Thompson Taraz Rand
Chartered Accountants | Registered Auditors

A look at...

Capital Taxes

2017

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CAPITAL GAINS TAX

A capital gain arises when certain capital (or 'chargeable') assets are sold at a profit. The gain is the sale proceeds (net of selling costs) less the purchase price (including acquisition costs).

What are the main features of the current system?

- From 6 April 2016 capital gains tax (CGT) is charged at the rate of 10% on gains (including any held over gains coming into charge) where net total taxable gains and income is below the income tax basic rate band threshold. Gains or any parts of gains above the basic rate band are charged at 20% with a few exceptions which are considered in the 'Exceptions to the CGT rates section' below.
- For disposals prior to 5 April 2016 capital gains tax (CGT) rates were 18% on gains within the basic rate band. Gains or any parts of gains above the basic rate band limit were charged at 28%.
- Entrepreneurs' relief may be available on certain business disposals.

Entrepreneurs' Relief (ER)

ER may be available for certain business disposals taking place on or after 6 April 2008 and has the effect of charging the first £10m (from 6 April 2011) of gains qualifying for the relief at an effective rate of 10%.
The relief will apply to gains arising on a disposal of:

- the whole, or part, of a trading business that is carried on by the individual, either alone or in partnership;
- shares in a trading company, or holding company of a trading group, provided that the individual owns broadly a 5% shareholding and has been an officer or employee of the company;
- assets used by a business or a company which has ceased;
- assets used in a partnership or by a company but owned by an individual, if the assets disposed of are 'associated' with the withdrawal of the individual from participation in the partnership or the company.

A trading business includes professions but only includes a property business if it is a 'furnished holiday lettings' business. Restrictions on obtaining the relief on an 'associated disposal' are likely to apply in certain specific situations. This includes the common situation where a property is currently in personal ownership, but is used in an unquoted company or partnership trade in return for a rent. Under ER the availability of relief is restricted where rent is paid from 6 April 2008 onwards.
What is clear is that careful planning will be required with ER but if you would like to discuss ER in detail and how it might affect your business, please do get in touch.

Investors Relief

Entrepreneurs' Relief has been extended to external investors (other than certain employees or officers of the company) in unlisted trading companies. To qualify for the 10% CGT rate under 'investors' relief' the following conditions need to be met:

- shares must be newly issued and subscribed for by the individual for new consideration

- be in an unlisted trading company, or an unlisted holding company of a trading group
- have been issued by the company on or after 17 March 2016 and have been held for a period of three years from 6 April 2016
- have been held continuously for a period of three years before disposal.

An individual's qualifying gains for investors' relief are subject to a lifetime cap of £10 million.

Simplification of the share identification rules

All shares of the same class in the same company are treated as forming a single asset, regardless of when they were originally acquired. However, 'same day' transactions are matched and the '30 day' anti-avoidance rules will remain.

Example

On 15 April 2017 Jeff sold 2000 shares in A plc from his holding of 4000 shares which he had acquired as follows:
1000 in January 1990
1500 in March 2001
1500 in July 2005
Due to significant stock market changes he decided to purchase 500 shares on 30 April 2017 in the same company.
The disposal of 2000 shares will be matched firstly with the later transaction of 500 shares as it is within the following 30 days and then with 1,500/4,000 (1000+1500+1500) of the single asset pool on an average cost basis.

CGT annual exemption

Every tax year each individual is allowed to make gains up to the annual exemption without paying any CGT. The annual exemption for 2017/18 is £11,300 (2016/17 £11,100). Consideration should be given to ensuring both spouses/civil partners utilise this facility.

Exceptions to the CGT rates

Although the rates of CGT were generally reduced to 10% and 20% from 6 April 2016 the previous 18% and 28% rates continue to apply for carried interest and for chargeable gains on residential property that does not qualify for private residence relief. In addition, the 28% rate still applies for ATED related chargeable gains accruing to any person (principally companies).

Other more complex areas

Capital gains can arise in many other situations. Some of these, such as gains on Enterprise Investment Scheme and Venture Capital Trust shares, and

deferred gains on share for share or share for loan note exchanges, can be complex. Please talk to us before making any decisions.

Other reliefs which you may be entitled to

And finally, many existing reliefs continue to be available, such as:

- private residence relief;
- business asset rollover relief, which enables the gain on a business asset to be deferred until a point in the future;
- business asset gift relief, which allows the gain on business assets that are given away to be held over until the assets are disposed of by the donee; and
- any unused allowable losses from previous years, which can be brought forward in order to reduce any gains.

How we can help

Careful planning of capital asset disposals is essential. We would be happy to discuss the options with you. Please contact us if you would like further advice.

CAPITAL GAINS TAX AND THE FAMILY HOME

The capital gains tax (CGT) exemption for gains made on the sale of your home is one of the most valuable reliefs from which many people benefit during their lifetime. The relief is well known: CGT exemption whatever the level of the capital gain on the sale of any property that has been your main residence. In this factsheet we look at the operation of the relief and consider factors that may cause it to be restricted.

