# Private clients newsletter

Including information on alternatives to pensions, how Gift Aid can work against you and potential threats to the Inheritance Tax regime

Spring 2018

pem.

# Welcome

**Do you find our tax system hard to understand? Then you're part of a growing and distinguished club.**

In his Spring Statement (made today as I write this welcome) Philip Hammond has stated that people and businesses have "certainty and stability to plan for their futures". However, when I consider this in light of some of the reviews I know are currently underway I wonder how any taxpayer can have certainty going forward.

In fact, even Philip has recognised that our Inheritance Tax regime is 'particularly complex' to the extent that he has asked the Office of Tax Simplification to come up with proposals for (you are ahead of me here) 'simplification'.

HMRC itself is no stranger to confusion. Last summer there were red faces as the IT 'experts' at HMRC confessed that their online calculators couldn't cope with the complex changes in tax legislation and as a result some taxpayers were overcharged.

Even if simplification is eventually achieved, at the moment the UK tax system is complicated and just like the Chancellor, you should not be afraid to seek help.

Start here with our Spring newsletter, which focuses on subjects to help you find your way through the maze – and if you have any queries, please do get in touch.

Sanchia

## Contents

# Pensions are restricted – what are your alternatives?

**Back in April 2006 Pensions 'A-Day' was supposed to make the rules governing pensions simpler.**

The idea was that there would be one set of rules covering how much individuals could put into their pension each year, and how large a pension pot they could have when they came to take their pensions.

So from 'A-Day' two limits were placed on pensions:

1. An annual allowance which limited the amount of tax relief on contributions into a pension scheme – this started at £210,000 in the 2006/07 tax year and increased to £255,000 in the 2010/11 tax year.

2. A lifetime allowance which limited the size of an individual's pension pot when benefits are taken out. This started at £1.5 million in the 2006/07 tax year with planned increases up to £1.8 million by the 2010/11 tax year.

But since 2010/11 there has been a steady reduction in both the annual allowance and the lifetime allowance. This has increasingly meant that high earners and those with large pension holdings need to regularly review their pensions.

For high earners (where adjusted earnings exceed £150,000) the introduction in 2016/17 of the annual tapering allowance now means that the limit for pension contributions each year could gradually taper down from £40,000 to as little as £10,000. The tax charge on contributions in excess of the tapered annual allowance could be as high as 45%, so high earners should not ignore this rule change.

The reduction in the lifetime allowance from its 2010/11 peak of £1.8 million down to £1 million is affecting an ever greater number of people who could be faced with a tax charge of up to 55% on any pension holdings in excess of £1 million.

These new rules and restrictions can also affect those people with many years' service in occupational final salary pension schemes. It is important to review your pension contributions and the size of your pension pots to ensure that you do not fall foul of these rules.

## Alternative investments

Higher earners affected by these recent restrictions are now looking for alternative tax efficient ways of building up retirement assets.

Venture Capital Trusts (VCTs) attract 30% income tax relief if held for at least five years, and also offer the prospect of tax-free dividend income. However, such investments carry a high level of risk, since the tax concessions are there to encourage investment in British companies involved in developing cutting edge technology and innovation.

Enterprise Investment Schemes (EIS) also offer income tax relief of 30% if held for at least three years and SEED EIS offer an even higher 50% income tax relief. Again these schemes carry high levels of investment risk.

People with a lower appetite for risk are forsaking immediate tax relief and instead are opting to use their annual ISA allowance of £20,000 giving long-term income and capital gains tax relief.

# The death of IHT as we know it?

**Anyone who has wrestled with estate planning and Inheritance Tax (IHT) knows that it is a complicated area, so it is good to hear that the Chancellor also finds the system "complex" and wants it to be "simpler, fairer and better".**

Soaring IHT receipts are in part down to the unprecedented rise in house prices in the last 30 years; owners of relatively modest properties have begun to pay a tax once only paid by the wealthy.

In January, Philip Hammond wrote to the Office of Tax Simplification (OTS) asking for a review of the IHT regime, "to ensure that the system is fit for purpose and makes the experience of those who interact with it as smooth as possible."

HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

19 January 2018

Angela Knight and Paul Morton
Office of Tax Simplification
1 Horse Guards Road
London
SW1A 2HQ

Dear Angela & Paul

Office of Tax Simplification review of Inheritance Tax (IHT)

I am writing to acknowledge the OTS's recent interest in the inheritance tax regime. Inheritance tax, and the system within which it operates, is particularly complex, and I would like to request that the OTS carry out a review into the IHT regime. I would be most interested to hear any proposals you may have for simplification, to ensure that the system is fit for purpose and makes the experience of those who interact with it as smooth as possible.

The review should include a focus on the technical and administrative issues within IHT, such as the process of submitting returns and paying any tax due, as well as practical issues around routine estate planning and disclosure. It could also look at how current gifts rules interact with the wider IHT system, and whether the current framework causes any distortions to taxpayers' decisions surrounding transfers, investments and other relevant transactions

I look forward to agreeing the detail of the terms of reference in the coming weeks.

Thank you for your ongoing work in reviewing the tax system and striving to make it simpler, fairer and better.

PHILIP HAMMOND

As you can see, he also highlighted the way current gift rules work with the wider IHT system, and wanted to know whether the current system causes "any distortions to taxpayers' decisions surrounding transfers, investments and other relevant transactions".

## What can we expect from the review?

One thing we can't expect is a major cut in IHT liability: in 2017 HMRC received £4.84 billion in IHT – double the amount in 2009.

The Government will not want to kill the goose that lays the golden eggs. In fact, entirely the opposite, an increase in potential revenues is arguably the driver for the review.

IHT is generally charged at 40% unless an exemption or relief is available. We believe it is those exemptions and reliefs that will be the subject of this review.

## Nil rate bands

Every individual benefits from a nil rate band (NRB) set at £325,000 until 2020/21. Assets within this will be free of IHT. However, this rate has been frozen for many years and has not kept pace with inflation.

The Transferable Nil Rate Band (TNRB) allows any unused percentage of the standard NRB to be transferred from a deceased spouse or civil partner to the surviving spouse or civil partner

Recent Conservative governments have shown sympathy for allowing people to hand on more of their wealth after death, particularly the family home.

Philip Hammond introduced a Residence Nil Rate Band (RNRB) – with the headline-grabbing promise of allowing couples to pass on up to £1 million free of tax including the family home.

Unfortunately, he only succeeded in adding a further layer of complexity to the IHT regime.

Closer examination of the rules shows that the full £1 million is only available in certain circumstances.

It is for married couples, or those in a civil partnership, with children and relies on one partner dying and passing their entire IHT exemptions to the surviving partner.

The eventual beneficiaries must be direct descendants, so single people and childless couples do not qualify for the £1 million bonanza. The RNRB has been criticised for being unnecessarily complicated, so may be in the firing line.

## Lifetime gifts

The annual tax-free gift allowance has remained at £3,000 since 1981 and its value has been considerably eroded.

Once again, burgeoning house prices come into play. Parents see their offspring struggling to get on the housing ladder and want to give financial help when it is needed, not when they die.

Although £3,000 would have been a reasonable deposit on a house in 1981, today the average first-time buyer needs £20,000, and in Cambridge significantly more!

The small gift exemption of £250 per receipient and gifts on consideration of marriage have been eroded in the same way.

A special exemption applies to regular gifts made from excess income. These gifts are not made from capital and fall completely outside the IHT net.

The OTS could recommend increasing the annual gift exemptions, but equally it might suggest there should be no need for these exemptions at all, as it is possible to make any level of gift to an individual as a potentially exempt transfer (PET) on which no IHT will be due if the donor survives for seven years after making the gift.

## Agriculture and business

The ability to pass on the family home intact has a very powerful appeal to the electorate, and the same applies to a family farm or business.

So both Agricultural Property Relief (APR) and Business Property Relief (BPR) will almost certainly come under scrutiny in the OTS review.

