# Private Client

*Growing and protecting your wealth*

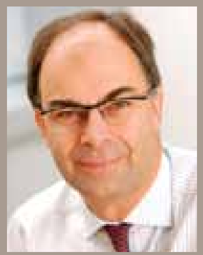
*Autumn 2011*

In this issue:



pwc

# Editorial



Welcome to the autumn edition of *Private Client*.

Those of you with good memories will recall that our summer 2011 edition highlighted the need for increased cyber security and the dangers of complacency when dealing with your personal information. The recent phone-hacking scandal has proved that no-one is immune to intrusion from unscrupulous hackers and serves as a timely reminder that your mobile and online security should never be taken for granted. You can read more about the need for protecting yourself against these threats in the September edition of *Hourglass* magazine, which can be found at www.pwc.co.uk/hourglass.

As a firm, we're in a position to be able to comment on the Government's tax proposals. The recent consultation papers which document the proposed changes to the residency and domicile rules are no exception. We share our views on those proposals in this edition of *Private Client* and outline the changes which are relevant to those of you who have international interests. The Government wants to encourage overseas investment from private individuals, but we do have certain concerns around how these proposed changes will affect that aim – particularly given the availability of other attractive expatriate regimes worldwide. We'll continue to push for a fair and flexible regime for those of you wanting to commit financially to the UK.

The higher income tax rates have pushed some taxpayers towards deferring remuneration, a move which has had a significant impact on HM Revenue & Customs' (HMRC's) tax receipts. So it's no surprise that HMRC has been trying to stop people using vehicles such as employee benefit trusts (EBTs) to defer or avoid income tax and national insurance contributions (NICs). If you've made use of an EBT or employer financed retirement benefit schemes (EFRBS) as part of your financial planning, it's probably prudent to consider the implications of the new rules on your plans.

Managing the impact of inheritance tax (IHT) on your family's wealth is something that may also be high on your agenda. In this edition, we look at how managing your lending can help your IHT position. We also look at wider business structures and highlight how adopting a partnership structure could bring significant benefits to your business. The added flexibility, coupled with the positive aspects on your tax management, mean that partnerships are no longer the preserve of professionals such as lawyers and accountants. Getting your business structure right should help to get the wheels of recovery in motion – we hope that the recent amendments and proposed changes to the tax system will achieve that aim.

As always, we'd love to hear your thoughts on any of the issues raised in this edition – you can email us at private.client@uk.pwc.com.

Clive Mackintosh

Regards,
**Clive Mackintosh**

# Contents

# ***New UK residency rules could be testing*** UK residency law and non-domiciled taxpayers

*If you're internationally mobile, then your tax position across different jurisdictions will be an important concern. The amount of tax you pay is also of great interest to the relevant tax authorities. With this in mind, the UK Government has issued two consultation documents which propose significant changes to the UK tax treatment of those who travel across international borders. We'll be submitting responses to both documents and highlight here some points which we welcome and others where we have concerns.*

***What does the consultation on residence propose?***

We welcome the overall aim of the residence consultation in seeking to end the current regime of limited statutory tests supplemented by uncertain case law, replacing this with a comprehensive residence test from 6 April 2012. But we're keen that any test should be practical and fair and we have concerns over some of the detail.

**Part A: Definitely non-UK resident**

We welcome the principle of having a definitive way of being regarded as non-UK resident by meeting any of three tests but we're concerned that the proposed tests are too narrow.

The proposal is that you'll be non-resident if:

- you weren't UK resident in the three previous tax years and you're present in the UK in fewer than 45 days in the current year
- having been resident in the UK in one or more of the previous three tax years, you're present in the UK for fewer than ten days in the current tax year, or
- you leave the UK to carry out full-time employment abroad, spending fewer than 90 days in the UK and no more than 20 days working in the UK in the tax year.

Full-time employment in this context is defined in the proposals as encompassing one full tax year with working hours of 35 hours a week – which should help to remove some of the current uncertainty. But the proposed level of 20 UK workdays is lower than HM Revenue & Customs (HMRC) has accepted in the past. We're also querying whether that limit is intended to include days spent on incidental duties, which under current law would not be regarded as UK workdays at all.

