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CIOT/ATT East Midlands Branch

**TAXATION AND TAX PLANNING ASPECTS
OF LIFE ASSURANCE PRODUCTS AND
INVESTMENTS**

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Date: Tuesday 3 June 2008

Venue:

Belvoir Castle,
Grantham, NG32 1PE

Timetable:

2pm – Refreshments and registration
2.30pm – Lecture begins
4pm – Break for refreshments
4.15pm – Lecture begins
5.45pm - Close

CPD Hours: 3

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**TAXATION AND TAX PLANNING ASPECTS
OF LIFE ASSURANCE PRODUCTS AND
INVESTMENTS**

for

CIOT EAST MIDLANDS BRANCH

Tuesday 3 June 2008

**Belvoir Castle
Grantham
NG32 1PE**



PART A: LIFE ASSURANCE

1. Overview
2. Taxing Non-qualifying Policies
3. Life Assurance Premium Contributions: HMT/HMRC Statement
4. Life Assurance for Partnerships
5. Appropriate Forms of Trust
6. Annuity and Endowment Arrangements: a Recent IHT Case
7. Gift and Loan Arrangements
8. Discounted Gift Schemes (DGS)
9. Anti-avoidance: Second-hand Life Assurance Policy Scheme Fails

PART A: LIFE ASSURANCE

1. The mitigation of IHT

The classic thinking behind life assurance is that value is being removed from the prospectively taxable estate (through payment of premiums) to build up a sum of money, typically payable on death, which will not be aggregable with that estate for IHT purposes. That thinking remains good.

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PART A: LIFE ASSURANCE

Different Types of Policy and Their Tax Treatment

- (a) *The distinction between qualifying and non-qualifying policies*
- (b) *Whole of life cover: a wide variety of options on offer*
- (c) *Term assurance*
- (d) *Endowment assurance*
- (e) *Non-qualifying life policies*

2 - 4

2. Taxing non-qualifying policies

- * When is there a chargeable event?
- * Partial surrenders

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Example 1

Giles took out on 1 January 2000 a single premium bond for £500,000. The annual allowances are £25,000. He takes no withdrawals until 1 July 2007 when he withdraws £250,000. That is in policy year 8. On 31 December at the end of that policy year the cumulative allowances are £25,000 x 8 = £200,000. The excess, viz £50,000, is liable to tax, subject to top-slicing relief.

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Example 2

Freda took out a non-qualifying life assurance policy on 1 January 1988 for £100,000. In each of the 20 policy years she took out the £5,000 allowance. When the policy matured on 1 January 2008 the amount received was £175,000. The gain is as follows:

<i>Amount paid out</i>	<i>£175,000</i>
<i>Withdrawals</i>	<i>£100,000</i>
	<i>£275,000</i>
<i>Less: premium paid</i>	<i>(£100,000)</i>
<i>Amount chargeable</i>	<i>£175,000</i>

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2. Taxing non-qualifying policies

- * Top-slicing relief

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**3. Life Assurance Premium Contributions:
HMT/HMRC Statement (of 12 April 2007)**

- * Pipeline cases

Those customers whose applications for policies were received by the insurer on or before 13.12.06 will be treated in the same way as those whose policies were issued before PBR - they will continue to benefit from tax relief, and will be unaffected by the announcement in the Budget, with the conditions below.

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**3. Life Assurance Premium Contributions:
HMT/HMRC Statement**

- * Term Assurance – applications received after 13.12.06

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4. Life Assurance for Partnerships

- * Death

Either:

(a) each of the partners would take out a policy on his own life, writing the benefits in trust for the surviving partners; or

(b) each partner would take out a policy on the lives of his other partners.

In either case funds would be produced to buy out the family of the deceased partner.

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Option (a) is generally to be preferred, as (b) is administratively complex in all but very small partnerships. It is important to be able to show commerciality for IHT purposes, to avoid a transfer of value (IHTA 1984 s10).

On maturity of the policy on death the proceeds should be free of all taxes: CGT as not being a second hand policy (TCGA 1992 s210); IHT and income tax (as being a qualifying life policy).

A further income tax point arises from the POA regime.

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4. Life Assurance for Partnerships

- * Retirement

Where land is comprised in the partnership share, SDLT was up to 9 October 2007 an issue where the business of the partnership is land-dealing or investment. However, following the Pre-Budget Report FA 2008 will repeal this charge with retrospective effect to 19 July 2007.

- * Disability

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5. Appropriate Forms of Trust

- * The relevant property regime

- * Who should be the beneficiaries?

Note the importance of excluding the possibility of anyone else (eg the family of the partner) from benefiting, in case HMRC argue that there is a GWR certainly HMRC consider that including the settlor as a beneficiary (to make the policy 'portable') triggers a GWR. The argument would be that, since the settlor is a beneficiary under the trusts made by his partners, he has reserved a benefit by associated operations.

8 - 9

6. Annuity and Endowment Arrangements: a Recent IHT Case

- * *Smith and others v HMRC*

The life assurance policies and annuities issued by the insurer satisfied the requirements of s263 and, given that the exception for non-associated operations did not apply, the deceased would be treated as having made a transfer of value.

In order for the section not to apply, the trustees had to prove that the purchase of the annuities and the making of the life assurance policies were not 'associated operations' as defined by IHTA 1984 s268.