Several important basic points

Only a property occupied as a residence can qualify for the exemption. An investment property in which you have never lived would not qualify.
The term 'residence' can include outbuildings separate from the main property but this is a difficult area. Please talk to us if this is likely to be relevant to you.
'Occupying' as a residence requires a degree of permanence so that living in a property for say, just two weeks with a view to benefiting from the exemption is unlikely to work.
The exemption includes land that is for 'occupation and enjoyment with the residence as its garden or grounds up to the permitted area'. The permitted area is half a hectare including the site of the property which equates to about 1.25 acres in old money! Larger gardens and grounds may qualify but only if they are appropriate to the size and character of the property and are required for the reasonable enjoyment of it. This can be a difficult test. In a court case the exemption was not given on land of 7.5 hectares attaching to a property. The owner said he needed that land to enjoy the property because he was keen on horses and riding. The courts decided that the owner's subjective liking for horses was irrelevant and, applying an objective test, the land was not needed for the reasonable enjoyment of the property.

Selling land separately

What if you want to sell off some of your garden for someone else to build on? Will the exemption apply? In simple terms it will if you continue to own the property with the rest of the garden and the total original area was within the half a hectare limit.
Where the total area exceeds half a hectare and some is sold then you would have to show that the part sold was needed for the reasonable enjoyment of the property and this can clearly be difficult if you were prepared to sell it off.
What if on the other hand you sell your house and part of the garden and then at a later date sell the rest of the garden off separately, say for development? Then you will not get the benefit of the exemption on the second sale because the land is no longer part of your main residence at the point of sale.

More than one residence

It is increasingly common for people to own more than one residence. However an individual can only benefit from the CGT exemption on one property at a time. In the case of a married couple (or civil partnership), there can only be one main residence for both. Where an individual has two (or more) residences then an election can be made to choose which should be the one to benefit from the CGT exemption on sale. Note that the property need not be in the UK to benefit although there are additional restrictions from April 2015 detailed below. Also foreign tax implications may need to be brought into the equation.
The election must normally be made within two years of the change in the number of residences and the potential consequences of failure to elect are shown in the case study that follows.

Furthermore the case study demonstrates the beneficial rule that allows CGT exemption for the last 18 months of ownership (36 months prior to 6 April 2014) of a property that has at some time been the main residence. Where the owner of the property is in long term care or a disabled person, and meets the necessary conditions, they continue to benefit from a 36 month exemption.

Case study

Wayne, an additional rate taxpayer, acquired a home in 2007 in which he lived full-time. In 2011 he bought a second home and divided his time between the two properties.

- Either property may qualify for the exemption as Wayne spends time at each - ie they both count as 'residences'.
- Choosing which property should benefit is not always easy since it depends on which is the more likely to be sold and which is the more likely to show a significant gain. Some crystal ball gazing may be needed!
- The choice of property needs to be made by election to HMRC within two years of acquiring the second home. Missing this time limit means that HMRC will decide on any future sale which property was, as a question of fact, the main residence.

Wayne elects for the second home to be treated as his main residence for CGT purposes. If in 2017 he sells both properties realising a gain of say £100,000 on the first property and £150,000 on the second property. The gain on the second property is CGT-free because of the election. Part of the gain on the first property is exempt. Namely that relating to:

- the four years before the second property was acquired (when the first property was the only residence) and
- the last 18 months of ownership will qualify providing the property has been the main residence at some time.

In other words out of the ten years of ownership, a total of five and a half years (66 months) would qualify for the exemption. Therefore 54/120ths of the gain - ie £45,000 will be taxable.

What if no election were made?

Without the election, and the first property being treated as the main residence throughout, the gain on the first property would be wholly exempt and the gain on the second property would be wholly chargeable. Failure to make an election can be an expensive mistake.

Can you claim PPR relief on your property?

From 6 April 2015 a person's residence will not be eligible for Principal Private Residence (PPR) relief for a tax year unless either:

- the person making the disposal was resident in the same country as the property for that tax year, or
- the person spent at least 90 midnights in that property.

The rules apply to both a UK resident disposing of a residence in another country and a non-resident disposing of a UK residence.

Business use

More and more people work from home these days. Does working from home affect the CGT exemption on sale? The answer is simple - it may do!
Rather more helpfully the basic rule is that the exemption will be denied to the extent that part of your home is used exclusively for business purposes. In many cases of course the business use is not exclusive, your office doubling as a spare bedroom for guests for example, in which case there is not a problem.

Where there is exclusive business use then part of the gain on sale will be chargeable rather than exempt. However, it may well be that you plan to acquire a further property, also with part for business use, in which case the business use element of the gain can be deferred by 'rolling over' the gain against the cost of the new property.

Residential letting

A further relief is given if your main residence has been let as residential accommodation during the period of ownership. The case study below best demonstrates the operation of this. The letting exemption can be very valuable but is only available on a property that has been your main residence. It is not available on a 'buy to let' property in which you never live.

