Newsletter

BURGES SALMON

Private Client Briefing

Issue 17

Welcome

Welcome to Issue 17 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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Keep Calm and GAARy on...

Tax avoidance continues to make the headlines, and the Treasury's latest addition to its armoury is a General Anti-Abuse Rule ("**GAAR**"), aimed at countering the most abusive tax schemes. Whether it will change the headlines is a different matter. John Barnett (who was a member of the GAAR interim advisory panel) and Ian Carnochan give their views on the GAAR and what it may mean in practice.

The GAAR - an overview

The GAAR will apply to schemes entered into after the Finance Bill 2013, expected to be in force in July 2013. Its purpose is to tackle tax advantages arising from "abusive tax arrangements". A tax arrangement is something which has a main purpose of obtaining a tax advantage, and so the main focus is whether or not the arrangement is "abusive".

Arrangements are abusive if they "cannot reasonably be regarded as a reasonable course of action in relation to the relevant tax provisions". The legislation does give some help in trying to work out what this means - regard is to be had to any principles or policy behind the tax legislation, whether the arrangements include contrived or abnormal steps or seek to exploit shortcomings in the legislation, and whether the tax result is significantly different from the economics of the transaction. However, if the arrangements are consistent with established practice accepted by HMRC at the time, they should not be abusive.

Safeguards for the taxpayer

The GAAR is a fundamentally different approach to tackling tax avoidance. Potentially, it allows a court to override specific tax rules where it finds an arrangement to be abusive. There are, however, a number of safeguards for the taxpayer:

- HMRC must show that the arrangements are abusive, rather than the taxpayer show that they are not.
- If there is a reasonable view that an arrangement was a reasonable course of action (even if there are reasonable views to the contrary), the GAAR cannot apply.
- Before HMRC can apply the GAAR, an independent advisory panel has to give its opinion as to whether the arrangement is a reasonable course of action.
- If the matter gets to court, the advisory panel's opinion must be taken into account, as well as official guidance sanctioned by the panel.

What will it mean in practice?

We expect that the GAAR will have limited practical impact for most taxpayers, and is unlikely to affect mainstream tax planning. However, it is also unlikely to deal with many of the tax arrangements that have made the headlines in recent years.

Though apparently capable of countering the most egregious schemes, of equal significance is the added uncertainty the GAAR will bring for tax planners: contrived and aggressive avoidance schemes are high risk already, and the new climate may mean that fewer promoters (and customers) will have the appetite for such schemes.

The precise scope of the GAAR will become clearer over time, especially as the advisory panel starts to give opinions, and the guidance is updated - but the grey area is likely to remain the borderline between what is avoidance and what is abusive.

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Furnished Holiday Lets - but no break from IHT?

Last year we reported on the decision of the First Tier Tax Tribunal to allow a claim for Business Property Relief for IHT on a holiday cottage on the Suffolk coast, in which the deceased, Mrs Pawson had a share.

It has long been the position that claims for BPR on furnished holiday lets are possible provided sufficient additional services are offered to move the business from simply one of investment activity (where no BPR is available) into that of being a trading business (on which BPR is available). The debate with HMRC normally focuses on the level of those additional services and whether they are sufficient to move the business away from the investment end of the spectrum into the trading end.

The surprising thing in the first decision in Pawson was how *few* additional services were offered. The case report suggests that the owner provided cleaning and gardening services as well as TV and telephone. However, most of those would be categorised as the bare minimum for a holiday cottage.

Therefore it was no great surprise to discover a few weeks ago that the Upper Tribunal had considered HMRC's appeal and decided that BPR was not available on Mrs Pawson's bungalow. However, more worryingly the Tribunal seems to have adopted a very restrictive view of what will secure BPR. The Tribunal judge's view was that at heart a holiday letting business is an investment business just like any other and that to be trading the additional services must be so significant as to *outweigh* the investment activity. On this very restrictive reading of the law, it is difficult to see how most furnished holiday lets will ever qualify for BPR.

Those who run furnished holiday letting businesses will be disappointed by this decision, though the taxpayer intends to appeal to the Court of Appeal, and a fighting fund to challenge the decision is being raised.

