TAX PULSE

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RAWLINSON & HUNTER

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WELCOME

Welcome to the first edition of *Tax Pulse* in 2022. We hope your year has started well and that 2022 proves a successful and healthy one for you.

In this edition of *Tax Pulse* we look again at the tax position of crypto-assets, the relief available where you have an asset which has become worthless, the tax issues if you borrow money from a family company and the VAT position if you are returning to the UK. Steve Griffiths of Saranac Partners considers the advantages of an outsourced CIO. This edition also sees the first article in a series entitled 'US Tax Corner' which will cover issues affecting US tax payers.

Many of you will have enjoyed the Netflix series *The Queen's Gambit*. As you will see Rawlinson & Hunter has its own chess champion and we take the opportunity to profile one of our tax consultants, Eugenia Imykshenova. We hope you enjoy the opportunity to meet one of our team.

Our offices are now fully operational and we look forward to seeing more of you in person in the months ahead. In the meantime, happy reading.

The Partners

RAWLINSON & HUNTER

CRYPTO-ASSETS: UPDATE AND NUDGE FROM HMRC

Read this for an update on the tax implications of holding Crypto-Assets and HMRC's 'nudge letters'.

In the last edition of Tax Pulse we summarised the key UK tax implications of holding crypto-assets (for example, crypto-currency such as Bitcoin).

We mentioned that HMRC is taking crypto-assets seriously, using the powers conferred by Parliament and exercising its rights under international treaties to request and gather data from crypto-exchanges, both in the UK and abroad; and that we understood HMRC already held 2019/20 crypto-asset data and would likely obtain similar data from third party crypto platforms for later tax years. We also suggested that HMRC enquiries into taxpayers holding crypto were only a matter of time and that keeping records of crypto transactions and being tax compliant in this area was key.

Since then, and as we predicted, HMRC has begun issuing 'nudge letters' to taxpayers whom HMRC hold information on as holding, or having held, crypto-assets and asking them to check if they have any unreported tax liabilities.

The focus of HMRC's 'nudge letters' is on the Capital Gains Tax (CGT) implications of disposing of crypto-assets i.e. that gains made by UK resident taxpayers are, in HMRC's view, generally liable to CGT. Disposals include where an individual exchanges one crypto-asset for another, for example, Bitcoin for Ethereum; where crypto-assets are used to pay for goods and services, or where an individual makes a gift of a crypto-asset (not mentioned by HMRC in their 'nudge letters'), say by a parent to an adult child.

HMRC's focus on CGT in the current economic climate is not surprising given that there are likely to be many taxpayers who have made substantial economic gains on crypto-assets. However, not all taxpayers may be aware that their realised digital asset gains are taxable, or that they have actually realised taxable gains (for example, if no cash proceeds are received). Hence the 'educational' nudge from HMRC. But if you receive one of these letters and take no action, don't be surprised if the next letter you receive from HMRC is a tax return enquiry letter.

One important issue for tax purposes is the location of crypto-assets. The technical analysis is complex, and there is no settled view. Foreign domiciled individuals may be able to use the remittance basis to shelter unremitted gains on crypto-assets, if the correct analysis is that they are non-UK assets. The location of crypto-assets may also be relevant for other reasons, such as estate and Inheritance Tax matters. For example, would an English will, which was limited to cover assets situated in the UK, include crypto-assets? Interestingly, our understanding is that HMRC's 'nudge letters' were not targeted at foreign domiciled taxpayers. However, HMRC has recently reiterated its published view in its crypto-assets manual that, in most cases, the location of crypto-assets will be the UK if the beneficial owner is UK resident.

Ultimately, in the absence of new legislation the location of crypto-assets will be a matter for the courts. However, an alternative view has been set out in a guidance note issued by one of the leading professional bodies. The argument is that crypto-assets, which are designed to have no location at all, can be allocated a location based on principles applied to other types of intangible property including: enforceability, recoverability, transferability, location of any physical assets to which the intangible is attached and the place where ownership is recorded or registered.