Case study

Frank bought a property in 2002 and lived in it as his main residence for eight years until 2010. Then he bought a second property which immediately became his main residence and the first property is then let from then until its sale in say 2017.
The gain on sale of the first property amounted to £210,000.
Some of this gain will be exempt as it has been Frank's main residence.
96 months (8 years actual occupation - from 2002 to 2010)
18 months (last 18 months of ownership - part way through 2016 and 2017)
So 114 months in total is exempt.
As the total period of ownership is 180 months (15 years) the exempt gain will be calculated as follows:
114/180 x £210,000 = £133,000
The balance of the gain (£77,000) relates to the period from 2010 to part way through 2016. The property was let during this period and had previously been Frank's main residence so that the letting exemption is available. Although the gain relating to this period amounts to £77,000 the exemption for letting is limited to a maximum of £40,000.
Overall £173,000 of Frank's gain is exempt leaving £37,000 chargeable to tax and this is subject to the annual exemption.

Periods of absence

Certain other periods of absence from your main residence may also qualify for CGT relief if say you have to leave your property to go and work elsewhere in the UK or abroad. The availability of the exemption depends on your circumstances and length of period of absence. Please talk to us if this is relevant for you. We would be delighted to set out the rules as they apply to your particular situation.

Trusts

The exemption is also available where a property is owned by trustees and occupied by one of the beneficiaries as their main residence.
Until December 2003 it was possible to transfer a property you owned but which was not eligible for CGT main residence relief into a trust for say the benefit of your adult children. Any gain could be deferred using the gift relief provisions. One of your children could then live in the property as their main residence and on sale the exemption would have covered the entire gain.
HMRC decided that this technique was being used as a mechanism to avoid CGT and so blocked the possibility of combining gift relief with the main residence exemption in these circumstances.

How we can help

The main residence exemption continues to be one of the most valuable CGT reliefs. However the operation of the relief is not always straightforward nor its availability a foregone conclusion. Advance planning can help enormously in identifying potential issues and maximising the available relief. We can help with this. Please contact us if you have any questions arising from this factsheet or would like specific advice relevant to your personal circumstances.

INHERITANCE TAX – A SUMMARY

Inheritance tax (IHT) is levied on a person's estate when they die, and certain gifts made during an individual's lifetime.
Gifts between UK-domiciled spouses during their lifetime or on death are exempt from IHT. In this factsheet spouse includes married couples and registered civil partners. Most gifts made more than seven years before death will escape tax. Therefore, if you plan in advance, gifts can be made tax-free and result in a substantial tax saving.
We give guidance below on some of the main opportunities for minimising the impact of the tax.
It is however important for you to seek specific professional advice appropriate to your personal circumstances.

Summary of IHT

Scope of the tax

When a person dies IHT becomes due on their estate. IHT can also fall due on some lifetime gifts but most are ignored providing the donor survives for seven years after the gift.
The rate of tax on death is 40% and 20% on lifetime transfers where chargeable. For 2017/18 the first £325,000 chargeable to IHT is at 0% and this is known as the nil rate band.

Residence nil rate band

An additional nil rate band is introduced for deaths on or after 6 April 2017 where an interest in a qualifying residence passes to direct descendants. The amount of relief is being phased in over four years; starting at £100,000 in the first year and rising to £175,000 for 2020/21. For many married couples and registered civil partnerships (hereafter referred to as spouses in this factsheet) the relief is effectively doubled as each individual has a main nil rate band and each will also potentially benefit from the residence nil rate band.
The residence nil rate band can only be used in respect of one residential property which does not have to be the main family home but must at some point have been a residence of the deceased. Restrictions apply where estates (before reliefs) are in excess of £2 million.
Where a person died before 6 April 2017, their estate will not qualify for the relief.
A surviving spouse may be entitled to an increase in the residence nil rate band if the spouse who died earlier has not used, or was not entitled to use, their full residence nil rate band. The calculations involved are potentially complex but the increase will often result in a doubling of the residence nil rate band for the surviving spouse.

Downsizing

The residence nil rate band may also be available when a person downsizes or ceases to own a home on or after 8 July 2015 where assets of an equivalent value, up to the value of the residence nil rate band, are passed on death to direct descendants.

Charitable giving

A reduced rate of IHT applies where 10% or more of a deceased's net estate (after deducting IHT exemptions, reliefs and the nil rate band) is left to charity. In those cases the 40% rate will be reduced to 36%.

IHT on lifetime gifts

Lifetime gifts fall into one of three categories:

- a transfer to a company or a trust (except a disabled trust) is immediately chargeable
- exempt gifts which will be ignored both when they are made and also

on the subsequent death of the donor, eg gifts to charity

- any other transfers will be potentially exempt transfers (PETs) and IHT is only due if the donor dies within seven years of making the gift. An alternative way of looking at this is that they are potentially chargeable until seven years has passed. The primary example of a PET is a gift to another individual.

IHT on death

The main IHT charge is likely to arise on death. IHT is charged on the value of the estate treated as beneficially owned by the deceased. This may include certain types of interest in trust property. Furthermore:

- PETs made within seven years become chargeable
- there may be an additional liability because of chargeable transfers(usually lifetime gifts to trusts) made within the previous seven years.

Estate planning

Much estate planning involves making lifetime transfers to utilise exemptions and reliefs or to benefit from a lower rate of tax on lifetime transfers. However, careful consideration needs to be given to other factors. For example a gift that saves IHT may unnecessarily create a capital gains tax (CGT) liability. Furthermore the prospect of saving IHT should not be allowed to jeopardise the financial security of those involved.