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Paintings can be wasting assets

Sir Joshua Reynolds' portrait of Omai arrived at Castle Howard in 1796, and (apart from brief tours of the world's galleries) remained there until it was sold by the executors of Lord Howard's estate. From 1952 until his death in 1984, Lord Howard had allowed the company which owned Castle Howard to use the painting as part of its business of charging the public for visiting the house and grounds. This arrangement continued after Lord Howard's death, until funds were needed to fund the present incumbent's divorce. In November 2001 the picture fetched £9.4m at Sotheby's.

The executors disputed HMRC's view that CGT was payable on the proceeds. This turned on the definition of "plant" within the CGT code, the significance being that if an asset is classed as plant, it is automatically treated as a wasting asset and can be disposed of with no CGT charge. To meet the definition of plant the asset must be used in a business, and that use must be permanent.

HMRC argued that the use by the company lacked permanence: the executors could demand its return at any time. The tribunal at first instance agreed, and despite accepting that the painting was used in a business, found that business was not that of the executors, who were claiming the relief, but the company's. They denied relief.

On appeal the upper tribunal reversed the first instance decision. HMRC's contention on permanence was rejected: the test was designed to distinguish "plant" from "stock-in-trade", being based on long term use, rather than necessarily a permanent right to possession.

Significantly, the tribunal judge found that though the executors did not carry on the business in which the painting was used, they could still claim the relief. If the painting was plant for the purposes of the business in the hands of the company, it could not at the same time not be plant in the hands of the executors, and so they should not be prevented from claiming the relief.

This case will interest those who allow valuable possessions to be used in house opening businesses - particularly under arrangements where trustees own chattels but do not run the business. However, the first tier tribunal did raise the concern of abuse of this type of arrangement, and so HMRC will no doubt scrutinise any claims of this type. We would suggest that forward planning should not rely upon this type of CGT exemption. On the other hand, there may be cases similar to the Castle Howard sale, where CGT has already been paid. Should the relief now be claimed and tax recovered?

Though significant for CGT purposes on sale, this case does not affect the inheritance tax treatment of art and heritage property on death, which we will look at in the next issue.

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We are family - paying the right price for domestic workers

In the recent case of *Nambalat v Tahor*, the Court of Appeal provided guidance as to when a domestic worker is 'treated as a member of the employer's family' and therefore not entitled to the National Minimum Wage (NMW).

Under the NMW Regulations, domestic workers will not qualify for the NMW where they are genuinely treated as a member of the employer's family. This could be the case where the worker is living in the employer's family home, not paying for food or accommodation, and sharing the family's tasks and leisure activities.

Ms Nambalat claimed that she was not treated as a member of the family and that she was therefore entitled to the NMW. The Court Appeal concluded that routine tasks were shared and that she was included in family outings and holidays, as well as visits to the park, cafes and restaurants. She was able to decline invitations to go out. Meals were shared, although rarely taken together. However, due to changing family circumstances, Ms Nambalat shared a bedroom with the two younger sons and then, when the family moved again, slept on a mattress on the dining room floor. Taking into account all the circumstances and, in particular noting that the entire family faced cramped conditions, the Court concluded that she was treated as a family member and not entitled to NMW.

Key points

- The majority of domestic workers will be entitled to the NMW. Only workers who are genuinely treated as family members are not entitled to the NMW.
- The worker need not share all meals, tasks and leisure activities with the family. This requirement will vary with the habits of the individual family.
- An overall approach to family membership is required. Particularly onerous or extensive demands may be inconsistent with treatment as a family member.

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Budget more exasperation than aspiration for farming community

An 'aspiration nation' budget was the tagline used by the Chancellor for his budget, but proposed changes to the way in which restrictions on the deductibility of certain debts for inheritance tax (IHT) purposes are dealt with could have an impact on farm borrowings.

The draft legislation was published in late April and it is clear that these changes will affect a common way of structuring farm borrowings which in the past would have reduced the potential IHT charge on death.

The following example illustrates how the system currently operates, and what may change: a farmer buys some farmland for £2m with cash and £1m of bank borrowing. He secures the debt on some non-agricultural cottages that he already owns. Because the cottages are non-agricultural they would not usually qualify for any IHT relief.

In the past the position on his death would be that the land would qualify for full APR (subject to the normal conditions for the relief) and the £1m of debt would be deductible against the value of the cottages. The IHT saving could be £400,000.

These changes limit the deductibility of debts attributable in whole or part to financing the purchase of agricultural and business property. As a result the value of the loan is first deducted against the value of the farm land that he purchased and only if the debt exceeds the value of the land would the balance be deductible against the cottages. In this example the cottages would therefore be subject to IHT with an extra IHT cost of £400,000.

