hillierhopkins LLP
Chartered Accountants and Tax Advisers

legal line

A Newsletter for Fellow Professionals from Hillier Hopkins LLP

Autumn 2007

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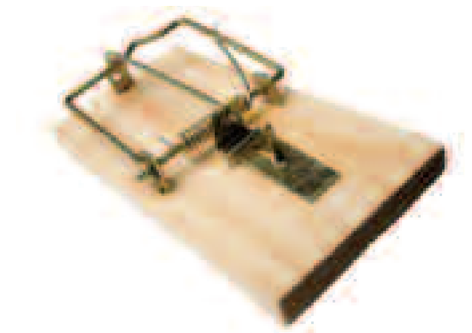

It seemed a simple enough scheme and a great deal of inheritance tax would be saved. Dr Phizackerley had always lived in accommodation supplied by his employer but on retirement in 1992 he bought a house for occupation by himself and his wife. Apart from a modest mortgage he paid for the property from his own funds. The property was purchased as joint tenants but in 1996 the joint tenancy was severed so that husband and wife owned the property as tenants in common.

Mrs Phizackerley died in April 2000. By her Will she left the nil rate sum on discretionary trusts and gave the residue of the estate to her husband absolutely. Her half share of the matrimonial home was assented to Dr Phizackerley who promised to pay the trustees the nil rate sum. Two years later Dr Phizackerley died and his executors claimed relief for the outstanding loan of £150,000. Deduction of the debt was not allowed on the basis that it was a debt within the provisions of s.103 IHTA 1984.

The provisions of s.103 are often overlooked with disastrous consequences as happened in this case. The section is simple in concept. If A gifts £100,000 to B then B might lend the money back to A. If A dies his executors might claim that his estate should be reduced by £100,000 in respect of the loan from B. However, s.103 provides that no deduction shall be given if consideration for the debt consists of property derived from the deceased. Because B was only able to lend the money because of the gift from A no deduction can be claimed. There is no time limit during which this rule applies. Hence, the loan made by Dr Phizackerley could not be deducted on his death because he was the originator of the consideration.

Two courses of action could have improved the situation and achieved the desired deduction. First, the Will of Mrs Phizackerley might have left a residuary life interest to her husband rather than an absolute entitlement. If that were the case then the loan would have been incurred by the Will trustees and would have been claimed by them as a deduction against the value of the trust assets on the death of Dr Phizackerley. S.103 would not then apply because the original consideration would not have come from the trustees.

Alternatively, the charge scheme might have been used on the death of Mrs Phizackerley instead of the debt scheme. There is a subtle difference. If the charge scheme was used then the executors would first have charged the property with the debt before assenting the property to Dr Phizackerley. In that situation s.103 does not arise because the deceased has not given any consideration.
This rather sad outcome for the family demonstrates the practical problems of trying to implement a nil rate band discretionary trust arrangement. In essence, it all looks fairly straightforward but there are many difficulties and traps for the unwary. However, most commentators would agree that the use of a nil rate band discretionary trust in a Will can still be an extremely attractive way of saving a substantial amount of inheritance tax. But handle with extreme care.

For further information please contact David Nye on 01442 220712 or email david.nye@hhllp.co.uk

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How to save capital gains tax

Much has been written in the press recently about the inequity of the low rate of capital gains tax (CGT) paid on profits made by private equity owners and indeed their ability to avoid CGT altogether. Why should this be? Anyone who disposes of shares in a trading company having held them for at least two years will effectively only suffer a CGT rate of 10%. That has been the case for some years and is a result of the generous rate of business asset taper relief.

CGT can normally only be avoided if the taxpayer is either non-resident or non domiciled for CGT purposes. Anyone in that happy situation will indeed avoid CGT on the disposal of UK assets (unless used in a trade). The age old rule meant that if your visits to this country did not exceed 90 days each year on average then you could safely claim to be non-resident. In calculating the 90 days the days of arrival and departure could be ignored. That is precisely what one taxpayer reckoned. He (like many others in today's business world) commuted to this country on a regular basis over very many years and claimed to be non-resident. HMRC disagreed. Because of his frequent visits to this country they claimed he had never left and the days of arrival and departure were therefore irrelevant. They won.