It's proposed that any day on which you work for at least three hours in the UK will count as a UK workday. This would apply even if the day doesn't count as a day of physical presence for the purpose of the main test because you're not here at midnight. We think this limit is too low.

**Part B: Definitely UK resident**

Unless Part A applies, you'll be regarded as UK tax resident if:

- your only home is in the UK or, if you have more than one home, they're all in the UK
- you're not working full-time abroad and you spend at least 183 days in the UK in the tax year, or
- you're working full-time in the UK (using the 35-hour test described above). Your work will be regarded as a full-time UK role if it covers a continuous period of more than nine months and over that period no more than 25% of the duties are undertaken outside the UK.

It's not clear how home is to be defined and we're pushing for greater certainty on this.

**Not within either Part A or B? (Part C)**

Where neither Part A nor B produces a conclusive result, further tests must be considered. Combined with the time you've spent in the UK, the factors are:

- the presence of your spouse and children
- accommodation that may be used as a residence and is used as such by you or your family
- substantive employment (at least 40 days of UK working with a working day defined as at least three hours of UK working)
- UK presence in the previous two tax years, and
- whether you spend more time in the UK than in other countries.

The more factors that apply the less time can be spent in the UK; but the tests are complex and apply differently for those arriving in and those departing from the UK. In particular, it will be harder to become non-resident when leaving the UK after a period of residence than it will be to become resident when an individual first comes to the UK. We think that further thought is needed on this, as well as on the impact of family connections and the three-hour test.

## Other suggestions

The proposal recommends reform of the law on ordinary residence but isn't definitive about what should be done. We're concerned that the proposals are less generous than both the system which applied in the UK until recently and most comparable expatriate regimes internationally.

The UK currently operates concessions which split the tax year into resident and non-resident periods in some circumstances. It's proposed that something along these lines should be enacted, although with specific anti-avoidance legislation aimed at preventing short-term departures from the UK to avoid income tax on investment income.

## *What does the consultation on domicile propose?*

We broadly welcome the proposed reforms to some aspects of the taxation of non-UK domiciled individuals, along with the prospect of a period of stability in the regime. As with the residence proposals, we do have some concerns about the details. There are three main elements in the domicile paper:

### An increased remittance basis charge (RBC)

The RBC will go up to £50k if you've been UK resident in at least 12 out of the previous 14 UK tax years. No changes are suggested in the operation of the £30k RBC currently payable if you've been resident in the UK in at least seven out of the previous nine UK tax years.

We think that this sharp increase for longer-term UK residents is disappointing and will be a particular disincentive to UK residence for those whose families are also non-domiciled. We'll be pressing for agreement on whether the RBC is a creditable tax for treaty purposes, especially in the US.

### Encouraging business investment

A welcome new relief is proposed to encourage remittance basis users to invest in the UK. It will mean that funds you bring to the UK to invest in trading companies, or companies investing in the development or letting of commercial property, won't be taxed as a UK remittance while they remain invested and for two weeks after the disposal of the investment. Inevitably, the proposals also include anti-avoidance provisions that would, for example, prevent you investing in a company holding only residential property in which you live.

Overall, the investment options are less restrictive than might have been expected, with no minimum or maximum amounts required for investment and modest reporting requirements via the existing tax return process. But we find it disappointing that no relief is offered for investment in partnerships. We also think that the two-week window within which funds must be transferred out of the UK is far too short.

### Simplifying the remittance basis

The consultation proposes some changes to the remittance regime.

- Nominated income: It's proposed that a de-minimis limit should be introduced so that £10 of nominated income or gains may be remitted without you becoming subject to the identification rules that currently apply. We welcome this relaxation to the current complex rules.
- Foreign currency bank accounts: It's proposed that all amounts held in foreign currency bank accounts will be removed from the scope of capital gains tax (CGT) which has the potential to significantly improve your reporting position.
- Taxation of assets sold in the UK: It's proposed that the existing exemption for bringing assets such as works of art and assets to the UK for your personal use be relaxed. This would allow assets to be imported for sale and would provide a two week window for you to send any sale proceeds abroad. While this relaxation is welcome, we'd like to have seen it widened further to include situations where your asset is lost or stolen or where you bring in offshore funds for a repair. Again, we think the two-week period is unworkable.
- Statement of Practice 1/09 (SP1/09): If you're an employee who's resident but not ordinarily resident in the UK, this concessionary practice allows you to identify the nature of funds remitted from a qualifying bank account containing predominantly earnings on an annualised basis. We welcome the Government's intention to enact law to replace this practice, provided that it continues to work with its current efficiency.

