Technical CONNECTION

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HMRC HAS PUBLISHED RESEARCH INTO LIFETIME GIFTING

While we were awaiting what proved to be the first stage of the Office for Tax Simplification (OTS) report on inheritance tax (IHT) simplification last year, there were rumours that the lifetime gifting rules would be 'simplified'.

Out would go the sundry collection of exemptions, many of which had not been updated for decades, and in their place would be one £10,000 annual exemption for all lifetime gifts. As a simplification measure, the proposal had much in its favour.

However, for a small, wealthy and informed minority the disappearance of the normal expenditure gift exemption would have been a serious loss. That exemption has no numerical limits - frozen or otherwise - and allows anyone with a high surplus income to make gifts that could comfortably reach five figures. The main downside is the reporting which falls to the executors on death (have a look at form IHT403).

In the event, the initial OTS report focused on administration issues and deferred analysis of technical matters for a second report due in 'Spring 2019'. With that report now imminent, it seems more than a coincidence that HMRC should have issued a 93-page report, 'Lifetime Gifting: Reliefs, Exemptions, and Behaviours'.

It is based on a survey of 2,090 individuals from the general population and 947 people who had

made lifetime gifts (other than to spouses, civil partners or their minor children) in the previous two years. The relatively small sample size means the detailed data needs to be treated with some care. Once analysis focuses on those who could be affected by IHT (about 4% of estates in 2015/16 according to the paper), the numbers are too small to be a basis for policy. With that important caveat in mind, the report's main conclusions were:

- 12% of the population said that they (or they and their spouse / civil partner) had made a single lifetime gift of £1,000 or more in the previous two years, with 7% saying that they had given multiple gifts of at least £250 totalling £3,000 or more. As these two groups largely overlapped, the overall proportion making lifetime gifts was 13%.

- 27% reported gifting £1,000 or more (in today's value) across their lifetime.

- Unsurprisingly, those most likely to be affected by IHT – older people who had substantial wealth or who intended to leave a large inheritance – were much more likely to make gifts, to be knowledgeable about IHT, and to say that it affected their gifting behaviour.

- The overall knowledge of IHT rules and exemptions among those who made gifts was relatively low (25% with a "working knowledge") and bore little relation to the number and value of gifts given. Only 37% recognised that it was true that "A married couple or civil partners can leave up to £900,000 (in 2018/19) to their children without paying IHT". And among those who did have some knowledge of the IHT rules, the proportion who reported being influenced by those rules when making lifetime gifts was relatively small (8% or less, depending upon the question asked).

- Much of the gifting was relatively small, driven by exemption levels. Few of the gifts were specifically to pass on assets: they were more likely to be for living expenses, education or care needs, to buy a property or as a 'present'. Gifts were often between the generations, predominantly parents to children (throughout their lives) but in the other direction as well (eg to fund care).

  Even amongst the wealthiest, whose gifting was more likely to be to help purchase a property, for education or to pass on assets rather than to assist with needs such as paying for living expenses or care, only a minority reported that gifting rules influenced their decisions.

It is worth producing the final paragraph of the conclusions chapter in full, as it could be a straw in the wind:

"The general picture was therefore one of gifting being conducted to support family members as their lives moved through different phases, with IHT and gifting rules being inconsequential for most. Further analysis of the data would be valuable to provide a more nuanced picture, and in particular to focus in on the group for whom IHT was most relevant and who were gifting relatively large amounts. There will be a limit to what can be gleaned, however: a methodological problem is presented by the fact that those passing on significant wealth via gifts are a very small proportion of the general population (less than one per cent of the general population)."

COMMENT

The HMRC survey provides useful ammunition for that £10,000 single exemption proposal. It also highlights the ignorance of the general population and their need for advice.

HOW TO IDENTIFY PARTNERSHIP PROPERTY

It is well known that when all the partners in a conventional partnership are key to the business, and they are also effecting life cover to fund share purchase having entered into an option agreement for sale/purchase, any key person cover can be simply added to the cover needed for share purchase and the policies written under business trusts for the benefit of the other partners. Any funds needed in the business to satisfy the key person need can, in the event of the death of one of them, be introduced into the firm by way of loans. This is probably the most tax-efficient arrangement, but it depends on all the partners being key and participating.

The situation gets more complicated when only one or some of the partners are key, so the business trusts route will not be appropriate, or the key person is an employee of the firm and not a partner. In such a situation it would normally be more appropriate for the policy to be held as an asset of the partnership as this is where the funds will be needed, and it does not complicate the tax position.