The intention of BPR was that family businesses did not have to end on death. Full relief from IHT is genrally given where the business qualifies.

## Agricultural Property Relief

Currently, an individual who dies owning farmland and farm buildings can claim APR on the agricultural value of those assets even if they are not a farmer. For people undertaking a genuine farming business there is no need for APR as BPR would provide the same relief.

This does however place even more importance on ensuring that you are running a qualifying business. Farmers who have had to diversify and rent out much of their land or buildings could be particularly at risk in this respect.

## Business Property Relief

Could we see BPR being restricted to those who participate in the business rather than simply invest in it? This could signal an end to BPR on investments in, for example, AIM companies.

One other rumour surrounding BPR is that the rules could be amended so that the recipient of the asset(s) must retain them as business assets for a certain period in order for relief to be due. Currently there is no such requirement.

## Trusts

Trusts are often used very effectively for IHT planning. HMRC has already announced a separate review of the taxation of trusts in 2018, to make them “simpler, fairer and more transparent”. It is likely that the OTS review will incorporate this.

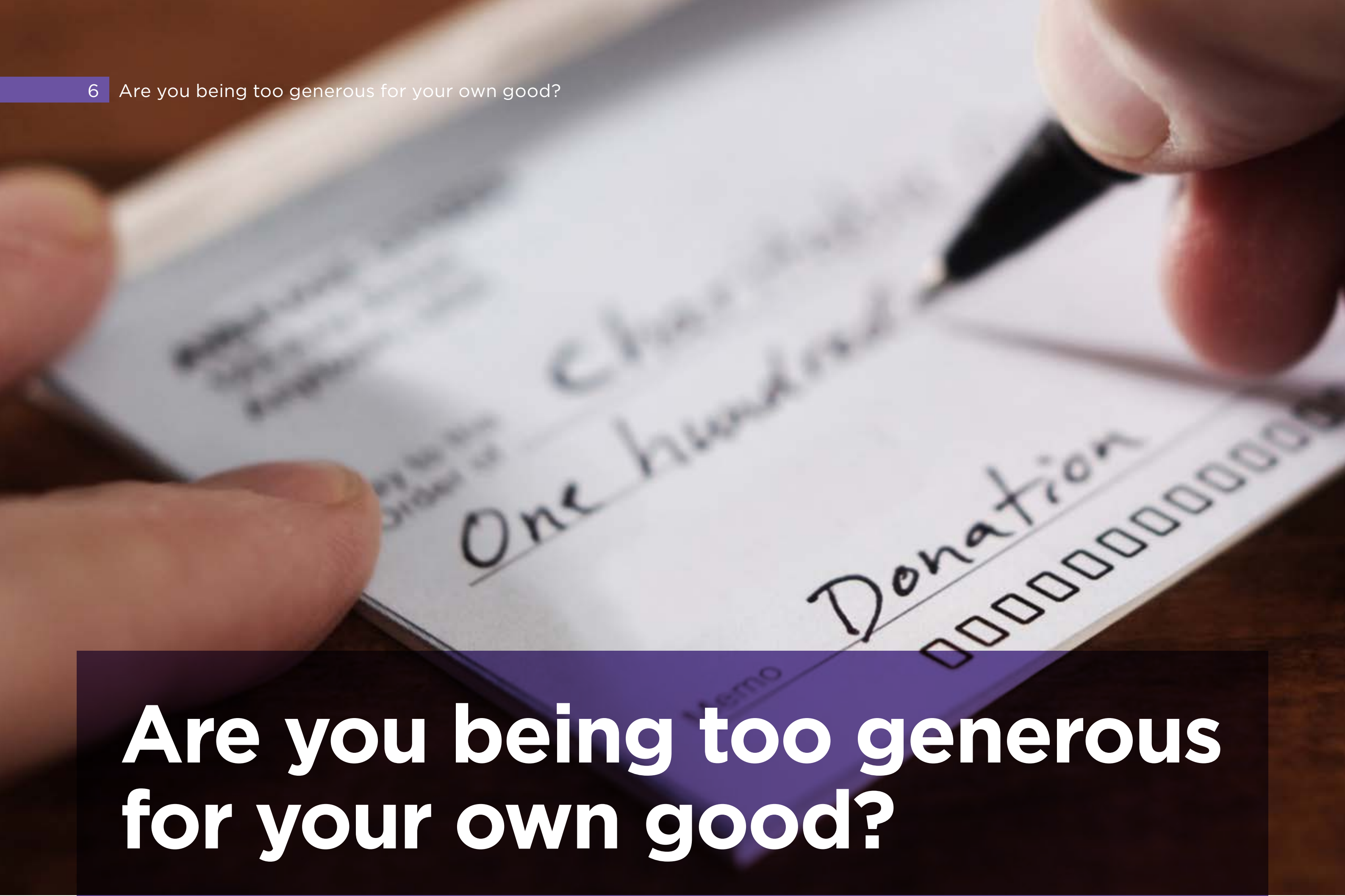
## Deeds of Variation

Where planning has not been undertaken it is possible to change a person’s Will after their death, using a Deed of Variation. This has received high profile scrutiny in recent years and the OTS may once again consider whether this should be allowed to continue.

## Summary

It is likely that the review will conclude that the current IHT regime is too generous otherwise there will be little movement in tax revenues. The result of the review may be announced in this year’s Budget in November.

Anyone who could be impacted by a change should act now to protect reliefs while available.




# Are you being too generous for your own good?

**Gift Aid is one those rare tax schemes where everyone wins; except when you don't...**

When you sign a Gift Aid declaration, the charity is able to reclaim basic rate tax from HMRC. For every £100 you donate in this way, the charity reclaims £25 from HMRC, making a simple gift from you of £100 worth £125 to the charity.

