TAX PULSE

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CONTENTS

WELCOME

Welcome to the Winter 2020 edition of Tax Pulse, our regular update on topical tax matters. We hope this edition finds our readers well and resilient in these challenging times.

This edition has little mention of “you know what” and it is a rare occasion when people would prefer to read about tax as opposed to other topics. So we have taken this opportunity to provide insight into some key inheritance and capital gains tax reliefs, a note on investing in UK technology and some thoughts on trading abroad.

September saw the retirement of our senior partner, Chris Bliss, after over 30 years with the Firm. We are pleased to report that Chris is remaining a consultant with the Firm and in this edition he reflects on his career.

The next edition of Tax Pulse will be in the Spring – so we look forward to seeing you all in the New Year. Until then, stay safe and well and as seasonal as possible.

The Partners

RAWLINSON & HUNTER

A BLISSFUL CAREER

What do the years 1984, 1988, 2011 and 2020 have in common?

The answer is that they were all landmark years in the career of Chris Bliss and therefore also landmarks in the history of Rawlinson & Hunter. Chris has just retired as Senior Partner (a position he has held with distinction since 2011) having joined the Firm some 36 years ago (July 1984) and having served as a partner since 1988 in Ewell, Leatherhead and London. Chris is known in the market as one of the Firm's finest ever ambassadors. Chris's reputation was built on his outstanding client service and his commitment to the profession.

Chris has also been one of those fortunate few who have managed to combine external interests (and in particular his love of motor sport) with his professional practice. Chris's advice may not always have been the most "racy" but it was always on track and the fact that his clients remained with him for so many years is a testament to what an outstanding practitioner he has been.

We asked Chris for some reflections of his time as a partner. His responses show why he has been (and remains) such an asset to the Firm – he emphasised the need to "keep learning" and, second, he was quick to praise the teams he has worked with especially the "non-chargeable staff who I sometimes think are overlooked for the contributions they make".

We are pleased to say that Chris will continue to serve the Firm as a consultant and we will all continue to have access to his breadth of experience. Chris will also continue to race across London on his motorbike (so be wary!).

MY HOME IS MY...

...castle, my heaven, my safe place, and like for many now, also my office.

Read this if you are working at home.

As some businesses close their doors and the general public desert the oh-so-empty streets, we seem to find ourselves with three camps of previously office-based workers.

The first group are keen to go back to resume some sort of normality and save Pret. The second are those with no desire to leave their comfy homeworking set-up – fighting to get that second monitor, a printer/scanner and a supply of ink and paper to last through the lockdown was no mean feat, but definitely worth it. Finally, there are those who – no longer needing to work anywhere in particular all the time – decide that perhaps a kitchen island in a small flat in the city centre is not ideal for the longer run. They consider renting or buying larger quarters in the great British countryside or dream of (the hopefully) sunnier climes of their second homes outside of the UK.

Being happy, comfortable and safe is not tax-driven of course – however, there are tax consequences of changing your existing home or indeed acquiring a new one which should not be overlooked.

Principal Private Residence ("PPR") relief is a capital gains tax ("CGT") measure that exempts a gain realised on the disposal of a dwelling that is or has been used as an individual's main or only residence. The gain will be exempt in full, where the property has been occupied as such since acquisition, or in part, where this was not the case. 'Occupation' in this context also includes 'deemed occupation' – in practice, this is an ignored period of absence which meets the conditions set out in the legislation. This includes absence for up to three years for any reason; a period of working elsewhere - up to four years, if in the UK, or indefinitely, if abroad; and the last nine months of ownership. Treating absences for work or any other reason as deemed occupation, however, is conditional on there being actual occupation thereafter. No issues, therefore, should arise for those who stayed put and revert to office life in the "new normal" or those who, having had enough of fresh air/open spaces/foreign food (delete as appropriate), promptly return to their original abodes. Consider, however, the decision to remain elsewhere and sell the former home instead: unless this happens within 9 months of departure and/or you do resume using it as home prior to the sale, some of the gain will likely become taxable.