9 - 10

6. Annuity and Endowment Arrangements: a Recent IHT Case

- * *Smith and others v HMRC*

For something to 'facilitate' another did not require a contractual link – the something merely needed to make the other thing easy or easier.

Thus for the statement of practice to apply, the insurer must have obtained full medical evidence in respect of the health of both the deceased and his wife.

10 - 11

6. Annuity and Endowment Arrangements: a Recent IHT Case

The High Court upholds the Special Commissioner

In those circumstances the Commissioner was plainly entitled to hold that the answers to the insurance company's questionnaire given by the wife did not provide 'full medical evidence'.

11 - 12

7. Gift and Loan Arrangements

- * How they work

Example 3 (with acknowledgement to Penny Bates of Menzies Chartered Accountants)

Ron wishes to invest £100,000 in a Gift and Loan Trust. He will demand repayment of his loan at 5% per annum and it is assumed that the fund will grow at 5% per annum.

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Year	Loan Outstanding	Repaid to Ron	Illustrated Investment growth outside estate
Initial	100,000		
Year 5	75,000	25,000	23,400
Year 10	50,000	50,000	47,700
Year 15	25,000	75,000	71,800
Year 20	0	100,000	95,500

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8. Discounted Gift Schemes (DGS)

- * The IHT Background
- * The valuation advantages of discounted gifts trusts

A male settlor aged 60 at his next birthday could invest as much as £659,000 in a discounted gift trust and take 5% withdrawals a year without incurring an IHT charge [as at June 2006].

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8. Discounted Gift Schemes (DGS)

- * The valuation advantages of discounted gifts trusts

The value of the settlor's fund would be £374,044 and the discounted gift value would be £284,956. *'If the settlor were to die, his beneficiaries would inherit the whole amount tax free because £374,044 is subject to an absolute or bare trust arrangement and the £284,956 falls under the nil-rate band for IHT purposes'*

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8. Discounted Gift Schemes (DGS)

- * The IHT Analysis

HMRC have confirmed that neither GWR nor POA will apply.

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Example 4 (with acknowledgement to Penny Bates of Menzies Chartered Accountants)

Alan, a widower, is aged 68 and has the following assets:

	£
House	250,000
Cash	<u>250,000</u>
Total estate	500,000
Less nil rate band	<u>(300,000)</u>
Chargeable to IHT	200,000
IHT due on death	£ 80,000

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Alan's cash provides him with interest at 4% gross (3.2% net of savings rate tax) and he has a reasonable pension from a previous employer. He is single, a non-smoker and in good health. He has made no other chargeable lifetime transfers.

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(a) Calculating the Discount

Alan's Financial Adviser suggests he considers a DGS for part of his cash. Alan decides to consider investing £200,000 into the scheme.

	£
Value of Investment	200,000
Immediate discount	<u>(99,000)</u>
Chargeable lifetime transfer (CLT)	£101,000

The immediate discount will fall outside his estate on making the investment and the CLT will fall outside his estate after seven years.

Provided Alan lives for seven years, his estate will be reduced to the value of his house and remaining cash (£250,000 + £50,000), just within the current nil-rate band for IHT purposes.

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In addition, Alan receives 5% withdrawals of capital from the initial fund amounting to £10,000 per annum. A marked improvement on the level of income he was receiving from the bank deposit account ($200,000 \times 3.2\% = £6,400$).

While capital appreciation on the bond will accrue outside the taxpayer's estate, IHT efficiency will be prejudiced if the taxpayer dies within the first 7 years.

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(b) Early Death

Alan dies in a car crash 30 months after effecting the investment. How will his estate be calculated for IHT purposes?

Value of initial investment into DGS	200,000
Less discount	<u>(99,000)</u>
Value of CLT	101,000
Balance of cash held	50,000
Value of house	<u>250,000</u>
Value of estate	401,000
Less nil-rate band	<u>(300,000)</u>
Chargeable to IHT	101,000

IHT due £40,400

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Alan has achieved an IHT saving of £39,600 (£80,000 – £40,400), which is equal to 40% of the discount.

If Alan had survived seven years after making the investment, the whole value would be outside his estate.

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8. Discounted Gift Schemes (DGS)

* HMRC's new basis of approach to valuation

- Valuation issues
- Position where there are joint settlors

15 - 16

Example 5: HMRC's 'old' approach

Husband (H) aged 80 and wife (W) aged 80 invest £100,000 equally in a DGS with monthly withdrawals of £416.67 payable until the death of the last to die of H and W.

Open market value (OMV) of the retained rights calculated as £46,300.

Transfer of value calculated as £100,000 - £46,300 = £53,700

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Of this, £26,850 is attributable to H and £26,850 attributable to W.

In practice, where the joint settlors are of similar ages and in similar states of health the results of this pragmatic approach do not differ dramatically from the results where the value of each settlor's retained rights are considered individually.

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8. Discounted Gift Schemes (DGS)

In HMRC's view, the correct approach is to value the retained rights in their entirety and to apportion this value between the joint settlors by reference to the OMV of each settlor's retained rights.

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8. Discounted Gift Schemes (DGS)

Discounted Gift Schemes (DGSs): HMRC's New Basis of Approach

The impact of this on the above example:

*OMV of H's retained rights = £16,400
OMV of W's retained rights = £19,900
OMV of the total retained rights = £46,300*

(The calculations of retained rights reflect the age, state of health and insurability of H and W respectively.)

