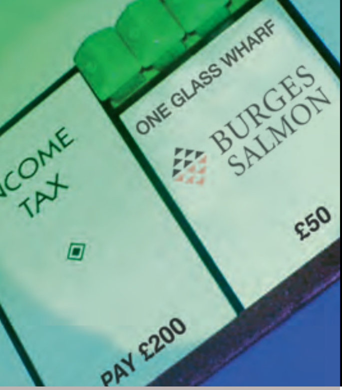

Newsletter

BURGES SALMON

Private Client Briefing

Issue 18

Welcome

Welcome to Issue 18 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.**

Contents

Our House: tax planning and the family home

In this second article looking at tax planning pitfalls and opportunities associated with the family home, we look at the capital gains tax problems that can arise.

Moving house

Assuming your family home has gone up in value since it was bought, capital gains tax ("CGT") may be payable on sale. However, where the house has been your only or main residence throughout the period of ownership (and certain periods of absence), principal private residence relief ("PPR") is available to relieve the tax charge.

As well as providing relief on the house itself, gardens or grounds which go with the house of up to 0.5 hectares should also qualify for relief. A larger area may qualify where the size and character of the house are deemed to need more land. Grounds can include drives, paddocks and orchards, but will not encompass any property with a commercial or agricultural use.

Care needs to be taken in relation to land which is retained after the main house has been sold: if you sell your house, but retain part of the garden in the hope that it may be sold separately with planning permission, the whole gain on that land when later sold may be chargeable, not just the gain since the house was sold.

PPR is only available for the period for which the house has actually been occupied by the owner, but will always automatically be available for the last three years before sale. The gain is apportioned throughout the ownership period, and then reduced for periods where the property has been unoccupied.

Example

Mr & Mrs Carter buy Hove House in 2000 for £1m, then move out in 2004 before finally selling it in 2013 for £2.2m, a gain of £1.2m.

They owned the house for 13 years, but occupied it for only four: combined with the final three years before disposal that means they qualify for relief for seven out of 13 years (about 54% of the time).

Therefore, they will not qualify for relief on 46% (or £553,846) of the gain, and will pay tax at 28% on it (assuming that they are higher rate tax payers).

However, some absences will not lose the relief. Provided you live in the property again afterwards, any absence of up to 3 years will still qualify for PPR. Also, being absent from the house for work abroad, or living in work provided accommodation can mean PPR still applies.

If the house has been rented out for part of the ownership period, lettings relief may apply to up to £40,000 of gains during the rental period. To take Mr & Mrs Carter's case, if they had let the house for the period of 6 years when they did not live in it, they could have reduced the gain by £80,000, as the relief can be claimed by both co-owners.

More than one house?

It is not unusual to use more than one house as a main residence, and even second houses occupied under a lease can count as your main residence for PPR. It is a matter of fact which one counts as your "main" residence for PPR, unless you make an election as to which residence should qualify.

This needs to be made within two years of actually starting to live in both houses as residences, not just when you acquire the second house. Married couples and civil partners can only have one main residence between them.

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The PPR election coupled with the automatic exemption for the final three years allows what has become known as 'flipping'. If you own two houses, each of which count as your residence, but one is standing at a higher gain (and typically has been owned for a shorter period), the election can be made over that property before a sale, then 'flipped' back to the other property after a short time.

This will mean that PPR will be available for the three years before sale (the effect is retrospective), which may wipe out the gain. If the other property is sold, PPR will be available, with the exception of the short period where the second property was subject to the election.

Though HMRC have made the wording of their guidance on this topic somewhat less encouraging in the wake of MP's enthusiasm for the scheme being revealed, it is still permitted.

Though flipping is within the tax rules, the second property must genuinely have been your second residence. Buying a property with the motive of selling it at a profit means that the relief will be disallowed, but other circumstances involving the sale of the property may also jeopardise the relief.