If it is not that easy to claim to be non-resident if frequent visits are made to this country it is even more difficult to claim to be non domiciled. This may be easier for those with a domicile of origin abroad who simply come to this country to work. They can normally demonstrate that they have families and property in their country of origin and intend to return there after they have finished their present contract or retire. They would not be liable to CGT on gains made on offshore assets provided that those gains are not remitted to this country. For those who have a domicile of origin in this country and who subsequently move abroad it is often much more difficult to prove that all links with the motherland have been severed. Quite often ties will remain with family or friends so that connections are never completely broken.

It may well be that some private equity shareholders avoid CGT but this will simply be a function of their tax status rather than a loophole in the legislation. Naturally, when we come to consider inheritance tax the legislation is different.

For further information please contact David Nye on 01442 220712 or email david.nye@hhllp.co.uk

Management Liabilities for Members of LLP's

Following the introduction of the 2000 Limited Liability Partnership Act, ever increasing numbers of partnerships have taken advantage of the benefits afforded by becoming a Limited Liability Partnership (LLP), including limiting the individual liability of its members.

However, many LLP members fail to recognise the additional liabilities that the LLP status has in fact created for its members.

Whilst Directors and Officers of a limited company have a fiduciary duty to the company, members of a limited liability partnership owe a duty of care to the LLP, and as such can be found liable for negligence and other torts, if they breach this.

For example:

Insolvency Act 1986

If proved that members knew (or should have known) that the partnership would become insolvent they risk having to repay monies they withdrew from the partnership.

Companies Act 1985

All LLP's are required to submit their accounts to Companies House. This in turn exposes members to all of the existing rules relating to wrongful or fraudulent trading and disqualification of directors.

And it doesn't end there...

Many LLP's, such as Solicitors and Accountants, are regulated professions and can therefore be exposed to wide ranging investigations, not only by their respective regulatory bodies, but from government bodies, including the Health & Safety Executive and the Serious Fraud Office.

The cost of legal representation at an investigation can be substantial and being able to afford good representation can be the difference between a successful outcome and the closure of a partnership.

What many LLP's don't realise is that they can purchase Insurance Protection specifically designed for LLP's. Whilst the directors of limited companies have long been able to procure Directors & Officers liability insurance, the LLP equivalent is still relatively new and is only offered by a handful of insurers in the UK.

However, the coverage available offers a very broad level of protection, and in addition to addressing the exposures detailed above, also includes coverage in respect of Employment Practice liabilities. In this respect, some of the most common claims arise following allegations of:

- Unfair / Constructive dismissal
- Failure to promote staff
- Sexual or Racial discrimination
- Harassment

All can involve significant defence costs, which at best, can dent the most healthy balance sheet, or at worst, could cripple a partnership.

For further information please contact Steve Cross, Technical Manager at Towergate ghbc on 01442 281243 or email stevecross@ghbc.co.uk

CPD WORKSHOP: Inheritance Tax Planning That Still Works

Wednesday 10th October 2007
Hemel Hempstead

Over the last 10 years the revenue raised by the government from inheritance tax has doubled. Far reaching and substantial changes were made in Finance Act 2006 to the way in which family trusts are taxed. So it is more important than ever to explore and make use of the opportunities that still exist to avoid this tax. Our workshop will highlight non-controversial and straightforward planning and give advice about the traps and pitfalls which can easily be avoided.

Our workshop will include the following areas:

- Do nil rate band discretionary trusts still work? Are they affected by the recent legislation? What about Phizackerley?
- Discounted gift trusts-what are the risks? How exactly do they work?
- Deeds of variation-maximising planning opportunities.
- Business property relief-tips and traps.
- Update on agricultural property relief especially farmhouses.
- Do AIM portfolios still work?
- Is life assurance an option?
- Use of multiple lifetime trusts.
- Advantages of discretionary trusts.

If you would like to attend please see the back page for further details and how to reserve your place.

UITF 40 - an update

Last year we gave an overview of the changes in accounting practice for individuals and partners following the publication of UITF 40 i.e. the need to recognise in your accounts a value of your time on uncompleted contracts.