## *What do the proposals mean for you?*

You'll be affected by the outlined proposals in different ways depending on your situation and the outcome of taking the residence test. It's likely that the proposals will benefit some taxpayers more than others. We'll continue to seek a regime that offers clarity, flexibility and quality for the many individuals who'd like to establish a financial commitment to the UK.

If you'd like to know more about the proposed changes to the residency and domicile rules, you can contact:

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# *Dealing with challenges to employee benefit trust planning*

*HM Revenue & Customs (HMRC) has been trying to stop employee benefit trusts (EBTs) being used to defer or avoid income tax and national insurance contributions (NIC) on employment benefits for some time. There have been a number of significant developments over the last year, which anyone with an interest in one of these arrangements (including beneficiaries, employers and their advisers) must understand in order to reconsider their long-term strategy. In some cases these developments will apply equally to employer-financed retirement benefit schemes (EFRBS), particularly where you've been given access to the EFRBS funds while still employed.*

### *Introduction of disguised remuneration rules*

Although these rules have applied from 6 April 2011, they'll also have an impact on all existing arrangements with some anti-forestalling rules applying to transactions as far back as 9 December 2010.

These rules are very complex, but have two key charging provisions:

**Earmarking** – You'll be taxed on the gross value of any new funds earmarked for your benefit. This probably stops any new additions to EBTs or EFRBS, but funds earmarked before 6 April 2011 will be grandfathered from this charge (grandfathering describes a situation in which an old rule continues to apply to some existing situations, while a new rule will apply to all future situations).

Fortunately, HMRC has exempted investment returns rolled up within an already earmarked fund from this charge.

**Provision of benefits** – You'll be taxed on the full capital value employed in providing the benefits. For example, new loans would trigger tax on the full capital advanced. Loans in place before 9 December 2010 are grandfathered from this charge, and loans made between 9 December 2010 and 5 April 2011 are covered by the anti-forestalling rules. So, income tax arises if these loans aren't repaid before 6 April 2012.

These rules are broadly drafted, so you'll need to be very careful in relation to any future transactions to avoid these triggering tax charges.

Another notable change is that the provision of benefits remains chargeable after the employment with the company has ceased and even after the death of the employee. This means it's unlikely you'll be able to continue to defer the income tax liabilities indefinitely.

### *Possible new test case*

HMRC has continued arguing that contributions to EBTs for particular individuals are taxable at the outset regardless of the corporation tax position, even though it's lost similar arguments in the courts in the past.

We understand that HMRC has taken a further test case on this point which, at the time of writing, is awaiting a decision from the courts. If HMRC wins, this could set a precedent which it could use to challenge other EBT contributions made in previous years.

We've seen HMRC taking steps to protect their power to collect pay-as-you-earn (PAYE) and NIC by opening enquiries and issuing assessments before the relevant time limits pass.

### *On 4 April 2011 HMRC updated their views on other potential EBT issues*

The good news is that HMRC appear to now accept that in most cases (investment companies being the highlighted exception) a contribution to an EBT won't give rise to an immediate 20% inheritance tax (IHT) charge for the beneficiary/employee or the contributing company/employer.

But it also raised the following points which could cause difficulties for some people:

**IHT:** HMRC's view is that EBT sub-funds won't normally qualify for exemption from discretionary trust IHT charges. Any risk here depends on the precise facts, but could mean that the trust may trigger IHT charges when assets leave the main fund (i.e. on the creation of sub-funds) or on each ten-year anniversary of the settlement of the trust.