Consider another scenario: you do not need to move. Your house is large enough, has a garden and a study – and your spouse is happy to work from the new fully-functioning, Zoom-friendly working space that used to be the guest bedroom. As PPR relief is only available in relation to a disposal of a main residence, partial business use of a room or a defined part of the property may result in it being restricted. In the above example, this will be the case if the study and the new office are used exclusively for the purposes of business or their residential use is only minor (e.g. there remains a wardrobe housing winter clothes). As long as the space is used for genuine domestic purposes reasonably frequently though – say, for virtual social events or family time in the evenings – no restriction is necessary. It is worth noting in this context that PPR restriction is also generally not dependent on whether income tax relief for a proportion of household expenses, such as electricity or heating, is claimed on account of home working. If relief is restricted, it should be done on a 'just and reasonable' basis - in essence, simply reflecting the extent to which one's home is used for business but this is not always easy to determine (and here also is not necessarily dependent on how much expenditure is claimed for income tax purposes).
Furthermore, historically, PPR relief also came with the added 'bonus' exemption for renting your home out, known as the PPR letting relief, which could result in a maximum of £40,000 of the gain being free of tax. With effect from 6 April 2020, however, letting your residence whilst you are away would of course secure an income stream, but the CGT relief will only be available if you continue to occupy the property at the same time.

A final point to make: as you are free to choose where to live, you are also free to decide which of your properties you consider to be your main home. This decision has to be formalised through an election submitted to HMRC and you have two years from the date the combination of residences available to you changes (for example, through a sale or a purchase of one). Whilst two years may seem like a long period, missing the deadline may trigger an unwanted tax charge as in the absence of an election, where the main home is will be determined by reference to the facts on a case by case basis. It is also worth noting that a married couple can only have one main residence between them – so if one spouse moves lock, stock and barrel (and children) to Dorset, whilst the other remains to work and live in their London flat, consideration must be given to where home now is or should be – an election is highly recommended, especially where one property is a rental and/or is more likely to go up in value. From 6 April 2020, the two year period for making an election does not apply if your interests in all but one of your residences have negligible market value, for example because they are rented.

All in all, as we embrace agile working, reconsider and reconfigure our home and office arrangements, getting advice on the tax impact of such actions should really come alongside packing, unpacking or ordering a new desk. It may well be that no tax consequences will ensue but it is better to check and plan ahead. Particularly if the CGT rates do go up later.

VENTURE FORTH

Guy Beech of Committed Capital Financial Services Limited looks at investing in the “new normal”.

We live in extraordinary times with a global pandemic rewriting the way we live and the way the global economy will function in the future. In the “new normal” certain parts of the economy will struggle and a number of business models may not survive. However, one area that is seen as not only a survivor but a winner is technology. A look at the performance of the NASDAQ Composite Index in the US, with nearly 50% exposure to technology companies saw it hitting new highs in September as investors backed technology stocks.

This stock market rally could be attributed to hope of a V shaped recovery or the “fear of missing out” but with technology there is a more tangible rationale. Covid has changed the way we want to live, work and learn and technology companies are making this a reality, from specialist software, cyber security and cloud computing improving home working to technology helping schools and universities enable remote learning. Fintech is another growth area creating disruptive technologies offering remote access, video and mobile phone recording for compliance, and higher quality user experiences. Given the current circumstances it is unsurprising that health related technology features strongly too.

So how can an investor access these opportunities?

In addition to publicly listed technology stocks and associated funds, investors can also find hidden gems among small early stage unlisted technology companies. This type of investing is known as venture capital and signifies the more adventurous nature of the investment. The good news is that for UK investors the UK is a centre of excellence for technology and there are numerous companies to consider before needing to look further afield. While an industry insider may feel comfortable investing directly in a technology company most investors will opt to invest via a venture capital manager. The VC manager will be able to identify and undertake due diligence on likely companies and then pro-actively support investee companies through their growth journey, including the important sourcing of capital from investors.

