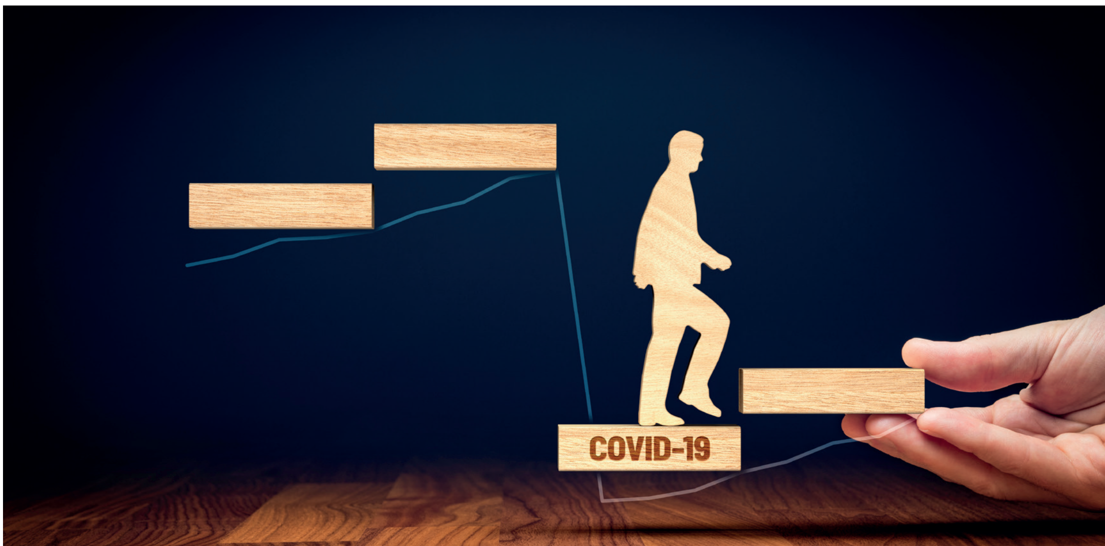

PRIVATE CLIENT ALERT

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DON'T PANIC AND CARRY ON PLANNING

THE COVID-19 TAX ENVIRONMENT

INTRODUCTION

With the UK national debt now over £2 trillion, it is self-evident that the Government must look to fiscal changes to help address the impact of COVID-19. What is less clear is the nature and timing of those changes. While the Chancellor has postponed his Autumn Budget, he will continue to focus on whether what is needed, when change arrives, is a simple hike in tax rates or whether this is a once-off opportunity to promote deeper structural change? Should any tax increases bite now or be postponed, for, say, 2 years, to provide room for the economy to recover?

In this note, we consider some of the changes which might be contemplated by the Chancellor and address the question of what taxpayers should be doing now.

THE FUTURE LANDSCAPE

Even the most insightful clairvoyant would struggle to predict the future tax landscape.

To start with, it might be revolutionised by the introduction of a wealth tax. In July 2020 the Institute of Fiscal Studies launched a new project investigating the feasibility of a wealth tax in the UK.

The problems with a wealth tax include valuation issues (which prompted its abolition in Germany in 1996) and how taxpayers can pay an annual tax out of illiquid assets.

Currently, Spain, Switzerland and Norway all operate an annual wealth tax. But problems such as those mentioned above, and the heavy cost of administration, have often rendered wealth taxes ineffective with France (in 2017) being the latest country to have abolished its wealth tax. While nothing can be ruled out, these factors might suggest that, at least in the shorter term, a wealth tax may not be on the Chancellor's agenda.

There might also be one-off taxes directed at specific sectors or the introduction of a digital sales tax.

Instead of introducing new taxes to broaden the tax base, the Chancellor may look to make existing taxes more effective from his standpoint. Inheritance Tax (IHT) and Capital Gains Tax (CGT) are considered by many to be prime candidates for this treatment.

In July 2019 the Office of Tax Simplification (OTS) published its report on simplification of

IHT. Measures suggested included amendments to the reliefs for business property, the removal of the present tax free CGT uplift on death (in cases where no IHT is payable) and the reduction in the 7 year period required for gifts to become exempt to 5 years but with the loss of taper relief.

Similarly, in July 2020 the Government asked the OTS to conduct a review of CGT, which many took to mean a request to consider the possibility of tax hikes and a look at which reliefs could be abolished. In 2018/19 the total CGT liability was £9.5 billion for 276,000 CGT taxpayers. This liability was realised on £62.8 billion of chargeable gains. The average tax rate was, however, only about 15%, reflecting the impact of the annual exempt amount and the varied rates of tax. These figures might suggest to the Chancellor that the time is right for structural changes to CGT.