Higher and additional rate taxpayers can claim further relief above their donations. For every £100 donation, a higher rate taxpayer will have a £25 reduction in their tax bill, and an additional rate taxpayer £31. For those suffering the 60% marginal rate of tax (between £100,000 and £123,000 of income in 2017/18) the benefit of a £100 donation is £50.

The declaration you sign confirms you will pay enough tax to cover the £25 the charity will reclaim. If you do not, you will get a surprise tax bill for any shortfall. Generous though HMRC appear to be they will not make a gift on your behalf.

Your Gift Aid donations might exceed the tax you have paid because:

## Changes in tax rules

The personal allowance has been steadily rising over the years – for 2018/19 it will be £11,850. In addition the introduction of the personal savings allowance (£1,000 tax free for basic rate taxpayers) and dividend allowance (£2,000 tax free in 2018/19) means that those on modest incomes may pay very little tax – or no tax at all.

## Changes in your circumstances

Should your income reduce, for whatever reason, your tax liability will inevitably follow. Ongoing direct debits under an historic Gift Aid declaration can be overlooked.

## Result

The charity may reclaim tax which you have not paid and HMRC will look to recover it from you.

## What should you do?

If you find yourself in this situation you may wish to consider whether you want to withdraw your Gift Aid declarations for future donations.It may be possible to re-organise donations within the household so that those who pay sufficient tax make the donation.

In particular, watch out for less obvious forms of Gift Aid such as donations of goods to charity shops and entrance fees to cultural attractions which may ask if you would like to Gift Aid your entry fee.

# It's a tough life!

**Whilst we generally don't have any sympathy for the tax man, 2017 was a difficult year for HMRC. It has become clear that its systems are struggling to cope with the increasing complexity of the UK tax regime.**

For the 2016/17 returns, HMRC's online tax calculators had not been updated to take into account the new personal allowances for savings and dividends, the savings starting rate or the personal allowance itself.

Factor in the complexity of the interaction between these allowances and the various tax bands and you have a toxic mix.

HMRC could not produce a correct tax computation for 11 specific scenarios. Honesty is the best policy, so the tax man owned up and promised to fix the problem. Unfortunately the solution to the original problem succeeded in creating 13 new errors.

