Technical CONNECTION

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CHANGES TO ENTREPRENEURS' RELIEF – AN UPDATE

In the 2020 Budget (anyone remember that?) the Chancellor announced key changes to entrepreneurs' relief which are likely to have a significant impact on the number of individuals/shareholders benefiting from the relief.

The main change was that the lifetime limit reduced from £10m to £1m for qualifying disposals made on or after 11 March 2020.

There are no transitional provisions. The new rules also provide that the lifetime limit must take into account the value of entrepreneurs' relief claimed in respect of qualifying gains in the past.

And entrepreneurs' relief is renamed 'business asset disposal relief' from the tax year 2020/21.

In addition, a couple of anti-avoidance measures were introduced:

- Normally, a disposal is treated as having been made on the date the contract is made, and not, if later, the date on which the asset is actually conveyed or transferred (section 28 of TCGA 1992) - unless the contract was conditional in which case the disposal date might be the date the condition was satisfied. So, you might imagine that where the contract was made before 11 March 2020, and was unconditional, the disposal would benefit from the £10m lifetime cap.

However, under the first anti-avoidance measure announced on Budget day, contracts made (i.e. disposals made) before 11 March that had not been completed before 11 March could be caught by the lower £1m lifetime cap unless:

1. The parties to the contract demonstrate that they did not enter into the contract with a purpose of obtaining a tax advantage by reason of the timing rule in section 28 of TCGA 1992; and

2. Where the parties to the contract are connected, that the contract was entered into for wholly commercial reasons.

So, broadly, this is an anti-forestalling provision intended to counter arrangements where a disposal was engineered to take place before the Budget announcement, for example by a contract being put in place before a genuine buyer had been found, to lock-in the higher £10m pre-Budget lifetime cap.

However, if a genuine contract made (disposal made) for commercial reasons had merely been accelerated in order to be in place before Budget day the higher £10m pre-Budget lifetime cap should still be available.

- Also, normally, where shares have been exchanged for those in another company, the new shares effectively stand in the shoes of the original holding, and there won't be a disposal until the replacement shares are sold, at perhaps a much later date. As this might be at a time when they might not be entitled to the relief, a shareholder can elect (under section 169Q TCGA 1992) to instead crystallise the gain on their old shares and pay the tax on the gain (with the benefit of entrepreneurs' relief) rather than defer the gain.

  However, under the second anti-avoidance measure announced on Budget day, where shares have been exchanged for those in another company on or after 6 April 2019 but before 11 March 2020, and:

  - both companies are owned or controlled by substantially the same persons, or

  - persons who held shares in company A hold a greater percentage of shares in company B than they did in company A and, on 11 March 2020, the personal company test, the trading company test and the employee/officer test are met in respect of company B,

  then if an election is made under section 169Q TCGA 1992 on or after 11 March 2020, the share disposal (i.e. the disposal of the original shares) is to be treated as taking place at the time of the election for entrepreneurs' relief purposes, i.e. on or after 11 March 2020, meaning that the new lifetime cap of £1m will apply.

A section 169Q TCGA 1992 election might be required because the shareholder holds less than 5% of the new shares. So, in certain circumstances, this anti-forestalling provision will mean that the new lower lifetime cap of £1m will apply as a result of the election, rather than the £10m cap in force at the time of the actual exchange or reorganisation, if the election had not actually been made before Budget day.

The Chartered Institute of Taxation (CIOT)'s concerns include:

1. There are no transitional provisions. This is striking as capital gains tax changes are inevitably retroactive, affecting gains that have already accrued but have not yet been realised, and investment decisions that have already been made. The draft legislation draws the line; those one side of it have the full benefit of the old £10m limit and those on the other side have the new £1m limit.

2. The line drawn is complicated by the two sets of anti-forestalling provisions. It is striking to have strong anti-forestalling measures for what is in essence a change of policy rather than anti-avoidance legislation.

3. One difficulty for taxpayers who have legitimately taken advantage of reliefs is uncertainty about when the rules for a particular relief might change. There will be people affected by this change who have reinvested money in the expectation of a relief that they will no longer receive. Such 'retroactive' effects are inevitable in a capital gains tax system. A transparent process of evaluation, conducted as an open consultation or public call for evidence, would have allowed taxpayers some indication of the direction of travel as a background to their investment decisions and reasonable expectations in the lead up to the Budget.

