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Chartered accountants & business advisers

Private Client

Summer 2018

On 30 April 2018 HMRC issued an update on its work to prioritise digital engagement: it is pausing some work and stopping other projects to make room for the considerable work required on Brexit matters.

In particular, HMRC is intending to delay plans to introduce further digital services for individuals. This means that so-called 'simple assessment' and real time tax code changes will not be taken any further at the moment. This does not impact on Making Tax Digital for Business which will continue on its current timetable (with VAT compliance mandated from 2019 and other taxes no earlier than 2020). HMRC has said it will also pause its work to digitise services that impact fewer numbers of customers, such as those paying inheritance tax, or applying for tax advantaged venture capital schemes and PAYE settlement agreements. However HMRC is still keen to encourage people to log-in to their personal tax accounts, as a gentle introduction to digital engagement with the tax authority.

The UK Trust Registration Service

In the summer 2017 Private Client Newsletter, we reported on the introduction of the new trust registration service (TRS). The TRS has been introduced by the UK government to comply with the EU 4th anti-money laundering directive (4AMLD) which was implemented on 26 June 2017.

The TRS allows trustees and personal representatives to register their trusts and complex estates online. The TRS gives HMRC and other law enforcement agencies access to trust data so they can draw links between all parties related to assets held in a trust. This will help prevent the use of trusts for money laundering and terrorist financing.

The TRS was first made available to trustees on 10 July 2017 and to agents from 17 October 2017. Our trust specialists and professional bodies have been working with HMRC since the launch of the TRS to suggest improvements and gain a better understanding of the information required to complete the register. The TRS has been burdened with problems since the beginning.

Who needs to register?

Trusts or complex estates which need to register for self-assessment (SA) for the first time must now use the TRS. The trust should be registered by 5 October after the end of the first tax year for which the trust had a liability to pay tax.

For relevant trusts or complex estates already in SA or if they don't need to register for SA, they have to register or update the register in subsequent years by 31 January after the end of the tax year in which the trust had a liability to pay one of the relevant taxes. The exception is trusts and complex estates which are wound up by the end of the tax year.

A relevant trust is defined as:

- A UK express trust ('express' means deliberately created by a settlor), or
- A non-UK express trust which receives UK source income or has UK assets on which it is liable to UK taxes

The relevant taxes include:

- Income tax
- Capital gains tax
- Inheritance tax
- Stamp duty land tax (or land and buildings transaction tax in Scotland), and
- Stamp duty reserve tax

What information is required for the TRS?

Below is a summary of the information required by trusts for the TRS (requirements for complex estates are far less onerous).

- Information about the trust provisions
- Details about each trustee, settlor, beneficiary and protector
- Details about any person with significant control over the trust
- Details of assets placed in the trust by the settlor when the settlement was first created.

Penalties for non-compliance

Due to the problems that have arisen in the first year of the TRS, HMRC has said it will take a pragmatic and risk-based approach to charging penalties.

For future years, HMRC will charge a £100 penalty if registration is up to

three months late, £200 if between three and six months late and the greater of £300 or 5% of the total taxes paid if more than six months late.

Access to the register

There is currently no facility to access submitted registers and as such it is not possible to notify HMRC of any changes to information online. HMRC will not charge penalties for information that has not been updated, until such access is made available.

Responsibilities of all trusts

4AMLD goes beyond the TRS. Trustees of ALL relevant trusts must maintain accurate written information on the trust and its beneficial owners. We will shortly be sending out a factsheet to all our trust and complex estate clients with full details of the information which should be maintained.

New rules for tax advantaged investment schemes

In the 2017 Budget the Government announced there would be new rules governing enterprise investment schemes (EIS) and venture capital trusts (VCTs) with reference to the type of investments that qualify for the significant and attractive tax benefits of these higher risk investment vehicles.

These changes have been implemented in Finance Act 2018 from 15 March 2018. The new qualifying conditions are based on a principles based test which will be used to determine if the investee company is a genuine entrepreneurial company.