These principles are not easily applied to crypto-assets where the asset exists as a computerised digital entry that has no single location. One option might be to apply the principle of where the crypto-currency can effectively be dealt with, a principle applied to shares, which is normally where the share register is located. In the case of crypto-currency, which might only be dealt with by access to a 'private key' to authorise transactions, the location of the private key or who controls it (not always the crypto-asset owner) might be one option for determining the crypto-asset location.

Another important point is which system of law should govern proprietary rights of an asset with ostensibly no location. One idea is that this should be the law of the place of residence of the participant in the crypto-currency system (which could be a third party crypto-currency exchange or another third party nominee, trustee or custodian) and not that of the residence of the crypto-currency beneficial owner.

Importantly, the professional body's guidance note states that if taxpayers conclude that crypto-assets owned by a UK resident are not located here, they will need to make a clear disclosure of that conclusion on their tax return, given the contrary HMRC view.

Taxpayers still have time to amend their 2020/21 tax returns to include crypto-asset transactions. For 2019/20 and earlier tax years, a voluntary disclosure to HMRC may be required. Specific tax advice should be taken as this is a specialist area.

Please speak to your usual R&H contact if you wish to discuss any aspect of the above.

IN FOR A PENNY...THEN OUT OF POUNDS

Read this if you have lost all hope that you will get anything back from your investments.

Let's look back five years or so. Things had been going quite well. You invested your hard earned cash into this funky molecular gastronomy venture and, whilst it did require further capital injections over the subsequent years, it finally became an unprecedented success.

Fast forward to 2020. Enter Covid-19. Enter Lockdown. One. Two. Three. The government's aid helped a little but, in reality, this did not even scratch the surface of the slow but steadily mounting losses as people became more hesitant, continued to stay away from Central London and got used to home cooking. On top of that, your chef decided to return to the Basque Country where he could stay at home without having to fork out for the EU settlement scheme fee for his whole family. That's all folks. There is no appetite from you or your fellow investors to part with any more of your funds, particularly faced with general economic uncertainty. What's next then?

There is no doubt how badly businesses have been hit during the pandemic; many have failed already and it is likely that many more will do so. Investors all over the world have felt the brunt of this, and many have ended up holding assets that have effectively become worthless. Whilst the basic principle is that a loss can only be claimed when you no longer own an asset – be it through a sale, a gift or the asset ceasing to exist – in such cases, it may be possible to get relief for the loss suffered through making a negligible value claim. Where an individual makes a successful negligible value claim, they are deemed to dispose of and immediately reacquire the asset, subject to the claim at its current value, which should at that point be – you've guessed it – negligible.

It is important to note a few key points in this context:

1. 'Negligible' is not defined in the legislation. HMRC guidance indicates that it means 'next to nothing'.

2. The interpretation of 'next to nothing' though, albeit seemingly objective, can vary. One of our clients was absolutely adamant that his shares were worthless. "You do not understand this, clearly" – he said: "They are telling me it is now £0.50 per share." He invested about £500K into 100,000 shares originally. All attempts to empathise with him given such a reduction in value, whilst trying to explain that HMRC were unlikely to agree £50K is 'worth next to nothing' fell on deaf ears. He submitted his Self-Assessment return with the claim included. Needless to say, an enquiry followed, then protracted discussions and finally penalties for having filed an incorrect return.

3. The negligible value claim needs to be made whilst you still own the asset – so in the case of shares, for example, if the company has already been liquidated, an actual loss will need to be claimed instead.

4. The asset must have become of negligible value after you acquired it, rather than being of negligible value at the outset.

5. The asset must be of negligible value at the time the claim is made, although it is possible to backdate the claim by two years if it can be demonstrated that the asset had become of negligible value at some point during that period.

