MACFARLANES

PRIVATE CLIENT UPDATE

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Welcome to the first issue of our Private Client Update, in which we aim to keep you updated on recent legal developments that may have an impact on you, as well as providing useful guides to help you navigate the many legal frameworks that you may encounter in your day-to-day life.

NEWS REVIEW

In the last Budget of this Parliament, held on 18 March 2015, George Osborne set out a number of measures, which are assessed in detail in our Budget briefing. Two of these measures were unexpected and their impact is discussed below.

Digital tax accounts

As part of the government's overall vision to modernise the tax system, it was announced that tax returns will be replaced by digital tax accounts in a "revolutionary simplification" of the current system. The briefing published on 18 March makes the bold promise that, by the end of the next Parliament, every individual and small business in the UK will have a digital account, accessible through the device of their choice.

The project recognises that the current self-assessment system requires taxpayers to provide information that HMRC already holds when filing their tax returns. It is expected that individuals will be able to view details of their income tax collected through the PAYE system, National Insurance contributions, pension income and interest from banks and building societies in their digital account. Taxpayers will be able to check and confirm that their details are complete and correct and the change will mean that millions of taxpayers with simple affairs will no longer need to complete a return. There is no detail as yet on how the system will operate for those with more complex affairs, but a roadmap setting out the policy and administrative changes needed to create the accounts will be published later in 2015 and the government will consult over summer on the legislative changes needed to amend the current self-assessment system. Taxpayers will still be able to authorise agents to view and manage their digital account.

This is a highly ambitious IT project and inevitably there will be concerns about both the government's ability to deliver tens of millions of accounts by 2020 and the security issues arising from putting such sensitive personal data online.

Consultation of the use of deeds of variation

Deeds of variation are a commonly used tool by which a beneficiary under a will can effectively re-write the will within two years of death and have those changes read back into the will and treated as made by the deceased for inheritance tax and capital gains tax purposes. The Chancellor, having referred to the use of a deed of variation in Ed Milliband's father's estate in his speech, announced proposals to review the use of deeds of variation in the autumn. There was no reference to any particular form of avoidance or mischief that is to be addressed and no suggestion was made in the brief statement that the changes, if any, would be effective as from the Budget day. The review will be undertaken, if it occurs, by the government in office after the General Election and whether any action is ultimately taken must be open to doubt. Nonetheless, any beneficiaries considering varying a will where the estate in question is still being administered should seek urgent advice.

The outcome of the General Election on 7 May did not create the period of uncertainty that had been widely anticipated. We now expect that, freed from the constraints of coalition, the Conservative Government will push ahead with tax and legal changes. We will provide guidance on these in our Autumn Update.

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THE DANGERS OF INTESTACY

Dying without a will means you are "intestate" and the situation is called an "intestacy". Two thirds of the people who die in England and Wales each year are intestate and to avoid complete limbo, the law imposes rules on the division of your assets. These rules are rigid, impersonal and inflexible.

Unless assets are held jointly in such a way that your co-owner inherits automatically, the rules may mean that your nearest and dearest inherit less than you intended, as well as unnecessarily paying more tax. Significant changes have recently been made to the intestacy rules and these apply to all deaths after 1 October 2014.

Who gets what?
This all depends on the family members you leave behind. If you are married or in a civil partnership and you have children, then your immediate family will inherit your assets but not necessarily in the proportions you would like. This note explores how the new intestacy rules work in a variety of situations.

What happens if you are married or are in a civil partnership and have no children or grandchildren?
In this scenario, your surviving husband, wife or civil partner (referred to in this note as your spouse) will inherit all of your assets. They should be able to claim the spouse exemption from inheritance tax and so there will be no inheritance tax to pay.

Two thirds of the people who die in England and Wales each year are intestate

What happens if you are married or in a civil partnership and have children?
Well, in this scenario, your children may end up with significantly more assets than you would like and at an age which you may think is too young. The rules provide that your spouse will take your personal chattels (jewellery, furniture, cars, paintings etc), £250,000 and 50 per cent of what is left. The other 50 per cent goes outright to your children.

For example, if you are married and have children and have assets in your own name worth £5m, then your spouse will inherit your personal chattels and assets worth £2.625m with your children taking £2.375m.

You may be happy with this division of assets but there are other considerations to think about:

- There is no exemption from tax on the assets passing to your children unless the assets themselves qualify for a relief (i.e. business property relief or agricultural property relief). In the above scenario, even if you have a full nil rate tax allowance available to set against the gift to your children, there will still be £820,000 of inheritance tax to pay.
- If the bulk of the value of your estate is in the family home, do you want your spouse and children co-owning it going forward? Would the house have to be sold when the children leave home?
- Under the intestacy rules, children become entitled outright to their inheritance at the age of 18. Would you be happy with your children inheriting a significant sum of money at this age? Would you prefer to have delayed their inheritance until they are a little older and settled in life?

TOP TIPS

- Make a will
- Follow exactly the instructions you are given for signing and dating the will
- Keep it under review at regular intervals, say every five years, so that it does not become out of date or let intestacy in "by the back door"
- Remember to make a new will if you get married or divorced

What happens to my unmarried partner?

The intestacy rules only provide for spouses, civil partners and close, usually blood relatives. Despite the common misconception to the contrary, a partner to whom you are not married (and who is not your "civil partner") is not treated like a spouse or a civil partner, and doesn't benefit under the rules. If you have children, then your children will inherit all of your assets with nothing going to your partner.