The rules go wider still: where a loan has been used to finance the maintenance or enhance the value of relievable property, the value of the debt will again be deducted against the relievable property rather than the rest of the estate.

It was first thought that the new rules would be retrospective and that they would apply to any debts of this sort in existence at the date of death irrespective of how long ago the arrangements were put in place. However a recent debate on the Finance Bill in Parliament suggests that pre 6 April 2013 debts will not be affected. Elderly clients with pre April 2013 debts may be well advised not to refinance if by doing so they come within the new regime.

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Our House: tax planning and the family home

Part 1: Ownership and the next generation

For many people, the family home is the most significant asset that they own. However, it is sometimes easy to overlook when thinking about tax and estate planning. In this first of two articles, we look at some of the tax planning pitfalls and opportunities associated with the family home.

Whose House?

The first issues to consider are who actually owns the house, and how do they own it? This may be particularly relevant on separation or divorce, but can also affect how the property passes on death.

It is vital to make sure that the ownership of the house reflects the intention of the parties. In the last issue of PCB we looked at how the court approaches the situation of a house being in the name of only one of a couple, but both people claim an interest in the property on separation *(What's in a name? Rights in the family home).*

Generally, the court will only become involved where there is a disagreement as to how the interests should be shared. It is important, therefore, for the issue to be considered and the agreement recorded. This can be done by way of a simple declaration of trust.

Alternatively, and particularly if the house is owned before a marriage by one of a couple, a prenuptial agreement could set out how they intend the benefit to be shared (if at all) on separation. Post-nuptial agreements can also be used to update agreements as the marriage continues.

Whatever document is used, it is important to make sure that they are reviewed and adhered to. They must also tie into what a person's Will leaves to their spouse. The Will may be more generous that than the agreement, but cannot be less so without a risk of a claim on the estate by the surviving spouse.

If both people intend that they should have an interest in the house then it should be owned in joint names, either as joint tenants or tenants in common. Joint tenants each own the entire property, and do not have a distinct share. They cannot deal with their share separately from the other person and on the death of one joint tenants, the survivor automatically inherits the whole property.

Tenants in common each own what is called an undivided share, and can deal with their shares differently. The shares can be set out to reflect different contributions of the parties, or their intention as to a division on separation. Tenants in common may also leave their share to someone other than the other person on death, and care needs to be taken to ensure that the Will reflects this.

Inheritance Tax: keeping it in the family

HMRC has for some time been keen to restrict opportunities to mitigate inheritance tax ("IHT") on the family home, and as such the options for planning are very limited. The Finance Bill 2013 has brought in further restrictions which make the situation rather bleak (see *Budget more exasperation than aspiration for farming community* in this issue of Private Client Briefing).

The most significant barriers to planning are the gift with reservation of benefit ("GROB"), and pre-owned asset tax ("POAT") rules. Each is designed to catch scenarios where a person purports to give away an asset, but actually continues to benefit from it, such as giving away all or part of the family home, but continuing to occupy it.

The GROB rules treat the asset for IHT as though it was never given away, and so the full value is included within the death estate. POAT applies an annual income tax charge on the benefit received from the retained use of the asset, which in the example above would be the cost of renting the property in the open market.

There are some exotic ways around the GROB and POAT regimes, such as the "home loan" or "double trust" structure. This was popular a number of years ago and involved selling your home to a trust in return for an IOU, which was then gifted to a second trust. However, this and other schemes like it have essentially been shut down by the Revenue, who look very closely at this kind of planning over the family home.

Aggressive planning schemes avoiding the family home should therefore be avoided, but there are less controversial alternatives. For example, if you give away a property, but pay a full market rent for continuing to use it you have not reserved a benefit. Care needs to be taken that the rent is reviewed to keep up with the market: you can fall back into the GROB regime if you cease to pay in full for the benefit.

If you share occupation of the house with someone, a gift of an undivided share to them will not be a reservation of benefit. Care needs to be taken that this doesn't result in the donee paying all the running costs of the house, as this may put you back into the regime.

Finally, life insurance to fund the IHT bill may be a more certain way to deal with the problem.

In the next issue of Private Client Briefing we will look at the capital gains tax issues which can arise on the family home.

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