If the firm is in Scotland this does not present a problem as a Scottish partnership has its own separate legal personality and can make contracts (such as life policies) in its own name. In England and Wales, on the other hand, a conventional partnership is not a legal person and so cannot effect a policy in its own name which means that any policy will have to be taken out by one partner or two partners jointly on the life of the key person. So how do you ensure that the policy belongs to the firm?

At this point it is convenient to refresh our knowledge of the general legal principles which apply to partnership property. The current law on partnerships is contained in the Partnership Act 1890 and section 20 provides as follows:

All property and rights and interests in property originally brought into the partnership stock or acquired, whether by purchase or otherwise, on account of the firm, or for the purposes and in the course of the partnership business, are called in this Act partnership property, and must be held and applied by the partners exclusively for the purposes of the partnership and in accordance with the partnership agreement.

And section 21 provides that:

Unless the contrary intention appears, property bought with money belonging to the firm is deemed to have been bought on account of the firm.

While the above is clear as far as it goes, if there is no sufficient evidence (in writing) that an asset which was acquired by one of the partners is in fact to be held as a partnership asset (i.e. so that each partner has a beneficial interest in the form of an undivided share in the asset) a dispute may well arise.

And the fact that the money comes out from the partnership account may also not be conclusive. Just because the premiums under a policy are paid from the partnership account will not necessarily mean that the asset is a partnership asset. For example, if partners take out policies under business

trusts for each other, it is likely the premiums will be paid from the firm's business account and apportioned (subject to any equalisation) between the partners. Irrespective of whether a policy is a partnership asset or not, the premiums will not be tax deductible unless the life insured is only an employee and the tests in the Anderson rules are satisfied.

Clearly, it will help if the asset in question is included in the balance sheet of the firm but even that may not be conclusive evidence. In the case of *Ham v Bell* [2016] EWHC 1791 land owned by the partnership had been listed in the partnership's accounts for five years before it was removed following a change in accountants. The fact that the land had been noted as a partnership asset was not conclusive evidence that the land was partnership property (and in this case it was found that the land did not belong to the partnership). It was emphasised that there must also be conduct to the effect that the partners intended certain land to be partnership property. The accounts may provide support for this intention but cannot be the only evidence. Although this case related to land, the principles are the same for other property.

The potential problems were recognised by the Law Commissions in their 2003 Report on Partnership Law and the proposed Partnerships Bill which was going to grant English partnerships a separate legal personality. The Bill also included a specific section defining partnership property in England and Wales as property to which the partnership is beneficially entitled whether or not the property is held in the partnership's name and providing that property held in the name of one of the partners which has been acquired on behalf of the partnership is to be regarded as held by the partner or partners in trust for the partnership. Such provisions would introduce the much-needed clarity.

The 2003 Report and the draft Bill were a joint project of the English and Scottish Law Commissions and followed a lengthy consultation in 2000 – 2001. Unfortunately, in 2006 the part of the project relating to general partnerships was shelved by the Government. (The two recommendations relating to Limited Partnerships were implemented in 2009). The 2013 Report on the implementation of the Law Commission's proposals, by the then Lord Chancellor, Chris Grayling, confirmed that "the Government plans to address the remaining recommendations as and when resources and priorities allow". Which means not any time soon, so we continue to be stuck with the XIX'th century legislation.

COMMENT

The only way to ensure certainty of the legal status of any asset is to ensure that there is clear written evidence of the intention of the partners – at least until such time when the Law Commissions' proposals, which would put the issue beyond doubt, are implemented. Of course, it does not need to be a formal trust deed, but a declaration of trust would be the easiest way to record that the policy is in fact partnership property. Ensuring the asset (the policy) is included on the balance sheet will help.

Of course, in some cases, especially in small, family firms, it may be preferable to hold the policy outside of the firm and for the surviving partners, who will benefit from the policy, to introduce the funds into the business by way of loans (obviously also clearly documented as such).

THE IMPACT OF CHARGEABLE EVENT GAINS ON THE PERSONAL ALLOWANCE

It is well known that when calculating income tax on a chargeable event gain arising on a life policy (typically a single premium bond), top-slicing relief is available. This can be useful in cases where the whole chargeable event gain can take the policyholder into higher bands of income tax yet the

top-sliced gain will keep the policyholder within the basic rate tax band. The common short-cut route to determine the reduced tax due to the relief is to add the top-sliced gain to the policyholder's other taxable income, calculate the tax on that top-sliced gain and then multiply by the top-slicing factor to determine the tax on the whole gain. The underlying legislation provides a more complex basis of calculation (see below).

