PARAPLANNERS ASSEMBLY

CHANGES TO TAX -RECENT ANNOUNCEMENTS
FAMILY INVESTMENT COMPANIES

SPEAKER - STEVE SAYER TEP, APFS

NOVEMBER 2021

A WEALTH *of* DIFFERENCE

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AGENDA

SESSION IS FOR APPROX 45 MINS PLUS QUESTIONS

AIM OF SESSION IS TO:

1. DISCUSS THE EFFECT OF RECENT TAX ANNOUNCEMENTS ON INDIVIDUALS AND TRUSTS

2. CONSIDER THE INPACT OF RECENT TAX ANNOUNCEMENTS ON FAMILY INVESTMENT COMPANIES

RECENT TAXATION ANNOUNCEMENTS

INDIVIDUALS

TRUSTS

FAMILY INVESTMENT COMPANIES

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1

RECENT TAXATION ANNOUNCEMENTS

THE BUDGET – MARCH 2021

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2021 BUDGET HEADLINES

LITTLE CHANGE OR WAS IT?

Personal Income Tax at rates up to 45% - unchanged

Capital Gains Tax (CGT) rates – unchanged

Capital Gains Tax Annual Exemption - unchanged

Inheritance Tax Nil Rate Bands (NRB & RNRB) – unchanged

Inheritance Tax rates - unchanged

VAT rate - unchanged

Individual Savings Accounts (ISAs) – unchanged

Tax Compliance – counter tax avoidance

Corporation Tax (CT)– new rate of 25% from April 2023

STEALTH TAXES

CAPITAL GAINS TAX
No change to AE
No change to rates

PERSONAL INCOME TAXES
SRBS – no change
PSA – no change

INHERITANCE TAX
No change to NRB or RNRB
No change to rates

PERSONAL INCOME TAX ALLOWANCE & BANDS
PA – increased to £12,570
BR - increased to £37,700
HR - `unchanged at £150,000

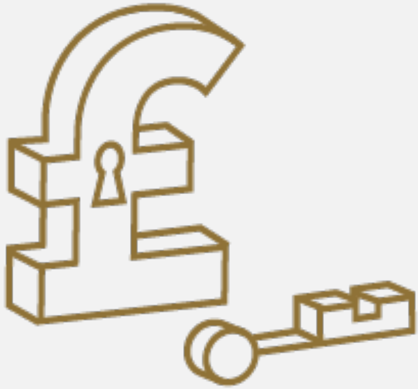
BUT
No further increase until after 2025/26

BUT
No further increase until 2025/26

EXTRA INHERITANCE TAX

THE NET EFFECTS OF FREEZING THE NRB AND RNRB

YEAR	NRB/ RNRB	ACTUAL VALUE IN 2025/26	VALUE IN 2025/26 IF INCREASED BY 2.5% P.A.	EXTRA TAX PAYABLE @ 40%
2021/22	£325,000	£325,000	£359,000	£13,600
2021/22	£175,000	£175,000	£193,000	£ 7,200
EXTRA TAX PAYABLE				**£20,800**
HUSBAND AND WIFE	**X 2**			**£41,600**



CORPORATION TAX

The current rate of corporation tax of 19% will increase from April 2023 to 25% for those companies making profits over £250,000. Companies classed as making 'small' profits (£50,000 or less) will continue to benefit from the current corporation tax rate and there will be relief for businesses with profits under £250,000 so that they pay less than the main rate.

Corporation tax rates

	2021/22	2022/23	2023/24
Main rate	19%	19%	25%
Small profits rate	N/A	N/A	19%
Lower Threshold	N/A	N/A	£50,000
Upper Threshold	N/A	N/A	£250,000

Small profits In line with the increase in the main rate, the Diverted Profits Tax rate will rise to 31% from April 2023 so that it remains an effective deterrent against diverting profits out of the UK.

2

RECENT ANNOUNCEMENTS

THE HEALTH AND SOCIAL CARE LEVY AND CHANGES TO DIVIDEND TAXATION

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WHAT WAS ANNOUNCED?