4. In relation to the second anti-avoidance measure covered above, the CIOT points out that some taxpayers who have never known or thought about this change in law or tried to forestall it, and who completed commercial reorganisations prior to Budget day will be caught by this as normally these elections are only filed after the event, with the tax return. Consequently, at Budget day, taxpayers would not reasonably have expected to have yet made an election because they would have waited until making the 2019/20 return - due by 31 January 2021.

   The CIOT has identified two categories that may be adversely affected by the exchange of shares anti-forestalling measure in ways that appear contrary to wider Government policy. This anti-forestalling provision potentially also affects management buyouts by key employees and family successions. In both cases where, immediately after the share exchange, the shareholder's minority holding no longer qualifies for entrepreneurs' relief (or they have fully disposed of their shares) it is very likely they would have made an election, irrespective of the change in lifetime limit, albeit the election would not have been made until the completion of the 2019/20 tax return in accordance with usual practice.

   The CIOT suggest this could be largely addressed by a relatively straightforward amendment to the Finance Bill incorporating a simple test of whether the seller qualified for entrepreneurs' relief immediately post exchange. If the seller did not so qualify, the election could still be made post 11 March with the £10m lifetime limit preserved.

   In cases where a minority shareholding immediately post exchange still qualifies for entrepreneurs' relief, but might not do so later for reasons outside their control, perhaps because of ill-health forcing retirement, the shareholding being diluted by further share issues to employees or the company ceasing to trade (possibly because of the current crisis), it is likely that an election in the extended period would similarly have been made regardless of the change in the lifetime limit. In this case, the CIOT says that it recognises that the motive for making the election is more challenging to test and formulate than in respect of a non-qualifying holding. It suggests that a 'rough and ready' statutory test might be based on conditions that the new holding is below 10% and that it had been reduced by at least a half compared to the old stake in the target company.

HUSBAND PENALISED DUE TO WIFE CLAIMING CHILD BENEFIT

In the recent case of Ramsdale v HMRC, 2020 UKFTT 155 TC, Mr Ramsdale chose to appeal against penalties imposed by HMRC for failure to notify his liability to the High Income Child Benefit Charge (HICBC) due to not knowing that his wife was claiming the benefit.

An individual may be liable to the HICBC if they, or their spouse, civil partner or partner (who is not married but who is living with them), has an adjusted net income of £50,000 or more and one of them receives child benefit. If both have an income of £50,000 or more, the charge will apply solely to the partner with the highest income. (The amount of the charge is a 1% deduction of the amount of child benefit for every £100 of income which exceeds £50,000, so that where adjusted net income exceeds £60,000, the HICBC will be equal to the full amount of the child benefit, i.e. 10,000/100 = 100%.) In the case in question, Mr Ramsdale had an adjusted net income in each tax year in question which exceeded £50,000. His income also exceeded that of his wife.

From a tax perspective, where a liability to the HICBC arises in any tax year, the individual who is subject to the charge must notify HMRC of a liability to income tax.

Mr Ramsdale was taxed under PAYE and had not ever needed to complete and submit a self-assessment tax return. However, after introduction of the HICBC, HMRC had written to various taxpayers who were taxed under PAYE and who may be affected by the charge. Mr Ramsdale said he never received the initial letter. A subsequent letter was sent, entitled 'Final Reminder: important information about the High Income Child Benefit Charge'. On receipt of this letter Mr Ramsdale replied as follows:

'As far as I am aware we have not received child benefits for a long time due to my higher rate earnings. Therefore I don't think this request applies to me.'

HMRC subsequently wrote back to Mr Ramsdale to say that, according to the records held, either Mr Ramsdale or someone in his household was claiming child benefit.

HMRC made assessments amounting to £5,120 and penalties of £333.20 which related to tax years 2012/13 to 2016/17 inclusive.

The evidence (taken from the case notes) put forward by Mr Ramsdale can be summarised as follows:

'(1) Neither he nor his wife were aware that the HICBC had been introduced in 2012–13 and did not become aware of it until Mr Ramsdale received HMRC's letter dated 22 October 2018.

(2) He was not aware that his wife was receiving child benefit. The child benefit was not paid into a joint account which he uses to pay bills, but to an account in the name of his wife.

(3) He is taxed under PAYE and has never been asked to complete a self-assessment return and did not realise he needed to do so.

(4) As soon as he became aware of the liability he provided details of his income and child benefit received.

(5) In all the circumstances the penalties are unfair.'