**Attributing trust income to beneficiaries:** It's generally accepted that trust income can be taxed on individuals when benefits are received where there isn't an employment tax charge. But HMRC has indicated that in some circumstances, such as EBTs set up for controlling shareholders, it considers tax may arise for the beneficiaries on the income received by the trustees whether it's distributed or not.

**UK source income:** UK source investment income in the EBT would normally be taxable in the trust – including interest paid on loans to UK beneficiaries. HMRC is checking compliance with these and is likely to challenge any planning to avoid this issue.

### *On 20 April 2011 HMRC issued a statement regarding a settlement opportunity for old EBTs*

HMRC has said it hopes to settle many EBT cases for full settlement of PAYE and NIC (but give a corporation tax (CT) deduction) at the point of contribution to the EBT. HMRC's view is that the developments we've mentioned cause enough problems to encourage settlement of many cases. But for many people this could also give benefits since:

- income tax and NIC rates have increased and CT rates have fallen, so the cost of paying tax on the original contributions may be far lower than on benefits now
- the disguised remuneration rules give an exemption where a settlement has been reached, which may mean the original contributions and growth in value can be distributed without employment tax, and
- HMRC indicates that it may be possible to agree a full CT deduction and disguised remuneration exemption even if some years of contribution are outside the scope of income tax assessment.

### *How can we help?*

It's really important that, where you have an interest in an EBT, you're able to take a balanced view of the historic issues and implications of the new rule changes on your plans. With this knowledge, you'll be better placed to make decisions on how to use these funds and to not unknowingly increase your tax risks. HMRC's initiative to settle EBT cases may also have benefits for some people and HMRC's offer to discuss details of particular cases should be given consideration.

If you have an interest in an EBT and would like to discuss how these developments may affect your arrangements or explore ways of taking any disputes with HMRC forward, please speak to your usual PwC adviser or drop a line to:

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# Partnerships
## Not just for professionals

*Not so long ago partnerships were used principally by lawyers, accountants, dentists and suchlike; professional people working in partnership to reduce overheads. Now partnerships are being used by all sorts of businesses from cleaners to property developers, gardeners to private equity structures. So would a partnership be a suitable structure for your business?*

Partnerships can be very informal, you just need two or more people carrying on a business in common with a view to a profit. It's generally wise, though, to have some sort of agreement in place to cover any unforeseen circumstances that may arise.

### Limited liability partnerships vs limited partnerships

One common structure is a limited liability partnership (LLP), which is widely used to provide the flexibility of partnerships but with the security of a limited liability status. Most professional services firms have now converted to LLP status. Private equity houses are also often structured as an LLP. LLPs are transparent for all taxes, including inheritance tax (IHT), so that tax is charged on the individual member.

Less common are limited partnerships (LPs) where the general partners have management control and joint liability for the partnership debts. The difference from an LLP is that the limited partners are silent investors and can have no input into the day-to-day running of the business. The general partner is often a company owned by the limited partners, effectively giving limited liability. LPs still have their uses, though – for example, enabling investment in a sole trader business without requiring the trader to incorporate.

Unlike LLPs, LPs are not transparent for IHT purposes so an offshore LP can own assets located in the UK – for example, property held via an offshore trust, without entering into the UK's IHT regime.

### Thinking of starting a new business?

A partnership can be more beneficial than a company for a new business as it gives instant relief for losses against other income. Care may be needed if a LP is the preferred route as there's a restriction on this sort of loss relief for the limited partners and in an LLP the loss relief can be limited depending on the hours worked and the type of business involved. Once your business is making a profit, it can be incorporated if that is your preferred route, with any capital gain being deferred.

You may be looking to buy investment property with other family members. A partnership can give more flexibility than a company, and will minimise the red tape and administration required. This can work really well where family members with no other income are partners as the overall tax is minimised by using their personal allowances and basic rate band. Proceeds of any sales are easily extracted too as they're not trapped in a company, requiring a double layer of tax to be paid to get the funds out.