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The OMV of H's retained rights, calculated in accordance with s161 is

$$\begin{array}{rcl} \underline{\pounds 16,400} & \times \pounds 46,300 & \\ (\pounds 16,400 + \pounds 19,900) & & = \pounds 20,900 \end{array}$$

The OMV of W's retained rights, calculated in accordance with s161 is

$$\begin{array}{rcl} \underline{\pounds 19,900} & \times \pounds 46,300 & \\ (\pounds 16,400 + \pounds 19,900) & & = \pounds 25,400 \end{array}$$

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So the values transferred by H and W are:

Value transferred by H = £50,000 - £20,900 = £29,100

Value transferred by W = £50,000 - £25,400 = £24,600

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8. Discounted Gift Schemes (DGS)

Discounted Gift Schemes (DGSs): HMRC's New Basis of Approach

Underwriting approach and basis of valuation

Following recent rises in interest rates HMRC announced a change in basis with effect from 1.6.07 from 5.5% pa to 6% pa and from 1.9.07 to 6.75%.

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8. Discounted Gift Schemes (DGS)

Discounted Gift Schemes (DGSs): HMRC's New Basis of Approach

Comment

Underwriting

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The HMRC view is that the evidence available indicates that such retained rights are not saleable unless the open market purchaser can effect life assurance on the settlor's life. Without life cover, the open market purchaser is at risk of the total loss of their investment should the settlor die shortly after the purchase.

If the settlor were to be uninsurable, the open market value of the retained rights would be nominal and the gift would be close to the whole amount invested by the settlor.

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8. A recent case: victory for the taxpayer on valuation

The Special Commissioner disagreed with this argument and concluded '*[I]t seems realistic in this case to say that the buyer need not necessarily be of the risk - averse category who would lay off the mortality risk and then run fairly conventional calculations, but might more appropriately be a speculator*'.

The Special Commissioner valued the retained rights at £4,200, as being the price which he considered a speculator would pay.

(Bower v HMRC, SpC)

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9. Anti-avoidance: Second-hand Life Assurance Policy Scheme Fails

(Drummond v HMRC)

The taxpayer was not entitled to exclude the proceeds of the surrender of second-hand life assurance policies from the consideration for the disposal of the policies pursuant to TCGA 1992 s37(1) where the surrender was part of a tax avoidance strategy.

It was clear from the documentation and from the oral evidence that there was no purpose in L plc's sale and in Mr Drummond's purchase of the rights to the five policies other than the facilitation of the tax avoidance strategy.

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9. Anti-avoidance: Second-hand Life Assurance Policy Scheme Fails

(Drummond v HMRC)

The common objective of all the participators was to generate a CGT loss by exploiting the statutory mismatch between the CGT and the '*chargeable event gain*' provisions. The offer to sell did not stand alone. The scheme was designed to achieve the tax shelter, not Mr Drummond's acquisition of the five policies.

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9. Anti-avoidance: Second-hand Life Assurance Policy Scheme Fails

(Drummond v HMRC)

Mr Drummond's position

The intended tax result for Mr Drummond was to have been as follows:

For income tax purposes, a small '*chargeable event gain*':

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	£
Surrender Proceeds	1,751,376
Less: Initial premia	(1,250)
Additional premia	(1,748,750)
Previous gains	<u>(25)</u>
Chargeable event gain	<u>1,351</u>

For CGT purposes, an allowable loss of £1.96 million arose.

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HMRC's arguments

HMRC had amended Mr Drummond's self-assessment tax return to deny the claimed loss for CGT on the following grounds:

(i) the £1,751,376 surrender proceeds had not already been taken into account in computing Mr Drummond's income and as such did not fall to be excluded for the purpose of the capital gains disposal computation;

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(ii) the difference between the £1,962,233 which Mr Drummond agreed to pay for the policies and the surrender proceeds of £1,751,376 (some £210,900) was to be excluded as acquisition consideration in the capital gains disposal computation, because it was not given by Mr Drummond *'wholly and exclusively for the acquisition of'* the life policies as required by TCGA 1992 s38(1); and

(iii) in any event, no part of the £1,962,233 was acquisition consideration because it was not incurred *'wholly and exclusively for the acquisition of'* the life policies as required by TCGA 1992 s38(1).

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9. Anti-avoidance: Second-hand Life Assurance Policy Scheme Fails

(Drummond v HMRC)

* What next?

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PART B: INVESTMENTS

1. Overview
2. The 'Usual Suspects – Gilts, Equities, Unit Trusts, OEICS and Investment Trusts
3. Bonds – of Various Descriptions
4. Offshore Funds
5. Enterprise Investment Scheme (EIS) and Venture Capital Trusts (VCT)
6. Employee Share Schemes
7. More Adventurous Possibilities
8. Tax Relieved Saving Arrangements
9. Real Property
10. Chattels
11. Trading Investments
12. Anti-avoidance
13. Pensions and Investment
14. The Offshore Element

1. Overview

- * What Do We Mean by 'Investments'?
- * The Fiscal Framework
 - The Income Tax/CGT Balance
 - IHT
 - The IHT/CGT Balance

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1. Overview

- * **CGT Reform 2008/09: Some Observations**
 - A single 18% rate from 2008/09
 - Losers and winners
 - Anti-avoidance rules catching conversion of income into capital
- * Risk of having past gains recategorised as income

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1. Overview

- * **Anti-avoidance Tax Rules for Trusts**
 - Summary
 - Income or capital?