The Court dismissed Mr Ramsdale's appeal on the basis that whilst Mr Ramsdale had an honest and genuine belief from 2013 until October 2018 that neither he nor his wife were in receipt of child benefit, there was a lot of publicly held information and media coverage regarding introduction of the HICBC.

In addition, given that Mr Ramsdale was aware that his wife had claimed child benefit at some stage not only did he appear not to have discussed the matter with his wife but it was also unclear as to why he believed she had stopped claiming the benefit.

COMMENT

This case highlights the importance of not only understanding one's tax obligations but also that even in cases where the taxpayer genuinely believes they have a reasonable excuse being able to prove this in practice can be extremely difficult.

In the current Covid-19 crisis, it is likely that some taxpayers who have opted out of claiming child benefit in the past because their adjusted net income was too high, should now restart child benefit because their adjusted net income for 2020/21 will be under £60,000. Anyone on the Coronavirus Job Retention Scheme, with its £2,500 maximum monthly payment, should certainly check the situation. The sooner action is taken, the better, as the maximum period for backdating child benefit is three months. The deadline for a full 12 months' payment in the current tax year is, therefore, 5 July 2020.

TRUSTS OF OFFSHORE BONDS DECLARED VALID DESPITE DEFECTIVE DOCUMENTATION

In the case of *Bowack* v *Saxton*, [2020] EWHC 1049 (Ch) the High Court has declared that two trusts relating to two AXA bonds were valid despite the lack of date, the lack of the details of the trust property and the lack of a witness signature on the "trust forms".

Whilst we are grappling with the problems of valid document execution during the period of self isolation and social distancing, the publication of the decision in this case could not be more timely, and useful. Even though E&W High Court judgments do not create legal precedents, the reasoned judgment from Judge Matthews is most useful, especially for those providing and those using "standard" trust forms.

The facts in *Bowack* v *Saxton*

In 2014, Mr Michael Bowack (a retired accountant) and his wife Ann Bowack (a retired magistrate) each invested £325,000 into an AXA Isle of Man Ltd ("Axa") bond to be issued subject to a discretionary trust. This was following advice from a financial planner from Hargreaves Lansdown Ltd ("HL").

They both executed "standard" declarations of trust (which were in the form of deeds, provided by AXA) appointing themselves and their daughter Claire Saxton as trustees, with the latter as principal beneficiary. However, when the documents were forwarded to AXA, it noted that Claire's signature on the trust forms had not been witnessed by an independent person and there was no ID verification for Claire and so the trusts were "not processed", which was advised to HL.

It also turned out that the declarations of trust as executed left the effective date blank and failed to identify the trust property as the two bonds. The reason why these were left blank on the forms was that the settlors were instructed on the trust forms to leave those blank, as they (i.e. the date and the bond policy numbers) were to be completed by AXA. However, this did not happen and so the dates and the bond numbers remained missing.

Even though the trusts were "not processed", AXA cashed the two cheques it had received in payment for the bonds, and duly issued the bonds, which were subject to Manx law and only assignable with the company's agreement.

A long correspondence ensued to try to set matters right. Ultimately, in the face of AXA's resistance, the Bowacks resorted to the courts, formally suing their own daughter to establish the validity of their estate plan. The claimants sought a declaration that each of their two trusts was properly and completely constituted (and, if so, who the trustees are), or, alternatively, rectification of the relevant documents so as to make them conform with the true intentions of the two settlors. Both HMRC and AXA (now called Utmost Wealth Solutions Ltd) were notified of the claim and neither opposed it.

The judgment

We have a 16 pages judgement going over some very technical points, which doubtless will be essential reading especially for those involved in drafting and administration of trusts. But the key important conclusions are as follows:

A failure to express the date on which the trust is constituted is not fatal to its validity. It is sufficient that it was constituted. Here, it is clear that the applicants intended that their bonds be subjected to a trust as soon as issued. Accordingly, if the trust was properly constituted on or shortly after issue, that is the date on which it takes effect.

As for the failure to identify the particular trust property in the trust deeds by inserting the bond numbers in them, again, it is not necessary for the validity of the trusts that the numbers be inserted, as long as the relevant property can be identified from the circumstances. Here it was clear which bonds were to be held in trusts.

The next issue was the effectiveness of the appointment of the additional trustee and assignment of the policy. The trust deed was to operate as an assignment of the bond by the applicant once issued. Here the Judge concluded that the assignment of the bonds once issued to the trustees was effective and valid under English law. He concluded that, given that the assignors' (settlors') signatures were witnessed, this was sufficient to justify the validity of the deed itself.

