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7 Staple Inn, London, WC1V 7QH.
Tel: 020 7405 1600 Fax: 020 7405 1601
E-mail: enquiries@technicalconnection.co.uk
www.techlink.co.uk

INHERITANCE TAX – FAMILY INVESTMENT COMPANIES

Since the extension of the trust inheritance tax (IHT) relevant property regime to effectively all trusts that offer a degree of beneficiary flexibility, family investment companies (FICs) have become popular.

By setting up a FIC a wealthy donor can transfer substantial wealth to the next generation without suffering an immediate IHT charge. They can also achieve this with flexibility.

This is achieved by a donor transferring a substantial cash sum into a FIC in which some or all of the shares are held in the names of children. This will represent a potentially exempt transfer (PET) for IHT purposes because it is an outright transfer between individuals. Control is exercised by vesting different rights in capital/dividends or voting in the donee at different times. This will enable the donor to ensure that voting control on the shares transferred does not vest in the donee until sometime in the future. In the meantime, the donor can retain shares that carry voting rights.

The taxation of the FIC itself is very effective. Frequently, the FIC will use the cash to invest in investments or perhaps even buy-to-let properties.

Either way, income paid to the FIC will only suffer corporation tax at 19% compared to the 45%/38.1% it could suffer in the hands of trustees of a discretionary trust. Furthermore, the FIC can claim a corporation tax deduction for interest paid (eg. on a loan for business purposes), and although the FIC doesn't benefit from a CGT annual exemption and no longer benefits from CGT indexation allowance, capital gains will only be taxed at the corporation tax rate, currently 19%.

The possible downside with FICs is the fact that, because of the extra compliance involved, costs and charges are much higher and it is generally thought that they would be unsuitable in cases where the cash being transferred is less than £2 million. Also, share rights need to be carefully drafted to deal with situations, such as the divorce of the donee, in order to avoid the donee's ex-spouse/ex-civil partner becoming entitled to the shares.

In light of the considerable tax benefits that FICs offer the very wealthy, especially in the area of IHT, it is perhaps not surprising that HMRC has announced (following a freedom of information request) that in April 2019 it set up a special unit with the specific remit to "look at FICs and do a qualitative and quantitative review into any tax risks associated with them with a focus on inheritance tax implications. The team's work is exploratory at this stage..."

COMMENT

Given the tax benefits that FICs offer the very wealthy it is probably not surprising that HMRC is reviewing their use, possibly as a means of circumventing the restrictions that apply to trusts. As HMRC has formed a special unit to look at FICs, it clearly has concerns over their use.

And bearing in mind that the IHT regime is probably under review by the Government following the publication of the Office of Tax Simplification's report in Autumn 2019, it would not be surprising if specific anti-avoidance rules were introduced to combat the use of FICs to avoid IHT. That is not to say that existing FICs do not work. Provided they are properly administered there should be no reason why they do not provide the current tax advantages they offer.

FCA CONCERNS ABOUT THE FINANCIAL SERVICES MARKETS

The FCA has published its annual assessment of the risks and potential harm to consumers across financial services markets. The report covers all the markets regulated by the FCA, grouped into seven sectors:

- retail banking and payments;
- retail lending;
- general insurance and protection;
- pensions, savings and retirement income;
- retail investments;
- investment management; and
- wholesale financial markets.

The kind of issues highlighted by the FCA include:

- Its Financial Lives data which shows that 7.4 million UK adults have debt beyond their means and find their financial commitment a burden;

- Pricing practices in insurance that still penalise loyal customers. According to the FCA, the 'loyalty penalty' in home and motor insurance cost 6 million longstanding consumers an extra £1.2 billion in 2018;

- High-risk retail investment products that are often marketed directly to retail consumers with poor communication of the risks involved, and implications that the investments are regulated when this is not the case; and

- New products that don't have protection in place for consumers, for example e-money services advertised as 'current accounts', which aren't covered by the Financial Services Compensation Scheme.

THE REMOVAL OF EIS QUALIFYING STATUS – HOW DOES THIS IMPACT INVESTORS?

