SCOTT-MONCRIEFF

EDINBURGH AND GLASGOW

# Tax Briefing

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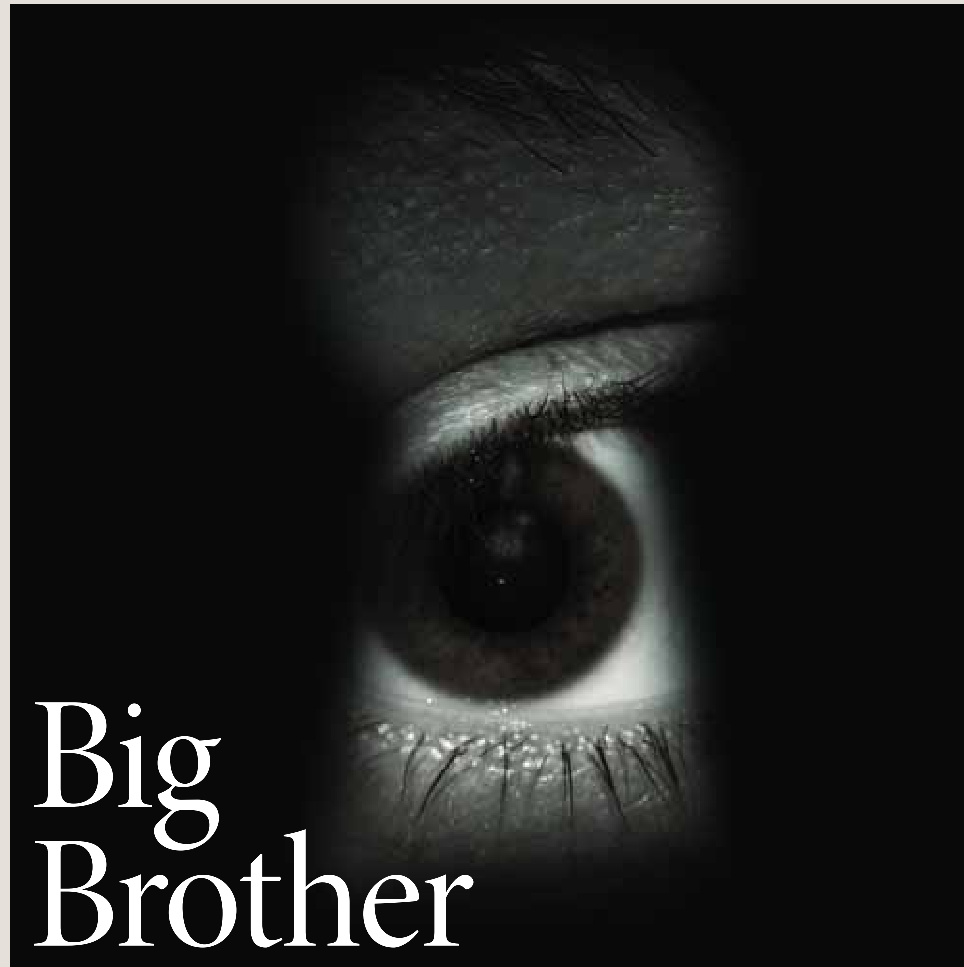


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# Welcome . . .

On the 9 October the new Chancellor Alistair Darling delivered his first budget speech. As well reconfirming Gordon Brown's growth forecast of around 3% this year is likely to be met, he reduced the forecast for next year from 2.5-3% to 2-2.5% on the back of the credit crunch which is impacting the markets.

However, the change to capital gains tax was the one which would have made most people sit up and take note – or at least those of you who are thinking about selling your business. All capital gains made on or after 6 April 2008 will be taxed at a flat rate of 18%, irrespective of the marginal income tax rate of the taxpayer concerned. This rate will apply to individuals and trusts, but companies liable to corporation tax are not affected by these proposals.

If you are thinking about selling your business then I would advise that you speak to the Scott-Moncrieff partner responsible for your affairs and download our CGT factsheet from our website to ensure that you are aware of the potential impact. The existing capital gains tax rules will apply for disposals made up to 5 April 2008.

Also in the Latest News section on our website you will find more information on the tax changes announced in the PBR to Inheritance tax and for non domiciliaries and the extended digital version of Tax Briefing.

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# Will the tax man come knocking?

New and established initiatives confirm the taxman's zeal. Don't get caught out, writes **Paul Renz**.

THERE'S a lot going on in the tax world at the moment, much reflecting HMRC's desire to identify taxpayers who may not be paying their fair share. Take the offshore disclosure initiative, dubbed a 'tax amnesty', which ran until 22 June. Individuals realising they had not paid tax on funds in offshore bank accounts – possibly just on the interest gained – had a chance to make a clean breast of it, in the anticipation that any penalties would be capped at 10%. Any tax due must be paid by 26 November.

### Offshore data

Why has HMRC done this? One possibility is that, having asked banks for information on offshore bank accounts, the taxman has been overwhelmed by the length of the lists of names supplied. Following them all up would be a huge task, hence the invitation for people to own up to any unpaid tax. Individuals who have simply forgotten to declare interest on offshore funds, but who should be paying tax on them, are unlikely to be of much further interest to the HMRC.

However, bigger fish who may have deposited gross income (such as bonuses) in these accounts without paying any tax will excite the taxman more.

Another initiative that reveals HMRC's interest in certain groups of taxpayers is the formation of a special unit focusing on buy-to-let landlords. HMRC appears worried that some may be mis-stating their expenses or committing other errors. Are they incorrectly charging capital payments as part of allowable interest expenses, for example? Buy-to-letters whose reported figures appear out of step with the norm can expect further detailed scrutiny.

