be politically expedient to tighten up on IHT under the cloak of 'closing loopholes' or increasing 'fairness'.

There is a real need to plan ahead for IHT and it is advisable not to wait too long. For example, there are aspects of ownership of unlisted businesses where early action is needed to ensure that Business Property Relief from IHT is secured and maintained.

But it is not just about IHT. Statistics show that there is more marriage breakdown and divorce these days and such complexities have highlighted the need to ensure that wishes are carried out and family wealth protected, perhaps through trusts.

Specialist advice ensures both peace of mind and tax savings.

CGT AND THE NEW INVESTORS' RELIEF

By Philip Harrison, partner at Meridian Private Client LLP

Philip Harrison

In his Budget on 16 March 2016, the Chancellor announced further changes to capital gains tax ('CGT'), including a reduction in the headline rates. In addition to some favourable changes to the technical detail of entrepreneurs' relief, which are outside the scope of this article, he also introduced a new relief ('investors' relief') to extend entrepreneurs' relief to "external" investors in unlisted trading companies.

Until 5 April 2016, most individuals paid CGT at 28%, although if taxable income and gains taken together did not exceed the higher rate income tax threshold for the year, the rate was 18%. The equivalent rates have now been reduced to 20% and 10%. In line with the Government's policy of punitive tax treatment for second home owners and residential property investors, the reduction does not apply to residential properties, where the rates continue at 28% and 18%.

The new rate is 20% for executors and trustees, except in relation to residential property, where it continues at 28%.

The lower CGT rates, coupled with the harsher tax treatment of dividends, may tend to distort investment decisions and possibly also encourage taxpayers to adopt aggressive tax planning methods to convert income into capital gains. However, the recent tightening of the "transactions in securities" anti-avoidance rules will make it harder to liquidate companies in order to extract accumulated profits without paying income tax.

Entrepreneurs' relief reduces the CGT rate to 10% on sales of unlisted trading businesses, provided numerous conditions are satisfied. In particular, entrepreneurs' relief is available only to sellers who have been 5% shareholders and directors or employees for at least a year.

Investors' relief is available to shareholders who have no other connection with the company and there is no minimum shareholding. However, it applies only to new ordinary shares issued on or after 17 March 2016. It does not apply to existing shares acquired by an investor. Entrepreneurs' relief has no such restriction. There are also anti-avoidance

rules which provide that the shares must be subscribed for genuine commercial reasons, not for tax avoidance.

Investors' relief is subject to more onerous ownership conditions of 3 years from 6 April 2016 and a continuous period of 3 years prior to disposal.

Like entrepreneurs' relief, investors' relief has a lifetime cap of £10m per individual. Entrepreneurs' relief is sometimes available to trusts where the main beneficiary satisfies the conditions for relief, but it is not clear whether investors' relief will be extended to trusts in equivalent circumstances.

Whilst these changes are undoubtedly welcome, they have created even greater complexity in the CGT rules, which have been in a state of flux for almost 10 years. There is greater need than ever to take specialist advice.

TRUSTS HIT BY DIVIDEND TAXATION CHANGES

By Vicki Bennett, solicitor at Meridian Private Client LLP

Vicki Bennett

The way in which dividends are taxed changed significantly from 6 April 2016. The new rules mean that trustees need to consider carefully both their tax position and reporting requirements.

From 6 April 2016, the notional 10% tax credit has been abolished and a dividend tax allowance introduced. The dividend tax allowance, available to individuals, exempts the first £5,000 of dividend income each year from taxation. Dividend income in excess of this allowance is now being taxed at 7.5% at the basic rate, 32.5% at the higher rate and 38.1% at the additional rate.

Trustees of discretionary trusts are particularly affected by the changes. As well as the notional 10% tax credit having been abolished, trustees of these trusts are not entitled to the dividend tax allowance of £5,000.

This means that trustees of these trusts must now pay tax on all dividends received, which will increase the work involved in reporting the trust's tax affairs.

The rate at which trustees of these trusts will pay tax will depend on the applicable tax band. The first £1,000 of income received falls within the standard rate band, although this is reduced where the same person has created more than one trust. Dividends within the standard rate band are subject to the lower 7.5% rate of tax while dividends received which are not covered by the standard rate band are subject to the highest rate of dividend tax at 38.1%.

The changes introduced have, as with other recent steps taken by the government, heavily impacted upon trustees and appear to be another attack on trusts. For example, before 6 April 2016, the first £1,000 (or the available standard rate band if less) of dividends received by trustees would be covered by the notional tax credit and there was no additional tax liability. Dividends not within the standard rate band would be taxed at a rate of 37.5% on the grossed up value of the dividend, with the notional 10% tax credit deducted when determining the liability to HMRC.

Furthermore, trustees of interest in possession trusts are also impacted by the changes and will now need to pay income tax at a rate of 7.5% on dividends received by them (unless the income is mandated directly to the life tenant). Previously, trustees of interest in possession trusts were not required to pay any tax on dividend income as their tax liability was covered by the notional tax credit.