7TH SEPTEMBER 2021

- The Prime Minister announced plans to substantially increase funding for health and social care over the next three years, to be funded by a new tax: the Health and Social Care Levy

- The Levy is to be based on National Insurance contributions (NICs)

  - A temporary 1.25 percentage point increase to both the main and additional rates of Class 1, Class 1A, Class 1B and Class 4 National Insurance contributions from April 2022 revenue raised will go directly to support the NHS and equivalent bodies across the UK.

- From April 2023 the Levy will be legislatively separate, and will also apply to individuals working above State Pension age, who are not liable to pay NICs on their earnings at present

- From April 2022 the Government also plans to increase the rates of income tax that apply to income from dividends, to help to fund these plans.

BENEFITS

The funds from the levy will be ringfenced to fund investment in health and social care:

- A cap on personal care costs of £86,000 from October 2023
- Increasing the upper capital limit (the threshold above which somebody is not eligible for local authority support towards their social care costs) from £23,250 to £100,000 from October 2023
- Increasing the lower capital limit from £14,250 to £20,000
- If somebody has capital between £20,000 and £100,000 the local authority may fund some of their care, but they may have to contribute up to 20% of their chargeable assets per year (in addition to their income)
- Increasing the amount of income that care recipients can retain after contributing towards their care costs (the Minimum Income Guarantee and the Personal Expenses Allowance) in line with inflation from April 2022.

A consultation on the charging reforms will be published in October 2021.

(2a)

INDIVIDUALS

WHAT WAS ANNOUNCED?

- Health and Social Tax (HSCL)
  - *Initially an increase of 1.25% N.I. payable by both ER and EE and self employed*
  - *Also payable by workers over the state pension age*
  - *Increase replaced by a separate Health and Social Care Levy from April 2023.*

- HSCL
  - *From April 2023, a separate tax identified separately on pay slips and self assessment returns*
  - *Difficult to reduce?*

- Increase tax rates for dividends
- Disposable Income ↓

DIVIDENDS

NOT subject to NIC

Increased income tax rates.

All dividend income tax rates for individuals will increase by 1.25%.

2021/22	Nil-Rate (2,000)	BRT	HRT	ART
Current Rates	0%	7.5%	32.5%	38.1%
New Rates	0%	8.75%	33.75%	39.35%
Change	0%	16.6%	3.8%	3.28%

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AN INCREASE TO THE TAX ON DIVIDENDS

- Only UK resident individuals pay UK tax on their dividend income so the increase would not impact those investing but not living in the UK
- The impact will therefore be felt by those:
  - › living in the UK and
  - › possibly those considering moving to the UK
  - › becoming deemed domicile.

FACTORS AFFECTING WRAPPER CHOICE

- Yield
- Interest or capital growth producing assets required?
- Capital gains tax position of investor – exemption being used etc.
- Investment term considered
- Amount invested and possible additions
- Withdrawing funds and how these will be taxed
- Fund taxation considerations
- Investor tax rates (current/future)
- Exemptions available (current/future)
- Access, Administration and Reporting
- Inheritance Tax considerations.

The correct wrapper and the right investment manager to maximise net returns

A CAP ON PERSONAL CARE COSTS OF £86,000

- Appeal to the elderly
- Protects succession for the next generation
- Increases financial security
  - *Use excess capital*
  - *Spend*
  - *Gift*
  - *Trust based planning.*

(2b)

TRUSTS

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DIVIDENDS RECEIVED BY DISCRETIONARY TRUSTS

The Government's policy document was silent on the rates that apply to trustees, but clarification in the Budget 27th Oct…

- increase in line with individuals' rates
- The 32.5% rate that applies to loans to participators of close companies) will be increased

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1015736/Build_Back_Better-_Our_Plan_for_Health_and_Social_Care.pdf

POSSIBLE TAXATION OF INCOME

RATE APPLICABLE TO TRUSTS (RAT)

- No dividend allowance!
- Standard rate band divided by number of trusts by the same settlor – minimum £200
- No need to complete tax return if all income falls within standard rate band and tax is deducted at source
- Trust pays additional rate of tax when income exceeds £1,000!