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2. The 'Usual Suspects' – Gilts, Equities, Unit Trusts, OEICS and Investment Trusts

- * **Gilts**
 - Description
 - Taxation

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2. The 'Usual Suspects' – Gilts, Equities, Unit Trusts, OEICS and Investment Trusts

- * **Equities**
 - Description
 - Taxation
 - Non-UK companies
 - *Budget 2007 announcement*
 - *Budget 2008 confirmation and extension*
 - *FB 2009 to give relief for larger shareholdings*

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2. The 'Usual Suspects' – Gilts, Equities, Unit Trusts, OEICS and Investment Trusts

- * **Equities**
 - The discretionary trust dividend tax cost

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Example 1

Assume the trustees have post-tax dividend income of £67.50, having paid the 32.5 % dividend trust rate of £22.50 with £10 met by the tax credit. The tax paid by the trustees, though not the tax credit, can be used to 'frank' the s 687 tax, which they must deduct on making the distribution.

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<i>Net income of trust</i>	<i>£67.50</i>
<i>liability on gross payment</i>	
<i>of £90 to beneficiary</i>	<i>£36.00</i>
<i>Met by trustees' payment above</i>	<i>(£22.50)</i>
<i>Remaining liability of trustees</i>	<i>(£13.50)</i>
<i>Available for distribution to beneficiary</i>	<i>£54.00</i>
<i>Grossed up @ 40%</i>	<i>£36.00</i>
<i>Gross income of beneficiary</i>	<i>£90.00</i>
<i>Tax thereon @ 40% (met by trustees)</i>	<i>(£36.00)</i>
<i>Net income of beneficiary</i>	<i>£54.00</i>

The point therefore is that, in the absence of a brought forward tax pool to pay the £13.50 above, a higher rate taxpayer will receive only £54 cash out of an original gross dividend received by the trustees of £100, an effective rate of tax for the beneficiary of 46 %.

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2. The 'Usual Suspects' – Gilts, Equities, Unit Trusts, OEICS and Investment Trusts

* Equities

- Stock dividends

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Example 2 (for 2007/08)

Pre-sale dividends have been used for some time to extract value from a company in a tax efficient way in order to reduce the shareholder's liability to CGT. To do so, however, the company must have sufficient distributable profit or reserves: if not, a stock dividend can provide a useful solution.

Sarah has recently acquired for £100,000 all the shares in a trading company, for which she has received an offer of £500,000. She is a higher rate taxpayer and, apart from the annual exemption, her liability to CGT would be £160,000. The company has no distributable reserves. The company might, instead of a dividend, issue new shares on the basis of four for one.

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For CGT purposes, the original shares must be treated separately from the new shares. Twenty % of the proceeds of sale, that is £100,000, will be attributed to the original shares, with no chargeable gain.

The remaining £400,000 will be treated as given for the new shares. This will attract income tax rather than CGT. Because the sale of the company follows immediately after the issue of the stock dividend, the stock dividend is valued on the basis of the sale consideration, ie £400,000. Income tax on this amount would be at 22.5 % (ie the dividend upper rate after the tax credit) viz £90,000.

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Note: The balance of advantage between income tax and CGT has rather been changed by the new CGT regime for 2008/09. With CGT of £72,000 on a gain of £400,000, this clearly beats the income tax suggestion. Stock dividends might still have a part to play in mopping up basic rate bands for income tax.

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2. The 'Usual Suspects' – Gilts, Equities, Unit Trusts, OEICS and Investment Trusts

* Equities

- Company purchase of own shares

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2. The 'Usual Suspects' – Gilts, Equities, Unit Trusts, OEICS and Investment Trusts

* Unit Trusts

- Description
- Taxation

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2. The 'Usual Suspects' – Gilts, Equities, Unit Trusts, OEICS and Investment Trusts

* Investment Trusts

- Description
- Taxation

* Open Ended Investment Companies (OEICs)

- Description
- Taxation

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2. The 'Usual Suspects' – Gilts, Equities, Unit Trusts, OEICS and Investment Trusts

* The Accrued Income Scheme

- Description
- Trust law/tax law difference
- Scope of the scheme
- How the scheme works

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Example 3

25 May 2008:

Trustees buy £10,000 of 5% Treasury Stock 2118

Accrued interest therein is £108.22 (7 March to 25 May)
7 September 2008: Interest payment

Interest paid gross £250.00

Relief for accrued interest
in the purchase £108.22

Income for tax purposes £141.78

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Example 4

25 May 2007: Trustees buy as in Example 9.3

25 June 2007: Sale of stock

Accrued interest:

On sale	106 days	£145.20
On purchase	78 days	<u>£108.22</u>

Assessable (miscellaneous income) £ 36.98

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Example 5 - Life tenant entitled to income

The whole of the interest received belongs to the beneficiary. There are two views:

Method 1: In Example 8, the beneficiary receives the income plus the tax recovery;

Method 2: Alternatively, if the trustees must pay tax on the accrued income out of capital, which is the case for trust law, they should retain the recovery on a rebate amount.

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HMRC do not mind which method is used, as in either case the statutory income is £141.78 gross.

The trustees receive:

Gross interest £250
Less tax (£ 50)
Net £200

Recovery of tax on rebate amount:
£141.78 @ 20% = £28.36.

Method 1: If the beneficiary receives the tax recovery as well as the interest, he has £228.36.