6. In practice, HMRC will always refer cases involving losses of £100,000 or more to their Share and Assets Valuation specialist unit (there is of course no guarantee they will not necessarily do it where lower amounts are involved), so do be prepared to provide plentiful, robust evidence to substantiate your claim.

7. It is possible to submit a post-transaction valuation check to HMRC to get them to opine on the value used in the computation. This can be done after the disposal but before the return reporting is filed. Whilst this is not compulsory, and doing so can lead ultimately to having to negotiate the value with HMRC, it will serve to mitigate future uncertainty as to whether HMRC may open an enquiry following submission of the return (or indeed a discovery assessment) and should the value ultimately be revised, the quantum of penalties and interest that may be payable.

If the loss achieved through the negligible value claim is a capital loss, it can be used to offset capital gains arising in the same or future years. In the case of unlisted shares, however, one should also consider whether relief for the loss generated by the claim can be given against income. Income tax relief is subject to certain conditions being met (very broadly, these are similar to the ones that need to be fulfilled for a company to be a qualifying company for Enterprise Investment Scheme purposes) and, if available, can then be used in the year of the claim or carried back one year. At current rates, this will allow saving up to 45% tax, so make sure you do not lose out on this!

Finally, it is worth adding that, unsurprisingly, depending on the particulars of a situation, claiming loss relief can get quite tricky – careful thought should go into how this is best done if, for example, you have other losses available to claim or have made gift aid donations, or indeed claimed EIS relief on the shares. It is also important not to forget the overarching limit on how much loss can be claimed each year.

TRANSFER OF RESIDENCE RELIEF

Read this if you are moving to the UK and want to be VAT efficient.

The effects of both Brexit and Covid over the last couple of years have seen many individuals re-evaluate their lifestyles and their place of residence.

Individuals returning to the UK from time overseas, or re-locating their main residence to the UK, may be able to take advantage of the Transfer of Residence Relief (ToR). Subject to certain conditions, this allows for relief from import VAT and Customs duties on personal effects by people transferring their residence:

- to Great Britain (GB) from outside of the UK; or
- to Northern Ireland (NI) from outside of the EU

Individuals moving from the EU to NI do not need to apply for ToR relief due to freedom of movement rules in the EU, which cover NI.

Who Can Claim Relief?

ToR relief exists for people who wish to make the UK their normal place of residence, meaning the UK will be their main principal home.

The relief is only available to 'living persons' and their personal property. It is not available to trusts, companies, corporations, associations, groups or organisations.

There is no relief for goods imported from secondary and holiday homes.

Eligible Goods

Relief is available on any personal property intended for your use or for meeting your household needs. This includes:

- household effects, personal effects, household linen, furnishings and any equipment intended for your personal use or for use within your household
- cycles, motor cycles, private motor vehicles (and their trailers), camping caravans, pleasure craft and private aircraft
- household provisions necessary for normal family requirements, household pets and saddle animals
- portable instruments of the applied or liberal arts required by you for your trade or profession

The relief specifically does not apply to alcohol or tobacco products or to commercial means of transport.

In addition, the relief does not remove the need for licences for restricted goods, such as firearms or endangered species.

Conditions For Relief

Individuals wishing to claim relief must satisfy all of the following criteria:

- been resident outside the UK for at least 12 consecutive months, prior to the date of moving to Great Britain or Northern Ireland
- be importing the goods within 12 months of coming to live in the UK

- intend to use the goods in the UK for the same purpose they were used for prior to moving

The goods can be imported in multiple consignments.

Any goods for which relief is granted cannot be lent, used as security, hired out or transferred to another person within 12 months.

The individual must have had the goods in his or her possession for at least six months prior to the date of importation.

There are variations to these rules for students moving to the UK for full-time study, or for goods imported on the occasion of a marriage or civil partnership.

How To Claim Relief

Approval should be sought from HMRC prior to importing the goods by completing form TOR1 and submitting it to HMRC detailing the goods to be imported.