It is therefore vital for you to have a will if you want to leave assets to your unmarried partner because without a will they may need to apply to the court for financial provision. This is a complicated and uncertain process, because the court has to weigh up a number of factors, such as your partner's financial needs and your moral obligations to them – the sort of things you would take into account far more simply and cheaply in making a will. It also sets your partner against the rest of your family who would otherwise get your assets. Making a will would avoid much of this unpleasantness and also the inevitable expense.

The intestacy rules only provide for spouses, civil partners and close, usually blood relatives

What happens if you are not married or in a civil partnership and have no children?

If you don't have any direct descendants (children, grandchildren etc), then it's a matter of finding your closest relative in accordance with a set list. Once you've found a living relative then he or she, together with any other relative in the same class, will inherit your assets. This means that the person you may be living with, or a close friend, will not be entitled to anything under the intestacy rules. If you have been supporting them financially they may need to bring a claim against your estate if they are still in need of this support.

Summary

If you make a will then you can leave your assets to the people you want to receive them rather than risk your assets being inherited by a long lost relative (whom you may never have actually met). It also allows you to decide when is an appropriate age for your children to inherit and you can choose the people who are best suited to act as your executors. These are the people who take control of your assets when you die and administer your estate. You can also take into account any inheritance tax charge which may arise on your death and take steps to mitigate this tax charge.

MAKING DONATIONS TO CHARITY MORE TAX EFFICIENT

Charity tax reliefs are an important part of a charity's income. In 2012/13 HMRC paid charities £1bn in Gift Aid alone (not including other reliefs). However, often the best tax relief is not obtained, and the net amount available for charity is reduced as a result. The National Audit Office estimates that up to £2.3bn of Gift Aid goes unclaimed each year.

It can however be straightforward for any UK taxpayer to structure their donations to charity so as to maximise tax reliefs. Below are some of the options to consider.

Give more for less – Gift Aid

Gift Aid is a tax incentive which applies to gifts of cash to charity. Gift Aid will not only uplift the amount of your donation, but it may also secure you a tax refund.

Impact of Gift Aid on a cash donation by a basic rate income tax payer…

The charity can reclaim an amount equal to the basic rate income tax which would otherwise have been payable by the donor in respect of a donation:

- the donor gives £80; and
- the charity re-claims £20 from HMRC.

In aggregate, the charity therefore receives £100 at a cost to the donor of **£80**.

You have up to four years from the end of the tax year during which the donation was made to claim Gift Aid relief

…And for higher or additional rate income tax payers

The donor can also claim a relief amounting to the difference between the basic rate of income tax (20 per cent) and the higher (40 per cent) or the additional rates (45 per cent):

- the donor (an additional rate tax payer) gives £80;
- the charity re-claims £20 from HMRC; and
- the donor's tax bill is reduced by £25.

In aggregate, the charity receives £100, at a cost to the donor of only **£55**, nearly half the amount of the cash gift.

You have up to four years from the end of the tax year during which the donation was made to claim Gift Aid relief.

Get a better result by donating non-cash assets?

The reliefs for donations of non-cash assets are more complex.

Some donations may qualify for no relief at all.

However, gifts of certain types of assets can be made very efficiently, particularly if the asset is standing at a capital gain. Two examples are below.

With care it will often be possible to structure a donation so as to keep the tax costs down, and allow maximum benefit to pass to charity

Qualifying investments (including listed shares, funds and UK property)

Donate a qualifying investment to a charity and you may qualify for income tax relief on the entire value of the donation.

If desired, the charity can then immediately sell the asset for cash.

In addition, no capital gains tax is payable on the donation, even if the asset was standing at an unrealised capital gain when donated.

The double effect of income tax and capital gains tax relief can make this the most efficient form of charitable giving.

Taking the example of a £100 listed shareholding which is standing at a large capital gain:

- If the shares are given directly to charity by an additional rate tax payer (a) no capital gains tax is payable and (b) the donor's taxable income is reduced by £100.

  For an additional rate tax payer their tax bill would be reduced by £45.

- If however the donor had sold the shares, capital gains tax at 28 per cent would have been payable on any gain (even if the sale proceeds were then given to charity under the Gift Aid rules).

The aggregate result is that the charity receives £100 at a cost to the donor of potentially as little as £27 (£45 income tax relief plus up to £28 capital gains tax relief).

The Cultural Gifts Scheme (CGS)
The CGS offers donors tax relief on gifts of pre-eminent objects to the nation.

Qualifying donors can reduce their income or capital gains tax liability by up to 30 per cent of the gift value, which can be spread over a five year period.

So, a gift to the nation of an object worth £100 could result in a tax saving of £30.

However, claiming under the CGS is a complicated process and so far relatively few gifts have been made in this way.

Summary
The differing value of tax reliefs on gifts to charity can vary significantly. The amount of available relief can depend on what is given, and also how it is given.

With care it will often be possible to structure a donation so as to keep the tax costs down, and allow maximum benefit to pass to charity. If every donor considered this issue the potential benefit to the charitable sector would be enormous.

THE FOUR STEPS TO SUCCESSFUL GIFT AID GIVING

- Make donations in cash
- Ensure the charity is registered with HMRC for Gift Aid purposes
- Provide the charity with a completed signed Gift Aid form
- Claim tax relief via your Self-Assessment tax return

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