Method 2: If the trustees withhold the recovery, the beneficiary has £200.

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3. Bonds – of Various Descriptions

- * Insurance Bonds
 - Description
 - Taxation for the Investor
- * Offshore Bonds
- * Personal Portfolio Bonds
- * Guaranteed Bonds

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3. Bonds – of Various Descriptions

- * Corporate Bonds – Qualifying and Non-Qualifying
 - The distinction

A recent High Court decision on the distinction has found for HMRC. The taxpayer Mr Harding had engineered a scheme designed to hold-over a gain on the sale of shares in exchange for loan notes from the acquiring company and then to claim that the subsequent redemption of the loan notes was not liable to tax.

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3. Bonds – of Various Descriptions

- * Corporate Bonds – Qualifying and Non-Qualifying
 - The distinction

The High Court, upholding the Special Commissioner, held that the lapse of the foreign currency redemption option did not cause the loan notes to cease to be securities for which a provision was made for redemption in a foreign currency. In essence the QCB trusts had to be satisfied at the date of the issue, not at the date of redemption.

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4. Offshore Funds

- * Description
- * Taxation

40 - 41

4. Offshore Funds

- * Budget 2008

It is expected that the conditions for obtaining the new qualifying funds status will be less onerous, and the tests required for this will be applied only at the outset (instead of, as now, annually). It is also envisaged that minor failures to keep to the conditions will not result, as they do at present, in the fund being removed retrospectively from the more favourable regime.

- * Update as at 31 March 2008

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5. Enterprise Investment Scheme (EIS) and Venture Capital Trusts (VCT)

- * Overview
- * The Qualifying Investment

- The Investment
- The company
- The trade
- Anti-avoidance rules
- No income tax relief for an individual connected with the company

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5. Enterprise Investment Scheme (EIS) and Venture Capital Trusts (VCT)

- * The Qualifying Investment

- EIS: Disqualifying Payments – or Not?

In effect, the finding of the Special Commissioner that there was a general intention to put money into the company in respect of shares, although it could not be treated as an application for shares, meant that the moneys which were received by the company were on account of capital and not a loan.

(Blackburn and another v HMRC, ChD)

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5. Enterprise Investment Scheme (EIS) and Venture Capital Trusts (VCT)

- * The Qualifying Investment

- EIS: Disqualifying Payments – or Not?

The company could never come under an obligation to repay them; it would become under an obligation to issue shares pursuant to the receipt of that money on capital account. That was the correct analysis on the facts of the case and the moneys paid by the first taxpayer were capital and could not be a loan.

(Blackburn and another v HMRC, ChD)

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5. Enterprise Investment Scheme (EIS) and Venture Capital Trusts (VCT)

- * The Qualifying Investment

- EIS: Disqualifying Payments – or Not?

The Special Commissioner's conclusion that the moneys were to be treated as a loan was incorrect and accordingly the appeal succeeded in its entirety.

(Blackburn and another v HMRC, ChD)

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5. Enterprise Investment Scheme (EIS) and Venture Capital Trusts (VCT)

- * CGT deferral
- * CGT losses

Example 6

Shares acquired under EIS	£20,000
Less 20% income tax relief	(£4,000)
Net cost	£16,000

Disposal proceeds after 5 years	£10,000
Cost after EIS relief	(£16,000)
Allowable loss	£ 6,000

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5. Enterprise Investment Scheme (EIS) and Venture Capital Trusts (VCT)

- * Disposing of the Shares
- * Venture Capital Trusts

- Description
- Taxation

Tax Trap: Because the VCT is quoted the taxpayer will not get business property relief from IHT, whereas had he made a direct investment in the underlying companies they could well have been relevant business property for BPR purposes.

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5. Enterprise Investment Scheme (EIS) and Venture Capital Trusts (VCT)

*** Budget 2008: Venture Capital Schemes**

- Operative date
- Current law and proposed revisions
 - EISA income tax relief and investment limit
 - Qualifying activities

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5. Enterprise Investment Scheme (EIS) and Venture Capital Trusts (VCT)

*** Income Tax Relief for Losses on Shares in Qualifying Trading Companies**

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6. Employee Share Schemes

*** Company Share Option Plans (CSOPs)**

- Conditions
- Taxation

*** Enterprise Management Incentives (EMI) Option**

- Conditions
- Budget 2008: proposed changes
- Taxation

49 - 51

6. Employee Share Schemes

*** Share Incentive Plan (SIP)**

- Conditions
- Taxation

*** Savings Related Share Option Schemes (SAYE)**

- Conditions
- Taxation

52 - 53

6. Employee Share Schemes

*** Employee Benefit Trusts (EBTs)**

- Overview
- Income Tax
- Capital Gains Tax
- Inheritance Tax

A commercial trust, that is one not established by a transfer of value, can still be subject to the 10 yearly and exit charge regimes.