Returns from venture capital investing can be significant but the risks of investing in small businesses are significant too. These companies are typically classed as “illiquid investments”, meaning investors will have to wait for an “exit” when the company is sold in part or in entirety or listed on an exchange which may take several years. Consequently while investors could opt for a single company investment most look to build up a portfolio or invest in a fund to diversify risk and benefit from a series of “exits” over time. Recognising this, VC managers will typically allow investors to invest relatively modest amounts, perhaps £25,000 upwards so it is easier to put a toe in the water and start a portfolio.

While the UK is home to many small technology companies, the UK's capital markets and banking system are not particularly supportive which is why venture capital investors are so important to the future success of these businesses. The UK government recognises this and offers a number of generous tax breaks to venture capital investors such as Enterprise Investment Schemes [EIS], Business Investment Relief [BIR] and Venture Capital Trusts [VCT]. These incentives can work for UK resident investors who are domiciled here or abroad and your Rawlinson & Hunter LLP contact can discuss which approach may be best for you.

So is now a good time to invest?

Not a question with a definitive answer. However, there are two points worthy of consideration. Historic evidence shows that VC funds investing after a steep market fall tend to do well as can be seen by examining returns from funds established in 2002 and 2009 following recessions in 2001 and 2008.
[*Source: BVCA performance measurement survey 2018*].

In addition and in part connected to the first point a recession is the moment when companies find it hardest to raise capital. As a consequence they may incentivise investors with the opportunity to invest at lower valuations which is in contrast to the currently higher valuations of most listed technology stocks.

Finally, how do you pick a good venture capital manager?

As with any investment manager the investment track record is a good starting point. The manager may quote a figure based on the return on the original investments that have been exited to date, but it is important to look through that figure to see how it has been achieved. How many exits have been made, how many at a profit, how many at a loss and how bad were the losses. The more exits and the better the success rate the more skilful the manager probably is. Secondly it is important to look at fees. Venture capital fees tend to be less standardised than retail investment funds. So ask the manager to explain their fees and how they compare to the competition.

Venture capital may not be a suitable investment for everybody but if you believe in technology, want to support UK companies, want to look at benefiting from generous tax reliefs and are comfortable with the associated risks now may be the time to venture forth.

The author has spent 35 years working for family offices and major investment institutions and is a consultant with venture capital manager Committed Capital Financial Services Limited.

BUSINESS PROPERTY RELIEF

Read this to find out about a valuable inheritance tax relief.

The Office for Tax Simplification (based on HMRC data) estimated in July 2019 that 16,380 estates were expected to benefit from Business Property Relief (BPR) or the similar Agricultural Property Relief (APR) over the next five years, with an average benefit for each eligible estate of both reliefs of £357,000.

This article looks at BPR. Relief is given in the form of a reduction, generally 100%, in the value of qualifying assets. These include unincorporated businesses and unquoted shares in a trading company (including those traded on the AIM or the OFEX markets), which can qualify for 100% relief. There is no minimum holding required; a single share can qualify. Less commonly, land, buildings or plant and machinery owned separately and used in a business or company, or shares and securities in a quoted company which give control, can qualify for 50% relief.

The relief is available on both lifetime transfers and on death. It is also available where discretionary and other trusts subject to IHT are liable to exit or 10 year anniversary charges.

There is no territorial restriction to the availability of BPR. So it is possible to obtain BPR on business undertakings located anywhere in the world.

To qualify for relief various conditions must be satisfied. Broadly speaking the business, or business undertaken by the company, must be wholly or mainly trading and it, or the shares, owned for at least two years. Business includes a profession or vocation but does not include businesses conducted otherwise than for gain which potentially excludes "hobby" businesses or loss-making businesses from relief.

