Newsletter

BURGES SALMON

Private Client Briefing

Issue 20

Welcome

Welcome to Issue 20 of **Private Client Briefing**, our periodical aimed at keeping you informed of current issues and news.

For further information on any issues raised in **Private Client Briefing** or individual legal advice generally please email **tom.hewitt@burges-salmon.com.**

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Family Investment Companies

An alternative to trusts?

Rewind 10 years. If you were considering a structure to pass down wealth to your family in a tax-efficient, managed and protected way, a trust would have most likely been the preferred choice.

However, in 2006 the inheritance tax ("**IHT**") treatment of trusts changed, and since then the value of assets you can transfer to a trust is restricted to your inheritance tax nil rate band (currently £325,000 per person or £650,000 for a couple) without incurring a tax charge at 20%, unless you have business or agricultural assets which might qualify for relief.

Consequently, professional advisers have for some time been exploring alternatives, including what are known as a family investment companies ("**FICs**"). Companies are often used as a business vehicle, but in fact they can offer unique benefits over other structures (including trusts) in wealth structuring.

A simple example

Bill and Jane have £2m of 'spare' cash which they would like to pass on to their children, Susan, Brian and Freya. Susan is 28 and is about to get married. Brian and Freya are both still in university and have not settled down.

They could make outright gifts to their children but don't consider that it is appropriate for them to have control of so much wealth at this stage of their lives. In particular, they have some concerns that Susan's fiancée is a spendthrift.

So, they want to be able to give away £2m of cash for the benefit of their children without triggering an immediate IHT charge, but to retain management, control and investment of the cash. Their solicitor suggests a FIC.

Management and ownership structure

Bill and Jane need to structure the company to ensure they maintain control over the management and investment of the cash, but to pass value and benefit to their children.

One level of control in a company is at board level, as the directors take the day-to-day management decisions. Bill and Jane are therefore appointed as the directors of the company.

A second level of control is at shareholder level. Usually in a company, the shareholders who have rights to make decisions regarding the company are also entitled to dividends and also to the capital asset value if the company is wound up. However, to achieve a separation of control and beneficial ownership, these two 'rights' need to be split from one another.

So Bill and Jane transfer the £2m of cash to the company and in return they are issued with two classes of share, each with their own characteristics. The 'V' shares carry all the rights to vote and the 'B' shares carry all the rights to receive the dividends and capital value and growth i.e. most of the value of the company, which is now significant.

Bill and Jane retain the V shares, thereby retaining control of the company at board and shareholder level. They then give away the B shares, thereby passing most of the value of the company to their children. In doing so, they have achieved their objective of making valuable gifts to their children but retaining control, through the FIC, of the investments themselves.

They could make the company more flexible by creating a different class of share for each of the children so they can treat them separately, rather than having to pay dividends to all of them at the same time.

Limited or unlimited?

In a commercial context, where risk is higher, limited companies prevail to shelter the shareholders from

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trading losses. However, in a family context risk is less pressing, and an unlimited company may be considered. The advantage of the latter is the reduced filing requirements with Companies House and so greater confidentiality, and more flexibility in dealing with share capital.

What about IHT?

If Bill and Jane had jointly transferred £2m of cash to a trust they would have triggered an immediate IHT charge of £270,000. However, there is no IHT charge when transferring assets to a company in the way Bill and Jane have done it. When they give away the valuable B shares, this is a gift for IHT purposes and so if they survive more than seven years their value will fall out of their estates altogether.

However, other taxes will need to be considered. For example, transferring assets to a company that carry a capital gain could result in a capital gains tax charge, and transferring properties to a company may trigger stamp duty land tax.

Protection

So what of Bill and Jane's concerns for their children inheriting this wealth? Crucially, the children do not own the cash directly; they own shares in the FIC, which are subject to any restrictions Bill and Jane want to include in the company articles. Bill and Jane as directors and V shareholders will decide when a dividend is declared and how much it will be, thereby controlling the flow of income to the children.

For Susan, given the concerns about her fiancée, Bill and Jane may consider discussing with her entering into a pre-nuptial agreement before she gets married or even make the gift of her shares conditional on her doing so. Otherwise, they could transfer some of Susan's shares to a trust (within their available nil rate bands) so that she does not own these outright.