53 - 57

6. Employee Share Schemes

*** Corporation Tax Relief**

*** Unapproved Arrangements**

57

7. More Adventurous Possibilities

- * **Traded Options**
 - Description
 - Taxation
- * **Futures**
 - Description
 - Taxation

58 - 59

7. More Adventurous Possibilities

- * **Warrants**
 - Description
 - Taxation
- * **Commodities**
 - Description
 - Taxation

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8. Tax-Relieved Saving Arrangements

- * **Personal Equity Plans (PEPs)**
- * **Tax Exempt Special Savings Accounts (TESSAs)**
- * **Individual Savings Accounts (ISAs)**
 - Description
 - Taxation
 - Budget 2007 rationalisation
- * **National Savings**

59 - 60

9. Real Property

- * **Overview: the IHT distinction between trade and investment**
- * **Furnished holiday accommodation**
- * **Real Estate Investment Trusts**

61 - 62

10. Chattels

- * **Overview**
 - Defining chattels
 - Facing up to the value
 - Lifetime gifts
 - The Capital Gains Tax angle
 - Pensions – A 'no no'

63 - 64

10. Chattels

- * **Valuation on Death**
 - The statutory rule
 - HMRC practice
 - Anticipating HMRC's questions

64 - 66

10. Chattels

* Inheritance Tax Mitigation

- Straightforward lifetime gifts
- Donor retains for full consideration
 - (i) *Avoiding reservation of benefit*
 - (ii) *Establishing full consideration*

66

Example 8

Valerie, a widow, lives in the Old Rectory where she much enjoys a variety of furniture, paintings and silver left by her late husband, Jack. But she is aware that, with values approaching £500,000 in total, an IHT bill of around £200,000 on her ultimate death (which should be at least 10 years hence) will prove unwelcome to her two daughters whom she wants to inherit in turn. So, on advice, she makes a Deed of Gift of specified chattels to each daughter, agreeing that on terms that she will pay the replacement value insurance and an arms length licence fee (to be re-negotiated every three years) she will continue to house the chattels at the Old Rectory.

68

Example 8

Negotiations are made between one auction house acting for Valerie and the other for each of the two daughters to arrive at an appropriate fee for each chattel or set of chattels.

This is paid annually by Valerie and the daughters pay Income Tax thereon. A careful eye is had to CGT (see 10.4 below). Happily, none of the values or gains on the chattels are sufficient to produce a CGT bill, given Valerie's annual exempt amount of £9,600 and some general brought-forward losses.

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10. Chattels

* Inheritance Tax Mitigation

- Donor retains for full consideration
 - (iii) *The pre-owned assets angle*
- Shared ownership
- Sale of reversion to lease for full consideration

68 - 69

10. Chattels

* The Capital Gains Tax Angle

- Computing the gain
- The annual exempt amount for 2007/08
- The chattels exemption

69 - 70

Example 9

Adrian gives to his son a Georgian chest which he bought at auction three years ago for £2,000, now worth £5,000. The disposal is exempt. He also gives to his daughter a picture worth £20,000 which he inherited two years ago when worth £10,000. The gain is £10,000. Five-thirds of the difference between £20,000 and £6,000 is £23,333. But the gain does not exceed this and so the figure of £10,000 stands.

70

10. Chattels

* The Capital Gains Tax Angle

- Use of relevant property trust

* Chattels Valuation: HMRC's Fiscal Forum

- Use of indices

SAV are keen to keep abreast of the latest information sources and establish which indices/databases are most commonly used and meaningful.

70

Anastasia Tennant (Christies) raised a case she was involved in where several siblings had been given part shares in assets on the same date. The Inspector was seeking to value each part share in isolation which would result in a discounted acquisition value for the siblings. This seemed to her not to be right and the siblings' acquisition value should be a fractional share of the whole with no discount.

HMRC capital gains specialists agreed that the Inspector appeared to be wrong and no discount was in point.

71

Susan Johnson noted that for CG purposes, the actual acquisition price is used if a chattel was bought jointly after March 1982, but a discounted joint ownership price is applied if a chattel was purchased before March 1982 and the taxpayer elects for rebasing to apply. Mike Fowler said this is a widely acknowledged feature of the legislation but, again, it is for the Inspector to advise SAV of the exact valuation requirement.

71

11. Trading Investments

* Film Schemes

- Loss relief in general
- Film tax relief under FA 2006 - commencement and transitional arrangements
 - (i) *Overview*
 - (ii) *Approval by the European Commission, subject to changes in definition*
 - (iii) *Transitional rules*
 - (iv) *Television productions*

72 - 74

11. Trading Investments

* Film Schemes

- Anti-avoidance: Restriction of Loss Relief for Individual Trading Partners
 - (i) *Context*
 - (ii) *The new restrictions, with effect from 2 March 2007*

74

11. Trading Investments

* Film Schemes

- Two subsequent amendments
- The purpose test
- The annual limit
- Relevant film-related expenditure

75

11. Trading Investments

* Film Schemes

- Anti-avoidance: Restriction of Loss Relief for Individual Trading Partners

(iii) *Budget 2008: Restrictions on Trade Loss Relief for Individuals*

- *Proposed revisions*

76

Where a loss arises to an individual carrying on a trade in a non-active capacity as a result of tax avoidance arrangements made on or after 12 March 2008, no sideways loss relief will be available for that loss. Otherwise there will be an annual limit of £25,000 on the total amount of sideways loss relief that an individual may claim from trades carried on in a non-active capacity.

76

11. Trading Investments

* Corporation Tax Associated Companies

(i) Background

We intend to apply the law across the board and not restrict the exercise to film partnerships only.'

(ii) The law

(iii) What about ESC C9, 'Associated companies'?

76 - 77

11. Trading Investments

* Corporation Tax Associated Companies

(iv) Holiday homes

(v) Budget 2008 relieves the problem

- Simplification of associated companies rules

The new wording and subsections will ensure that the rights or powers held by business partners will be attributed only when 'relevant tax planning arrangements have at any time had effect in respect of the taxpayer company'.