The main aim of the new test is to exclude tax-motivated investments, where the tax relief provides most of the return for an investor with limited risk to the original investment. The condition depends on taking a 'reasonable' view as to whether an investment has been structured to provide a low risk return for investors. This has had a significant impact on some investment structures within popular EIS and VCT schemes in much the same way as a previous rule change which excluded renewable energy investments such as solar and wind power generation.

The new test has two parts: firstly does the company have objectives to grow and develop over the long-term, this broadly mirrors an existing test within the schemes; second, whether there is a significant risk that there could be a loss of capital to the investor of an amount greater than the net return. The condition requires all relevant factors about the investment to be considered in the round.

This will pose two particular challenges for investors; what impact will the changes have on future investment choices and will the risk profile of future qualifying investments be acceptable.

Many of the currently perceived lower risk investment choices such as asset backed investments where some form of property is used as security against an investment are unlikely to be acceptable in the future. This will naturally lead to a change in the type of investments that will be available, possibly resulting in less liquidity and higher investment risk.

Investors will need to pay very close attention to the underlying investment structure, track record and experience of the investment manager and consider the overall term of the investment. Investment terms may be longer if investments are in truly entrepreneurial companies as exit opportunities may be less predictable. There will undoubtedly be an increase in the risk profile of the underlying investments and investors will need to weigh this against the still very attractive benefits of tax relief, tax free growth and income (tax free income applies to VCT only) plus for EIS investors, deferral of capital gains tax and potential inheritance tax exemption.

It is pleasing that Government continues to back tax breaks to raise capital for investment in smaller and usually innovative businesses in turn creating employment opportunities and tax revenue for the country as a whole. Investors should also be encouraged that these approved tax advantaged vehicles remain in place albeit they should be aware of the changing risk profile and consider carefully if this is suitable for their circumstances. Consideration should be given to the key risks of investing in these vehicles such as illiquidity, concentration in very few unquoted companies and potential for loss of capital.

Non-resident Capital Gains Tax, widening of the net

From 6 April 2015, the disposal of all UK residential property by non-UK resident persons was brought within the scope of UK CGT albeit with various exceptions and reliefs - prior to that CGT had not been charged on immovable property held by non-residents, and this change in policy brought the UK into line with most other countries. In 2016, changes to the 'transactions in land' rules ensured that development profit arising on UK property development by non-residents could not escape the UK tax net.

At the 2017 autumn Budget, the Chancellor announced plans to bring the disposal of all UK land and property within the scope of UK tax – regardless of the residence of the person selling the land. These changes are due to have effect from April 2019 (1 April for companies and 6 April for non-corporate entities such as individuals and trusts). As a result, the disposal of all UK-sited residential and commercial property will be subject to UK tax - either corporation tax or capital gains tax.

The main changes are:

- All gains on UK land and property will be subject to UK tax, thus removing the current limitation which charges disposals of residential property only.
- Some of the exemptions currently available for residential disposals will be removed – for instance, disposals of UK land and property by widely-owned non-resident companies will become taxable.
- 'Indirect disposals' will be taxed. This means that the disposal of an interest in an offshore or onshore entity by a non-resident that substantially derives its value from UK immovable property will be subject to UK tax (eg shares in a property company).

Existing UK land and property owned by non-residents, which is brought within the scope of UK tax for the first time in April 2019, will be rebased to its market value in April 2019. This means that only the growth in value after this date will be subject to UK tax.

An anti-forestalling rule has been in effect since 22 November 2017. This rule counter-acts arrangements undertaken to avoid the impact of the new rules by taking advantage of provisions within the UK's treaty network – essentially preventing treaty shopping.

We hope that the complex 'ATED-related CGT' rules will be withdrawn as soon as the extended NRCGT charge is introduced, as at that point, all gains on UK real estate will be covered by the existing and extended NRCGT. The current rules are tortuous to say the least.