### European focus

Interest in undeclared income is shared by tax authorities across Europe. The EU Savings Directive, which came into effect from July 2005, established a system whereby banks would supply tax authorities with information on interest paid where no tax is deducted at source. Even jurisdictions outside the EU have joined the scheme, including the Channel Islands and the Isle of Man. Some taxpayers have encountered problems with the system – suffering tax withheld when it should not have been. Such problems can generally be sorted out. If in doubt about your personal situation, remember that if you are UK domiciled and resident, you are taxable on all worldwide income on an arising basis.

*"If you are UK domiciled and resident, you are taxable on all worldwide income"*

If UK resident but not domiciled, you are taxable on any UK income arising and any overseas income and gains remitted to the UK.

If in doubt about your position, or whether you should have declared certain income or gains to the taxman, contact your Scott-Moncrieff adviser. Keeping errors quiet is likely to get harder. It's always best to freely declare your mistakes to HMRC, rather than waiting for them to come knocking on your door. ■

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# No need for nil rate alarm

Don't panic! Despite some scare-mongering news reports, the end is not nigh for nil rate inheritance tax planning. Writes **Linsey Addie**.

THE recent excitement was caused by the case of the Phizackerleys, a husband and wife who tried to use nil rate band planning, involving a discretionary trust, to reduce their inheritance tax (IHT) liability. Unfortunately, the particular circumstances of this case defeated their plans.

It is established practice for married couples to use the nil rate band, as follows. When the first spouse dies, he or she leaves their half of the property to a discretionary trust, which assigns that half back to the surviving spouse in return for a debt. On the second death, the value of the whole house is taken into this deceased's estate, but reduced by the debt.

Unfortunately for the Phizackerleys, a number of facts in combination counted against them. Special Commissioner John Avery Jones had no option but to rule that the value of the whole house was liable to IHT on the death of the second spouse, in this case Dr Phizackerley.

The outcome could have been different if Dr Phizackerley, who provided all the funds for the purchase of the house, had died first. The couple's plan could also have worked had the debt been secured against the property by taking a charge. A good adviser should have been able to ensure that the couple's nil rate planning was successful.

*"Potential traps that exist for those without a complete understanding of the law"*

Although it is preferable if both partners in the marriage have liquid assets, even where the principal asset is the family home it is till possible to reduce the ultimate IHT liability. This remains unchanged, despite the Phizackerley ruling.

The case illustrates the potential traps that exist for those without a complete understanding of the law. If you have any concerns about your IHT liability, please contact your Scott-Moncrieff adviser for help. There are many options available, of which nil rate band planning is one. ■

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# Interest clearance alert

Clearance for paying interest gross may soon be given more quickly, but at the cost of business certainty, writes **David Boyd**.

WITHHOLDING tax from interest payments is something that many businesses need to think about. In some circumstances HMRC will allow interest payments to be made gross. Take a UK company paying interest to an overseas company with which it is connected. Rather than having to withhold tax, the UK company will often seek clearance to pay its interest gross. This is allowable under double taxation treaties, which seek to avoid entities being taxed on the same income in two jurisdictions. Paying interest gross not only avoids this problem, but also cuts out the admin associated with having to withhold tax and then pay it to the tax authorities.

Traditionally, before giving clearance to pay interest gross, HMRC would look at the details of the arrangement to ensure it is being made on an arm's length basis. In other words, if the interest/loan appeared unusually high, clearance would not be given and tax would have to be withheld.

However, HMRC is now changing the clearance procedure. In future, HMRC will no longer assess the arm's length nature of the transaction up front. As long as the application is valid under the relevant tax treaty, companies will generally be given permission to pay interest gross. HMRC is applying a self-assessment approach to these interest payments, whereby companies will be expected to confirm for themselves that the payments are arm's length. The risk is that, should HMRC subsequently come to a different conclusion, the tax that should have been withheld will be demanded, along with interest and, in extreme cases, penalties.

The change should mean that companies receive the initial rubber stamp of approval more quickly. However, they will no longer have the comfort of knowing HMRC has looked at their specific situation and approved it. Expert advice will be even more essential. ■

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Gdansk Old Town, Poland

# Bricks and mortar European-style

Property in eastern Europe has been performing well over recent years, but how should you go about investing? **Raymond Ellis** reports.

PROPERTY has been an established asset class for many years and the UK market has delivered strong returns. For diversification, however, investors have increasingly been looking overseas for new opportunities – particularly those where fast-growing and developing economies could result in higher returns.

A few years ago, investors keen to enter the eastern European property market would often need to go it alone – identifying their own, individual properties in target locations such as Poland, Bulgaria or Slovakia. This isn't necessarily an easy option. Identifying suitable properties and completing the purchase can require considerable effort. The need to maintain the property and handle rental agreements creates further time demands. However, for those with the necessary commitment, this strategy has often worked well.

### Ongoing opportunity

With the Bank of England raising interest rates, concerns over the domestic housing sector are growing. Repossessions are now at a ten year high and first time buyers at the lowest level for 25 years. Buy to let investments have also created a disposable market within the housing sector, something unheard of ten or more years ago.

By comparison, the dynamics of the economies in many eastern European countries still make property investments very attractive. For example, Poland is one of the fastest-growing European economies, enjoys large amounts of EU funding, and is set to receive £82bn of EU cash between 2007 and 2013. The country also benefits from large amounts of foreign direct investment – £6bn in 2005.

Property in such countries remains relatively affordable, but prices are rising and are expected to continue doing so for a number of reasons. At present, salaries in eastern Europe are relatively low by western European standards, but are expected to equalise over the next five to ten years. This will have a direct impact on the local population's ability to borrow and as the availability of debt increases, also very low as a percentage of GDP, so should property prices.

### Fund focus

Recognising the potential for future investment returns, and the increasing demand among individual investors, sector specific funds are being established to focus on property in eastern Europe. Some funds focus on specific countries, for example, several have been set up to focus on residential and/or commercial property in Poland. Alternatively, investors might choose a fund that covers a number of different countries within the central and eastern European region. For example, one particular property fund invests in a total of 15 central and eastern European countries. Either way, investors can diversify their risks by spreading their investment across a number of properties rather than concentrating them through a single property purchased directly themselves.