77 - 78

11. Trading Investments

* Business property relief

* Farming

* Woodlands

- Agricultural property relief

- Deferral relief

- Business property relief

78 - 80

12. Anti-avoidance

* Trading or Investment: the 'Badges of Trade'

* Transactions in Securities

- Overview

- Risk of Having Past Gains Recategorised As Income: HMRC practice

81 - 83

12. Anti-avoidance

- * Transactions in Securities
 - Capital Gains Tax Reform – Amended FAQ

Q. What will HMRC consider reasonable rearranging of affairs where a clearance has been given under ITA 2007 s701 (or TA 1988 s707)?

83

12. Anti-avoidance

- * Artificial Transactions in Land
- * Transfers of Assets Abroad
 - Overview
 - History
 - Scope
 - The motive test – widened from 5 December 2005

84 - 86

12. Anti-avoidance

- * Deeply Discounted Securities
 - An income tax charge on disposal
 - A scheme fails

(Astell & Anor v HMRC, SpC)

88

12. Anti-avoidance

- * Trusts and Losses
 - * CGT: Allowable Losses
- Anti-avoidance Rule from 6 December 2006
- The rule
 - HMRC's guidance
 - The CIOT's take

89 - 90

13. Pensions and Investment

- * Pensions not to be used for IHT Mitigation!
- * So what policy should be adopted on reaching 75? Two alternative approaches
 - ASP v annuity purchase

91 - 92

Example 11

<i>Member's and spouse's ages</i>	-	<i>75</i>
<i>Fund value</i>	-	<i>£410,000</i>
<i>Single life annuity</i>	-	<i>c. 39,000 pa</i>
<i>Joint-life annuity</i>		
<i>(50% widow's pension)</i>	-	<i>c. 35,000 pa</i>
<i>Widow's payment on death</i>		<i>£17,500 pa</i>
<i>Drawdown</i>	-	<i>c. 37,000 pa</i>

92

The widow's pension would depend on the residual capital available at the death of the member, which in turn would be determined by investment performance over the period. Assuming the scheme achieved a 6% per annum return net of expenses, then the potential widow's pension would be as follows:

<u>Death after</u>	<u>Residual fund</u>	<u>Widow's pension</u>
Five years	£344,000	£39,695 pa
Ten years	£258,000	£37,320 pa
Fifteen years	£142,000	£25,760 pa

These should be compared with the £17,500 per annum widow's pension that would have been payable from an annuity.

92

NB If the spouse pre-deceased the member, it would almost certainly be preferable to defer purchasing any annuity, because in that event a single-life pension purchased at an older age would provide an even greater pension

92

Pension v taxed investment option: Example 12 [2007/08 tax rates]

The following compares the consequences for the client's estate based on a requirement to provide a gross income in retirement of £35,000 per annum and the following assumptions:

Tax rate (pre-retirement)	-	40%
Tax rate (post-retirement)	-	22%
Pension investment return	-	6% pa
Personal/taxed investment return	-	5% pa
Inheritance tax	-	40%
Target fund	-	£800,000

93

1 Pension option

Pension contribution required for 20 years at 6% per annum - £21,747 pa (age 60)

Pension commencement lump sum	-	£200,000
Residual fund	-	£600,000
Residual pension	-	£35,000 pa
Residual fund at death (mid 80s)	-	say £400,000
Less tax at 82%	-	(£328,000)
Residue for beneficiaries (net of all taxes)	-	£ 72,000

93

2 Personal/taxed investment option

Comparable net investment - £13,048 per annum - £466,000 (age 60) (£21,747 less 40%)

Less allowance for pension commencement lump sum - £200,000

Comparable amount available for retirement income - £266,000

At £27,300 (equivalent to £35,000 gross i.e. less 22%) per annum, £266,000 would be exhausted after 14 years assuming 5% per annum investment return.

93

13. Pensions and Investment

* So what policy should be adopted on reaching 75? Two alternative approaches

- An alternative suggestion: Maximise income in retirement
- Back-to-back arrangements

94

14. The Offshore Element

- * Overview
- * FB 2008: Residence and Domicile Review
 - Budget 2008: the new statutory residence rule
 - The statutory rule from 2008/09

A day will be counted only where the taxpayer is physically present in the UK at midnight.

94 - 95

14. The Offshore Element

- * FB 2008: Residence and Domicile Review
 - The statutory rule from 2008/09

Now, transit passengers who change between different terminals of the same airport, between different airports or arriving and departing by different modes of transport will not be regarded as present in the UK even when here at midnight. However, they must not engage in activities 'to a substantial extent unrelated to their passage through the UK', for example business meetings.

95

14. The Offshore Element

- Budget 2008: UK Resident Non-UK Domiciliaries - Taxation from 2008/09
 - The £30,000 charge

There are three main changes to the draft legislation: (a) the de minimis has been raised from £1,000 to £2,000; (b) the charge will apply only to adults, so will become payable in the year a person turns 18; and (c) it will be a tax charge on unremitted income and gains rather than a stand-alone charge.

95

14. The Offshore Element

- Budget 2008: UK Resident Non-UK Domiciliaries - Taxation from 2008/09
 - The £30,000 charge

If the £30,000 charge is paid from an offshore source direct to HMRC by cheque or electronic transfer, it will not itself be taxed as a remittance.