Relief is denied if the business consists wholly or mainly of dealing in securities, stock or shares, land or buildings or making or holding investments. Property investment companies will not qualify for relief, but property development can. The "wholly or mainly" test is not simply a 50% or more test but is a qualitative one determined by the nature of activities conducted by the business. So, trading business or companies that have significant non-trading activities or investments may qualify for relief. Case law has involved the courts looking at such things as capital employed, the time spent by employees and consultants, turnover and gross and net profit on each activity and the overall context of the business to determine whether the business as a whole qualified for relief.

There are traps for the unwary. For example, loans to a company or partnership do not qualify for relief. If at the time of the transfer a binding contract for sale of the business or company has been entered into, this can preclude the availability of relief. Individuals thinking of either transferring or selling their businesses now or in the future should therefore take advice as early as possible and ideally well in advance of any such transactions to ensure that business property relief is not inadvertently lost. It would also be prudent to have business interests periodically reviewed to check that they would qualify for relief, for example, on death if no specific transaction during lifetime is being contemplated now or in the foreseeable future.

The value of any relevant business property which is attributable to "excepted assets" does not qualify for relief. Excepted assets are broadly those assets neither used wholly or mainly for the purpose of the business throughout the last two years before the relevant date, nor required at that time for the future use of the business. Surplus cash is a particular area of concern and likely to be regarded by HMRC as an "excepted asset" unless it can be clearly demonstrated that the cash has been earmarked or required for some discernible business purpose. Board minutes may be important evidence of intention.

The two year ownership requirement is treated as satisfied if the property and other qualifying property which it replaced have together been owned for two of the last five years.

In these challenging economic times where assets may have relatively low market values, taxpayers may wish to think about transferring their business interests or business assets to other family members or to the next generation. This might be by way of outright gift to individual family members or into, say, a discretionary trust for the benefit of a wide class of family members. Other taxes, particularly, Capital Gains Tax will also need to be considered on such transactions but reliefs for gifts may be available to mitigate any tax exposure on such transactions.

There is always a risk that the Government may change the Inheritance Tax rules. The Government is clearly also needing to look for fiscal changes to help address the impact of Covid-19. The July 2019 Office for Tax Simplification's report made various recommendations, including proposed amendments to BPR (such as considering whether it is appropriate for the level of trading activity for BPR to be set, as it currently is, at a lower level than for equivalent Capital Gains Tax reliefs such as Gift Holdover Relief or Business Asset Disposal Relief). Since then, the All Party Parliamentary Group on Inheritance and Intergenerational Fairness which published its report on the reform of Inheritance Tax in January 2020 suggested replacing the current inheritance tax regime with a flat rate gift tax payable (at say a rate of 10%) on both lifetime and death transfers without the need for complex reliefs such as BPR.

It is difficult to predict what the Government will do, in terms of future tax rates and changes to existing taxes such as Inheritance Tax. Now, however, may be an opportune time to "bank" BPR while it is still available or available its current form and to review whether business interests and business assets would qualify for relief. As the saying goes, use it or lose it.

INHERITANCE TAX – NORMAL EXPENDITURE OUT OF INCOME

Read this if you have disposable income.

In a recent review of the UK inheritance tax regime, the Office of Tax Simplification (OTS) found that the normal expenditure out of income exemption was rarely used by taxpayers despite being one of the more generous provisions available. The low uptake was ascribed to confusion caused by poorly defined rules and the requirement to keep extensive records.

Following their review, the OTS has recommended certain changes to the regime and for the exemption to be replaced with a personal gift allowance. The exemption could therefore be less generous going forwards should the Treasury wish to act on the OTS recommendations.

However, currently no monetary limit applies to the exemption. Therefore, it should still be considered as part of a prudent inheritance tax planning strategy, particularly where the taxpayer is in receipt of a high annual income and has utilised their annual exemption from inheritance tax. This article provides an overview of the relief and the practical issues to consider.

Generally, gifts which do not qualify for any reliefs or exemptions are subject to inheritance tax at up to 40%, if the donor dies within seven years of making the gift. The expenditure out of income exemption allows individuals to make gifts from their disposable income without those gifts ever being subject to inheritance tax.
In order for a gift to benefit from the exemption, the gift must form part of the normal expenditure of the donor, be made out of the donor's income and the donor must be able to maintain their usual standard of living after making the gift, without drawing on capital reserves.

