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MOVING BETWEEN SHARE/UNIT CLASSES

HMRC has issued regulations that clarify the capital gains tax (CGT) position on 'clean price' fund conversions.

HMRC's stance on taxing rebate commissions from 6 April 2013 and the FCA's recent decision to end the payment of cash rebates by platforms, from 6 April 2016 on past business and from 6 April 2014 on new business, have raised the profile of how conversions between different series of units/shares in the same fund are treated for tax purposes.

In practice, the topic had been under consideration for some while, with bodies such as the Tax Incentivised Savings Association having been in discussion with HMRC for many months on draft regulations. On 7 June, those regulations finally emerged to no great fanfare. They cover the CGT treatment of 'exchanges, mergers and schemes of reconstruction' undertaken by collective investment schemes (CISs).

The key part of these regulations is that CGT will not arise where:

- A CIS investor exchanges their shares/units in a scheme for other shares/units in the scheme "of substantially the same value" and the scheme property and rights of investors (ignoring any changes as a result of a variation in management charges) are unaltered; or

- A scheme reorganises in a way that all investors in one or more unit/share class (or all classes) exchange their holdings for other shares/units in the scheme.

The exchange is treated for CGT purposes as a share reorganisation under sections 127-131 of the Taxation of Chargeable Gains Act 1992 in which case the original base cost is carried across to the new holding and no disposal occurs.

Note that the word used throughout the regulations is 'exchange', *not* 'switch'. A switch – generally considered in terms of a sale and purchase – would not be covered by these regulations because the sale would be a disposal, even if the repurchase was of a different class of units/shares in the same fund. However, the regulations do include a CGT exemption for:

- A scheme reconstruction involving the issue of shares/units, eg where all investors in one or more classes of shares/units in scheme A have their holdings cancelled and replaced by new holdings in scheme B – typically on the wind up of a fund A; or

- A scheme reconstruction involving a conversion scheme occurs where the rights to a unit/share exchange extend to investors in both the scheme being 'converted' and its recipient scheme.

The new regulations took effect from 8 June 2013, although it is unlikely that HMRC would challenge the assumption of sections 127-131 TCGA 1992 treatment for the exchanges detailed in the regulations if they were made prior to that date. For example, guidance has long made clear that exchanges between accumulation and income series of units within the same fund are not subject to CGT.

COMMENT

These regulations put to rest any concerns about CGT liabilities being created by either individual investors choosing to move between unit/share classes or schemes carrying out a bulk reconstruction, provided the transaction is an exchange, not a sell/buy switch.

LAW SOCIETY TO INTRODUCE NEW "WILLS AND INHERITANCE" ACCREDITATION SCHEME

Following the Government's decision not to regulate will writing - see last month's bulletin - the Law Society has confirmed it will introduce a new accreditation scheme, called the Wills and Inheritance Scheme, for solicitors providing will-writing and probate services.

Details of the scheme have yet to be confirmed, but the Law Society expects that it will be launched in July and open for applications in October.

A Law Society spokeswoman said: "The scheme will aim to set minimum practice standards for firms advising on will-writing and estate administration and will enable consumers to differentiate providers with expertise from others."

The Institute of Professional Willwriters (IPW) already operates a Code of Practice, which is unique in the legal services sector in that it has been approved by the Trading Standards Institute (TSI) under its Consumer Codes Approval Scheme. Chairman, Paul Sharpe, has defended the IPW Code of Practice saying "Having a Code of Practice is one thing, but it is easy for firms to pay lip service to it and therefore for it to have no teeth and no effect. It's therefore important that its provisions are independently approved by an organisation such as the TSI and that they are monitored and enforced - and seen to be monitored and enforced".

COMMENT

While mandatory regulation may have been the preferred option for the legal profession, voluntary accreditation schemes will nonetheless help to highlight the quality of accredited firms. Whether the consumer will find it any easier to make an informed choice in a market of competing rival codes and qualifications (such as STEP) remains to be seen!

PROFESSIONAL NEGLIGENCE: THE MEHJOO CASE

A few newspapers (including the Times) have reported on the Mehjoo professional negligence case and concluded that the High Court judgment means that a firm of accountants has a duty to advise wealthy clients to avoid tax.

The taxpayer in this case was a UK resident (Iranian) non-dom. It seems that his accountant, while advising his client on a scheme to avoid capital gains tax on a sale that didn't work, failed to make him aware of the Bearer Warrant Scheme (BWS) under which he would have been able to move ownership of his company to an offshore trust. The company could then have been sold on and he would have avoided capital gains tax.