Excess above standard rate band

Income subject to RAT

45% tax on income

39.35% on dividends

Standard rate band up to £1,000
Basic rate (20%) liability on income
8.75% on dividends

THE TAX POOL FOR DISCRETIONARY TRUSTS

- Trustees are responsible for recording the tax paid or deducted at source with regards trust income they have received
- The record of tax paid is known as the "tax pool"
- The tax pool is made up of tax paid by the trustees
- This means that whenever the trustees pay income to a beneficiary the tax pool is reduced by the 45% tax credit which passes out to a beneficiary. This is recorded on form R185
- If there are insufficient tax credits in the tax pool to cover the 45% tax credit passing to the beneficiary, the trustees must pay the difference
- This is achieved via the trustees self assessment.

THE TAX POOL FOR DISCRETIONARY TRUSTS

RATE APPLICABLE TO TRUSTS (RAT)2022/23

- Income paid to beneficiaries should be paid with 45% tax certified i.e. deemed net of 45% tax
- However, there must be enough money in the tax pool to cover the 45% tax credit!
- This can cause particular issues where dividends are received and/or where tax paid by trustees is within standard rate:

Gross dividend	Net income distributed	45% tax credit	Tax paid by trust	Tax shortfall
£1,000	£550	£450	£87.5	*£362.5
£2,000	£1,100	£900	£481	*£419.0

* taken from trust capital

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A&M & DISCRETIONARY TRUSTS

£2,000 OF DIVIDEND INCOME RECEIVED 2022/23

£2,000
In offshore bond

£1,519 after tax

More income being accumulated each year as a result of investment via an offshore bond – only subject to tax when CE occurs!

These figures are for illustration purposes only

ON ENCASHMENT – WHO TO CHARGE

POSITION	PERSONS LIABLE
Non-charitable disc' trust the UK resident settlor created and they are alive in the tax year the gain occurs. **S465 ITTOIA**.	UK resident Settlor.
Rights held on non-charitable disc' trusts – absent settlor conditions are met (for example they are no longer UK resident or have died).	UK resident Trustees
Bare trust	<18 Beneficiary providing the trust wasn't settled by their parent >18 Beneficiary.
Following assignment	**Beneficiary**

ITTOIA – Income tax (Trading and Other Income) Act 2005.

IS THERE A WAY OF AVOIDING THE TRUSTEE RATE?

- Assignment of policy or segments to beneficiary prior to surrender
- Use CRB so that chargeable events only occur when the trustees want them to
- Result – can get beneficiaries prevailing rates of tax.

TRUSTEES AND OFFSHORE BONDS

DISCRETIONARY TRUST

FEATURE/ASPECT	BENEFIT
Capital redemption bond	Timing of tax management – no surprises
• **Dividends** and **income** taxable at **7.5% (8.75%)** and **20%** within standard rate • **38.1% (39.35%)** and **45% above standard rate** • During settlor's lifetime gains fall on settlor due to s465 ITTOIA	• Tax deferred within bond – improved accumulation? • Gains will only fall on trustee following UK settlor death – assignment is often then used to mitigate 45% position.
Assignment	Tax management - Over 18 - utilise beneficiary's income tax allowances. Below 18 – assign to bare trust for non-parental settlements?
Non income producing	Eases administrative burden in terms of self assessment and tax management i.e. tax pool Improve income position for beneficiaries where dividends distributed.
Open architecture	Helps to meet TA 2000 standard investment criteria

- How often do the trustees use their CGT exemption? (£6,150 at best or £1,230 at worst!)
- How much of portfolio will be turned over every year?
- What is the cost of rebalancing?

(3)

FAMILY INVESTMENT COMPANIES

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FAMILY INVESTMENT COMPANIES (FICs)

CREATION AND STRUCTURE

What are they?

- Usually UK incorporated companies (limited or unlimited)
- Carry on an investment business
- May engage the service of investment managers.

A simple structure

- Client and spouse can be directors
- Family members hold shares in the company
- Company may be funded by way of loan
- Different classes of shares can be issued.

Why?

- HNWIs seeking tax deferral
- Alternative to trusts.