### Family limited partnerships vs family trusts

A particular type of LP is emerging as one of the viable alternatives to trusts for those of you wishing to pass wealth down to the next generation without incurring significant tax charges or losing any control of the business. Known as the family limited partnership (FLP), this vehicle has a general partner (typically a company owned by the first generation) and family members as limited partners. You can set up the partnership and either gradually pass partnership shares to your children or grandchildren as they get older (and more sensible!), or include them as partners from the beginning. FLPs have been widely used in the US as a method of separating control and ownership.

There's no immediate IHT charge on contributions into the partnership and no maximum 6% charge every 10 years, as is the case for most trusts. This is a significant advantage over setting up a trust following the changes made in 2006. Instead, the transfer into the partnership will be entirely exempt from IHT if you survive for seven years. But if your assets qualify for business property relief, you may not need the IHT advantage of the FLP so may prefer the traditional trust option.

You need to take care with capital gains tax (CGT) if you're contributing assets to a FLP. Cash and assets not standing at a gain are fine, as are assets used in a business because holdover relief can be claimed (deferring tax on the gain until later). This ability to claim holdover relief is another advantage of FLPs as this is not possible for a trust where you want to retain some benefit or younger children are involved. Investment assets are likely to trigger a CGT liability, although this is the same for trusts. CGT can also arise when partnership shares are changed.

A specific downside to FLPs is that they're treated as collective investment schemes, which means that the general partner must either be Financial Services Authority (FSA) registered or will need to delegate its investment management to an FSA authorised person.

### Food for thought?

Partnerships, in their various forms, can provide great structures for managing tax effectively and maximising flexibility for new ventures as well as established businesses. If you're thinking of the next big thing or looking to provide for your family, it's worth considering a partnership rather than automatically setting up a new company or trust.


If you'd like to find out more about the benefits that partnerships can offer, you can contact:

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# *Inheritance tax*
## Making the most of business property relief

*Over the last few years, your private company may have been conserving cash from profits and managing this resource as best you can. Similarly, if you're a private individual you may have been retaining significant liquid funds from asset sales.*

But as the economic situation improves, you may start to think about your longer-term investment options. Alongside this, you'll need to consider what the best tax structure for holding such assets will be. The impact of corporation tax, income tax and capital gains tax will normally be your main concern but what about inheritance tax (IHT)?

IHT business property relief (BPR) can reduce the value of trading businesses to nil when calculating IHT liabilities. But cash and investment assets held within private trading companies will often restrict the availability of the relief, which means you could get unexpected 40% IHT liabilities arising on the death of a shareholder. For individuals, investment assets will never qualify for this relief so, if you fall into this category, you'll be left fully exposed to tax at 40%.

A case in 2006 (the *Phillips'* case) indicated that BPR relief may be more widely available than had previously been thought. In this article we explain how it might be possible to reduce the impact of IHT by establishing a money-lending business as a source of funds for your corporate and family-owned investment and trading businesses.

### *Potential tax charges*

If you hold cash and investment assets, these will normally be subject to IHT at the time of your death – unless they're left to your surviving spouse/civil partner. If the total of your chargeable assets and transfers during the previous seven years exceeds £325,000 at current rates – ignoring the transfer of a spouse/civil partner's unused nil-rate band – then that excess will be subject to IHT at 40%.

If you hold shares in private companies these are also subject to IHT although, in the case of most trading companies, BPR will apply to reduce the value when IHT arises. There's a dimmer switch test to apply here: first, do you get any relief at all; and if so, how much BPR do you qualify for? No BPR is available where your company is wholly or mainly an investment company. If your company is wholly or mainly a trading company, BPR should (subject to the other conditions being satisfied) be available, but will be restricted by the value of any excepted assets. In effect, the amount of BPR given is restricted to only those assets which are used in the trade and any qualifying investment activities. This is relevant because cash and certain investments which are not required for use in the business are excepted assets, with IHT potentially being payable at 40% of their value. This may be significant.

### *The Phillips' case*

The use of a dedicated money lending company to finance the activities of other family businesses (in effect, an in-house finance company) was examined by the Special Commissioners in the *Phillips'* case. The case involved a family-owned company which was financing the activities of sister companies through interest-bearing loans. When a sister company wanted to acquire assets, it would request a loan from the finance company. This would then be considered by the directors and, if the position was commercially sound, a loan would be granted. Because the finance company's activities didn't amount to investment, the Special Commissioners concluded that BPR was available to reduce the value of the shares to nil for IHT purposes.