The BWS was subsequently closed down by HMRC, but at the time it was available to use and was effective.

The main point to take from the judgment is not that professional advisers are obliged to advise on aggressive tax avoidance schemes that could be accessed by their clients. The key point in the judgment was that the accountants didn't have sufficient expertise to advise on a matter that they took on. Here are two extracts from the judgment:

"The Defendants had a contractual duty or concurrent tortious duty as reasonably competent generalist accountants in October 2004 to have advised the Claimant that (i) he had, or very probably (or alternatively might have) had, non-dom status; (ii) non-dom status carried with it potentially significant tax advantages; and (iii) he should therefore take tax advice from a firm of accountants or tax advisers who specialised in advising individuals who had (or might have) non-dom status" **and** *"I know that this judgment will be a great disappointment for Mr. Purnell (Mister Mehjoo's accountant), who obviously was an accomplished accountant and who was determined to help his clients to the best of his ability. Sadly, he erred by failing to advise the Claimant to take the advice of a non-dom specialist after many years of successfully helping the Claimant and I hope that he understands why I have reached my decision."*

COMMENT

It seems that the judge didn't say that the accountant had to advise him on the scheme. It just so happens that the client would have gone on to use an avoidance scheme, or so the judge concluded.

The received wisdom in this area is that professional advisers should guard against claims by including a suitable clause in their engagement letters that makes it clear what their areas of *expertise and operation are and are not; and that they will not advise on issues that are not within their stated areas of expertise.*

It should also be borne in mind that, in giving advice in the current "climate", it is essential to take into account the potential impact of the GAAR (when enacted) as well as any relevant TAARs.

HMRC LAUNCHES FURTHER CONSULTATION ON THE SIMPLIFICATION OF IHT RELEVANT PROPERTY CHARGES

The following is an overview of HMRC's proposals for the simplification of relevant property trust charges as outlined in the recently published consultation document "Inheritance Tax: Simplifying Charges on Trusts – The Next Stage".

HMRC previously consulted in this area in July 2012. This latest consultation builds on the earlier one by responding to the comments received and developing HMRC's proposed policy. It invites comment on HMRC's proposals for the simplification of the IHT periodic and exit charges on relevant property trusts; seeks views on proposals to align the payment and filing dates for these charges and examines the treatment of accumulated income. The consultation period runs to 23 August 2013.

The calculation of periodic and exit charges can be complicated and it is not uncommon for the professional costs incurred in calculating the tax liability to exceed the amount of tax at stake. HMRC recognises this and proposes to simplify these calculations by:

- Ignoring the settlor's previous lifetime transfers when determining the available nil rate band for the purposes of calculating the hypothetical transfer that is used to calculate periodic charges and exit charges.

- Ignoring non-relevant property for the purposes of the calculation of periodic and exit charges.

- Splitting the nil rate band across the number of relevant property settlements which the settlor has made over a period of time which is dependent on whether the charge is the first or a subsequent periodic charge or an exit charge within the first 10 years or after 10 years – this important potential change is considered in detail in the next article.

- Applying a simple rate of 6% to the chargeable transfer that exceeds the available nil rate band for the purposes of the periodic and exit charges, rather than requiring lengthy calculations of an effective rate.

HMRC also proposes to align filing and payment dates for IHT with those under the self-assessment framework so that due dates for payment will never fall before the due date for delivering an account. It also intends to clarify the treatment of accumulated income by:

- Making express provision in the legislation to the effect that income which is accumulated and added to capital is relevant property for the purposes of the periodic and exit charge calculation from the date at which the accumulation takes place. This does not represent any change from the current treatment.

- Deeming income arising to a trust, where the trustees have a power to accumulate or a duty to accumulate coupled with a power to distribute, to be accumulated and added to capital if it remains undistributed from the start of the second tax year after the end of the tax year of receipt.

HMRC will publish a summary of the responses to the consultation around the 2013 Autumn Statement. Legislation is likely to be introduced in Finance Bill 2014.