Gifts to individuals during lifetime

As these gifts are PETs rather than chargeable transfers when made, no tax at all is due if the donor survives for seven years. Even where a death occurs within seven years IHT may be saved as a result of the lifetime gifts because the charge is based on the value at the date of the gift and does not include any growth on value to date of death.

Nil rate band and seven year cumulation

Chargeable transfers (such as lifetime gifts to trusts) covered by the nil rate band can be made without incurring any IHT liability. Once seven years have elapsed between chargeable transfers an earlier transfer is no longer taken into account in determining IHT on subsequent transfers. Therefore every seven years a full nil rate band will be available to make lifetime chargeable transfers.

Transferable nil rate band

It is possible for spouses and civil partners to transfer the nil rate band unused on the first death to the surviving spouse for use on the death of the surviving spouse/partner. On that second death, their estate will be able to use their own nil rate band and in addition the same proportion of a second nil rate band that corresponds to the proportion unused on the first death. This allows the possibility of doubling the nil rate band available on the second death. This arrangement can apply where the second death happens after 9 October 2007 irrespective of the date of the first death.

Annual exemption

£3,000 per annum may be given by an individual without an IHT charge. An unused annual exemption may be carried forward for use in the immediately following tax year only.

Gifts between spouses

Gifts between spouses are generally exempt, if both are either UK or non UK domiciled. It may be desirable to use the spouse exemption to transfer assets to ensure that both spouses can make full

use of lifetime exemptions, the nil rate band and PETs. Special rules apply where only one spouse has a UK domicile.

Small gifts

Gifts to individuals not exceeding £250 in total per tax year per recipient are exempt. The exemption cannot be used to cover part of a larger gift.

Normal expenditure out of income

Gifts which are made out of income which are typical and habitual and do not result in a fall in the standard of living of the donor are exempt. Payments under deed of covenant and the payment of annual premiums on life insurance policies would usually fall within this exemption.

Family maintenance

A gift for family maintenance does not give rise to an IHT charge. This would include the transfer of property made on divorce under a court order, gifts for the education of children or maintenance of a dependent relative.

Wedding presents

Gifts in consideration of marriage are exempt up to £5,000 if made by a parent with lower limits for other donors.

Gifts to charities

Gifts to registered charities are exempt provided that the gift becomes the property of the charity or is held for charitable purposes.

Business property relief (BPR)

When 'business property' is transferred there is a percentage reduction in the value of the transfer. Often this provides full relief. In cases where full relief is available there is little incentive, from a tax point of view, to transfer such assets in lifetime. Additionally no CGT will be payable where the asset is included in the estate on death. Professional advice should be sought to determine whether you have qualifying business property.

Agricultural property relief (APR)

APR is similar to BPR in that it reduces the value of the transfer but it may not give full relief on the value. It is available on the transfer of agricultural property so long as various conditions are met.

Use of trusts

Trusts can provide an effective means of transferring assets out of an estate whilst still allowing flexibility in the ultimate destination and/or permitting the donor to retain some control over the assets. Provided that the donor does not obtain any benefit or enjoyment from the trust, the property is removed from the estate. We can advise you on whether a trust is suitable for your circumstances and the types of trust arrangements available.

Life assurance

Life assurance arrangements can be used as a means of removing value from an estate and also as a method of funding IHT liabilities.

A policy can also be arranged to cover IHT due on death. It is particularly useful in providing funds to meet an IHT liability where the assets are not easily realised, eg family company shares.

Complexity - is your Will up to date?

From April 2017 we have three nil rate bands to consider. The standard nil rate band has been available for many years. In 2007 the ability to utilise the unused nil rate band of a deceased spouse was introduced which may enable surviving spouses to have a nil rate band of up to £650,000.

From 6 April 2020 some surviving spouses will also have an additional £350,000 in respect of the residence nil rate band to arrive at a total nil rate band of £1 million. However this will only be achieved by careful planning and, in some cases, it may be better for the first deceased spouse to gift some assets to

the next generation and use up some or all of the available nil rate bands.
For many individuals, the residence nil rate band will be important but individuals will need to revisit their wills to ensure that the relief will be available and efficiently utilised.

How we can help

Whilst some general tips can be made about IHT planning it is always necessary to tailor the strategy to fit your situation.
Any plan must take account of your circumstances and aspirations. The need to ensure your financial security (and your family's) cannot be ignored. If you propose to make gifts the interaction of IHT with other taxes needs to be considered carefully.
However there can be scope for substantial savings which may be missed unless professional advice is sought as to the appropriate course of action. We would welcome the opportunity to assist you in formulating a strategy suitable for your own requirements. Please do not hesitate to contact us.