It is always wise to take advice on which property investment opportunity is most appropriate. Members of the Scott-Moncrieff Wealth Management Division will be happy to help. ■

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# When I'm sixty five

## Andrew Cumming advises on transfer values on final salary pension schemes.

A NUMBER of clients have asked me about the option of a transfer value on their final salary pension scheme but are unsure of the benefits. The short answer is that in the vast majority of circumstances, transfer values from final salary pension schemes offer poor value for money, and transferring will usually result in inferior benefits. This is due mainly to the assumptions used by the actuaries which can significantly undervalue the cost of providing the same benefits on the open market. For 9% or more, a transfer will not be appropriate, however, for some people a transfer can provide options which are not otherwise available. Advice on final salary transfers is a specialist area and the FSA is very clear on the level of qualifications needed to provide advice and transact such business. It is important to ensure that the person you are talking to is a properly qualified transfer advice specialist.

Final salary pension schemes are usually set up to provide benefits in a clear and defined manner with very little choice about structure. For example, most will increase pensions at around 3% per annum and provide a spouse's pension of 50% on the pensioner's death. These benefits come at a significant cost and, should you not need them, the money 'reserved by the actuary' on providing them will be wasted, unless you take a transfer value, where the cost of provision is included.

For example, to provide a pension of £10,000 increasing each year at 3% for a man aged 65 with a wife of 62 who will inherit 50% of his pension would cost £209,590. However, the same man who was single would be able to buy a pension of £11,242 – an increase of 11% guaranteed for life. If he chose to give up the increase on the annuity then he would able to purchase an income of £15,291 – 52% more than the original income and still guaranteed for life.

For those with serious illnesses, smokers or just in poor health, an even better annuity rate may be available through specialist providers who can provide a better rate of income based on the insurance company's opinion of life expectancy (impaired life annuities).

The other side of this equation is that final salary schemes will often not provide for unmarried (or un-civil partnered) partners. On this basis, the spouse's pension provided by the scheme is equally useless to the member but he or she may still want to provide for their partner. By taking a transfer value, it is again possible to structure pension benefits so that an unmarried spouse can benefit from their partner's pension fund.

Other areas where a transfer may be appropriate include where benefits are not protected in full by the Pension Protection Fund, wanting to retire earlier than permitted by the scheme rules, needing more control over the benefits from the fund to take partial benefits, and terminally ill individuals who can markedly improve their death benefits. ■

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# Capital concerns

## The extension of certain anti-avoidance rules to individuals could have nasty consequences for many married couples, writes **Paul Renz**.

THE 2006 Budget introduced rules for companies targeting tax avoidance involving the use of capital losses. As a result, there use was restricted in some situations where arrangements had been put in place to mitigate tax.

Then, in the Pre-Budget Report of 6 December 2006, the government sprung a nasty surprise, announcing the extension of such anti-avoidance rules to individuals, trustees and personal representatives. The new rules came into effect from 6 December 2006, even though the Finance Act only received Royal Assent this July.

One of the challenges with these new anti-avoidance measures is that the Finance Act provisions are relatively loosely drawn. This means that the HM Revenue & Customs guidance is important in determining the impact of the changes, at least before any potential future court cases establish precedents.

### Wide coverage

Unfortunately, the taxman seems to be taking a wide view of the kinds of situations that could be caught. It was only in July that the Revenue's final guidance on how to apply the rules appeared. As had been expected, the rules covered individuals entering into some form of scheme that was marketed as a way to create a capital loss for offsetting against gains or income. However, the Revenue's examples of situations caught by the new rules go far beyond such marketed schemes. Many actions previously considered normal acceptable practice by tax professionals could now be deemed avoidance by the tax authorities.

There are potentially serious implications for husbands and wives. Consider a situation where one spouse – say the husband – holds shares in a company. The shares lose value, the husband decides to sell them and realises a loss. The wife independently buys back those shares at the new low value. According to the Revenue, if husband and wife don't talk about these transactions to each other, the loss crystallised in the husband's hands will be an allowable loss and can be offset against income or gains. However, if they speak about their intentions, the loss will not be allowable. Given that spouses naturally talk about their finances, imagining a situation where they would not talk about such share sales seems ridiculous.

### Arbitrary rules

Many aspects of the Revenue's guidance seem arbitrary. For example, in the example above, there would be no problem if 30 days elapsed before the wife bought back the shares. But who says that 30 days is a sensible time period?

Its early days for these rules but taxpayers need to be aware that they may no longer be able to use capital losses as they have before. Techniques such as 'bed and spousing' – buying back shares in your spouse's name – could cause problems.■

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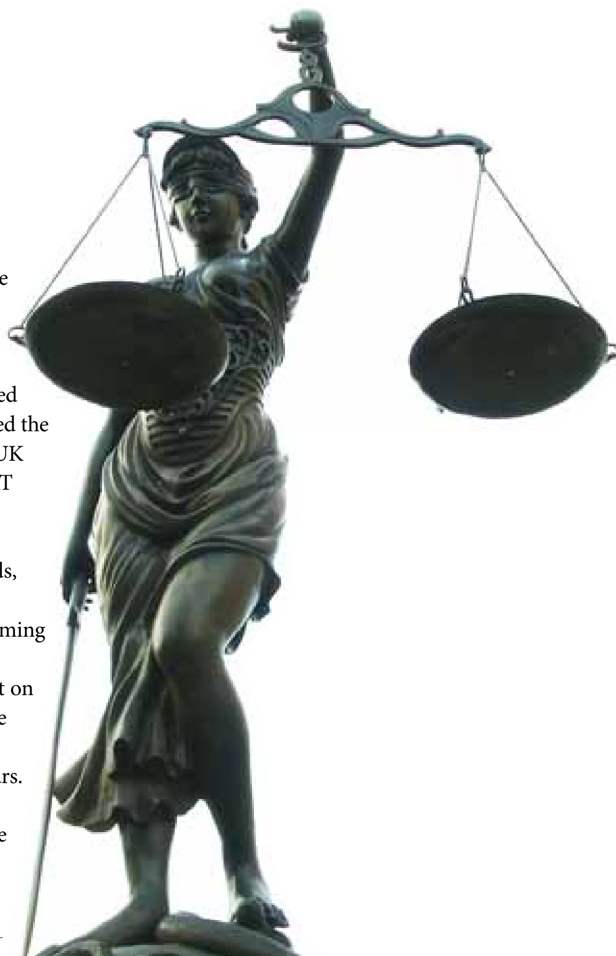
# Ruling round-up