Therefore, trustees of either type of trust who are in receipt of dividend income should consider whether there are steps they can take to mandate dividend income to beneficiaries for tax efficiency.

Specialist advice should be sought to ensure that the trust provisions allow this and that the implications have been considered.

NEW RULES TO BLOCK TAX AVOIDANCE BY LAND DEVELOPERS

By Jon Croxford, partner at Meridian Private Client LLP

Jon Croxford

The recent Budget contained measures to stop land developers avoiding tax by the use of offshore structures. The Government believes that this is timely given the increase in UK house building.

The main changes are designed to ensure that profits derived from developing or trading in UK land will be taxable in the UK regardless of how the business is structured and where it is located.

The UK tax treaties with Jersey, Guernsey and the Isle of Man have also been changed to ensure that profits realised by an enterprise located in one of those territories can still be taxed in the UK.

Further details are available from your usual contact at Meridian Private Client LLP.

THE NEW RESIDENCE NIL RATE BAND COULD SAVE UP TO £140,000 OF INHERITANCE TAX BUT CAREFUL PLANNING NEEDED

By Peter Gate, associate at Meridian Private Client LLP

In the appropriate circumstances, substantial tax savings can be achieved following the introduction of the 'Residence Nil Rate Band' ('RNRB') where death takes place after 6 April 2017.

The RNRB will be added to existing inheritance tax thresholds (currently £325,000 for a single person and £650,000 for a married couple or civil partners). The RNRB will start at £100,000 per person and will increase by £25,000 each year until 2020/1, when it will reach £175,000. A couple will be able to leave a residence valued up to £1m to their children without paying inheritance tax.

To the extent that the RNRB is unused on the first death, it can be transferred (carried forward) to a surviving spouse or civil partner if the survivor dies on or after 6 April 2017 (similar to the current £325,000 nil-rate band), even if the first death occurred before 6 April 2017.

However, whilst many estates will benefit from the RNRB, many others will not.

- The RNRB only applies to people who leave their residence to children or grandchildren, but not for example to nieces and nephews.
- The RNRB applies to a deceased's residence. Only one residential property can qualify for the allowance and it must be a property in which the deceased has lived so cannot be used for investment properties.
- There will be a tapered withdrawal of the RNRB for estates with a net value of more than £2m on the second death. This will be a withdrawal of £1 for every £2 over this amount.

Although the RNRB will also be available when a person downsizes or ceases to own a home (because for example they move into care) and assets of an equivalent value, up to the value of the RNRB, are passed to lineal descendants on death, the rules are complex and detailed records will need to be kept.

In order to maximise the benefit of this relief, specialist advice should be taken. For some couples, updating their Wills could save significant inheritance tax.

For example, if on the first death everything passed to the surviving spouse, the RNRB is not used, with the surviving spouse inheriting the full unused RNRB. But if the combined estate on the second death is greater than £2m then both RNRBs could be lost due to tapering. If on the first death, the deceased could use his or her RNRB by leaving part of their share in the family home to their children, the full RNRB could be claimed. This could save up to £140,000 in inheritance tax!

HIGHER RATES OF STAMP DUTY LAND TAX MAKE HELPING CHILDREN WITH THE PURCHASE OF THEIR FIRST HOMES MORE DIFFICULT

By Peter Gate, associate at Meridian Private Client LLP

Peter Gate

From 1 April 2016, Stamp Duty Land Tax (SDLT) has been increased by three per cent for purchases of "additional properties" meaning that SDLT will be charged at between three per cent and 15 per cent depending upon the value of the property.

The higher rate will apply if any of the purchasers, or their spouses or civil partners or minor children, beneficially own any other property (including property held in trust, and property held outside England and Wales).

The only exception is where the purchased property replaces a main residence (which is sold on the day of the purchase, or within the previous 18 months), regardless of how many other properties are owned. If the previous main residence is sold within 18 months following the purchase, the higher rate will be charged, but then refunded on the sale. Main residence is assessed as a question of fact, and is not open to election.

The new rules present a particular challenge to parents looking to help their children on to the property ladder. It has been common for properties to be purchased in the joint names of parents and children, or for the property to be owned by a trust controlled by the parents for asset protection reasons (such as preventing children from re-mortgaging the property or to protect the value of the property in the event of divorce). However, such arrangements will require careful planning moving forward to avoid the higher rate of SDLT.

- Parents retaining a share in the property alongside their children would pay the higher rate. However, if parents loaned the funds to children and secured the loan on the property by way of a legal charge, this would avoid the higher rate.
- Purchasing the property through a discretionary trust would attract the higher rate of SDLT, but if a life interest trust is established for the child who will live in the property this will avoid the higher rate.
- Parents gifting funds into a discretionary trust and then the trust making a loan to the child (which could be secured on the property) would also avoid the higher rate.

As well as the SDLT and asset protection considerations, parents will also need to consider the inheritance tax and capital gains tax implications of these options. This is a complex area and it is essential that specialist legal and taxation advice is taken.

Where relevant, the content of this newsletter is based on the Finance Bill, which may, at the date of publication, be subject to change. 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.