EXISTING OR NEW COMPANY

Existing Company

Balance Sheet	£
Assets	10,000,000
Share Capital	1,000
P&L/Reserves	9,999,000

Large Initial CGT Liability

New Company

Balance Sheet	£
Assets	10,000,000
Share Capital+Loan	10,000,000

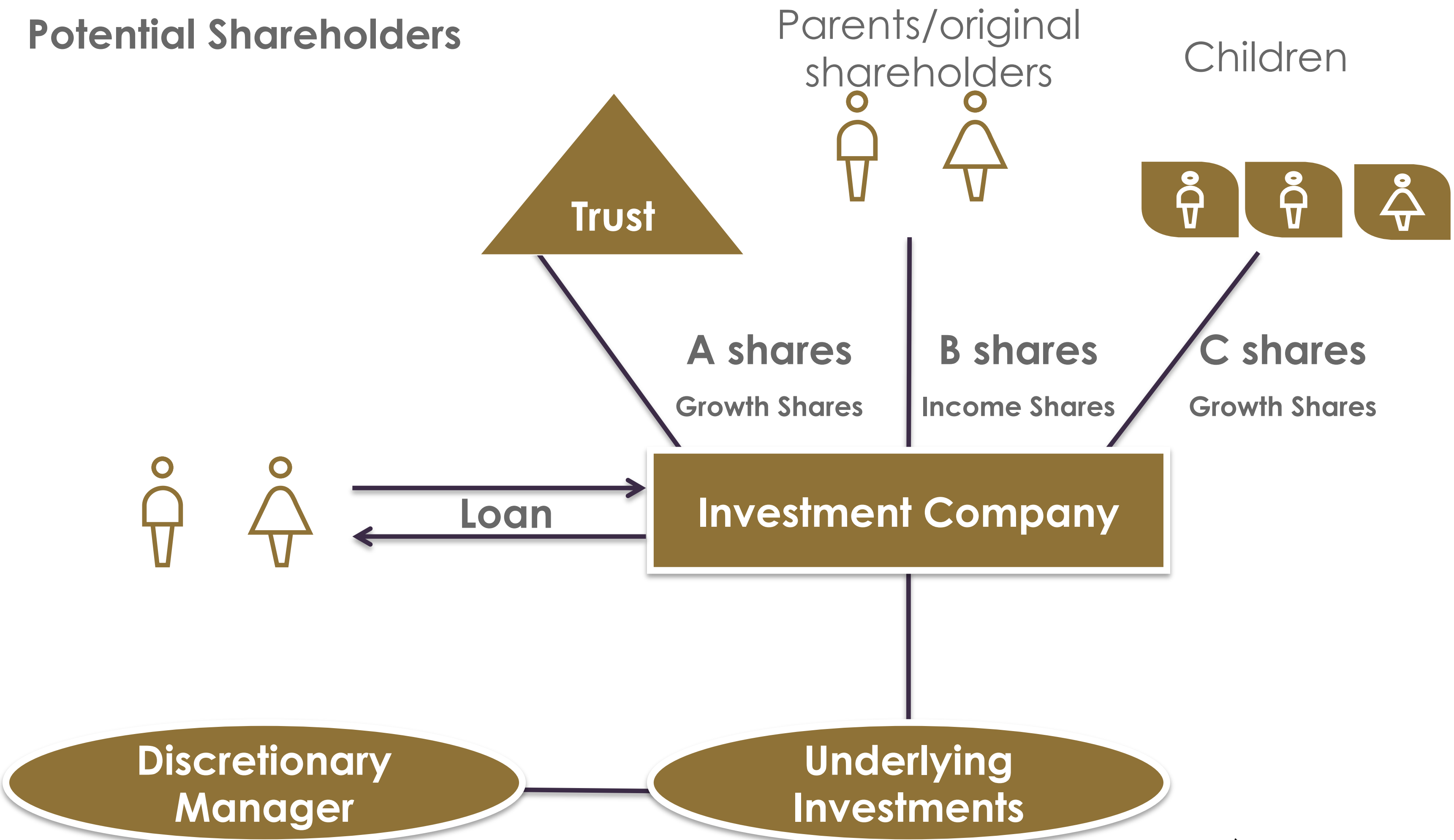
Small Initial CGT Liability

NEW FICs FUNDING

CREATION AND STRUCTURE

- Parent(s) provide funds either via an "interest free" loan or by subscribing for shares
- The parent(s) can subscribe for "voting shares" which gives control of the company at shareholder and board level
- They can also subscribe for non-voting shares which can then be given to their children
- Different share classes often used to enable flexibility
- Articles of association and the shareholders agreement can be drafted to protect the shares from sale outside of the family i.e. divorce.

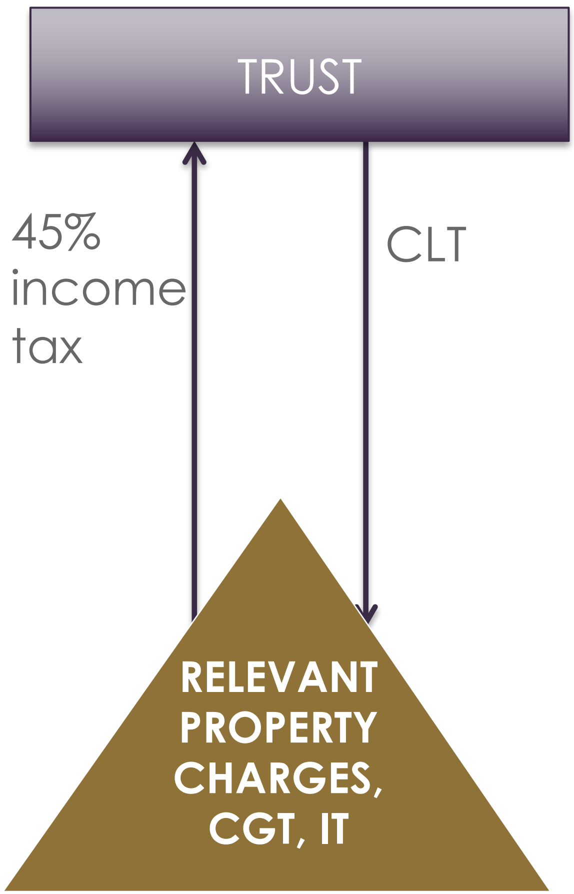
FICs


Potential Shareholders
Parents/original shareholders
Children
Trust
A shares
Growth Shares
B shares
Income Shares
C shares
Growth Shares
Loan
Investment Company
Discretionary Manager
Underlying Investments

SELLING FIC SHARES

- Provisions are generally included in the Articles of Association to ensure that the shares cannot be registered other than with the consent of the founder/parent/designated shareholder
- This ensures that without consent and agreement, legal title cannot pass and a prudent purchaser would (hopefully) review the Articles before purchasing any shares and realise they would not get full title
- The main benefit provided to family shareholders therefore is the potential to receive dividends and;
- Distribution of capital on company wind up.

TAX ADVANTAGES?



FIC

Different share structures to deal with family's need for:

Voting control

Capital appreciation

PETs for IHT based on share class gifted

Corporation Tax 19% - 25% from April 2023

Dividends received exempt from tax BUT…

Interest payments/rental income

There may be withholding tax on overseas dividends and interest

FAMILY INVESTMENT COMPANIES (FICs)

INVESTMENTS – CAPITAL GROWTH

- Capital growth in debt instruments potentially subject to the loan relationship rules as investment companies taxed on current cost/fair value basis. i.e. no tax deferral
- This means that capital growth could be taxed year on year even with no disposal
- Invest in equity based portfolios to avoid impact of loan relationship rules on debt instruments? i.e. corporate bonds, gilts, interest paying collective funds etc.