When calculating the tax liability on the top-sliced gain it has, for a long time, been accepted that the full chargeable event gain is still included in the calculations to determine whether the policyholder is entitled to a full income tax personal allowance. As is well known, the personal allowance is reduced by £1 for each £2 by which a person's adjusted net income exceeds £100,000. So, in 2019/20 when the personal allowance is £12,500, entitlement to a personal allowance will be totally lost when adjusted net income is £125,000 or more.

So, in the past, if a policyholder encashed a single premium bond that he had owned for 10 years which gave rise to a chargeable event gain of £100,000, this full chargeable event gain would be taken into account in determining entitlement to the personal allowance, even though the top-sliced gain was only £10,000.

This approach has been found to be wrong in the recent First-tier Tax Tribunal case of Marina Silver v The Commissioners for HMRC (2019) UKFTT 0263 (TC). Here the Tribunal Judge, Barbara Mosedale, found that, both on the basis of the legislation in sections 530, 535 and 536 ITTOIA 2005 and Parliament's presumed intention, only the top-sliced gain should be included as part of the client's adjusted net income to determine whether the personal allowance is available when calculating top-slicing relief. The top-sliced gain is known as the 'annual equivalent'.

The law

Top-slicing relief (which is given by section 26(1)(a) ITA 2007) works as follows:

(a) Calculate the income tax liability on the chargeable event gain based on the policyholder's adjusted net income taking account of the whole chargeable event gain under section 535(3) ITTOIA 2005. A deduction is then made for deemed basic rate tax paid on the tax on the chargeable event gain under a UK policy (section 530(1) ITTOIA 2005).

(b) Calculate the income tax liability on the top-sliced chargeable event gain based on the policyholder's adjusted net income taking account of the top-sliced chargeable event gain instead of the full (unreduced) chargeable event gain (section 536 ITTOIA 2005). A deduction is made for deemed basic rate tax paid on the top-sliced gain (the annual equivalent) under a UK policy (section 536(1) ITTOIA 2005).

This gives the tax on the annual equivalent. This is then multiplied by the number of years the policy has been in force to determine the total liability under section 536.

The top-slicing relief is the tax calculated in (a) less the tax calculated in (b).

The facts of the Silver case

- Mrs Silver invested £55,000 into a life insurance bond in October 1993.
- Withdrawals of £46,616 were made from the bond over 21 years.
- Mrs Silver surrendered the bond in May 2015 for £119,105.

- The chargeable event certificate showed a gain of £110,721. Mrs Silver accepted that this was correct.

- In tax year 2015/16 (when the bond was encashed), Mrs Silver had other income of £31,101 on which a tax liability of £4,059 arose.

- The case reports that in 2015/16, the income tax personal allowance was £11,000 (whereas it was in fact £10,600 with the basic rate tax band of £31,785 giving a higher rate threshold of £42,385).

The question was whether in calculating the tax on the top-sliced gain in section 536, did she qualify for the full personal allowance or was her personal allowance reduced because the full chargeable event gain was included for these purposes?

HMRC took the view that Mrs Silver lost all of her personal allowance in 2015/16 and so top-slicing relief did not help her.

Mrs Silver argued that this was a hypothetical calculation and as her hypothetical income was £36,373, section 35(2) ITA 2007 was not applicable as the hypothetical income did not exceed £100,000. Therefore, in this hypothetical scenario, Mrs Silver was entitled to a personal allowance.

Mr Silver represented his wife and the Tribunal preferred Mr Silver's interpretation of the legislation. Section 536 clearly directed a hypothetical tax calculation to be carried out on certain assumptions. It would be wrong to carry out the calculation without using those assumptions consistently. Consistently applying the assumption that Mrs Silver's income was only £36,373 meant that she was (in this hypothetical scenario) entitled to a personal allowance in this calculation.

Moreover, Parliament's intent with top-slicing relief was to allow a person who has taken income over a number of years to have relief when provisions taxed them on the entire income in a single year, as here. The relief was intended to make the tax liability approximate to what it would have been had the income been taxed in the year it was actually received. So when carrying out the hypothetical tax calculation it made every kind of sense that the taxpayer should be treated as entitled to the reliefs that that hypothetical income would have entitled her to.

HMRC's interpretation, on the other hand, is clearly inconsistent with Parliament's presumed intent. HMRC's interpretation would result in someone who was a basic rate taxpayer in the year of realisation and who would not have had any higher rate tax to pay on the withdrawals from the bond had it been taxable year by year, nevertheless having to pay higher rate tax on the entire gain. Top-slicing relief would be denied to those it was intended to help.