On the other hand, if the Chancellor favours a more traditional approach, he may simply rely on tax rises. Speculation (but that is all it is) is rife that he may align the CGT rates with income tax rates or possibly extend the higher CGT rate for property (28%) to all assets.

If, as some have suggested, the Chancellor were to raise corporation tax from its present 19% to 24% he would raise £12bn next year and £17bn in 2023/24.

If the Chancellor does see tax hikes as the solutions to his woes, he may feel tempted to look closely at income tax, National Insurance Contributions (NICs) and VAT as these are the backbone of his system. In 2018/19, of the UK total tax receipts (c£620bn), £327bn came from income tax and national insurance and £132bn from VAT.

His challenge is that the 2019 Conservative manifesto pledged no increase to these heavy hitters of the system. The Chancellor may feel, however, that recent events permit a change of mind. A single percentage point increase in the basic rate of income tax to 21% would raise £4.7bn in 2020/21.

The Chancellor could choose to bring the 9% Class 4 NICs rate paid by the self-employed into line with the 12% rate for employees. Chancellor Philip Hammond initially went down this path in 2017, but quickly retraced his steps. In the present environment Mr Sunak might feel more confident in the idea and in March (as part of his COVID-19 measures to help the self-employed) he uttered words which may yet prove to be prophetic: "If we all want to benefit equally from state support, we must pay in equally".

Pension reform is another topic which is coming sharply into focus. Pension savings tax relief was estimated to cost £38 billion in 2018/19. The Chancellor may be tempted to introduce a flat rate relief on pension contributions for all taxpayers rather than by reference to a taxpayer's marginal income tax rate.

WHAT TO DO NOW?

Given all this uncertainty, what should taxpayers be doing now? The immediate answer to the question is clear: *Don't Panic.*

History has shown that steps taken in contemplation of rumoured tax changes can often worsen the position either because the changes do not materialise or, when they do, there is a relief mechanism or rebasing provision which would have resulted in a more favourable position than that generated by the pre-emptive steps.

That is not to say that taxpayers should simply sit still and await the Chancellor's changes. Delay may be costly.

Reliefs and exemptions may well be abolished, tax rates are likely to rise. So taxpayers should be undertaking a review of their affairs and taking appropriate cautionary steps. Prudent planning now is the order of the day.

IHT planning is a prime example of this. The present regime is settled and offers many opportunities. Taxpayers who have contemplated planning should no longer delay. Balancing an estate now, perhaps by gifts to children and grandchildren, may help mitigate the impact of a wealth tax should this be introduced. Most gifts to individuals will be exempt if the donor survives his/her gift by 7 years. If you have disposable income which is not needed to maintain your normal standard of living, then regular gifts from this income are immediately tax free. This relief is often overlooked, but now may be an appropriate moment to consider it. If assets qualify for relief, then consider placing them in a trust for family members. Although there is normally a 20% IHT charge on

placing assets in a trust, this can be avoided (for example) if the asset placed in the trust qualifies for business property relief, which will be the case for many family companies. If business property relief is to be changed (see above) now may be the time to use it or its close relation, agricultural property relief.

A gift of an asset (as opposed to cash) may trigger a capital gain. Some assets (for example shares in unquoted trading companies) may qualify for gift relief. In other cases, assets may be standing at a lower value because of recent events and some taxpayers are making the gift and paying the CGT now for fear that CGT rates may rise later. Some elderly taxpayers may be holding onto assets because they get a tax free CGT uplift on death and no IHT because they qualify for reliefs or exemptions. This at present remains a viable strategy but the report of the OTS, as mentioned above, might warrant at least a gentle review to see if there is an opportunity to move assets tax efficiently across generations now in case the Chancellor is inspired by all the reports on his desk to make at least one radical change.

Prudent CGT planning is appropriate too. The CGT annual exemption (£12,300) could be abolished, so use it. Ensure where possible that losses have been taken and used. Consider realising assets at the present tax rates where possible. If selling shares as part of this strategy be mindful of the 30 day 'bed and breakfast' rules, but consider a sale by one spouse and a repurchase by the other. The question is often asked as to whether the Chancellor can change tax rates in the middle of a tax year. While this makes life even more complex, the answer is 'yes'. For example, on 23 June 2010 the rate of CGT was changed with immediate effect to 18% for individuals with total taxable income and gains up to the upper limit of the basic rate Income Tax Band.