They can also include provisions in the articles which restrict who Brian, Susan and Freya can give their shares to, either on death or during their lifetimes.

Should I consider a FIC?

Ultimately it will depend on your and your family's particularly circumstances as there are a number of options when considering how best to structure your family's wealth. However, a FIC may be the right choice on its own or could form part of a wider wealth and tax planning strategy.

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Shoots and VAT exemption: A simpler solution?

VAT and shoots - A brief history

One might think that a shoot, large or small, which never makes a profit should not be within the scope of VAT: not so. Where a shoot is carried out "in the course or furtherance of a business", even if not successfully, then it may be within the VAT rules and be required to charge VAT at 20% to guns.

VAT is charged on a "taxable supply", which includes the rights to shoot and take game, as well as making available the land for the shoot. Registration for VAT only bites when the taxable turnover of the shoot exceeds £81,000, and so it is only relevant to larger operations. Previously, any shoot with a turnover in excess of the threshold which charged fees would need to register for VAT, unless it fell within a narrow exemption.

The exemption applies to supplies made by an 'eligible body' of sport-related services, but only where supplies are made to members of that eligible body. A shoot fulfilling certain requirements can be an eligible body, which broadly speaking means the shoot must be non-profit making, and not subject to commercial influence.

Generally, a syndicate will fall within the exemption, provided the members simply share the costs of the shooting. But, if non-members regularly shoot or the syndicate sells days of shooting then the members may be carrying on a commercial activity, and may need to charge VAT both to members and non-members alike.

There is also a risk where a commercial shoot sits alongside a private shoot: both activities will be treated as one for VAT purposes, even though the latter does not generate any income.

Previous complexity

Previously, complex structures were put in place to ensure that shoots remained an 'eligible body' and that only members use their facilities. These may have required provisions for multiple levels of membership: one with voting rights for the family on whose land the shoot takes place; and one for ordinary members who attend shoots as "days out".

These shoots have typically been run as members' clubs, with the need to keep careful records (including membership forms and up-to-date members' details) and provide benefits such as newsletters or social activities, to demonstrate that arrangements are genuine.

New rules - a simplified structure

From 1 January, new legislation makes this 'sporting exemption' from VAT more attainable; it applies to all VAT-able supplies made by eligible bodies that enable participation in a sport, whether supplies are made to members or non-members.

This means that administrative requirements on shoots wishing to claim the exemption will be significantly reduced, so that:

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- Participants will neither need to be members of the shoot nor meet the three month minimum membership previously required;
- Membership records will not be needed and shoots can relax their operation, and;
- Shoots currently operating commercially and paying VAT may consider restructuring to meet the non-profit criteria required under the exemption.

As a result, shoots can radically simplify their operating structures and still come within the VAT 'sporting exemption'.

However, HMRC may continue to scrutinise them. Shoots can expect their non-profit making status and the relationship between supplies made and the sporting activities to be examined to ensure that they remain 'eligible bodies'.

Nevertheless, removal of the membership requirement will lessen the administrative burden which will be welcomed.

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FATCA: A brave new world of reporting for Trustees

The Foreign Account Tax Compliance Act, or "**FATCA**", regulations came into effect in the UK in 2013. The legislation itself is very complex, and the guidance and compliance requirements for practitioners and trustees has shifted considerably in 12 months, and is only recently finalised.

FATCA is an information gathering exercise by the US government to enable the IRS to police the taxation of those with a connection to the US. The UK has agreed to provide information and liaise with the IRS to enforce the rules, putting a heavy burden of reporting on UK institutions, even if there is no US connection. Trustees must give careful thought to how to deal with the strict reporting obligations, or find themselves facing penalties.

FFI, or NFFE? That is the question.

The first step is to ascertain whether or not your trust, or any of the institutions that it appoints (investment managers, banks etc.) is a Foreign Financial Institution (**FFI**). Being an FFI means that registration with the IRS by 25 October 2014 is compulsory, regardless of whether or not the trust has any US connections.