There is no statutory definition of ‘normal expenditure’. HMRC accept that expenditure is ‘normal’ if the donor establishes a regular pattern of giving. This means that it is possible for a single gift to qualify providing that it is intended to be the first of a sequence of payments. Regular commitments also qualify for the exemption. A taxpayer’s position is strengthened further if the gifts are comparable in size or type (for example dividends from a particular shareholding) and are made to recipients of the same category (such as grandchildren or children).

The term ‘income’ includes income from employment and self-employment, rents from property, pensions, interest and dividends. The exemption does not apply to gifts comprising of the capital element of a purchased life annuity or capital assets such as investments unless, exceptionally, the asset was purchased using income specifically set aside for making the gift. Gifts are deemed to be made in priority from current year income before income of earlier years. Although it is possible to claim the exemption with respect to income from earlier years, HMRC may challenge the claim, as the guidance states that income loses its character at some point and is treated as capital thereafter. The exact point at which the transition takes place depends on the facts of each case.

Where a claim is made, the taxpayer must maintain records to show that the gifts were normal expenditure and that they have been made from surplus income. Taxpayers may want to consider signing a Memorandum or Deed of Gift clearly stating that the gift is intended to be part of a regular series of payments and leave the donor with sufficient income to maintain their standard living. Taxpayers should also consider setting up a standing order, keeping copies of bank statements and maintaining a record of payments made, income received and expenditure paid.

No monetary limit currently applies to the exemption because different individuals have different levels of income. The exemption is therefore limited only by an individual’s level of surplus income and could result in substantial inheritance tax savings.

The exemption does not prevent the gift with reservation of benefit rules from applying; these would result in the property being taxed as part of the death estate of the donor, and so care should be taken to make sure the donor receives no benefit from his gift.

Although this exemption is often overlooked, it can be very useful as part of an inheritance tax planning strategy. Perhaps it is time to look at the exemption more closely?

IF YOU HAVEN’T SEEN THEM…

Do catch up with some of our recent tax publications.

We have recently issued a tax alert on the circumstances in which CGT may need to be paid to HMRC within 30 days of the sale of a property click here for the link.

We have also published some thoughts on the possibility of future tax rises and planning that might sensibly be undertaken now. Click here.

THE OFFSHORE DIMENSION

Read this if you are thinking of establishing an offshore business

In our ever shrinking world it is not unusual for individuals living in the UK to think of starting a business overseas or owning assets outside the UK. The individual who (for example) forms a company in Hong Kong to trade there might expect the Hong Kong profits to be outside the scope of UK tax.

The UK tax man, however, will take a close look and may suggest in many cases that HMRC's ability to collect tax can extend to the profits of the Hong Kong company.

Since the 1930's, HMRC have had a powerful income tax anti-avoidance provision in their armoury known as the "transfer of assets" code. This is designed to prevent UK resident individuals from avoiding UK income tax by the simple step of moving their income producing assets offshore. Thus, it would enable HMRC to tax the UK resident individual who moved his cash into an offshore company with a view to escaping tax on the interest generated (in days when interest rates were high enough to make this worth contemplating). The "transfer of assets" code would be invoked by HMRC to pierce the corporate veil and tax the individual on the profits. The remittance basis would be available for non-domiciled tax payers; if claimed, it would protect the individual from being taxed under these provisions on unremitted foreign income.

HMRC might also seek to use these same provisions to tax the individual in our example on the profits of the Hong Kong company. To prevent that, the individual would need to satisfy the Inspector of Taxes that he did not have a UK tax avoidance motive and was therefore able to claim the statutory "defence" that, in essence, applies where there is a commercial reason for the use of a Hong Kong company. It has proved very difficult for taxpayers to claim the defence and recently the Courts have made it even more difficult by blurring the lines between tax avoidance and tax mitigation.