96

14. The Offshore Element

- Budget 2008: UK Resident Non-UK Domiciliaries - Taxation from 2008/09
 - Personal allowances and the remittance basis
 - Closing loopholes in the remittance basis
 - 'Ceased source'
 - 'Cash only'

96

14. The Offshore Element

- Budget 2008: UK Resident Non-UK Domiciliaries - Taxation from 2008/09

There will be exemptions for personal effects (that is, clothes, shoes, jewellery and watches), assets costing less than £1,000, assets brought into the UK for repair and restoration and assets in the UK for less than a total 9 month period purchased out of relevant foreign income.

96

14. The Offshore Element

- Budget 2008: UK Resident Non-UK Domiciliaries - Taxation from 2008/09

Any asset purchased out of untaxed relevant foreign income which an individual owned on 11.3.08 will be exempt from a charge under the remittance basis, so long as that individual owns it, even if that asset is currently outside the UK and later imported. Any asset in the UK on 5.4.08 will also be exempt from a charge under the remittance basis, for so long as the current owner owns it, even if that asset is later exported and then re-imported. The existing charge which arises if such an asset is sold in the UK will remain.

96

14. The Offshore Element

- Budget 2008: UK Resident Non-UK Domiciliaries - Taxation from 2008/09

- Closing loopholes in the remittance basis
 - 'Claims mechanism'
 - Mixed funds

96

14. The Offshore Element

- Budget 2008: UK Resident Non-UK Domiciliaries - Taxation from 2008/09

- Closing loopholes in the remittance basis
 - Alienation

The definition of 'immediate family' will be more limited than the 'relevant person' definition proposed in the draft legislation of 18.1.08. It will be limited to spouses, civil partners, individuals living together as spouses or civil partners and their children or grandchildren under 18.

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14. The Offshore Element

- Budget 2008: UK Resident Non-UK Domiciliaries - Taxation from 2008/09

- Closing loopholes in the remittance basis
 - Alienation

It will also cover close companies, or foreign companies which would be close if UK resident, of which any of them are participators and trusts of which any of them are settlors or beneficiaries.

97

14. The Offshore Element

- Budget 2008: UK Resident Non-UK Domiciliaries - Taxation from 2008/09

- Closing loopholes in the remittance basis
 - Non-resident trusts
 - Non-resident companies
 - Transfer of assets abroad

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14. The Offshore Element

- Budget 2008: UK Resident Non-UK Domiciliaries - Taxation from 2008/09

- Closing loopholes in the remittance basis
 - Accrued income scheme
 - CGT losses
 - Offshore mortgages
 - Art for public display

97 - 99

14. The Offshore Element

- Budget 2008: UK Resident Non-UK Domiciliaries - Taxation from 2008/09
 - Closing loopholes in the remittance basis
 - Changes for employment-related securities
 - Foreign dividend income

Remittance basis users liable at the higher rate will be taxed at 40% on foreign dividend income remitted to the UK.

99 - 100

14. The Offshore Element

- Budget 2008: UK Resident Non-UK Domiciliaries - Taxation from 2008/09
 - Residence and Domicile Reform: Non-UK Domiciliaries

STEP's understanding of several important points which were made at that meeting

100

14. The Offshore Element

- Budget 2008 – Residence and Domicile: Aligning the CGT Treatment for Non-UK Resident Trusts
 - Changes
 - Rebasing

The election will not in itself trigger any deemed disposal. The one limited purpose of the election is simply that, when there is a later actual disposal of the asset, the trust gains realised on that disposal will be split between the pre-6.4.08 and post-5.4.08 elements.

100 - 103

14. The Offshore Element

- Budget 2008 – Residence and Domicile: Aligning the CGT Treatment for Non-UK Resident Trusts
 - Rebasing

Non-UK domiciled beneficiaries will not be taxed insofar as any capital payments are matched to the pre 6.4.08 element of gain. So there will still be one trust pool but trustees will need to keep a record of pre-6.4.08 and post-5.4.08 gains for the purposes of being able to tell non-UK domiciled beneficiaries whether they are taxable.

103

14. The Offshore Element

- Budget 2008 – Residence and Domicile: Aligning the CGT Treatment for Non-UK Resident Trusts
 - Rebasing

Making a rebasing election will entail an exception to the normal LIFO rule.

- Offshore Income Gains (OIGs)
- TCGA 1992 Sch 4C (transfers between trusts)
- HMRC's FAQs

103 - 105

14. The Offshore Element

- * Budget 2008: Authorised Investment Funds

Funds of alternative investment funds: current law and proposed revisions

Property authorised investment funds: current law and proposed revisions

105 - 106

14. The Offshore Element

*** The Offshore Disclosure Facility**

- **Context**
- **What are the terms of this facility?**
- **What disclosures are unlikely to be settled through this facility?**

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14. The Offshore Element

*** The Offshore Disclosure Facility**

- **What disclosures are outside this facility?**
- **Interest and Penalties**
- **The outcome to date**
- **The second offensive**

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14. Offshore Assets: Good Reasons for Brits to Hold Them?

Context

Bank accounts

Offshore bonds

Accumulation fund

109 - 110

APPENDIX

PENSION SIMPLIFICATION LEGISLATION AND PLANNING IDEAS

- 1. Contribution rules**
- 2. Investments**
- 3. Retirement benefits**
- 4. Death benefits**
- 5. Strategies to minimise 82% tax**

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