To be classed as an FFI the trust must be:

- UK resident for all tax purposes;
- Not a charitable trust; and
- Managed by an entity so that more than 50% of the trust's gross income derives from trading in money market investments, market instruments, portfolio management or the investment and administration of funds.

If your Trust owns land rather than investments and doesn't meet the 50% threshold, then it will not be classed as an FFI, but as a Non-Financial Foreign Entity (**NFFE**). NFFE's do not need to register with the IRS, but must record that they have considered their FATCA status and concluded that they need not report.

However, if a trust has a corporate trustee it will automatically qualify as an FFI regardless of the assets of the trust fund, and registration will be compulsory.

How to report

Once your Trust has been classified, there are four main approaches to ensure that either the trustees or the trust is registered with the IRS. These are:

- **"Trustee Documented"** status will apply where there is a corporate Trustee, which must register itself with the IRS. This means that any of the trusts for which it acts as trustee have no further registration obligations. This is the position adopted by any trusts of which our trust corporation is appointed a trustee.
- **"Owner Documented"** is a service being offered by many of the large investment managers and banks where they will register on behalf of the Trust. They will require detailed information on the trust, trustees and trust assets before registering. This route can only be used if one institution manages all the trust assets. If, for instance, there is an investment manager and a Trustee bank account, this route is not effective.
- **"Sponsored Entity"** reporting is a contractual obligation between the trustees and a third party to carry out the registration and ongoing compliance. As yet, not many institutions are offering this service, and it does not remove ultimate responsibility from the trustees to comply.
- **"Single FFI"** applies where the Trustees decide to register the Trust themselves and will be the approach taken by most Trustees where a corporate Trustee is not in place.

Once the trust or trustee is registered with the IRS, you are fully FATCA compliant. However, annual reports must then be made to HMRC. This will generally be a "nil return" if there are no US connections, but the format for reporting to HMRC is yet to be unveiled.

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Penalties

Penalties will be applied for noncompliance, including a US withholding tax of 30% of any US income and HMRC's usual penalty regime for noncompliance will apply. Finally, if a trust is noncompliant, investment managers and banks should refuse to manage the trust assets which will have sever practical implications.

The regulations and requirements are complex, but it is hoped that once the initial classification and registration have been undertaken, the ongoing reporting will far less onerous. Let us hope so.

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PCB bulletins

Follower Notice and Advanced Payment Notices

HMRC has new powers to demand tax be paid where a taxpayer is disputing the bill.

"Follower Notices" can be used where a decision is made by the courts or tribunal against a scheme or arrangement, and direct other taxpayers involved in the same arrangements to follow the decision and pay up.

"Advanced Payment Notices" allow HMRC to demand tax be paid in advance of the settlement of a dispute or enquiry. If the taxpayer is successful they can expect a refund of the additional tax paid.

In neither case is there a right to appeal, but taxpayers may write to HMRC with representations within 90 days of the notice.

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Autumn Statement: Essentials

SDLT: New "slicing" regime for residential property

From 4 December SDLT on residential property purchases has changed, from a system of applying a single rate of tax to the whole sale price to a graduated system similar to the banding of income tax.

Whilst houses selling for less than £937,500 will suffer the same or less tax, purchasers spending more than that will see their SDLT bill rise from what they would have paid under the previous rules. London estate agents are already seeing property pricing to come within the new rate jump, and some believe it can only be a matter of time before this spreads more widely.

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ATED: Pushing the envelope even further

From April this year, charges under the ATED regime applying to residential property held by companies or other entities will increase by 50%, in addition to the annual increase in line with the consumer prices index.

For example, a property currently within the regime valued at between £2m and £5m would currently face an annual charge of £15,400, but from April the charge is likely to be in the region of £23,500.

The new rates will not apply to properties be brought into charge from April 2015 and April 2016 (see PCB Edition No.19) as the charging threshold is reduced.

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Taxation of Trusts: "SNRB" Dropped

As reported in the last edition of PCB, HMRC has been consulting on changes to the taxation of trusts. The Autumn Statement announced that the proposed Settlor Nil-Rate Band proposal has been abandoned in favour of more targeted measures to prevent the perceived misuses of the current rules. What these are remain to be seen, but current rules prevail for settlors wishing to establish more than one trust in their lifetime.

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