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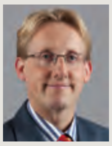

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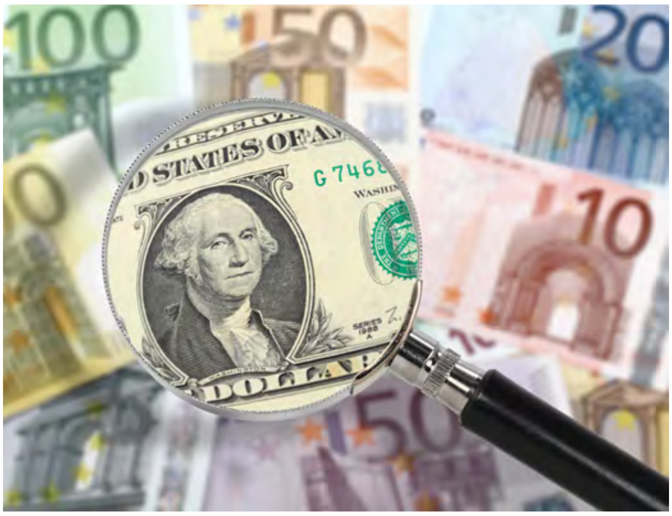
Introducing FATCA



In common with other jurisdictions, the US wants to stop tax avoidance and evasion. A US law, the Foreign Account Tax Compliance Act ("FATCA" for short), has been enacted with the aim of obtaining information about US citizens who hold investments outside the US. Very broadly, the way FATCA works is to encourage financial institutions around the world to report to the US authorities on their US account-holders.

Under FATCA, non-US financial institutions (which include banks, stockbrokers and investment funds) are given a choice. Either they become FATCA-compliant, which involves registering with the IRS and reporting on US account-holders, or they risk being subject to a 30 per cent. withholding tax on certain payments with, or attributable to, a US source or connection.

The UK has entered into an agreement with the US in order to regulate how FATCA is to apply to UK financial institutions. The good news is that UK financial institutions will generally be treated as FATCA compliant, and should not be subject to withholding. The not so good news is that they are still required to register with the IRS and will have to report information about their US account holders to HMRC, which will report back to the IRS.

The UK is also entering into FATCA-style agreements with a number of other jurisdictions. This will result in automatic information exchange with those jurisdictions.

One concern in the UK is how trusts will be treated. This depends on whether FATCA treats the trust as a "financial institution" under the rules. If a company provides its services as trustee, or as manager of the trust or of its financial assets, this could result in the trust being caught. If this is the case, the trust would be required to register with the IRS and report to HMRC (although there may be exemptions). Trusts which are not financial intuitions themselves may need to provide information to the financial institutions holding their investments. More detailed guidance on the application of FATCA to trusts is expected to be published.

There is still time to get ready for FATCA. In the UK, the first reporting deadline is 31 May 2015 in respect of the 2014 calendar year. However, those affected by FATCA will need to understand their obligations and carry out any necessary due diligence in preparation for this.

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As workers go west, employers need to know new immigration rules

From 1 January 2014, working restrictions on Bulgarian and Romanian nationals are to be lifted and Bulgarians and Romanians will have unrestricted permission to enter and work in the UK.

As working restrictions are lifted on nationals of two member states, they are being imposed on those of another. The UK government has recently put in place transitional immigration rules for the newest member of the EU - Croatia. Croatia joined the EU on 1 July 2013 and, while Croatians can travel to the UK freely, they will need permission if they want to work here. Permission will generally only be provided to skilled workers and only if a UK employer is able to sponsor the Croatian national. These restrictions are designed to control a surge of low-skilled labor into the UK from Croatia.

In the ever-changing landscape of Europe and the Home Office's immigration rules, it is critical that employers have good systems in place. If employees do not have permission to work for an employer, the employer will be liable for a fine of £10,000 per employee unless it can show that it carried out prescribed checks of the person's immigration documents. A three step process of "check, validate and keep" must be carried out on all employees (to avoid allegations of discrimination), and we recommend that employers put in place a simple check list for all employees to ensure that this is done before they start work.

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Company Assets and Divorce: Prest v Petrodel and the corporate veil

Increasingly people are looking to take steps to safeguard assets from relationship breakdown, much as they do from tax and on death. In June, the Supreme Court gave a key judgment in *Prest v Petrodel Resources* which provides helpful guidance on the wide ranging powers of the family courts to distribute assets on divorce.

Assets are often held in companies, both for business purposes and for succession planning. On divorce, a person's shareholding in a company will be valued, and that shareholding could be transferred to the other spouse in satisfaction of their claim. This is, however, rarely a particularly attractive remedy for anyone concerned.

It is often preferable to "buy out" the other spouse's claim, by transferring or selling assets. However, there may be a difficulty if those assets are actually owned by the company. This was the issue in *Prest v Petrodel*.

This case reaffirmed the traditional position that a company is a separate entity from its shareholders and therefore the shareholders have no legal rights in any company assets. However, the Supreme Court held that although that legal principle was correct, based on the facts of the case they could look behind the appearance of corporate ownership and treat the company assets as if they belonged to the husband.