INHERITANCE TAX AVOIDANCE – PRE-OWNED ASSETS

Inheritance tax (IHT) was introduced approximately 30 years ago and broadly charges to tax certain lifetime gifts of capital and estates on death.
With IHT came the concept of 'potentially exempt transfers' (PETs): make a lifetime gift of capital to an individual and, so long as you live for seven years from making the gift, there can be no possible IHT charge on it whatever the value of the gift. The rules create uncertainty until the seven year period has elapsed but, at the same time, opportunity to pass significant capital value down the generations without an IHT charge. Of course this is to over simplify the position and potentially ignore a whole host of other factors, both tax and non-tax, that may be relevant.
However many people are simply not in a position to make significant lifetime gifts of capital. There are a number of reasons for this, the most obvious being that their capital is tied up in assets such as the family home and business interests and/or it produces income they need to live on.

Gifting the family home?

But what is to stop a gift of the family home being made to, say, your (adult) children whilst you continue to live in it? The answer is simple: nothing! However such a course of action is unattractive not to say foolhardy for a number of reasons the most significant being:

- security of tenure may become a problem
- loss of main residence exemption for capital gains tax purposes
- it doesn't actually work for IHT purposes.

The reason such a gift doesn't work for IHT is because the 'gift with reservation' (GWR) rules deem the property to continue to form part of your estate because you continue to derive benefit from it by virtue of living there. This is a complex area so do get in touch if you would like some advice.

Getting around the rules

To get around the GWR rules a variety of complex schemes were developed, the most common being the 'home loan' or 'double trust' scheme, which allowed continued occupation of the family home whilst removing it from the IHT estate. For an individual with a family home worth say £500,000 the prospect of an ultimate IHT saving of £200,000 (being £500,000 x 40%) was an attractive one.

HMRC's response

Over time the schemes were tested in the courts and blocked for the future. However HMRC wanted to find a more general blocking mechanism. Their approach has been somewhat unorthodox with the GWR rules remaining as they are. Instead a new income tax charge is levied on the previous owner of an asset if they continue to be able to enjoy use of it. The rules are referred to as the Pre-Owned Assets (POA) rules. They are aimed primarily at land and buildings but also apply to chattels and certain interests in trusts.

Scope

In broad outline, the rules apply where an individual successfully removes an asset from their estate for IHT purposes (ie the GWR rules do not apply) but is able to continue to use the asset or benefit from it.

Example 1

Ed gave his home to his son Oliver in 2004 by way of an outright gift and Ed continues to live in the property.
This is not caught by the POA rules because the house is still part of Ed's IHT estate by virtue of the GWR rules.

Example 2

As example 1 but Ed's 'gift' in 2004 was made using a valid 'home loan' scheme.
This is caught by the POA rules because the house is not part of Ed's estate for IHT.
Even if Ed did not live in the property full-time because say it is a holiday home, the rules would still apply.
If Ed had sold the entire property to his son for full market value, the POA rules would not apply, nor would the GWR rules.
The rules also catch situations where an individual has contributed towards the purchase of property from which they later benefit unless the period between the original gift and the occupation of the property by the original owner exceeds seven years.

Example 3

In 2003 Hugh made a gift of cash to his daughter Caroline. Caroline later used the cash to buy a property which Hugh then moved into in 2009. The POA rules apply.
The rules would still apply even if Caroline had used the initial cash to buy a portfolio of shares which she later sold using the proceeds to buy a property for Hugh to live in.
If Hugh's occupation of the property had commenced in 2011, the POA rules would not apply because there is a gap of more than seven years between the gift and occupation.
There are a number of exclusions from the rules, one of the most important being that transactions will not be caught where a property is transferred to a spouse or former spouse under a court order. Cash gifts made after 6 April 1998 are also caught within the rules.

Start date - retrospection?

Despite the fact that the regime is only effective from 6 April 2005, it can apply to arrangements that may have been put in place at any time since March 1986. This aspect of the rules has come in for some harsh criticism. At the very least it means that pre-existing schemes need to be reviewed to see if the charge will apply.

Calculating the charge

The charge is based on a notional market rent for the property. Assuming a rental yield of, say, 5%, the income tax charge for a higher rate taxpayer on a £1 million property will be £20,000 each year.
The rental yield or value is established assuming a tenant's repairing lease.
Properties need to be valued once every five years. In situations where events happened prior to 6 April 2005, the first

year of charge was 2005/06 and the first valuation date was 6 April 2005. In these cases a new valuation should have been made on 6 April 2010 and 6 April 2015.
The charge is reduced by any actual rent paid by the occupier – so that there is no charge where a full market rent is paid.
The charge will not apply where the deemed income in relation to all property affected by the rules is less than £5,000.
The rules are more complex where part interests in properties are involved.

Avoiding the charge

There are a number of options for avoiding the charge where it would otherwise apply.

- Consider dismantling the scheme or arrangement. However this may not always be possible and even where it is the costs of doing so may be prohibitively high.
- Ensure a full market rent is paid for occupation of the property - not always an attractive option.
- Elect to treat the property as part of the IHT estate – this election cannot be revoked once the first filing date for a POA charge has passed.

The election

The effect of the election using the example above is that the annual £20,000 income tax charge will be avoided but instead the £1 million property is effectively treated as part of the IHT estate and could give rise to an IHT liability of £400,000 for the donee one day. Whether or not the election should be made will depend on personal circumstances but the following will act as a guide.

Reasons for making the election

Where the asset qualifies for business or agricultural property reliefs for IHT.
Where the value of the asset is within the IHT nil rate band even when added to other assets in the estate.
Where the asset's owner is young and healthy.