FAMILY INVESTMENT COMPANIES (FICs)

THE CHANGES ANNOUNCED IN THE BUDGET

- The small profits rate will not apply to close investment-holding companies, the definition of which will follow the definition found in s34 CTA 2010. FICs will in future be less attractive as an increase in the corporation tax rates from 1 April 2023 will reduce the potential net returns and make active investment management of underlying assets much more difficult
- A FIC will suffer a potential 25% Corporation tax liability on any of its realised gains and the shareholders will be liable to a Capital Gains Tax liability (currently a maximum of 20% but expected to increase) on the liquidation proceeds
- Existing FIC investors have some time to reconsider their investment structures and may decide to capitalise on the current 19% Corporation Tax rate and the unchanged CGT rates to invest in other solutions.

CAPITAL AND INCOME EXTRACTION

TAXATION OF INDIVIDUAL

Loan from Company to Shareholder/Participant

S455 CTA charge

- If loan still outstanding 9 months after company year end then
    - Corporation tax payable on loan of 32.5% (33.75%?)
    - Tax can be reclaimed by the company 9 months after the end of the accounting period in which the loan is repaid by the shareholder.

No recycling

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CAPITAL AND INCOME EXTRACTION

TAXATION OF INDIVIDUAL

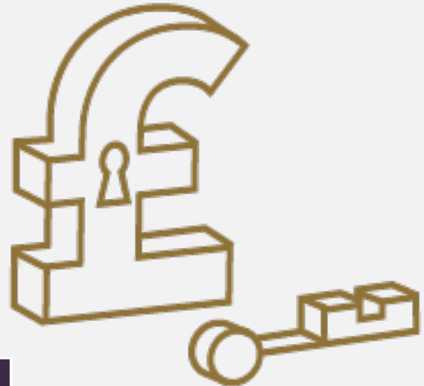
- Profits typically extracted as loan repayments or dividends
- Loan repayments are tax free in hands of individual (surrender of underlying investment may trigger corporation tax within FIC)
- Dividends subject to tax…

TAXABLE INCOME BAND	TAX RATE	FUTURE RATES 2022/23
0 - £2,000 (dividends only)	0%	0%
£2,001 - £37,700	7.5%	8.75%
£37,701 - £150,000	32.5%	33.75%
£150,001 +	38.1%	39.35%

CORPORATION TAX

EXTRA TAX DUE ON THE REALISATION OF £100,000 GAINS FOLLOWED BY A DIVIDEND PAYMENT

YEAR	CORP TAX RATE	CT	NET GAIN
2022	19%	£19,000	£81,000
2023	25%	£25,000	£75,000
% CHANGE	6%		



YEAR	TAX IF NET GAIN PAID AS DIVIDEND*	NET PROCEEDS	EFFECTIVE TAX RATE
2021/22	£30,861.00	£50,139.00	49.8%
2023/24	£29,512.50	£45,487.50	54.125%

* Additional rate taxpayer

FICs WIND UP

- Shareholders charged to CGT on gains following sale or liquidation of the company
- Entrepreneur's relief would not apply as investment company
- Full individual annual exemption potentially available
- CGT rates therefore charged at individual rates i.e. 10% or 20% on whole increase if shares subscribed for at par!
- Liquidation costs and delays.

FICs

SUMMARY

ADVANTAGES	DISADVANTAGES
Corporation tax regime more favourable than income tax regime	Company value and assets potentially in public domain – limited vs. unlimited
Long term control maintained via articles of association/shareholder agreement	Managing of portfolio inside the company could generate corporation tax liabilities on realised gains
Large amounts invested/gifted. Succession planning not limited by nil rate band i.e. PETs	Potential double taxation on distributed profits and wind up
Depending on structure, shares cannot be held by non family members e.g. divorce	Ability to diversify investments reduced? Investment in debt - loan relationship rules i.e. potential tax with no disposal
Possible to employ family members and make pension contributions on their behalf	IHT valuation issues?
	Access for children – only divis until company is liquidated?
	Reporting/accounts
	Complexity and fees?

FICs – POTENTIAL PITFALLS

- Tax inefficient if all income/gains of the Company need to be paid out to the family, as there would potentially be a double layer of tax
- The tax efficiencies are based on current law. Future changes e.g. April 2023 to corporation tax or changes to other taxes (e.g. on a change in Government), to which the Company would be exposed, may create inefficiencies in the future
- If shares are retained by the subscriber, the value of the FIC will be included in their estate for IHT purposes AND, although the value of the FIC shares will be rebased for CGT purposes, disposals of investments by the FIC will be liable to a Corporation tax liability of potentially 25%
- Additional costs arising through formation and ongoing corporate compliance requirements (Companies House and HMRC).