The above is an overview of the Customs relief available to individuals moving their permanent place of residence to the UK. Eligible individuals should review the rules relevant to their personal circumstances and take specific advice as appropriate.

A LOAN IS JUST THE BEGINNING

Read this if you have borrowed money from your company or you are thinking about doing so.

If you are a shareholder in a close company (broadly, a UK resident company controlled by any number of directors or by five or fewer shareholders) and the company makes a loan to you, the company could be liable for a significant corporation tax charge (known as 'loan to participators' tax') based on the amount of the loan and dependent on when you repay your loan to the company. These rules are designed to target circumstances where a shareholder extracts funds from a company on a temporary basis without the company paying a dividend.

In more detail, where a close company makes a loan to a shareholder, the company becomes liable to the loan to participators' tax charge of 32.5% (increasing to 33.75% from 6 April 2022) on the amount of the loan which remains outstanding at the company's year end. If the shareholder repays their loan to the company, either by way of a cash repayment (subject to 'bed & breakfasting' rules) or by declaring a dividend within nine months of the company's year end, then the company can make a claim to prevent the loan to participators' tax from becoming due. Failure to meet this critical nine-month post-year repayment window could adversely impact the company's cash flow, as the company will need to bank its loan to participators' tax with HMRC from this date until nine months after the accounting period in which the loan is repaid to the company.

The loan to participators rules catch not just loans to individual shareholders but also apply to loans or advances of money made to an associate (often a relative) of a shareholder, a trustee shareholder and a partnership, where one of the partners is an individual who is a shareholder in the company.

Additionally, the definition of 'participator' is broader than just a shareholder and includes a loan creditor, being a person holding redeemable loan capital in the company and certain other debt, plus any person who is entitled to acquire share capital, voting rights or distributions in the company at some point in the future (e.g. option holders).

The 'bed & breakfasting' rules prevent shareholders repaying their loan just within nine months after the company's year end and then subsequently re-borrowing or taking another loan from the company. The '30-day rule' involves 'matching' repayments of £5,000 or more with new loans, advances or transfers of value within 30 days, such that all or some of the repayment is first treated as repaying the new loan in priority to the older loan. There is also the 'arrangement rule' which broadly prevents any repayments of loans being taken into account where, at the time the repayment is made, there are arrangements (which could include an intention) to re-borrow from the company.

Loans made to full-time directors or employees of the company with a participation of 5% or less in the company are excluded from the rules where their total loans outstanding are less than £15,000. Also excluded are trade debts (with credit terms not exceeding third party debtor terms or six months if less) and loans made by a company carrying on a business of lending money.

The above is a high level commentary on the 'loan to participators' tax rules, but the rules are considerably broader than summarised and can sometimes apply to circumstances where a loan, in the normal sense of the word, is not even made!

Professional advice should always be taken where a company is contemplating making a loan to its shareholders.

HAVE YOU HEARD OF THE OUTSOURCED CHIEF INVESTMENT OFFICER?

Steve Griffiths of Saranac Partners considers the use of an outsourced Chief Investment Officer (CIO) to meet sophisticated investment objectives.

A century or so ago, Henry Ford told potential customers that they could have a car in any colour they liked so long as it was black. In the intervening period, the car market has moved on, particularly at the top end, and today extensive customisation is possible. Has the asset management industry moved on as materially in relation to private clients?

In some respects, no. For example. some organisations still seem to have the mantra "you can have any product you like, so long as it's ours". Perhaps these are now a minority, and many others do undertake rigorous client suitability exercises, and offer 'open architecture' to the whole market in terms of fund availability. However, even these organisations create only a limited number of pooled portfolios, in public markets, and in accordance with 'model' risk profiles to which a client is allocated. Cash and lower risk fixed income exposures dominate at one end of the spectrum through to all-equity portfolios in the higher risk category. So, in some respects there is customisation, and for many clients it provides an effective solution.