It should be added that on the last point the Judge recognised an alternative argument, by reference to *T Choithram International SA v Pagarani* [2001] 1WLR 1, (contrary to what he had held), that the assignment to the other trustees could be ineffective, but even if there were no effective assignment to the other trustees, the trust would still be completely constituted with that applicant as trustee, although if it was still desired to appoint the other persons trustees, that would have to be carried out later.

Given the above findings, there was no need to consider the claim for rectification. The law would treat the Bonds as having been issued under trust from outset.

COMMENT

It is of course well known that, in England and Wales, there are no special legal formalities to satisfy in order to make a trust (other than for trusts of land or equitable interests) so the findings of Judge Matthews on this are not surprising. However, despite the Judge's findings it is best to do *things properly.*

UPDATE ON THE TRUST REGISTRATION SERVICE (TRS) AND 5MLD

With little progress on the expansion of the TRS to comply with 5MLD, the European Commission has launched enforcement action.

Whilst most of the EU's Fifth Money Laundering Directive (5MLD) provisions were transposed into UK law in January 2020 (the *Money Laundering and Terrorist Financing (Amendment) Regulations 2019)*, the provisions relating to trust registration (in effect expanding the Register to cover more trusts than currently) have been delayed until later in 2020, following a more detailed technical consultation on implementation.

Although the Consultation ended on 21 February, there has been no news on any final proposals to complete this project. According to the HMRC website, it is analysing the feedback.

However, last month, HMRC announced that the first element of the "new TRS" had been released, allowing details of trusts already registered to be updated. HMRC says that the new TRS will provide more functionality and a better user experience than the current service.

The new updating function is available to agents but involves additional authorisation steps, including a trustee setting up a digital tax account for the trust and confirming the agent authority digitally.

There have been lengthy discussions between the professional bodies and HMRC about the difficulties that 'digital handshakes' by clients in HMRC digital services create but, as yet, there is no resolution. However, for the trust registration service the digital handshake to authorise the agent is required.

The current system to register a new trust remains unchanged, but the new service to register trusts is available for a private trial.

COMMENT

Although the UK has agreed to implement 5MLD regardless of Brexit, it is difficult to forecast anything in the current circumstances. Clearly, however, work on the expanded TRS continues.

NEW FUEL RATES FOR COMPANY CARS

HMRC has announced the new fuel rates for company cars applicable to all journeys from 1 June 2020 until further notice. The rates per mile are based on fuel prices and adjusted miles per gallon figures.

Rates from 1 June 2020:

Engine size	**Petrol**	**LPG**	**Engine size**	**Diesel**
1,400 cc or less	10p	6p	1,600 or less	8p
1,401cc to 2,000cc	12p	8p	1,601cc to 2,000cc	9p
Over 2,000cc	17p	11p	Over 2,000cc	12p

UPDATED SDLT GUIDANCE – WILL YOU STILL BE ELIGIBLE FOR A REFUND?

HMRC has recently updated its guidance on the higher rates of Stamp Duty Land Tax (SDLT). Broadly, an individual must pay the higher SDLT rates when they buy a residential property (or a part of one) for £40,000 or more, if all the following apply:

- it will not be the only residential property worth £40,000 or more that they own (or part own) anywhere in the world;
- they have not sold or given away their previous main home;
- no one else has a lease on the property which has more than 21 years left to run.

In cases where an individual owns another property but is in fact replacing their main residence, ordinarily the higher rates of SDLT would not apply. However, if they have not yet sold their previous main residence, they would be required to pay the higher rates of SDLT but would have the ability to apply for a refund provided they sell their previous main residence within three years.

HMRC's guidance has been updated to state that if individuals purchased their new (replacement) home on or after 1 January 2017 and have been unable to sell their previous home within three years they may still be able to apply for a refund. In order to be able to get the refund, the delay in selling must be because of reasons outside of the individual's control.

The reasons can include, but are not limited to, the impact of coronavirus (COVID-19) preventing the sale and an action taken by a public authority preventing the sale.

Once the reason has ended, individuals must sell their previous home in order to be able to apply for the refund.

COMMENT

The higher rates of SDLT can impose a significant upfront payment for those who have not sold their previous home, with some needing to borrow further funds to pay the extra charge. This updated guidance will no doubt be welcomed by those who have been unable to sell their previous home due to qualifying reasons which have been outside their control.

INCOME WITHDRAWAL RATE FOR JUNE 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 June 2020 is 0.5%.