Reasons not to make the election

The life expectancy of the donor is short due to age or illness and the income tax charge for a relatively short period of time will be substantially less than the IHT charge.
The amount of the POA charge is below the £5,000 de minimis.
The donor does not want to pass the IHT burden to the donee.
The election must be made by 31 January in the year following that in which the charge would first apply. In other words if it would apply for 2015/16 the election should have been made by 31 January 2017. HMRC will however allow a late election at their discretion.

What now?

The rules undoubtedly make effective tax planning with the family home more difficult. However they do not rule it out altogether and the ideas we mention below may be appropriate depending on your circumstances.

Sharing arrangements

Where a share of your family home is given to a family member (say an adult child) who lives with you, both IHT and the POA charge can be avoided. The expenses of the property should be shared. This course of action is only suitable where the sharing is likely to be long term and there are not other family members who would be compromised by the making of the gift.

Equity release schemes

Equity release schemes whereby you sell all or part of your home to a commercial company or bank have been popular in recent years. Such a transaction is not caught by the POA rules.
If the sale is to a family member, a sale of the whole property is outside the POA rules but the sale of only a part is caught if the sale was on or after 7 March 2005. There is no apparent logic in this date. The cash you receive under such a scheme will be part of your IHT estate but you may be able to give this away later.

Wills

Wills are not affected by the regime and so it is more important than ever to ensure you have a tax-efficient Will.

Summary

This is a complex area and professional advice is necessary before embarking on any course of action. The POA rules are limited in their application but having said that they have the potential to affect transactions undertaken as long ago as March 1986.

How we can help

Please do contact us if you have any questions or would like some IHT planning advice.

STAMP DUTY LAND TAX

Who pays the tax?

SDLT is payable by the purchaser in a land transaction England, Wales and Northern Ireland.

What is a land transaction?

A transaction will trigger liability if it involves the acquisition of an interest in land. This will include a simple conveyance of land such as buying a house, creating a lease or assigning a lease.

When is the tax payable?

The tax has to be paid when a contract has been substantially performed. In cases where the purchaser takes possession of the property on completion that will be the date. However, if the purchaser effectively takes possession before completion - known as 'resting on contract' - that will be regarded as triggering the tax.

How much tax is payable on residential property?

Each SDLT rate is payable on the portion of the property value which falls within each band. The current rates and thresholds are:

Residential property Purchase price of property	**Rates (%)**
£0 - £125,000	0
£125,001 - £250,000	2
£250,001 - £925,000	5
£925,001 - £1,500,000	10
£1,500,001 and over	12

Additional residential properties

Higher rates of SDLT are charged on purchases of additional residential properties (above £40,000).
The main target of the higher rates is purchases of buy to let properties or second homes. However, there will be some purchasers who will have to pay the additional charge even though the property purchased will not be a buy to let or a second home. The proposed 36 month rules set out below will help to remove some transactions from the additional rates (or allow a refund).
Care will be needed if an individual already owns, or partly owns, a property and transacts to purchase another property without having disposed of the first property.
The higher rates are three percentage points above the SDLT rates shown in the table above. The higher rates potentially apply if, at the end of the day of the purchase transaction, the individual owns two or more residential properties.
Some further detail:

- purchasers will have 36 months to claim a refund of the higher rates if they buy a new main residence before disposing of their previous main residence
- purchasers will also have 36 months between selling a main residence and replacing it with another main residence without having to pay the higher rates
- a small share in a property which has been inherited within the 36 months prior to a transaction will not be considered as an additional property when applying the higher rates
- there will be no exemption from the higher rates for significant investors.

What about non-residential and mixed property?

The rates for non-residential and mixed property are set out in the table below. The SDLT rates are payable on the portion of the property value which falls within each band.

Non-residential and mixed	Rate %
£0 - £150,000	0
£150,001 - £250,000	2
£250,001 and over	5

Broadly speaking, 'residential property' means a building that is suitable for use as a dwelling. Obviously it includes ordinary houses. Buildings such as hotels are not residential.

More than one dwelling

There is a relief available for purchasers of residential property who acquire interests in more than one dwelling at the same time. Where the relief is claimed the rate of SDLT is determined not by the aggregate consideration but instead by the mean consideration (ie by the aggregate consideration divided by the number of dwellings) subject to a minimum rate of 1%.

Are there any exemptions?

Yes. There are a number of situations in which the transfer of land will not be caught for SDLT. These include:

- a licence to occupy
- a gift of land
- transfers of land in a divorce
- transfer of land to a charity
- transfers of land within a group of companies.

What is the tax charged on?

Tax is chargeable on the consideration. This will usually be the actual cash that passes on the sale. However the definition is very wide and is intended to catch all sorts of situations where value might be given other than in cash. For example if the purchaser agrees to do certain work on the property.

You mentioned that leases are caught. How does the tax work on them?