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FAMILY INVESTMENT COMPANIES

SHARE VALUATION

HM Revenue
& Customs

Guidance

HMRC Shares and Assets Valuations (SAV)

Updated 1 February 2017

https://www.gov.uk/government/publications/hmrc-shares-and-assets-valuations-sav/hmrc-shares-and-assets-valuations-sav#unquoted-shares

SUMMARY

FURTHER PROBLEMS?

Disadvantages:

- Growth stocks subject to corporation tax on disposal. A minor change in CT…
- **Double layer of tax on extraction**
- Changes to CGT rates or exemptions
- All shareholders subject to same investment objectives
- Future changes in legislation may affect tax treatment e.g. OTS report

- S13 TCGA Non Doms need to be Remittance Basis Users!
- Loan repayments may be seen as aggressive? A return of capital may not be a continuing feature
- HMRC could, however, invoke the settlements legislation to tax the lender on the income entitlements of other family members, on the grounds that the loan is uncommercial and so confers 'bounty' on them.

AN HMRC TARGET?

"In the research we undertook there was no evidence to suggest that there was a correlation between those who establish a FIC structure and non-compliant behaviours. As with any analysis of a taxpaying population, the same broad range of tax-compliance behaviours were observed, with no evidence to suggest those using FICs were more inclined towards avoidance."

FICs will now be treated as 'business as usual' by HMRC, rather than be subject to the scrutiny of a dedicated unit.

LOAN TRUSTS AS AN ALTERNATIVE

	FIC	DISCRETIONARY LOAN TRUST	BARE LOAN TRUST
CREATION	No transfer	No transfer of value	No transfer of value
GROWTH	Not part of estate on gifted shares	Not part of estate	Not part of estate
OUTSTANDING LOAN	Part of estate*	Part of estate	Part of estate
SUCCESSION	PET to individual CLT to discretionary trust	Waived loan – CLT	Waived loan – PET
TAX IN STRUCTURE	Corporation tax (19 → 25%)	Rate applicable to trusts (45%/38.1%(39.35%) Potential periodic charges	Beneficiary/Parental settlement
TAX IN UNDERLYING WRAPPER	Collectives – no tax on dividends or savings interest 20% corporation tax on non savings income	Offshore bond – grows largely tax free (apart from possible withholding tax)	Offshore bond – grows largely tax free (apart from possible withholding tax)
DISTRIBUTION	Dividends – taxed on individual	Segment surrender or part withdrawal	Segment surrender or part withdrawal
CONTROL FOR FOUNDER/SETTLOR	Directors	Trustee	Trustees until beneficiary reaches 18
WIND UP/FINAL DISTRIBUTION	Corporation tax on gains after and CGT on individual?	Within trust 45%. Tax free assignment – individual savings allowances	Tax free assignment – individual savings allowances

*Assuming initial loan made to FIC

INVESTMENT BONDS AS AN ALTERNATIVE

SUMMARY

	FICs	INVESTMENT BONDS
TAX DEFERRAL	Available but LRR may apply, rent, interest	Available
TAX FREE SWITCHING	Any encashment may give rise to CT	Yes
TAXATION OF DIVIDENDS	No further tax on UK dividends. Foreign dividends and Interest may be subject to CT.	Tax Free save for any withholding tax
TAX DEFERRED WITHDRAWALS	All dividend payments subject to Income tax in the hands of the shareholder	5%
PORTABILITY	Controlled Foreign Company Issues?	May be tax efficient
ASSIGNMENT	Disposal for CGT	No Income tax or CGT if by way of Gift.
EXTRACTION OF PROFITS/GAINS	Repayment of shareholder loans. Dividends Double tax on Gains	Chargeable events regime in the UK Top Slicing Relief available Savings Income

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THANK YOU FOR YOUR TIME

ANY QUESTIONS?

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