Other prudent planning measures would be to align assets between spouses to take advantage of lower rates and available allowances while the exemption for inter spouse transfers is available (as that might be another target for the Chancellor)[1]. Taxpayers should take the opportunity of a review to make sure that they have not overlooked the basics - for example, the tax efficiency of an ISA, the allowance for which in 2020/21 is £20,000.
[1] *In this context, see the article in the last edition of Tax Pulse, our regular tax newsletter.*

There is speculation of tax charges on second homes, or the abolition of the CGT exemption (known as the PPR relief)on the sale of a main residence. Although homes are often a major part of a taxpayer's wealth, they are normally the most difficult asset to plan for. This is because if the taxpayer continues to live in or use the property after the gift, the gift is ineffective for IHT purposes. It is possible to give away part of a home for CGT purposes, but this may lose future access to the PPR exemption if (as many expect) it is retained. Given these difficulties, if you do wish to consider planning in relation to your residential properties, speak with your usual Rawlinson & Hunter tax adviser.

There are more ambitious CGT planning techniques. For example, taxpayers can lock in the present CGT rates without actually completing the disposal until later. However, when in March 2020 the Chancellor took a sword to the level of entrepreneurs' relief (reducing the lifetime limit to £1m and re-branding the relief as 'Business Asset Disposal Relief'), he also introduced what he termed 'forestalling measures' directed at those who had endeavoured to use such planning to bank their full entrepreneurs' relief ahead of the Budget. This may perhaps suggest that such planning needs to be fact specific to be appropriate.

Further planning in the income tax context might include the advancing of income receipts (e.g. the payment of dividends) or, where possible, the receipt of interest. The Chancellor might, for example, increase the rate of income tax paid on dividends or introduce a NIC charge where a dividend is paid in lieu of remuneration by personal service companies.

If tax rates are set to rise, investors may wish to consider "wrapping" their investments so that receipts are sheltered from the higher income tax rates. In this context, Family Investment Companies (FICs) have become increasingly popular in recent times. A taxpayer could hold investments via a FIC to access the lower corporation tax rates. Placing assets in a 'wrapper' can trigger a tax charge, but the present time may nevertheless be a good one to consider this.

If, as is rumoured, corporation tax rates are to rise then FIC owners may wish to review the position to see if assets can be realised ahead of the tax changes.

Investors may also wish to consider the use of an offshore bond to defer tax, again a topic considered in the Spring 2020 edition of Tax Pulse.

A pension review would also be prudent. You should check with your pension adviser whether you have any unused allowances from this or the prior 3 years (the annual allowance is currently capped at £40,000 and any contributions over this limit do not attract relief).At the moment, once a taxpayer is 55, he/she can withdraw a tax free lump sum equal to 25% of the value of the pension pot and this figure might be reduced or lowered by a Chancellor desperate for tax receipts.However, if retained in the pension, the monies might be thought to be more secure from the ravages of taxation on any growth, not least if the Chancellor did opt for a wealth tax. The impact of COVID-19 on investment returns will, in many cases, also have to be taken into consideration.

Trustees or beneficiaries of trusts should review the tax position of the trusts and their investments. For example, beneficiaries of offshore trusts may wish to consider distributions ahead of any possible rise in tax rates.

2017 saw fundamental changes to the regimefor taxpayers who are resident but not domiciled in the UK. The Chancellor may feel that further changes now would add unnecessary complexity, albeit he might be tempted to lower the number of years in which an individual can reside in the UK before becoming deemed domiciled (thereby losing access to the remittance basis) or to increase the amount of the remittance basis charge. There is growing evidence too of HMRC challenging claims to be domiciled outside the UK. Those taxpayers who are non-UK domiciled, particularly if they are not yet deemed domiciled, should consider whether any assets should be realised or perhaps trusts created (for example, to avail of the IHT advantages offered by an excluded property trust) while they have access to the existing tax regime.

VAT planning is perhaps the most practical of all areas. Treat yourself now in case VAT rates rise!

CONCLUSION

The immediate future remains uncertain, including the extent and form of any tax rises. In such uncertain times, it is more important than ever for taxpayers to review their affairs and the planning opportunities available to them.

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To view this publication and all other recent Rawlinson & Hunter LLP updates, please see the technical updates section on our website here.

Additionally, to assist our clients and readers in sourcing relevant information about government initiatives, financial assistance, guides and support eligibility, we have set up a dedicated COVID-19 Business Relief website containing technical resources and insights. We will be updating this hub regularly as new information becomes available. View our COVID-19 resource hub here.

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