HMRC has recently written to several companies removing their Enterprise Investment Scheme (EIS) qualifying status after trading for a period of four years. This has resulted from HMRC challenging a technical point several years after the investments have been made and, critically, after advance assurances were given. Note that HMRC has not removed EIS status from these companies because of a performance issue.

To be a qualifying EIS company the company must satisfy certain conditions, and most of those conditions must apply throughout a period that starts with the issue of the shares and ends immediately before the termination date (normally the third anniversary of the date on which the shares were issued). It is possible to obtain advance assurances from HMRC before issuing shares to investors. Advance assurance is not a requirement of the EIS company, and does not guarantee that a share issue will qualify, but it is normally useful, both in attracting investors and in ironing out any problems before it's too late.

However, HMRC's view is that it cannot be known for certain whether a company qualifies in relation to a given share issue until the termination date related to that issue. This applies in respect of both income tax relief and deferral relief.

It would appear that HMRC is saying that these companies failed to meet the required qualifying conditions during this period.

The affected companies appear to be isolated cases. However, we thought it would be useful to take a look at what happens in cases such as this, and the impact on investors, specifically:

- the process of paying back the income tax relief;

- how deferred capital gains are treated;

- if the EIS investment generates a capital gain, is this subject to capital gains tax (CGT)?

- if the EIS company is still trading, do the shares still qualify for inheritance tax (IHT) business relief?

To recap, EIS investors may be eligible for:

- 30% income tax relief (assuming they have enough income tax liability in the current or preceding tax year);

- the deferral of payment of CGT (at rates of up to 28%);

- 100% IHT business relief on holding the shares for 2 years.

The legislation provides for the complete withdrawal of any relief attributable to shares if, by reason of some event, any of the conditions for the relief ceases to be satisfied.

In particular, relief is not due, and must therefore be wholly withdrawn, where it transpires that the company is not a qualifying company. HMRC also states as follows in its VCM at 15010. 'However, relief given to an individual cannot be withdrawn by reason of any event occurring after the death of that individual. Similarly, any relief left following the disposal of the shares by the individual cannot be withdrawn by reason of any subsequent event unless, exceptionally, it occurs at a time when the individual is connected with the company, within the meaning of VCM 11050, for example, as an employee'.

We understand that the companies concerned will be appealing against HMRC's decision to withdraw relief. However, even if the companies fail to appeal, or if a Tribunal decides in favour of HMRC, a shareholder may subsequently make their own appeal against a withdrawal assessment.

Note that HMRC does not need to await determination of any appeal by a company before making an assessment to withdraw relief from individual investors. If such assessments are made HMRC must ensure that all individuals assessed are aware of the fact and that the company's appeal is heard first (or at the same time).

The process of paying back the income tax relief

Where HMRC becomes aware that relief should be withdrawn, it must notify the tax offices dealing with the individuals concerned, including the following details:

- the reason for the withdrawal;
- the amount to be withdrawn, if not the whole of the relief;
- the year in which the shares to which the relief relates were issued; and
- the reckonable date for interest.

Withdrawal of relief is usually by Special Assessment issued by HMRC to the investor.
Where an assessment to withdraw relief is required because of an event occurring after the date of the claim to relief, it may usually be made by HMRC within six years after the end of the year of assessment in which that event occurred.

Where EIS relief is to be withdrawn because of an event occurring after the date of the claim, there are special rules for determining the relevant date from which interest starts to run. This date will always precede the date when the assessment withdrawing relief is made. Normally the relevant date from which interest starts to run will be 31 January next following the tax year in respect of which the assessment is made.

How deferred capital gains are treated

The deferred gain, or part of the deferred gain, will be brought back into the charge to CGT when there is a "chargeable event". A chargeable event can arise when the shares cease, or are treated as having ceased, to be eligible shares, which can happen if HMRC discovers that the shares cease to be eligible because the company does not satisfy all of the conditions. In this case, HMRC should notify the EIS company that the shares cease to be eligible on a certain date.

If the EIS investment generates a capital gain, is this subject to CGT?