## A number of recent tax cases could have a range of implications, writes **David Boyd**.



GOOD news for the taxpayer. A recent European Court of Justice (ECJ) decision in the case of Sempra Metals has opened the door for compound interest to be charged by taxpayers who are due tax back from HMRC. The Revenue argued that it only had to pay simple interest, but lost its case.

Another defeat for the taxman has been inflicted by Mars and William Grant. The case concerned the treatment of depreciation capitalised in stock. The House of Lords ruled against the Revenue's preferred treatment for determining how much depreciation should be added back in tax calculation. In effect, the ruling means that companies that have capitalised depreciation in stock should be entitled to money back from the Revenue. An adjustment in the current year is likely to be the easiest method.

Meanwhile, many investment trust companies are putting in claims to HMRC for VAT previously paid on fees charged by third party management companies. The claims follow an ECJ ruling in a case brought by JP Morgan Claverhouse Investment Trust plc. The case was triggered by investment trust companies (ITCs) having to pay VAT on management charges, while so-called 'special investment funds' such as authorised unit trusts did not. The ECJ has now backed the ITCs, and the ruling must be acted on by UK courts – a big step on the way to a new VAT treatment for ITCs.

Another important decision is eagerly awaited, this time from the House of Lords, which in November will hear the cases of Condé Nast Publications and Michael Fleming concerning the legality (or otherwise) of HMRC's introduction of a three year limit on VAT reclaims. If the Lords rule against the taxman, many businesses may be able to reclaim VAT going back beyond three years. It would be worth preparing such claims now, as HMRC is sure to want to close the claims window quickly. ■

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# Taper relief traps

## Confident about getting your business asset taper relief? Take care – many potential pitfalls lie between you and your target 10% tax rate, writes **David Boyd**.

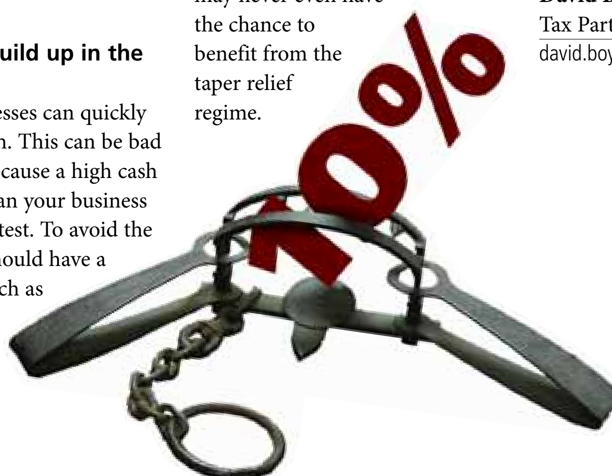
### Pitfall 1:
**Thinking that after two years that 10% rate is yours.**
Everyone assumes business asset taper relief (BAT) involves a two-year ownership test – but think ten years instead! You have to look back over your period of ownership to see whether your assets qualified each year. Because the rules have changed frequently, BAT might not always have been available.

### Pitfall 2:
**Assuming you run a trading business.**
You run a property business. That's a trading company, right? Not necessarily. Property development is considered a trading activity and so qualifies for BAT, but property letting might not.

### Pitfall 3:
**Forgetting the old rules.**
In 2000 new rules meant it became easier to pass the taper relief test, but that doesn't mean the old rules don't count. If you've held your business asset for ten years, you need to comply with the old rules for the earlier period of ownership.

### Pitfall 4:
**Letting cash build up in the business.**
Profitable businesses can quickly become cash rich. This can be bad news for BAT because a high cash balance may mean your business fails the trading test. To avoid the problem, cash should have a clear purpose such as funding expansion or asset purchases.

### Pitfall 5:
**Employment-related securities.**
The rules on employment-related securities are extremely complicated, but have serious implications. Shares received by reason of your employment could be deemed subject to income tax, not capital gains tax. Thus they may never even have the chance to benefit from the taper relief regime.




### Pitfall 6:
**Losing out on the sale of a business.**
Say you sell BAT-qualifying shares after only one year. Must you pay 20% tax on any gain? Not necessarily. You could use loan notes to extend your ownership and ultimately access the 10% rate. ■

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# Can money grow on trees?

Investing in forestry can make good financial sense. Writes **Raymond Ellis**.

WITH news reports constantly highlighting the dangers of global warming, support for sustainable and green businesses is growing. Forestry is a longstanding, sustainable activity and one that investors increasingly appreciate.

There are two key ways to invest in the forestry sector: by buying a piece of forest directly, or investing in a forestry-focused fund. Both options bring the same tax advantages, which are significant. After two years, as a result of business property relief, your investment will fall completely outside your estate for inheritance tax purposes on death. Furthermore, if you decide to sell your forestry holding during your lifetime, there is no capital gains tax chargeable. Income generated is also tax-free, which is another advantage why forestry has such strong appeal over recent years.

*"If you want to commune with nature, buying your own piece of forest could be the answer"*

When it comes to choosing how to make the investment, forestry funds will be the right option for those who want minimal direct involvement with the land. All issues connected with the management of the fund will be taken care of. However, for some, buying direct brings special benefits – the ability to get out in the fresh air with your family and enjoy your own piece of Britain. If you want to commune with nature, buying your own piece of forest could be the answer.