So applying the legislation, both literally and in accordance with Parliament's presumed intent, results in the steps set out in section 23 ITA 2007 being applied in full to the hypothetical situation postulated by section 536(1). And that means that, at Step 2 of the section 536 tax calculation, Mrs Silver, hypothetically, was entitled to a personal allowance.

The result of that is that her liability to tax on the annual equivalent was nil. This is because deducting her hypothetical personal allowance of £11,000 (actually £10,600) resulted in her total hypothetical income at the end of Stage 3 being £26,373.43. That is well below the basic rate limit of £32,000 (actually £31,785) for tax year 2015/16. Therefore, the annual equivalent of £5,272.43

would have been taxable only at the basic rate; and as Mrs Silver was given credit for the basic rate, her relieved (ie hypothetical) liability would be £0.

COMMENT

The decision in this case is clearly contrary to HMRC's previous views on how the legislation should work.

We do not know if they will appeal the decision. They may well be inclined to request a change of law in order to provide more certainty.

Those clients encashing bonds, who may be affected by a loss or reduction of personal allowance, should clearly bear this Tribunal decision in mind. It will, we believe, still be appropriate, where possible, to arrange encashments so that adjusted net income (taking account of full chargeable event gains) does not exceed £100,000 or, if acceptable making unconditional absolute assignments to an adult taxpayer (normally a spouse) with a lower income before encashment.

NEW FUEL RATES FOR COMPANY CARS

HMRC has announced the new fuel rates for company cars applicable to all journeys from 1 June 2019 until further notice.

The rates per mile are based on fuel prices and adjusted miles per gallon figures.

For one month from the date of the change, employers may use either the previous or the latest rates. They may make or require supplementary payments, but are under no obligation to do either. Hybrid cars are treated as either petrol or diesel cars for this purpose.

Rates from 1 June 2019:

Engine size	**Petrol**	**LPG**	**Engine size**	**Diesel**
1,400 cc or less	12p	8p	1,600 or less	10p
1,401cc to 2,000cc	15p	9p	1,601cc to 2,000cc	12p
Over 2,000cc	22p	14p	Over 2,000cc	14p

Advisory Electricity Rate

As advised in our bulletin dated 22 August, the Advisory Electricity Rate for fully electric cars is 4p per mile.

Electricity is not a fuel for car fuel benefit purposes.

HMRC GUIDANCE – THE DEEMED DOMICILE RULES AND IHT – UPDATE FROM THE CIOT

Changes to inheritance tax for non-UK domiciled individuals came into force on 6 April 2017.

To assist professional advisers with a number of areas of uncertainty in the tax legislation around the extension of inheritance tax to UK residential property interests held indirectly through an offshore structure by a non-UK domicile, a number of professional bodies have come together to produce a set of helpful Questions and Answers (Qs and As). The Chartered Institute of Taxation (CIOT) has now published an update to include the latest comments received by HMRC in relation to these Qs and As.

Given how complex this area of taxation is, individuals should seek professional advice from a specialist prior to taking any action. However, we thought these updated Qs and As may be useful as an initial reference point.

A reminder of the key 2017 changes:

- An individual is UK domiciled if they've been resident in the UK for 15 of the 20 years before the relevant year - reduced from 17 of the 20 years (for IHT purposes only) ending with the year in which the relevant time falls;

- A new concept of 'formerly domiciled resident' has been introduced which applies to those cases where an individual is born in the UK with a UK domicile of origin, has acquired another non-UK domicile of choice, and is resident in the UK and was resident in the UK in at least one of the two previous tax years.

  Foreign property and property they settled on trust when they weren't domiciled in the UK will be within the scope of UK inheritance tax while the individual is UK resident, as long as they were UK resident in at least one of the two years prior to the year in which any inheritance tax charge arises.

- UK residential property owned indirectly by non-UK domiciled individuals (or by the trustees of trusts that they have created) together with related loan finance is now within the scope of UK inheritance tax. So, all UK residential property is now subject to UK inheritance tax – even if held indirectly through an offshore structure by a non-UK domicile.

  Previously, it was possible for non-UK domiciled individuals and trustees to avoid a charge to inheritance tax by holding UK residential property interests through an offshore vehicle, such as a company incorporated outside the UK. The company shares, being a foreign asset, were classified as excluded property and so were not within the scope of UK inheritance tax.

Individuals with a non-UK domicile of origin are not affected by the above-mentioned 'formerly domiciled resident' rules. They are, however, subject to the above deemed domicile rules and UK residential property rules.

INCOME WITHDRAWAL RATE FOR JUNE 2019

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 June 2019 is 1.5%.