If the investor does not obtain any income tax relief on a subscription for shares in an EIS company (e.g. because it has been withdrawn) then there is no CGT exemption for those shares (which there would be with an EIS after 3 years).

Note that if the investor never actually claimed EIS income tax relief in the first place (some do forget), then no 3 year CGT relief will have been available anyway.

If the EIS company is still trading, do the shares still qualify for IHT business relief?

Business relief can provide relief from IHT, at a rate of 100%, on the transfer of relevant business assets, including unquoted shares, provided the shares are held by the investor for at least two years. This means that even if the EIS company loses its qualifying status, provided it remains an unquoted trading company, that is carried on for profit (and is not one of 'wholly or mainly dealing …… in securities, stocks or shares, land or buildings or making or holding investments') the shares can still qualify for IHT business relief.

NEW FUEL RATES FOR COMPANY CARS

HMRC has announced the new fuel rates for company cars applicable to all journeys from 1 March 2020 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 March 2020:

Engine size	Petrol	LPG	Engine size	Diesel
1,400 cc or less	12p	8p	1,600 or less	9p
1,401cc to 2,000cc	14p	10p	1,601cc to 2,000cc	11p
Over 2,000cc	20p	14p	Over 2,000cc	13p

THE IMPORTANCE OF RECORDING THE NATURE OF CAPITAL PAYMENTS MADE DURING LIFETIME

A recent Scottish Court decision illustrates the problems arising after a death when there is no evidence of payments made by the deceased before they died. Briefly, the facts of the case in *S Mailer v M Mailer and AM Quinn [2019] SCPER101* were as follows.

Mrs Mary Mailer (known as Molly) died in 2017 leaving three children. Under her Will (made in 2015) her son, Michael, was to receive a legacy of £15,000 and her daughter, Suzanne, the residue of the estate, which consisted mainly of cash in the bank. The family home was held in a trust created by Molly's husband on his earlier death (Molly had a liferent (ie. life interest) and the house passed to the three children on her death and so was not part of Molly's estate). The third child was not mentioned in the Will but, as the law of succession in Scotland applied, he was entitled to his legal rights.

In transpired that in 2016 Molly made a payment of £9,950 into an account of Michael's partner, which was to help with their house building project at a time they were in financial difficulties. There was no written evidence of what this payment was. There were three possibilities: a loan, an advance against Michael's legacy or an outright gift. The nature of the payment would, of course, make a difference to the amounts inherited by the respective children. If it was a loan it would have to be repaid to the estate by Michael/his partner; if it was an advance, it would be deducted from Michaels' legacy; if it was a gift, it would reduce the residue available to Suzanne.

Molly did apparently say to Suzanne that she would "sort" out the position of the payment, but she never did. As Michael and Suzanne could not agree on the outcome, the case ended up in Court.

The Court decided that, in the absence of any document indicating a requirement that the payment should be repaid or otherwise taken into account when distributing the estate, the £9,950 payment should be treated as an outright gift.

The Court also discussed what is known as the 'presumption against donation' which is a legal rule that, ordinarily, someone would expect repayment when giving someone money. However, this presumption can be rebutted when a payment is held to be made "from natural affection and duty". In this case the Sheriff decided that Molly was making a payment to help her son out "in an hour of need" and "out of a sense of natural obligation". Although this was a Scottish case, similar principles apply in England.

It may seem surprising that the dispute ended up in Court, given the relatively small sum involved, but it is actually symptomatic of the growing number of estate disputes ending up in the Courts. It is of course nothing new: as the saying goes; "When it comes to divide an estate, the politest men quarrel" (Ralph Waldo Emerson).

In his decision, the Sheriff actually commented that it was "a matter of regret that such a bitter dispute has developed between [the siblings] following [their mother's] death over a relatively small proportion of the monies to which they became entitled after Molly's death".

COMMENT

Of course, each case will be decided on its own facts but it is never ideal to end up in Court. When discussing estate/Will planning with clients, they should be reminded that it is important to keep proper records of any payments. A simple letter confirming the nature of any payment, i.e. a loan, an advance, or an outright gift, will usually suffice. If any payment is to be deducted from an entitlement under a Will then a codicil or a new Will should be made.