The value of the shares in sister companies was also reduced to the extent of their indebtedness to the finance company.

### *Practical applications*

**1. Companies with surplus cash**

If you're a trading company with surplus cash you might consider establishing an in-house finance subsidiary to provide cash to family members, companies and partnerships. The effect might be to prevent significant cash balances from becoming excepted assets chargeable to IHT at 40%.

Alternatively, if you're a company which is currently carrying on an investment business – i.e. where BPR would not be available at all – the money-lending business could be held outside the existing corporate structure. This would allow the shares in the money-lending business to qualify for BPR after two years of ownership.

Extracting the funds to achieve this is likely to trigger a tax charge. But it might be possible for the investment company to establish the finance company as a subsidiary. This might later be demerged without the need to extract funds by way of dividend or bonus.

**2. Individuals with surplus cash**

Family members could establish a new company or partnership to make similar lending possible. Forming a business like this might result in BPR becoming available once the two-year ownership period has passed. This, coupled with the deductibility of the loans in the hands of the borrowers, could result in very significant IHT savings.

The practicalities of operating a money-lending business require some attention to detail, but this shouldn't be too time-consuming for you. The company's Articles must allow it to operate as a money-lending business. The familiar badges of trade should be considered and it's crucial that the business qualifies as a trade of making loans, rather than investing in loans. The terms of any loan made should be similar to loans made on commercial terms between third parties. For example, a commercial rate of interest, bearing in mind any specific circumstances, should be charged and paid by the creditor company. The loan may be unsecured. It's helpful if the money-lending business reports its income on its tax return as trade income rather than non-trade credits. The company's accounts should also make note of its trading status.

### *Planning for the future*

There are still robust commercial and economic reasons to support larger cash balances being held by private companies. But if there's a full recovery in the wider economy, these reasons are likely to reduce and HM Revenue & Customs (HMRC) may be keener to challenge the level of cash required for the future needs of a business. A restriction on BPR may expose excess cash to 40% IHT.

If you're a private individual, your cash and investment businesses won't generally qualify for BPR at all. Taking this into account, a money-lending business could prove a useful way of providing funds for family businesses and family members in an IHT-efficient manner.

If you'd like to find out more about IHT planning, you can contact:


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# Preparing for a sporting shoot

*Are you fully prepared for the new shooting season? How tightly do you manage your exposure to VAT? What are the VAT consequences for charges relating to shooting activity?*

There are various points you need to consider if you're setting up a sporting shoot. These will have a direct bearing on whether or not HM Revenue & Customs (HMRC) considers the shoot to be a commercial venture. If it's deemed to be a commercial shoot, VAT is applicable to the supplies you make which are, in the main, the charges paid by the guns (the individual participants).

HMRC has also recently targeted existing shoots to establish whether there's a need for retrospective VAT registration. If the shoot has inadvertently overlooked appropriate VAT registration, the costs, together with interest and penalties, can be significant. In this article we look at the important points to consider if you're involved in organising and running shoots.

### Family and friends

The making of recharges within a syndicate for the shooting days taken is not generally seen as a business activity. This means that recharges from an individual (the owner) to other syndicate members shouldn't create any VAT registration or accounting liabilities. But the syndicate won't be able to reclaim any VAT that it incurs in relation to its own shooting – and this in itself increases the costs.

HMRC's own guidance states that it will generally not consider a shoot to be a business activity where all of the following apply:

- Only friends and relatives of the landowner take part in the shoot's activities.
- There's no advertising or publicity given to the shoot's activities.
- The shoot accounts show an annual loss equivalent to the annual contribution made by any one gun (this loss equates to the landowner's personal contribution) and the loss is borne by the landowner personally and not by his business.

### Third party sales

Whilst your syndicate doesn't need to keep separate daily accounts, if you're involved in any supplies to third parties for the days when the syndicate is not shooting, then you should keep separate accounts relating to these activities. Such involvement could be, for example, marketing the event or collecting payment from those taking part.