If an existing lease is purchased, SDLT is calculated in the same way as the purchase of a freehold property. If a lease is created for the payment of a premium ie a lump sum in addition to any rent, then the amount of the premium is the consideration subject to SDLT and is also calculated in the same way as the purchase of a freehold property.
However, there is also a potential charge to SDLT on the rental element. The calculation takes account of various factors including the rent that will be paid under the lease. If the calculated value exceeds £125,000 for residential property and £150,000 for non-residential, the excess is charged at 1%. A 2% rate applies to rent paid under a non-residential lease where the NPV of the rent is above £5 million.
The government has SDLT calculators which work out the amount of SDLT payable. The calculators can be found at www.gov.uk/stamp-duty-land-tax-calculators.

How do I tell HMRC about a liability?

The purchaser must complete an SDLT1 return and this must be submitted to a special HMRC office within 30 days of the transaction. You must also send a cheque for the tax at the same time so this means that you have to calculate the tax due. A late return triggers an

automatic penalty of £100, and late payment of the tax will mean a charge to interest.

What will HMRC do then?

A certificate will be sent to you to show that you have paid the tax. You will need this in order to change the details of the property ownership at the Land Registry. The fact that HMRC has given you the certificate does not mean your calculations are agreed. HMRC has nine months in which to decide whether or not to enquire into your return and challenge your figures.

How we can help

If you are planning to enter into an arrangement to purchase land, we can advise you of the precise impact of SDLT on the transaction so please contact us. We can also help you complete the SDLT1 and submit it to HMRC.

LAND AND BUILDINGS TRANSACTION TAX

Land and Buildings Transaction Tax (LBTT) is payable by the purchaser in a land transaction which occurs in Scotland. These types of transaction would include a simple conveyance of land such as buying a house but also creating a lease or assigning a lease.

Who pays the tax?

LBTT is payable by the purchaser in a land transaction Scotland.

What is a land transaction?

A transaction will trigger liability if it involves the acquisition of an interest in land. This will include a simple conveyance of land such as buying a house, creating a lease or assigning a lease.

When is the tax payable?

The tax has to be paid when a contract has been substantially performed. In cases where the purchaser takes possession of the property on completion that will be the date. However, if the purchaser effectively takes possession before completion - known as 'resting on contract' - that will be regarded as triggering the tax.

Land and Buildings Transaction Tax

Land and Buildings Transaction Tax (LBTT) is payable on land and property transactions in Scotland with an effective date on or after 1 April 2015.

Residential property	Rate %
£0 - £145,000	0
£145,001 - £250,000	2
£250,001 - £325,000	5
£325,001 - £750,000	10
£750,001 and over	12

The rates apply to the portion of the total value which falls within each band.

Higher rates for additional residential properties

Higher rates of LBTT are charged in Scotland on purchases of additional residential properties (above £40,000), such as buy to let properties and second homes.
The main target of the higher rates is purchases of buy to let properties or second homes. However, there will be some purchasers who will have to pay the additional charge even though the property purchased will not be a buy to let or a second home. The 18 month rules set out below will help to remove some transactions from the additional rates (or allow a refund). Care will be needed if an individual already owns, or partly owns, a property and transacts to purchase another property without having disposed of the first property.
The higher rates are three percentage points above the LBTT rates shown in the table above. The higher rates potentially apply if, at the end of the day of the purchase transaction, the individual owns two or more residential properties.
Some further detail:

- purchasers will have 18 months to claim a refund of the higher rates if they buy a new main residence before disposing of their previous main residence
- purchasers will also have 18 months between selling a main residence and replacing it with another main residence without having to pay the higher rates
- a small share in a property which has been inherited within the 18 months prior to a transaction will not be considered as an additional

property when applying the higher rates

- there will be no exemption from the higher rates for significant investors
- LBTT has been enacted with 18 month periods rather than 36 months which applies for SDLT.

Non-residential	**Rate %**
£0 - £150,000	0
£150,001 - £350,000	3
£350,001 and over	4.5

The Scottish government has LBTT calculators which work out the amount of LBTT payable. The calculators can be found at www.revenue.scot/land-buildings-transaction-tax/tax-calculators. For transactions prior to 1 April 2015 see the factsheet on Stamp Duty Land Tax.

How we can help

If you are planning to enter into an arrangement to purchase land, we can advise you of the precise impact of LBTT on the transaction so please contact us.

TRUSTS

What are trusts?

Trusts are a long established mechanism which allow individuals to benefit from the assets whilst others (the trustees) have the legal ownership and day to day control over the assets. A trust can be extremely flexible and have an existence totally independent of the person who established it and those who benefit from it.
A person who transfers property into a trust is called a settlor. Persons who enjoy income or capital from a trust are called beneficiaries.
Trusts are separate persons for UK tax purposes and have specific rules for all the main taxes. There are also a range of anti-avoidance measures aimed at preventing exploitation of potential tax benefits.

Types of trusts

There are two basic types of trust in regular use for individual beneficiaries:

- life interest trusts (sometimes referred to as interest in possession trusts and in Scotland known as life renter trusts)
- discretionary trusts.

Life interest trusts

A life interest trust has the following features:

- a nominated beneficiary (the life tenant or life renter in Scotland) has an interest in the income from the assets in the trust or has the use of trust assets. This right may be for life or some shorter period (perhaps to a certain age)
- the capital may pass onto another beneficiary or beneficiaries.