Still reeling from a difficult 2017, HMRC have further challenges ahead.

## Class 2 National Insurance Contributions (NIC)

The abolition of Class 2 NIC for the self-employed was due to go ahead from 6 April 2018, but this has been postponed to 6 April 2019 at the earliest.

The delay has arisen, in part, because HMRC is still grappling with how to provide the self-employed with their entitlement to state benefits, such as the state pension, which accrue from the payment of Class 2 NIC.

Linking the state benefit entitlement to Class 4 NIC contributions will not work as previously thought. Currently the self-employed who have low earnings or losses would not have a liability to Class 4 but are able to pay Class 2 NIC on a voluntary basis to accrue their benefit entitlements.

## Making Tax Digital (MTD)

There was more embarrassment for HMRC last summer when it announced that it was delaying, yet again, the start of MTD.

MTD is due to apply for VAT registered businesses with turnover greater than £85,000 from April 2019,


and extending to all businesses, self-employed individuals and landlords with turnover greater than £85,000 from April 2020.

However, we are still waiting for the detail.

## Penalties and interest

As part of the reforms HMRC would like to introduce a new system to replace the existing penalty and interest regimes.

Firstly, it is proposed to introduce a points-based system, similar to points on a driving licence, to determine when a penalty will apply.

Secondly, it is proposed to charge a penal rate of interest where tax is paid late, possibly as much as 10% of the tax unpaid.

HMRC is currently consulting on the proposals.

## Summary

HMRC has stated it wants to transform the tax system so it is more efficient to administer and simpler for taxpayers. Their track record of simplification is poor!

# About us

Our experienced Private Clients team offers expert advice and support for all areas of personal taxation to suit your specific needs. Please meet our Private Clients team who will be happy to talk to you about any issues you may have.

For further advice, information or to feed back please do not hesitate to contact Sanchia Norris on 01223 728225 or email snorris@pem.co.uk

**Sanchia Norris**
Partner, Private Clients
01223 728225
snorris@pem.co.uk

**Daren Peacock**
Partner, Private Clients
01223 728220
dpeacock@pem.co.uk

**Heidi Reed**
Assistant Director
01223 728222
hreed@pem.co.uk

**Ryan Steel**
Manager
01223 728222
rsteel@pem.co.uk

**Sara Tollerton**
Assistant Manager
01223 728222
stollerton@pem.co.uk

**Jacqui Denney**
Assistant Manager - Trusts
01223 728268
jdenney@pem.co.uk

**Michael Dean**
Tax Adviser
01223 728229
mdean@pem.co.uk

**Daniel Simper**
Tax Adviser
01223 728222
dsimper@pem.co.uk

**James Willett**
Trainee Tax Adviser
01223 728222
jwillett@pem.co.uk

**Jon Driscoll**
Financial Adviser
01223 728222
jon.driscoll@lighthousegroup.plc.uk

**Nicola Anderson**
Partner, Private Clients
01223 728261
nanderson@pem.co.uk

**Mary Shoesmith**
Director
01223 728260
mshoesmith@pem.co.uk

**Chris Whiteoak**
Manager
01223 728253
cwhiteoak@pem.co.uk

**Pat Greenwood**
Manager - Trusts
01223 728255
pgreenwood@pem.co.uk

**Anna Mackender**
Assistant Manager
01223 728227
amackender@pem.co.uk

**Fiona Walker**
Tax Adviser
01223 728285
fwalker@pem.co.uk

**Harriet Sim**
Tax Adviser
01223 728222
hsim@pem.co.uk

**Harriet Jones**
Trainee Tax Adviser
01223 728222
hjones@pem.co.uk

**Brian Gannon**
Financial Adviser
01223 728222
brian.gannon@lighthousegroup.plc.uk

**David Mullen**
Financial Adviser
01223 728222
david.mullen@lighthousegroup.plc.uk


**PEM**
Salisbury House
Station Road
Cambridge CB1 2LA

t. 01223 728222
e. pem@pem.co.uk

**pem.co.uk**