WITNESSING A DEED VIA SKYPE IS NOT ACCEPTABLE

A transfer deed that was signed in Hong Kong, and witnessed by one signatory's solicitor in London via Skype, may not have been validly executed under English law. The subject of “electronic deeds” is of particular interest to those involved with trusts and associated deeds, such as deeds of appointment of trustees and deeds of assignment.

When it comes to trust-related documents which are required to be made by way of a deed, there are statutory requirements that must be met for a deed to be legally valid. These requirements are set down in the Law of Property (Miscellaneous Provisions) Act 1989. One of these requirements is in section 1(3) of the Act, as follows:

‘An instrument is validly executed as a deed by an individual if, and only if —

(a) it is signed —

(i) by him in the presence of a witness who attests the signature; or

(ii) at his direction and in his presence and the presence of two witnesses who each attest the signature; and

(b) it is delivered as a deed.’

The Law Commission, in their report on the subject, stated that their “view is that the requirement under the current law is that a deed which must be signed ‘in the presence of a witness’ requires the physical presence of that witness”. This therefore would eliminate, for the time being at least, witnessing by video-links, something that had been considered during the consultation.

This view has now been followed by the First-tier Tribunal (FTT) in *Man Ching Yuen* v *Landy Chet Kin Wong* (FTT (Property Chamber) 2020 ref. 2016/1089).

The case involved an allegation that a transfer of property had been forged; alternatively, that the transfer was not validly executed. The signing of the transfer deed took place in Hong Kong, in a meeting between the applicant and respondent. The respondent’s solicitor, based in the UK, joined the meeting by Skype. She had taken steps to verify the applicant’s identity before he signed the transfer deed and viewed the signing remotely. When the transfer deed had been posted to her in the UK, the solicitor then added her own signature and details to attest the signature.

Although the applicant’s claim failed on other grounds, the Tribunal judge held that there was an arguable case that the transfer deed had not been validly executed. In the absence of judicial authority, the Tribunal judge decided that, given the views expressed by the Law Commission, the Courts might conclude that a deed was not validly executed where the witness viewed the signature remotely.

Interestingly, the later addition of the witness’s signature was not a reason for holding that the deed was invalidly executed. In another recent case the Court had held that the witness could witness the signature (whilst physically present) and then add their own signature later.

COMMENT

The FTT's opinion on this point is not binding so it would be really useful if we got a definitive ruling by the Court (in the absence of any firm guidelines in the form of legislation). Meanwhile, of course, it is advisable that when executing a deed the witnesses are physically present.

AUTOMATIC ENROLMENT EVALUATION REPORT 2019

DWP have published the final annual evaluation report on the implementation of automatic enrolment to workplace pension schemes. Since the start of automatic enrolment in 2012 more than 10.2 million workers have been automatically enrolled and over 1.6 million employers have met their duties.

New analysis within the report includes:

- In 2019 62% of private sector employers had some form of workplace pension provision, up from 47% in 2017. These companies employed 94% of all private sector employees.
- In 2019 39% of private sector employers stated that the introduction of automatic enrolment has resulted in an increase in the total contributions their organisation had to make.
- Throughout the implementation period the opt-out rate has remained consistently low with around 9% for those automatically enrolled in 2018/19 opting out. This was the same level as in 2016/17.

HMRC HAS RECENTLY ISSUED A PRESS RELEASE ON THE HELP TO SAVE SCHEME

HMRC has recently issued a press release which states that around 163,000 people have signed up to the Government's Help to Save saving scheme – depositing more than £53 million.

As a reminder the Help to Save scheme enables regular savers to deposit up to £50 a month over four years (so a maximum of £2,400) and receive up to £1,200 in tax-free bonuses. At the end of two years, savers will get a 50% bonus based on the highest balance achieved.

Customers can carry on saving for another two years and get another 50% bonus on their additional savings. It therefore helps those on lower incomes to build up a 'rainy day' fund and encourage a long-term savings habit.

INCOME WITHDRAWAL RATE FOR MARCH 2020

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 March 2020 is 0.75%.