In terms of assessing a forestry investment, as an asset class it is generally thought of as relatively low risk. With the on-going interest in environmental issues, forestry investments may begin to attract a green premium. Demand for forestry investment opportunities is certainly high, with funds quickly becoming fully subscribed once available. New forestry funds are expected to come on stream this summer. Interested investors should look out for further details. ■

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# **Tax:** Property tax planning

# Top of the Props

Top ten property planning tips from **Paul Renz**, **David Boyd** and **Scott Craig**.

**1** Where there is an intention to buy more than one property it can be more efficient to use a company than purchase in your own name.

**2** If you do purchase a property personally, consider doing so in joint names with your spouse, particularly if they are a lower rate taxpayer.

**3** If the property is being rented out, remember that tax relief can be claimed for a wide range of expenses connected with the letting of the property, including repairs. Tax relief on "repairs" that are essentially "improvements" and add value to the property, can only be claimed when the property is eventually sold.

**4** Enhanced tax relief is available for landlords where money is spent improving the energy efficiency of let residential properties. Draft proofing, insulating the loft, walls and hot water system are all eligible works.

**5** Tax relief can be claimed for interest paid on a loan used to acquire a buy-to-let property, whether the loan is short or long term and no matter how it is secured. It should therefore be possible to extend the mortgage on your own residential home, use the funds to acquire a buy-to-let property, and claim tax relief on the mortgage interest against the rents received.

**6** If you decide to rent out a property that has been your residential home, a proportion of the gain achieved when you sell the property (that relates to the period when it was let out), will not be eligible for the 'private residence' tax exemption, however it will be eligible for 'property letting' tax exemption – currently £40,000.

For tax purposes you are deemed to live in the property during the last three years of ownership, even if you didn't actually do so. This means you could rent your home out for up to three years, without losing the "private residence" tax exemption.

**7** Ensure you determine whether VAT is applicable to the purchase of property and confirm the recovery of this at the financing stage.

NB. Land and Buildings that cost more than £250,000 are subject to the Capital Goods Scheme – over a 10 year period of adjustment.

**8** Do not rent out a property without addressing the resulting VAT liabilities and effect this has on the overall VAT recovery position. Exempt supplies can reduce the recovery of VAT.

**9** Look at electing to waive the exempt VAT status of commercial property if significant amounts of VAT will be incurred on the acquisition of buildings or repair/renovation/construction work. This action should allow VAT on all associated costs to be recovered in full.

**10** Look at selling tenanted properties as the transfer of a property rental business as a going concern.

If specific conditions are met the sale will not attract VAT. This in turn can reduce the amount of stamp duty due on the transaction.

*"If property is being rented out, remember that tax relief can be claimed for a wide range of expenses."*

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## Tax: VAT

# Changes and updates

Over the last few months, a number of VAT-based issues have come to the fore. Writes **Scott Craig**.

### Partial exemption

HMRC has changed the system for agreeing special methods for calculating reclaimable VAT by partially exempt businesses. Since 1 April, any partially exempt business (such as property or financial services companies) that propose a special method for reclaiming VAT must sign a declaration that the method is fair and reasonable. Should HMRC dislike the method in future, it will be able to go back and apply a different approach.

Although agreeing special methods for VAT reclaims with HMRC should now be quicker, businesses no longer have certainty that their approach won't be revised retrospectively. Making sure the proposed method is fair and reasonable is therefore more important than ever.

### Carousel controls

Traders in mobile phones and computer chips are now subject to a 'reverse charge' mechanism designed to counter carousel fraud. Carousel or missing trader fraud involves the movement of goods between EU Member States, where at some point during the chain of transactions one of the traders goes missing - along with a large amount of VAT. Any transactions of £5,000 or more are affected. The effect of the reverse charge mechanism is to defer VAT collection until goods are sold by retailers. Hence traders in the chain have no opportunity to disappear with VAT they have collected.

The new mechanism represents a significant change for affected businesses, which will need to adjust their VAT accounting systems and make an additional VAT report. The reverse charge could be extended in future, sowatch this space.

### Invoice changes

Significant changes have been proposed to the UK's VAT invoicing rules, including the requirement for invoices to show a 'sequential number based on one or more series which uniquely identifies the document', rather than just an 'identifying number'. In addition, businesses making exempt supplies to business customers in other EU member states will in future need to issue VAT invoices. This was not previously required.

A recent policy announcement from HMRC confirms the changes, but delays the beginning of the new rules to the start of October. HMRC has also said it will, within reason, apply a 'light touch' in enforcing the rules during the first 12 months, recognising that many businesses will need to change software and stationery in order to comply. ■

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# Tax: Other news

## Tax amnesty action

**Individuals who declared income from offshore bank accounts on which tax is due have a new deadline to meet.**

HMRC set a June deadline for declarations of offshore income. Under a 'tax amnesty', as the press dubbed it, such declarations would be rewarded with a low 10% penalty.

Now anyone who made such a declaration has until 26 November to supply the Revenue with details and pay the tax due and penalty. This may mean trawling through bank accounts to find the relevant information, but it is important to meet the deadline. If tax is due, failure to pay by 26 November will result in a higher penalty.

Around 60,000 declarations were made to the Revenue by June. Meanwhile, the taxman may still pursue others who it believes should have made a declaration, but did not.

## CIS penalties alert

**Contractors and subcontractors beware: penalties will soon become chargeable under the Construction Industry Scheme.**

IT may have seemed pretty quiet on the CIS front since the scheme's introduction in April this year. That's partly because penalties were initially waived for the first six months and you could file late and suffer no financial cost.

This all changes from October. Any monthly returns filed late or incorrectly after 19 October will incur automatic penalties. Returns with 'nil' entries must also be filed or penalties will result. These can mount up rapidly. For example, a return concerning 53 subcontractors which is late by four months and 15 days late would incur a penalty of £1,000. It's important not to get caught out. Contact your Scott-Moncrieff adviser if in any doubt about your filing requirements.