Does this level of customisation do the job for all parts of the market? For those at the top end of the market, the situation can be more complex. Let's think of a specific example: say an entrepreneur in his forties, who is in the process of selling a highly successful company, but intends to 'start again' even after receipt of substantial cash. These situations involve far more complexity than simply an assessment as to whether their risk tolerance is high or low. The complexity of the particular case will be unique to that client's circumstances. In reality, there are multiple dimensions for our entrepreneur to take into account in developing a successful strategy. Let's consider two of the more important ones:

Firstly, there are many separate investment aspects to consider. Establishing risk tolerance is indeed a necessary condition for a successful strategy – is the ambition at one end of the spectrum to preserve the spending power of the current assets, or at the other end to grow them aggressively? However, there are other investment dimensions to consider as well. What is the appropriate currency base, and indeed is there more than one? If a significant portion of the existing assets are to be devoted to the new venture, should the remaining assets be positioned to diversify away from this concentrated risk? If there is to be a private markets component of the investments, should the venture capital component be independent of or complementary to it? More generally, in some cases it is becoming more important for Environmental, Social and Governance views to be reflected in portfolios, with these 'tilts' very much reflecting each asset owner's views. A good strategy will take into account a broad range of investment issues, not just a simple return objective.

Second, governance matters. How is the strategy to be developed, implemented and monitored over time, and how should the strategy change if market conditions or the client's circumstances, or indeed preferences, change? More generally, how are the assets to be run, and how much does our entrepreneur wish to be involved? Governance does not simply reflect decision-taking structures, as it is closely associated with the appropriate investments. For example, a low-cost, low maintenance and transparent passive approach to public equities could be complementary to a more aggressive private markets strategy, where the returns to a more focused strategy may be greater. At one end of the spectrum, the right answer to the governance issue might be a family office, perhaps taking very active decisions in both public and private markets. This model does, however, have drawbacks. The costs in terms of time and money can be material, and prohibitive unless the assets are substantial.

There are, fortunately, alternative approaches, and in many cases a high-quality 'governance-light' model can be preferable. An outsourced CIO works with clients directly, as well as with family offices, to develop and implement these bespoke strategies for clients seeking a more disciplined and transparent approach to their investments, without requiring a deep involvement in investment issues, which necessitates a large demand on their time.

Steve Griffiths
stephen.griffiths@saranacpartners.com

INTRODUCTION TO US TAX CORNER

Welcome to US Tax Corner. This is a new column series in Tax Pulse with the aim of providing an insight into the complex and not always logical world of US taxation. In each quarterly edition of Tax Pulse we take a key theme of US taxation and explore it in more detail.

All of our articles in US Tax Corner are written by our in-house US/UK tax team here at Rawlinson & Hunter. In this first edition, we will take a first-look at the tax effects of US citizenship.

Born in the USA?

In 1966, George Harrison was angry. The Beatles were world-famous, rock-superstars making big bucks. But their guitarist still felt robbed: "I had discovered I was paying a huge amount to the taxman. You are so happy you finally started earning money – and then you find out about tax," Harrison later wrote.

It was this discovery in 1966 that later inspired George Harrison to write the song Taxman. "If you get too cold, I'll tax the heat, if you take a walk, I'll tax your feet". It was perhaps the commonly understood sentiment of this song that continues to resonate – most people only tend to start to think about tax once they finally started to make some money.

Unfortunately, for citizens of the United States, the extent of the tax exposure to Uncle Sam goes beyond just taxing the heat or their feet.

The US operates a 'citizenship basis of taxation' based in no small part on the American Revolution slogan of "No taxation without representation. This makes the US one of a few countries to have a taxation system based on citizenship and not residence, which can often lead to some, often expensive, misunderstandings for any US citizen whilst living and working outside the US.

Where the Rubber Meets the Road

For most US citizens, they have the typical indicia of US citizenship, a passport and a US Social Security Number. However, where an individual has neither of these, it is often not clear whether they are US citizens.