Obviously, the first years accounts in which UITF 40 is adopted will be much improved because of the acceleration of income recognition but the downside is that there is an increased tax liability. Where you adopted the changes from UITF 40 for the first time in the first period of account ending on or after 22 June 2005 (mandatory) it is possible to spread the additional tax burden over a period of three to six years.

The formula is that the amounts treated as arising and chargeable to tax in the first three years for all businesses is the lower of:

- One third of the total WIP adjustment, and
- One sixth of the profits of the business, before capital allowances and any other reductions in profit reflecting other changes in accounting policy.
  Assuming profits remain constant your spread should be: -

- 3 years if the WIP adjustment is up to 50% of normal profits; and
- up to 6 years if the WIP adjustment is more than 50% of normal profits.

Remember that this is the spread for the tax returns, but the tax will be paid earlier than this because of increased payments on account.

Partnerships
The spreading for partnerships is calculated on a firm basis and shared out amongst all partners using the previous years profit sharing arrangement (PSA) – therefore this will impact on retiring partners and also fixed profit share partners.

In the first year, the amount chargeable is spread between the partners according to the PSA in the twelve months preceding the change. Thus partners leaving the firm at the end of the last period before UITF 40 is adopted will share in the WIP adjustment. However, for each subsequent year, the PSA for the twelve months following that last used will be applied to the amount of the WIP adjustment coming into charge. Thus, partners who had been expecting to take a full share in the adjustment income although they retired before the change was made, will now bear at most one-third of their share, and less if profits are low in the year of change.

Election to increase the amount taxable
In all cases, the amount taxable can be increased to any amount that the individual wishes, but for a partnership, the amount taxed on the "firm" is only increased if all partners taking a share in the adjustment income elect together - i.e. the partners in the 12 months preceding the current accounting period.

When the election has been made, the original adjustment is reduced by the additional amount brought into charge. Thus the benefit is felt in all of the remaining years, as the new net WIP adjustment produces the one-third spread for the balance of the period.

For further information please contact Debbie Wilson on 01442 220710 or email debbie.wilson@hhllp.co.uk

Discretionary trusts – tax efficient holding of assets

Trustees of discretionary trusts often agree that a proportion of the trust assets should be invested in stocks and shares. Stocks and shares along with property have historically produced the most attractive returns for investors over the long term.

Trustees should also consider how best to hold assets within a trust. A typical discretionary trust could get its equity exposure from:

(a) A portfolio managed by a stockbroker
(b) A unit trust or open ended investment company or similar
(c) A UK non qualifying life assurance bond
(d) An offshore non qualifying life assurance bond

For the purposes of this note let us assume that the performance of the underlying assets is the same in each of these examples.

Income Tax

The dividends paid by the equities generally arrive with a non reclaimable tax credit. The final total tax on the income will depend on whether income is being paid to beneficiaries, whether it is being treated as the settlor's and so on. Let us for a moment assume that the trust is merely accumulating some income. The figures in brackets show the position for a £90 dividend received.

Under (a) and (b) the trust will suffer a further liability of 22.5% on the grossed up amount – effectively 25% of the net dividend received. (£ 22.50)

Under (c) and (d) no further tax will be due (£0)

If we instead assume that the trust distributes to a 40% income tax paying beneficiary (and no existing tax pool), the picture looks like this:-

Under (a) and (b) Trustees must pay tax on distribution of 40% of net dividend received. (£36)

Under (c) if the trustees assign segments of the bond to beneficiaries and then let the beneficiary cash in the segment, he or she will be liable to tax at 20% on the (non grossed up) gain under the chargeable event legislation. (maximum of £18)

Under (d) if the trustees assign segments of the bond to beneficiaries and then let the beneficiary cash in the segment, he or she

will be liable to tax at 40% on the gain under the chargeable event legislation. (maximum of £36)

Regardless of the rate of tax paid by the beneficiary, the total income tax burden will be the same or less if the assets are held in a bond (options c & d) compared to the other options. In many cases there will be a material advantage to holding equities in an offshore bond. Of course one must also consider the CGT position, I will write on that next time.