## LPAs introduced

**A new form of protection for vulnerable people became available from 1 October.**

LASTING Powers of Attorney (LPA) have been introduced to replace the previously available Enduring Power of Attorney (EPA). This is a result of the Mental Health Act 2005, which has finally come into force.

The idea behind LPAs, as with EPAs, is that individuals can take steps to make sure that, should they in future lose their mental capability, their interests will be protected. However, while EPAs could only cover property and financial affairs, two types of LPA are now available. Thus, it is possible to choose one or more individuals to make decisions not only about your property and affairs, but potentially about your personal welfare as well, for example, in relation to health treatment. Anyone with an existing EPA are now able to set up an LPA solely to address personal welfare issues.

LPAs operate slightly differently from EPAs. For instance, LPAs have to be registered with the Public Guardian before they can be used. This may result in higher costs being incurred than previously when setting up an EPA. Nevertheless, the peace of mind benefits remain.

### Revenue gets nosey

HMRC has added some new tax return questions for people claiming to be domiciled outside the UK and/or non resident.

For individuals claiming to be non-UK domiciled, the details required on the 2006/07 tax return have been expanded considerably. For example, individuals born and domiciled outside the UK must enter the date on which they came to live in the UK. Similarly, additional questions relating to residency status have been added, including a request for information on the number of separate occasions the individual was present in the UK during the year. Note that some people may be selected for further review based on their responses.

### Planning ahead

Do you like giving HMRC £120,000 out of your estate? No, of course you don't, which is why no doubt you'll have in place a will trust as one of the inheritance tax (IHT) planning measures you're taking to make sure as a couple you're not missing out on using a nil rate band on the first death. But what about all the other exemptions and reliefs out there? If you're not taking action on a yearly basis, you'll be missing out. Who knows how long some of the current IHT reliefs will survive? So it's worth thinking about crystallising some of them now.

IHT planning is one of those things most people leave way too late, but a chat today might save an awful lot tomorrow.

### Property prospects

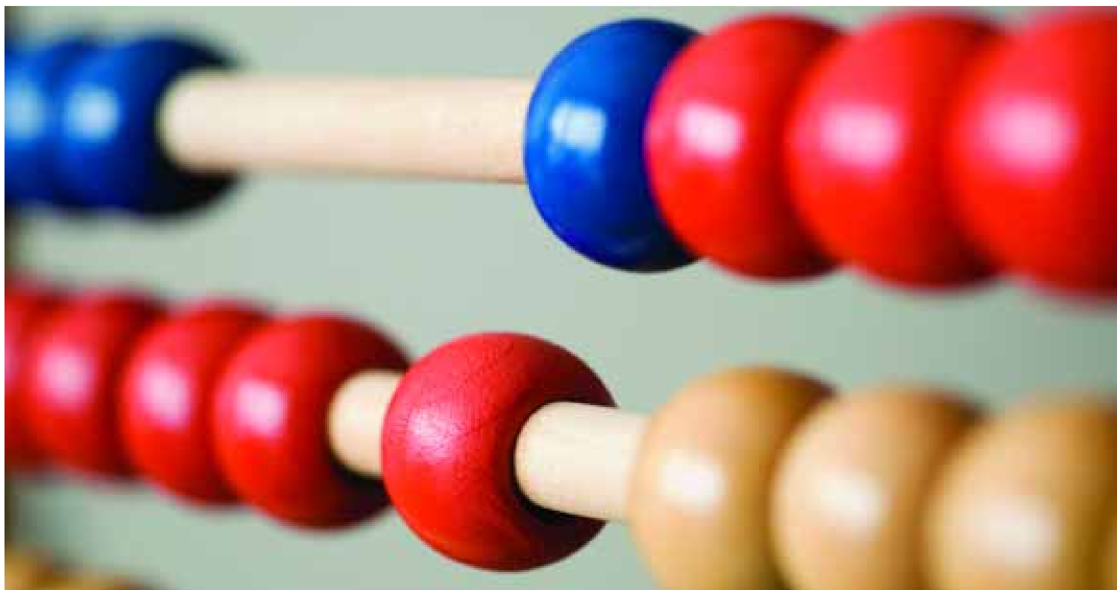
Risks associated with investments in individual commercial property can now be diversified by investing in specialist commercial property funds.

Commercial property can be an attractive investment class, particularly for pension funds. Initially, most investment opportunities revolved around single properties – making them inevitably higher risk. The good news is that there are now specialist funds with diversified commercial property portfolios, enabling investors to reduce their risks. ■

**Tax:** Pre-budget statement

# Important changes to capital gains tax

In his recent statement, the Chancellor announced significant changes to the UK capital gains tax regime for individuals, trustees and personal representatives for gains made on or after 6 April 2008.



**All capital gains made on or after 6 April 2008 will be taxed at a flat rate of 18%. This is irrespective of the marginal income tax rate of the taxpayer concerned. This rate will apply to individuals and trusts.**

Legislation will be enacted in Finance Bill 2008 to bring the new regime into force from that date. No draft legislation is currently available. The existing capital gains tax rules will apply for disposals made up to 5 April 2008. Companies liable to corporation tax are not affected by these proposals.

### The basics

The proposed changes are as follows:

- All capital gains made on or after 6 April 2008 will be taxed at a flat rate of 18%. This is irrespective of the marginal income tax rate of the taxpayer concerned. This rate will apply to individuals and trusts.
- The current system of taper relief will be abolished.
- The system of indexation allowance, which was in place prior to the introduction of the taper relief rules, will also be abolished.

In addition, certain other rules will be amended or abolished including, compulsory use of market value at 31 March 1982 for assets held at that date, abolition of 'halving relief' and simplification of share identification rules.

It should be noted that the annual exemption for capital gains tax, i.e. the amount that can be earned before paying capital gains tax, will remain in place.