A typical example is where a widow is left the income for life and on her death the capital passes to the children.

Discretionary trusts

A discretionary trust has the following features:

- no beneficiary is entitled to the income as of right
- the settlor gives the trustees discretion to pay the income to one, some or all of a nominated class of possible beneficiaries
- income can be retained by the trustees
- capital can be gifted to nominated individuals or to a class of beneficiaries at the discretion of the trustees.

Inheritance tax consequences

Importance of 22 March 2006

Major changes were made in the IHT regime for trusts with effect from 22 March 2006. The old distinction between the tax treatment of discretionary and life interest trusts was swept away. The approach now is to identify trusts which fall in the so-called 'relevant property' regime and those which do not.

Relevant property trusts

Trusts which fall in the relevant property regime are:

- all discretionary trusts whenever created
- all life interest trusts created in the settlor's lifetime after 22 March 2006
- any life interest trust created before 22 March 2006 where the beneficiaries were changed after 6 October 2008. A key exception

exists where a change occurs after 6 October 2008 in favour of a spouse on the death of a life tenant.

If a relevant property trust is set up in the settlor's lifetime, this gives rise to an immediate charge to inheritance tax but at the lifetime rate of 20%. If the value of the gift (and certain earlier gifts) is below £325,000 no tax is payable. Discretionary trusts set up under a will attract the normal inheritance tax charge at the death rate of 40%.
Relevant property trusts are charged to tax every ten years (known as the periodic charge) at a maximum rate of 6% of the value of the assets on each tenth anniversary of the setting up of the trust. A fair prorate charge of less than 6% (and often much lower) is also made if assets are appointed out of the trust known as an 'exit charge'.

Benefits of a relevant property trust

Whilst the inheritance tax charges do not look attractive, the relevant property trust has a significant benefit in that no tax charge will arise when a beneficiary dies because the assets in the trust do not form part of a beneficiary's estate for IHT purposes. There can be significant long-term IHT advantages in using such trusts.

Trusts which are not relevant property

Within this group are:

- life interest trusts created before 22 March 2006 where the pre-2006 beneficiaries remain in place or were changed before 6 October 2008 or where a second spouse has taken over the life interest on the death of the first spouse
- the trust was created after 22 March 2006 under the terms of a will and gives an immediate interest (cannot be replaced by another) in the income to a beneficiary and the trust is neither a bereaved minor's nor a disabled person's trust; or
- the trust is created in the settlor's lifetime or on death for a disabled person.

In these circumstances a lifetime transfer into a life interest trust will be a potentially exempt transfer (PET) and no inheritance tax would be payable if the settlor survived for 7 years. Transfers into a trust on death would be chargeable unless the life tenant was the spouse of the settlor. There is no periodic charge on such trusts. There will be a charge when the life tenant dies because the value of the assets in the trust in which they have an interest has to be included in the value of their own estate for IHT purposes.

Capital gains tax consequences

If assets are transferred to trustees, this is considered a disposal for capital gains tax purposes at market value but in many situations any capital gain arising can be deferred and passed on to the trustees.
Gains made by trustees are chargeable at 20% from 2016/17 and onwards (28% for 2015/16 and earlier). There is an exception for residential property gains which continue to be charged at 28%.
Where assets leave the trust on transfer to a beneficiary who becomes legally entitled to them, there will be a CGT charge by reference to the then market value. Again it may be possible to defer that charge.

Income tax consequences

Life interest trusts are taxed on their income at 7.5% on dividends and 20% on other income. Discretionary trusts pay tax at 38.1% (dividends) and 45% (other income).
Income paid to life interest beneficiaries has an appropriate tax credit available

with the effect that the beneficiaries are treated as if they receive the income as the owners of the assets.
If income is distributed at trustee discretion from discretionary trusts, the beneficiaries will receive the income net of 45% tax. They are generally able to obtain refunds of any overpaid tax and if they pay tax at 45%, they will get credit for the tax paid. Refund exceptions may apply in certain settlor trust situations.

Could I use a trust

Trusts can be used in a variety of situations both to save tax and also to achieve other benefits for the family. Particular benefits are as follows:

- if you transfer assets into a trust in your lifetime you can remove the assets from your estate but could act as trustee so that you retain control over the assets (always remembering that they must be used for the beneficiaries)
- a transfer of family company shares into a trust in lifetime (or on death) can be a way of ensuring that the valuable business property relief is utilised
- by putting assets into a trust you can give the beneficiary the income from the asset without actually giving them the asset which could be important if the beneficiary is likely to spend the capital or the capital could be at risk from predators such as a divorced spouse
- trusts (particularly discretionary trusts) can give great flexibility in directing benefit for different members of the family without incurring significant tax charges
- if you want to make some IHT transfers in your lifetime but are not sure who you would like to benefit from them, a transfer to a discretionary trust can enable you to reduce your estate and leave the trustees to decide how to make the transfers on in later years. It also means that the assets transferred do not now hit the estates of the beneficiaries.

How we can help

This factsheet briefly covers some aspects of trusts. If you are interested in providing for your family through the use of trusts please contact us.
We will be more than happy to provide you with additional information and assistance.