The legal reason here is that the companies were held to be a trustee of the assets for Mr Prest, even though there was no express paperwork to this effect. That relationship was established by the way in which the company acquired the assets and how they were subsequently treated.

When will the courts conclude there is a trust of this sort? Every case depends on its facts, but one key question will be "who paid for the asset"? If, for instance, the trading company is named as the buyer, but all of the money for the purchase comes directly from personal funds with no evidence that that is a loan or gift, then that will indicate strongly that the company is a trustee and the asset is available for the family court judge to attack.

The notion that transferring an asset into a company puts it beyond the reach of the courts on divorce is now questionable, quite apart from whether it is a sensible commercial or fiscal move (which it often will not be). Advice should certainly be taken before taking any such action.

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Disguised Remuneration: Income tax trap for gifts to employees

Gifts to employees are by no means uncommon, but should care be taken when these gifts are more significant than a bottle at Christmas?

In 2011 rules were brought in to impose a tax charge on benefits received by reason of a person's employment, but which were received outside the normal course of their employment. This was designed in the main to catch schemes intended to avoid income tax and national insurance contributions by using trusts and other intermediaries to pass funds to employees other than as employment income - so called "disguised remuneration".

The rules bring disguised remuneration back within the income tax charge, and will apply where an employer provides, or takes steps to provide, rewards or recognition to their employee by reason of their employment.

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Though designed to catch more esoteric arrangements, gifts to employees either in lifetime or made by Will are capable of falling foul of the rules. Gifts in Wills are a particular concern, as the scope of the rules suggest a tax charge could be imposed on death, or even (some have suggested) at the time the Will is made. As a result a gift to an employee could be taxed twice: inheritance tax must be paid by the estate, and income tax paid by the recipient.

As the question of when the income tax charge arises is yet to be decided, caution in making new Wills is the best option. Such gifts should not be expressed to be "by virtue of X's long service" and if anything needs to be said then something along the lines of "due to our long standing acquaintance" may be appropriate.

Where a Will is already in place which makes such gifts, the Will should be reviewed and if necessary the phrasing of the gift amended. It may be that in some cases, the objective of providing the employees with a benefit overrides the possible income tax charges, but the position should be considered carefully.

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In Brief

Suzanna Harvey: New Partner and Top 35 under 35 Award winner

We are pleased to report that Suzanna Harvey has been promoted as a partner in the Private Client and Wealth Structuring team. Suzanna has been with the firm for seven years, and was made a partner in May this year. Suzanna specializes in UK and international tax and trusts work, and has substantial experience of advising non-UK domiciliaries on the income tax, capital gains tax and inheritance tax implications of UK residence. She also advises UK domiciliaries on tax and estate planning issues and a number of international trust companies on trust matters.

Suzanna's skill and expertise was recognized in September by Private Client Practitioner magazine in their Top 35 under 35 Awards.

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Burges Salmon Family Business Team

Burges Salmon's already strong credentials in advising clients in both their business and personal affairs are now being bolstered by a dedicated Family Business team. Headed by Private Client and Wealth Structuring Partner Jim Aveline and Senior Associate Douglas Streatfield-James of the Corporate team, the team combines the firm's business and private client expertise to advise family businesses of all sizes through the complexities of running those entities, from commercial factors and business structures, to employment issues and taxation.

One key area of the team's focus is succession planning within family businesses, working with clients on strategies to prepare for the handover to the next generation. Alongside agreeing the correct structure for the business in the future, the team can address concerns about asset protection, what happens on death of a family member, and ways of achieving fairness between the next generation, all of which are crucial for a successful transition.

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Domicile Election for Inheritance Tax: non-domiciled spouses

Where a UK domiciled person leaves assets on their death to a non-UK domiciled spouse or civil partner, the usual inheritance tax exemption which applies to such transfers only applies to the first £55,000. This includes lifetime transfers, so where gifts have been made before death, the limit can be used up very quickly.

It is now possible for the non-domiciled spouse or civil partner to elect that they are UK domiciled for inheritance tax purposes: this will mean that they can take the benefit of the spouse exemption, but the disadvantage is that their worldwide assets may fall within the net of UK inheritance tax.

The election can be made during lifetime, or following the death of the UK domiciled spouse or civil partner, or even by the personal representatives of the non-domiciled spouse or civil partner after their deaths. The election is irrevocable.

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