### The detail

The proposed changes are as significant as those in 1998 when the taper relief rules were introduced. Those anticipating paying capital gains tax at a certain rate, whether 10%, 40% or some rate in between, will find a significantly different rate applying to their capital gains.

Those individuals whose assets currently fall within the non-business asset taper relief regime are likely to be significantly better off under the new rules. Subject to any antiavoidance provisions (see below) it would appear better to delay a disposal until after 6 April 2008 and benefit from the new 18% rate.

People who are expecting to achieve gains with an effective rate of 10% (under the business asset taper relief regime) are likely to be worse off in respect of any disposals of those business assets after 6 April 2008. Consideration should be given to action to improve this potential situation, in particular if a sale is in progress or envisaged in the near future, as it may be possible to protect the 10% rate.

The loss of indexation allowance may have a significant impact for those who have held their assets for a significant period prior to 1998 and therefore accrued a significant amount of indexation, as no indexation allowance at all will be available from 6 April 2008.

The compulsory use of market value at 31 March 1982 may affect a minority of taxpayers whose capital gains tax asset was held at that date and whose value at that date was less than cost acquisition.

Since no legislation has yet been issued in respect of the proposals, it is not clear whether there will be anti-avoidance provisions to prevent people taking advantage of their situation by ensuring their gains are taxed under either the current or new regime.

### In summary

The proposed changes will have a significant impact on the capital gains tax regime in the UK for individuals, trustees and personal representatives.

Action may need to be taken prior to 6 April 2008, if possible, in order to ensure that you are not adversely affected by the new rules. ■

# Tax: Pre-budget statement

# Tax changes for non domiciliaries

Draft legislation is promised for later in the year, and the changes apparently do not take effect until 6 April 2008.

After spending many years reviewing the tax treatment of non domiciled individuals, the government appear to have decided that the advantageous treatment afforded to non domiciled individuals, which helps to attract them to the UK, is beneficial to the UK economy and should continue. However, they have also decided that the time is right to introduce a charge for this benefit.

## The basics

The principal features of the new proposals are as follows:

- The introduction of an additional tax charge for individuals using the remittance basis, to be set at £30,000 per annum.
- The withdrawal of personal allowances for individuals claiming the remittance basis, which is likely to cost at least £2,000 per annum.
- Ending traditional methods of capitalising income, such that funds could be remitted without a tax liability arising, and to extend the scope of certain anti-avoidance provisions.
- For individuals claiming non residence, the number of days spent in the UK is to now include both the days of arrival and departure.

Only limited information is available in respect of these new proposals, and action should not therefore be taken on the basis of this brief synopsis. Draft legislation is promised for later in the year, and the changes apparently do not take effect until 6 April 2008. There may, therefore, be a window of opportunity to make some rearrangements prior to 5 April 2008.

## The additional tax levy

UK resident non domiciliaries can currently use the remittance basis of taxation. While this is optional, it is generally favourable. It means that offshore investment income and capital gains (and in some cases offshore earned income) is only taxed if and when remitted to the UK.

It is proposed that non domiciliaries can continue to claim the benefit of the remittance basis until they have been resident here for seven years. However, non domiciliaries who have been resident for more than seven years out of the previous ten years can only continue to claim the benefit of the remittance basis if they pay an additional levy of £30,000 for the privilege.

From the announcement it appears that the additional £30,000 tax charge applies after seven years of residence, i.e. in the eighth and

subsequent years. For example, for an individual for whom 2007/08 is the fourth year of residence, 2011/12 will be the eighth year of residence and the first year in which the £30,000 levy could be payable.

The remittance basis also applies to individuals who are resident but not ordinarily resident in the UK (irrespective of their domicile status). It appears from the details provided so far that such individuals can continue to claim the benefit of the remittance basis whilst not ordinarily resident, without having to pay the additional £30,000 levy.

## Personal allowances

An individual who is resident in the UK is entitled to a personal allowance. However, it is proposed that anyone claiming the benefit of the remittance basis (because they are not UK domiciled or not ordinarily resident) will be unable to claim the personal allowance as well.

Personal allowances reduce an individual's tax liability by about £2,000 per annum (for a top rate/40% tax payer). Hence, for the non domiciliary who has been resident for seven years or more the additional tax charge, including the new levy, is some £32,000 per annum.

There is a de minimis limit, which allows an individual claiming the remittance basis to retain the benefit of the personal allowance without paying the £30,000 levy, if their unremitted foreign income is less than £1,000 per annum.

## Anti-avoidance measures

Other changes affecting the remittance basis:

- Although unusual, it is possible for an individual who is entitled to use the remittance basis to do so some years, but not others (in which he is assessed on the normal arising basis for world wide income). It is proposed that this will be prevented in future.
- At present, offshore investment income, which is taxed on the remittance basis, is taxable in the year of remittance, but only if the source of that income is in existence in the tax year in which the remittance arose. Hence, by closing a bank deposit account one tax year, the accumulated interest from that account could be remitted in a subsequent tax year, without being subject to UK tax. This 'source ceased' principle is to be abolished.
- There are proposals to extend what is to be regarded as a remittance o constructive remittance. These may include provisions for tracing non UK income and gains subsequently enjoyed in the UK, via offshore company or trust structures.
- Certain anti-avoidance measures which currently do not apply to individuals using the remittance basis may be amended, so that in future they can apply.

## Residence

An individual who is present in the UK for 183 days or more in a tax year is regarded as resident. Alternatively an individual can be resident if visits to the UK amount to an average of more than 90 days per annum.

It has been normal practice to treat the day of arrival in and day of departure from the UK as being days of absence for this purpose. It is proposed that from 6 April 2008, the days of arrival and departure will be regarded as days of presence. For visitors who come for one or two relatively lengthy visits in the UK, this change has minimal impact. However, for visitors with multiple visits to the UK, the change is of major significance.