Some hope may, however, be available to taxpayers following the recent decision of the Upper Tier Tribunal in the case of Fisher. The Fishers ran a very successful bookmaking company in the UK. However, their business was under threat because as a UK company they paid gambling duty which their offshore competitors did not. The Fishers therefore decided to avoid gambling duty by running their UK business via the medium of a company based in Gibraltar. HMRC sought to invoke the transfer of assets code and subject the Fisher family to income tax on the profits of the Gibraltar company – this despite HMRC accepting that the Fishers did not have a motive to avoid income tax and indeed had not improved their income tax position.

The Court agreed with HMRC that there was a tax avoidance motive (being the intention to avoid gambling duty) but the Court then found that the commercial motive of the Fishers (if they did not move offshore, gambling duty would have driven them out of business) effectively "trumped" the tax avoidance motive and prevented HMRC from applying the transfer of assets provisions. The Court also ruled that EU Law was available to two of the Fishers to also prevent HMRC from involving this anti-avoidance provision.

HMRC have tightened the wording of the legislation since the events of the Fisher case (the Fishers' planning took place several years ago, albeit the case has only just reached the Upper Tribunal) and the Court also noted that an income tax avoidance motive was not necessary for this code to apply. Nevertheless, the Fisher case does offer some encouragement for individuals seeking to establish businesses outside the UK. The commercial rationale for operating via an offshore company (as opposed to via a UK company which would pay corporation tax on its profits) will require careful review and the facts of each case will be critical.

If you are thinking of establishing an overseas trade speak to your usual Rawlinson & Hunter tax adviser for guidance.

For further information on any of these topics, please contact your usual Rawlinson & Hunter advisor or one of the contacts found on the next page.

This publication and all other recent Rawlinson & Hunter LLP updates, including technical support on COVID-19 related initiatives, please see the technical updates section on our website here.

Partners

Mark Harris
Private Client Services
mark.harris@rawlinson-hunter.com
0207 842 2125

David Barker
Private Client Services
david.barker@rawlinson-hunter.com
0207 842 2128

Kulwarn Nagra
Corporate Services
kulwarn.nagra@rawlinson-hunter.com
0207 842 2130

Paul Baker
Private Client Services
paul.baker@rawlinson-hunter.com
0207 842 2132

Andrew Shilling
Corporate Tax & Stamp Duty Services
andrew.shilling@rawlinson-hunter.com
0207 842 2135

Craig Davies
Corporate Services
craig.davies@rawlinson-hunter.com
0207 842 2136

Graeme Privett
Private Client & US Tax Services
graeme.privett@rawlinson-hunter.com
0207 842 2137

Chris Hawley
Trust & Wealth Services
chris.hawley@rawlinson-hunter.com
0207 842 2138

Phil Collington
Private Client Services
phil.collington@rawlinson-hunter.com
0207 842 2139

Toby Crooks
Trust, Wealth & Private Client Services
toby.crooks@rawlinson-hunter.com
0207 842 2140

Michael Foster
Trust, Wealth & Private Client Services
michael.foster@rawlinson-hunter.com
0207 842 2223

Paul Huggins
Private Client Services
paul.huggins@rawlinson-hunter.com
0207 842 2197

Trevor Warmington
Private Client Services
trevor.warmington@rawlinson-hunter.com
0207 842 2198

James Randall
Corporate Tax Services
james.randall@rawlinson-hunter.com
0207 842 2131

Kristina Volodeva
Private Client Tax
kristina.volodeva@rawlinson-hunter.com
0207 842 2126

David Kilshaw
Private Client Services
david.kilshaw@rawlinson-hunter.com
0207 842 2129

Alan Ive
Private Client Services
alan.ive@rawlinson-hunter.com
0207 842 2256

Catherine Thompson
Corporate Services
catherine.thompson@rawlinson-hunter.com
0207 842 2028

London Office

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

Leatherhead Office

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

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