COMMENT

Being able to ignore the settlor's cumulative total and the value of non-relevant property will avoid the problems and associated costs of having to obtain historic records and valuations – this will be particularly useful for ***those*** *pre-2006 settlements which* ***fall within*** *the relevant property regime but previously had no record keeping requirements. However, any tax advantage is likely to be counterbalanced by the new flat rate of 6% (which will still be apportioned on an exit). The consultation document includes a number of examples which compare the 'before and after' position and it can be seen from these that there will largely be winners.*

Of course, those most adversely affected by the change (if implemented) will be those who take advantage of 'Rysaffe' planning as illustrated by the next article.

THE SIMPLIFICATION OF IHT RELEVANT PROPERTY CHARGES – THE IMPLICATIONS FOR "RYSAFFE" PLANNING

After the good news that "Rysaffe" style trust fragmentation will not be attacked under the GAAR because it represents practice accepted by HMRC, we have the less good news from the Inheritance Tax: Simplifying Charges on Trusts: The Next Stage consultation document that (among other IHT trust simplifications) HMRC is proposing legislative action to prevent IHT tax loss, and deliver simplicity, by "anti-fragmentation" provisions - see also the preceding article.

This is not yet law but it is a firm proposal made in the consultation document, perhaps surprisingly, based on responses.

Here are some explanatory extracts from the document:

From the introduction:

'Splitting the nil-rate band is integral to the proposals to simplify the calculations. Without this provision, the scope for any changes to simplify the calculations would be limited due to the risk that it would lead to greater avoidance and the adverse impact to the Exchequer. Dividing the nil-rate band equally or apportioning it between the number of trusts in existence would ensure fairness in the system and protect IHT revenues.'

From the responses section:

'Settlors are currently able to set up multiple settlements. But if they are not created on the same day they are not related settlements for IHT purposes and they each qualify for their own unrestricted NRB. In response to HMRC concerns that simplification could increase the risk of fragmentation of settlements, a third of respondents suggested that the IHT NRB could be shared between the number of trusts established by the same settlor. They added that dividing the NRB in

this way could replace the burdensome requirement for historical information when calculating the IHT charges.'

HMRC's proposals for simplifying the IHT calculations draw on this suggestion.

From the "simplification" section:

'The nil-rate band should be split by the number of relevant property settlements which the settlor has made. This will alleviate the risk that settlors might seek to fragment ownership of property across a number of trusts to maximise the availability of reliefs or exempt amounts.'

and

'Settlors currently benefit from the use of multiple settlements because if they are not created on the same day they are not related settlements for IHT purposes. The current fragmentation rule aims to prevent a settlor reducing trust charges through the use of multiple trusts each with its own unrestricted nil-rate band. But the rule can be easily side-stepped by those setting up trusts during their lifetime by simply setting up a series of trusts, each on a different day enabling the settlor to avoid IHT trust charges.

A new rule which splits the nil-rate band between settlements made by the same settlor would mean that the "related settlements" rule would no longer be necessary.

Under a more simplified regime, HMRC's proposal for the first ten year charge is that the nil-rate band is split between all relevant property settlements made by the settlor and in existence at any time between the date the trust concerned was set up and the time of the charge. This would include any settlements which had been wound up before the date of charge.'

COMMENT

Developments will need to be watched very carefully but there seems to be a strong likelihood that legislation will ensue.

HMRC's suggestion that new provisions splitting a single nil rate band among all relevant property settlements made by the same settlor and in existence at any time between the date the trust commenced and the time of the charge, is a little worrying. It gives no reassurance that trusts established on the Rysaffe basis before any new legislation was introduced would not be affected. Given that such multiple unrelated trusts would have been established based on clearly established law and practice "accepted by HMRC" (See the HMRC GAAR guidance) it is to be hoped that there would be strong and coherent resistance to the application of any new anti-fragmentation rules to such arrangements.

This development reminds us that just because GAAR doesn't apply to a strategy doesn't mean that specific legislation, say in the form of a TAAR, will not be drafted to achieve a required HMRC outcome.

TAXPAYER SUCCEEDS IN CLAIM FOR PRINCIPAL PRIVATE RESIDENCE RELIEF

In the recent case of Morgan v HMRC, the taxpayer succeeded in his claim for principal private residence relief on the grounds that he intended to occupy the property as his main residence.

Mr Morgan bought the property in 2001 which he intended to occupy with his fiancée as their marital home. However, shortly before completion, his fiancée (Miss Varley) ended the engagement providing him with no explanation. Mr Morgan assumed that his fiancée was merely having cold feet and that they would soon reconcile the relationship and she would move into his new house with him. On this basis, he decided to go ahead with the property purchase and moved in. A mortgage was arranged in Mr Morgan's name but with a note on the Deeds under the heading 'Special Conditions – Non-Borrowing Occupiers' stating: 'We believe that the persons(s) named below may live at the property..... Miss Paula Emma Lucy Varley'.