## Consultation

The above is only a summary of the proposals. Draft legislation, which should provide further details will be published later in the year, following which there will be a period of consultation. One of the matters up for consultation is whether individuals who have been in the UK for more than ten years should pay a greater levy. ■

**Tax:** Pre-budget statement

# Changes to inheritance tax

While the proposed amendments to inheritance tax have been 'warmly welcomed' by the Society for Trusts and Estate Practitioners as introducing a long wished for transferable nil rate band for spouses and civil partners, there may be some surprises for those who have prudently planned ahead.

**Presently each taxpayer has an allowance, currently £300,000 for 2007/8, at which inheritance tax is payable at zero per cent (the nil rate band) on their death.**

### The current law

Presently each taxpayer has an allowance, currently £300,000 for 2007/8, at which inheritance tax is payable at zero per cent (the nil rate band) on their death. As between spouses and civil partners it is common on a first death for the entire estate to be left to the survivor under the spousal exemption with the resultant effect that on the second death only one nil rate band will be available.

Previously, careful estate planning was necessary to utilise both nil rate bands.

### The proposals

Under the proposals as contained in the Finance Bill 2008 the new rules will allow the unused proportion of the nil rate band of the first dying spouse or civil partner to be used on the death of the widow/er or civil partner at the rate applicable at the time of the second death.

For example, Mr X dies leaving £50,000 chargeable and the remainder of his estate to his wife. At that time, the nil rate band is £200,000, so he has not used 75% of the nil rate band. When Mrs X dies, the nil rate band is £300,000. Mrs X, therefore, benefits from an enhanced nil rate band of £525,000 (£300,000 plus 75% of £300,000).

The Finance Bill also makes provision for the utilisation of the unused nil rate band against any alternatively funded pension scheme charges.

A claim for the transfer of the unused nil rate band from a deceased spouse or civil partner (irrespective of the date of their death) may be made by the estate of their surviving spouse who dies on or after 9 October 2007. The claim should be made by the personal representative or, failing them, the person liable to the inheritance tax charge within two years of the date of the second death.

*"Potentially, where a surviving spouse remarries, a nil rate band may still be lost."*

### What the proposals mean

The proposals have been widely reported as being an increase in the nil rate band for couples to £600,000. This is not in fact the case. What it represents is another method of ensuring that a couple jointly enjoy the benefit of two nil rate bands.

While the principle behind the proposal is welcomed, caution must be exercised in the case of people with existing nil rate band trust wills who may not obtain the benefit of the uplift to the nil rate band value at the date of the second death. This change in the rules may pose a dilemma for a person who may still wish to ring-fence their nil rate band for the ultimate use of the children, but at the risk of not receiving an uplift in the nil rate band value at time of second death, assuming that the surviving spouse has not remarried.

The proposals become complicated and do not fully address the complexities of what happens on re-marriage of the surviving spouse, save to suggest that on a surviving spouse's death only one nil rate band is transferable. Potentially then, where a surviving spouse remarries, a nil rate band may still be lost.

It is anticipated that further discussion will follow the publication of the Pre-Budget Report and further guidance should follow. ■

SCOTT-MONCRIEFF

# Profile

# Justine Riccomini … senior tax manager at Scott-Moncrieff, enjoys the rich variety of working life she sees as an employment tax specialist.

Justine joined the firm two years ago, charged with developing a specialist employment tax division to sit alongside the existing VAT, corporate and personal tax experts. She loves her employment tax specialty. "It's so varied," she says. "Take today. I am going to put a share scheme in for somebody. Then I am advising one of our Moore Stephens members in Northern Ireland about some Republic of Ireland construction workers who are going to be working in the UK. Tomorrow I will be doing something completely different again."

The nature of employment means there are constantly problems to solve. "There will always be issues, whether a business is taking people on, getting rid of them, or someone is retiring," Justine says. "The employer might want to structure remuneration in a certain way. What I'm doing affects peoples' lives and their remuneration packages. It could involve anything from providing childcare vouchers through to dealing with someone dying at work."

Her job increasingly involves working with

employment lawyers. Questions about employment status crop up regularly – whether an individual is employed or self-employed. "The Construction Industry Scheme, for example, is placing higher responsibility on people," Riccomini says. "There are grey areas and you have to investigate the facts. I am constantly dealing with HR managers as well as finance directors."

She first began focusing on employment tax issues when working as an inspector at the Inland Revenue (as was). "It was an enjoyable time," Justine says. "I travelled all over the UK doing inspections of large employers and government departments." After ten years she moved into practice, working for a number of firms before joining Scott Moncrieff in 2005. She currently has part-time support from colleague Barry Anderson, and is looking to recruit extra permanent personnel.

To relax, Justine enjoys walking, cycling and singing. "I'm a member of the Royal Scottish National Orchestra Chorus," she says. "My husband bought me a guitar for my 35th birthday and it started from there. I sing classical music – it suits my voice and it's challenging. So I won't be auditioning for the X Factor!" ■

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# Key Taxation Dates: November to February

For the full year in tax deadlines visit our website: **www.scott-moncrieff.com**

## November

**November 2**
Form P46 (CAR) due for quarter to 5 October
Quarterly filing date for change of car notification.

## December

**Party Season**
£150 tax free per employee for party
Tax is due on the full amount by the employee via form P11D unless the employer enters into a PAYE

**December 25**
Receiving financial gifts. Tips on what to do with a windfall – contact us

**December 30**
Deadline for self-assessment online
End of CT61 quarter

## January

**31 January**
File tax returns. Automatic late returns penalty: £100.
Final date to settle the balance of tax due for the year to 5 April previous, and the first payment on account of tax for the current tax year,

**31 January**
Deadline to carry back gift aid contributions to the previous year.

## February

**2 February**
P46 (CAR)
Quarterly filing date for notification of change of car.

**28 February**
Self assessment 5% surcharge
Surcharge on tax due 31 Jan but still not paid by 28 Feb.

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