However more change is expected. It used to be common practice for non-domiciliaries to hold UK residential property through an offshore company or partnership, with the result that the asset was excluded property for inheritance tax (IHT) purposes. Legislation was introduced last year, affecting all chargeable events on or after 6 April 2017, which removes excluded property status from such structures to the extent that the value in them is attributable to UK residential property. In view of the changes to NRCGT next year, it appears there is a strong likelihood of UK commercial property being brought into the scope of UK IHT, as well as CGT, in the near future - regardless of ownership structure.

In summary, major changes are on the way for UK commercial property held by non-residents which will radically change the current landscape.

Inheritance Tax - Disclosure of Tax Avoidance Schemes

New inheritance tax (IHT) disclosure regulations took effect from 1 April 2018 and replace the previous rules on disclosing IHT planning to HMRC.

The IHT rules, when they were initially introduced in 2011, included 'grandfathering' provisions to ensure IHT planning (or arrangements that were substantially similar) that was first made available before 6 April 2011 would not be disclosable. These 'grandfathering' provisions ceased from 1 April 2018 when the new IHT rules took effect. This means that arrangements that would not have been disclosable before 1 April 2018 will now have to be tested against the new rules.

The new rules provide that IHT planning is notifiable if it would be reasonable to expect an informed observer, who has studied the arrangements and had regard to all relevant circumstances, to conclude that two conditions are met. 'Arrangements' in this context includes any scheme, transaction or series of transactions.

Condition 1

Condition 1 is that the main purpose, or one of the main purposes, of the arrangements is to enable a person to obtain an advantage in relation to IHT set out in one or more of (a) to (d).

(a) arrangements which reduce or avoid the charge which would otherwise arise when property is put into a trust.

(b) the avoidance or reduction of the charge on trust property at the ten-year anniversary; the charge on exits from a trust; the charge on property leaving employee or newspaper trusts; and the charge arising in connection with close company transfers

(c) the avoidance or reduction of a charge to IHT arising from the 'gift with reservation of benefit' rules in circumstances where there is also no charge to income tax under the pre-owned assets tax rules

(d) a reduction in the value of the person's estate without giving rise to a chargeable transfer or potentially exempt transfer.

Such planning is only notifiable if it also meets condition 2.

'Established practice' exception

The established practice exception is intended to ensure that no notification is needed if the conditions are met. Arrangements will not be notifiable, if they:

(a) implement a proposal which has been implemented by 'related arrangements' (being planning carried out before 1 April 2018, to which HMRC has indicated its acceptance), and

(b) are substantially the same as the related arrangements

This is designed to remove established IHT planning schemes, whose workings are well understood and agreed, from the obligation to notify.

Condition 2

Condition 2 is that the arrangements involve one or more contrived or abnormal steps without which the tax advantage could not be obtained.

This means reviewing the arrangements to conclude whether they involve one or more 'contrived or abnormal steps' and then considering whether those steps are necessary to achieve the tax advantage.

For example, the use of trusts is not of itself contrived or abnormal. A gift into a discretionary trust would not, on its own, meet condition 2. The gift would be an immediately chargeable transfer and the fact that the gift was to a discretionary trust would not mean that the arrangements included a contrived or abnormal step. If a more complex trust structure was used instead, for example for added protection of the trust assets, the additional complexity might lead an informed observer to conclude that those additional steps are 'contrived or abnormal' in the sense that it was unusual to go to those lengths and levels of complexity.

HMRC has confirmed that a straightforward trust arrangement is not contrived or abnormal in this context. Nor is the making of a loan to trustees of a trust that an individual has set up, or to a company to which the individual has a connection. Equally, choosing to invest money into assets which will qualify for relief from IHT (such as enterprise investment scheme investments) would be neither contrived nor abnormal.

IHT planning that requires greater complexity or contrivance to achieve the intended tax advantages is likely to be notifiable. Particular emphasis is likely to be placed on whether the economic consequences are as expected. For example, making a gift presupposes that the donor no longer beneficially owns the gifted property. If the donor is able to enjoy the gifted property in broadly the same way as previously this might well be an indicator of a disclosable scheme.

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