A few weeks later it became apparent that there was no hope of reconciliation as Miss Varley had left Mr Morgan for another man. Mr Morgan had purchased the property budgeting on his fiancée paying towards some of the living costs. As this was no longer the case, he weighed up his options and chose to rent out the property.

Approximately 5 years later, Mr Morgan moved back into the property with the intention to sell it. The property was sold within 4 months. HMRC assessed Mr Morgan to capital gains tax on the gain. HMRC said that the two periods Mr Morgan had stayed in the property were temporary and it therefore did not qualify for principal private residence relief.

Mr Morgan appealed this decision to the First-tier Tax Tribunal on the basis that he had satisfied the conditions to receive principal private residence relief.

Broadly speaking, principal private residence relief is available where:

- A dwelling-house (or part of a dwelling-house) has been an individual's only or main residence at some time during his period of ownership (section 222(1)(a), Taxation of Chargeable Gains Act 1992(TCGA 1992)).

- The dwelling-house was not acquired for the purpose of realising a gain on its disposal (section 224(3), TCGA 1992).

Provided the dwelling-house has qualified for principal private residence relief at some point during the individual's period of ownership, the last three years always qualify for the relief. In addition, letting relief is available where principal private residence relief is restricted due to (all or part of) the dwelling-house being rented out as residential accommodation – which in many cases can eliminate most of the taxable gain.

HMRC argued that there was conflicting evidence to prove that this was his main residence as he had not, for example, advised his bank of a change of address, his gas bills were low and he had moved in with little furniture but these factors were largely dismissed on the basis that he lived there through summer months and the property was largely fitted with cupboards.

The Tribunal found it "finely balanced" but Miss Varley's name was on the mortgage deed as a future occupant and this gave the Tribunal irrefutable evidence of intent. It was its view that it is not the "quality" of the occupation, but the intention of the occupier that matters when determining whether or not the property is an individual's principal private residence.

It found that although Mr Morgan's actual occupation of the flat was just for a short time it was nevertheless occupied as his main residence and as such principal private residence relief was available.

COMMENT

The outcome of this case is particularly surprising as the ultimate decision was based on Mr Morgan's intention to occupy the property as his main residence. Further, it is evident that the Tribunal accepted Mr Morgan's assertion that he had hoped, when he occupied the house, that his fiancée might return. Therefore, he had not bought the property with a view to making a short-term profit and avoid paying capital gains tax. Instead, the property was purchased as he wanted it to become his marital home. Of course, had he decided to rent out the property before moving in it is likely that the position would have been different!

We would have expected to see HMRC appeal this decision, but it appears that the period of time to lodge an appeal has now elapsed.

HMRC WINS £1.6M TAX AVOIDANCE SCHEME CASE

A property development company, Abbeyland, has failed in its attempt to avoid paying tax on a property sale by creating a 'loss' of £1.6m, following a First-tier Tribunal ruling that this was solely for the purpose of a tax avoidance scheme. Abbeyland used a scheme in 2004 which involved buying and surrendering investment bonds issued by a life assurance company.

The First-tier Tribunal heard that Abbeyland expected a large capital gain to accrue on the sale of one of its properties in 2004. Court documents revealed that "Abbeyland was advised by its accountants, that planning using a capital redemption policy would allow Abbeyland to realise a significant capital loss that could be set against gains arising in the same accounting period or carried forward to set against future gains."

The First-tier Tribunal ruled that the acquisition and subsequent disposal of the bonds were solely for the purposes of a tax avoidance scheme, all the steps of which were pre-ordained, with no commercial motive or effect (other than the necessary incurring of commissions and fees).

The Exchequer Secretary to the Treasury, David Gauke, said: "Many tax payers comply with the law and regulations governing their tax affairs, but there are some promoters of technically complex and contrived tax avoidance schemes that believe they are safe from legal challenge by HMRC. Following changes brought in by the Government, HMRC is better prepared to tackle tax avoidance schemes."

INCOME WITHDRAWAL RATE FOR JULY 2013

The appropriate gilt yield, used to determine the 'relevant annuity rate' from HMRC's tables for an adult member commencing income withdrawals (or reaching an income withdrawal review date), in July 2013 is 2.50%.