The US possess 'Jus Soli', translated from Latin as 'right of soil', otherwise commonly referred to as 'birthright citizenship'. This means that to become a US citizen, you do not necessarily have to have either parents with any affiliation with or citizenship of the US, being born in the US will suffice. However, this does not apply in all circumstances - citizenship is not conferred on children born in the US where one parent is there performing certain diplomatic duties.

In addition to acquiring US citizenship by virtue of being born in the US, US citizenship can also be acquired by individuals born outside the US to one or two parents who hold US citizenship.

Naturally, the assumption for some US parents with children born outside the US, is that their child is not automatically entitled to US citizenship. Furthermore, regardless of whether or not a United States passport is applied for by the parents on behalf of the child, the child will have been automatically treated as a US citizen from birth, in addition to the citizenship of the country of birth, if the relevant conditions of the country of birth are met.

As will be appreciated, US immigration law has evolved considerably over time, so US immigration advice should always be taken where there is any doubt over citizenship, particularly for children.

I Walk the Line

A common issue we see is the fate of the Accidental American, who has acquired their US citizenship due to circumstances and little real connection with the US. Often, the first that they realise that there is an issue is when the Accidental American engages in seemingly routine activities, such as applying for a bank account or starting full-time employment.

For those individuals, the IRS will welcome back the prodigal son or daughter into embrace of the US tax system under the Streamlined Procedure introduced in September 2012 to address, at least in part, the significant number of Accidental Americans living abroad. Over the years, we have dealt with many cases to bring back clients into compliance in the US. As we will discuss in later editions of Tax Pulse, there are important tax differences between the UK and the US on many issues, which can lead to unusual and often unexpected results. We will also cover the decision to revoke US citizenship and the tax consequences to consider should this be the way forward.

THE QUEEN'S GAMBIT PLAYS RAWLINSON & HUNTER LLP

We are fortunate at R&H to have very accomplished advisers to help clients and others navigate the complex world of UK tax. In the first of an occasional series, we profile one such team member – Eugenia Imykshenova ('Eugenia' to everyone!).

Eugenia joined R&H in 2016 and is a consultant in our private client team, where she assists clients with tax returns and advisory matters. She has twin daughters who have just won places at Cambridge and Oxford (and a son who has just achieved 97% in his maths mock exams) – hopefully R&H advisers of the future.

In a story that could inspire a novel and a Netflix series, at the age of 13 Eugenia won the National Chess Championship in her native Russia. Chess is a national sport in Russia and Eugenia, who was to put the city of her birth Ulan-Ude (on the shores of Lake Baikal) on the map, was competing against girls trained from the age of three to be chess champions. In contrast, Eugenia only had the experience of her local chess club – and the inspiration of her father (a maths teacher) who taught her to play at the age of five.

Showing the talent and determination that makes her such an asset to R&H, Eugenia battled through to emerge as a national chess champion.

If any readers want to challenge R&H to a chess contest, please be advised that Eugenia will be sitting opposite you! Tax and chess can be equally demanding, requiring intelligence, clarity and forward thinking.

Above: Eugenia pictured at the age of 13 (top row, fourth from right), at the Russian National Chess Championship.

RAWLINSON & HUNTER

Tax Pulse was brought to you by:

Editors:	David Kilshaw, Paul Huggins, Stephen Yates
Writers:	Steve Griffiths (Saranac Partners) Kristina Volodeva, Jeremy Stein, Sharon Gillies, Sarah Fernando, Graeme Privett, Henry Smith-Langridge
Document Production:	Steph Bailhache
Sub-Editor:	Caroline Watson

London Office
Rawlinson & Hunter LLP
Eighth Floor
6 New Street Square
New Fetter Lane
London EC4A 3AQ

Surrey Office
Rawlinson & Hunter LLP
Q3, The Square
Randalls Way
Leatherhead
Surrey KT22 7TW

Tel: 0207 842 2000
www.rawlinson-hunter.com

RAWLINSON
& HUNTER