Moving existing assets creates all sorts of complications but for new and substantial cash funded trusts, an offshore bond structure must be very carefully considered.

For further information, please contact Ben Sherwood on 01442 220713 or email ben.sherwood@hhllp.co.uk

New HMRC guidance on discounts -

a further acknowledgement that this IHT planning device is likely to be effective

For many years we have had the Discounted Gift Trust (DGT) in our armoury of anti inheritance tax (IHT) weaponry. DGTs allow clients to give away a sum of money but to retain a regular flow of payments for the rest of the clients' lifetimes. They can be suitable for clients who would be happy to give away capital but feel that they would miss the income receipts generated by that capital.

The investment is usually held in some sort of non-qualifying life policy. Hillier Hopkins tend to use offshore arrangements which allow for near gross roll up of income and capital gains. Under current legislation seven years after the gift has been made the capital sum gifted plus any growth thereafter is outside of the client's estate. This is the "gift" bit of the DGT and is not very controversial. The gift is made to a trust with children, or grandchildren or someone else as potential beneficiaries, but with some form of retained or carved out right for the settlors. For larger DGTs clients can consider using bare trusts to avoid any immediate liability to IHT in respect of the chargeable transfer that arises on a gift to a discretionary trust. This again is not very controversial and is the "trust" bit of the DGT.

Finally, there is the "discount" bit of the DGT. When a DGT is established clients usually achieve an immediate reduction in their estate's liability to IHT. This is because the settlors' retained right to a flow of income reduces the value of the gift. This is only relevant during the initial seven year period; death after seven years means that the entire gift is outside of the estate as above. If death occurs in this initial seven year period then the value of the gift added back to the estate is less than the value of the original payment to the scheme. This is an attractive feature of the arrangement – average life expectancies are not longevity guarantees. We now have some experience of clients with DGTs passing away in this seven year period. As I have reported before, our experience is that the Capital Taxes Office might query the quantum of the discount but not its existence. Nevertheless, agreeing the discount can be time consuming. It depends on the age and health of the settlors, the amount of the regular payments being made to them and various other factors.

At the end of April 2007 HMRC published an undated note on their website indicating their preferred discount calculation methodology and advised that this would apply to all new DGTs entered into after 1 June 2007. They detail their preferred mortality table, their interest rate assumption and other details. They also restated that they do not believe any discount exists for settlors aged over 90 at outset of the arrangement.

This is largely excellent news. A statement such as this is as close as we are likely to get to a clear endorsement from HMRC that the planning is effective. So we have here a piece of IHT planning that immediately reduces the estate on Day 1, removes the capital sum from the estate after seven years and allows settlors to retain a flow of quasi income payments until their death. And this device has notes on the HMRC website explaining how the discount will be calculated. Where more basic planning opportunities have already been used DGTs must be high up the list of other solutions worth considering. In some cases we have looked at recently a DGT is hugely more attractive than a seven yearly gift to a discretionary trust.

STOP PRESS HMRC
have just announced that the default interest rate used in calculating the discount has just been raised from 6.0% to 6.75% from 1st September. This will have the effect of slightly reducing the discount.

For further information please contact Ben Sherwood on 01442 220713 or email ben.sherwood@hhllp.co.uk

CPD WORKSHOP (cont): Reserve You Place

Date:	**Wednesday 10th October 2007**	
Timings:	**8.00 a.m**	**A light breakfast will be served.**
	8.30 a.m	**Presentations will start promptly.**
	10.00 a.m	**Questions and answers.**
	10.30 a.m	**Close**
Venue:	**Charter Court, Midland Road,Hemel Hempstead, HP2 5GE**	
Cost:	**£35 plus VAT (41.13) per delegate per workshop**	

The above workshop qualifies for 1½ CPD Hours.

If you would like to attend, please contact Anna Blake on 01442 220718 or email anna.blake@hhllp.co.uk

This newsletter is for general guidance only and no liability is accepted for action taken in reliance upon these notes where appropriate professional advice should be taken. For more information please contact us on: 01442 220788 or email solicitors@hhllp.co.uk