These third party days could constitute a business activity for your syndicate, if you're involved in arranging them. Simply by becoming involved in such days, you could bring all of the syndicate shooting days within the scope of VAT – and if so, recharges of costs to syndicate members would become liable to VAT. This is a risk that should be carefully managed if you want to minimise any exposure to VAT and possible penalties.

### Land owned by a company

If charges are made by a company (to both the syndicate and any third parties) these will usually be business supplies. They will generally be subject to VAT on the basis that the company is providing the right to shoot game on its land. If your company is charging VAT to a syndicate then you should be entitled to recover the VAT incurred on purchases connected with the shooting activities.

If your company lets days to third parties directly, this will usually be a business activity for you, so VAT will be due.

If specific days are sold by your company, with either the whole amount being charged to one person, or with the charges being made to each person that is participating in the shoot, then this situation is reasonably straightforward. The only VAT supply that takes place is a supply from a company to individuals or groups that will be shooting. This would be a business activity for your company and it would be subject to VAT.

If instead the costs are shared amongst your syndicate (or another group of family and friends) for a day or days which you don't intend to generate any profit from, then this shouldn't be a business activity and shouldn't make you liable to register for VAT. The tests are as mentioned on the previous page in HMRC's guidance.

If someone purchases a day and then markets the places on that day to external parties with a view to making a profit, that individual may be making taxable supplies and may be required to register for VAT if the annual VAT threshold (currently £73,000) is exceeded. Companies can apply for voluntary VAT registration if their supplies are below the VAT registration threshold. But as most guns are individuals who wouldn't want to bear VAT unless absolutely necessary, this scenario would be unusual. Again, registration should allow the recovery of input tax incurred on the costs, including any charges from a company for such days.

### The solutions

As long as your syndicate isn't involved in the provision of shooting days to external parties, the VAT position can be managed very efficiently. But if your syndicate is involved in making supplies of external days, the entire activity of the syndicate may become subject to VAT – and this might just make your hobby too expensive.

If your syndicate makes business supplies but the annual level of supplies is under the VAT threshold, you'll be able to choose whether or not you want to register for VAT and weigh up the right to recover VAT relating to business supplies to the requirement to charge VAT to your customers. But don't overlook the administrative burden of completing VAT returns – it's unlikely that your customers, the guns, will be able to reclaim the VAT.

Give some thought to the costs incurred. If some are not subject to VAT, it may be worth considering whether the invoices can separate out the costs, to potentially allow some of these costs to be charged across to your syndicate without VAT being added (as disbursements). Obtaining this treatment is difficult in practice but the benefits are measurable. It's better for costs like these to be incurred directly by the parties that are shooting, rather than those being charged through a company. Examples of costs relating to shooting that might not be subject to VAT could be casual workers hired for the shoot, or insurance arranged through a company for the shooters. By taking this approach you could reduce your overall costs for the shoot.

We've had great success in helping our clients find the most suitable solution by working with them to agree an approach before the activity begins. We've also helped clients minimise their assessments of VAT, interest and penalties when facing potentially lengthy and costly enquiries into the historic supplies of their shoots. So, don't hold back on either asking your professional adviser and/or approaching HMRC for guidance on whether they consider a business is being carried out. We'll be happy to help you assess the VAT eligibility of your shoot.

If you'd like to find out more about managing the VAT paid for your shoot, you can call:

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# *Giving it all away*
# Changes to the rules on charitable legacies

*If you're considering leaving a large sum to charity in your will, then you should be aware of the proposed changes to the inheritance tax (IHT) rules announced on 10 June 2011. A consultation document proposes a reduced IHT rate of 36% where you leave 10% or more of your estate to charity on or after 6 April 2012. So what will happen if this proposal is enacted?*

If your estate will be subject to IHT and you're considering significant charitable donations after your passing, you may want to structure your legacies in such a way that you'll achieve this 10% reduction in the tax rate.

You're probably already aware that under the current rules, any gifts which you plan to make to a charity from your estate will be exempt from IHT. If you qualify for this proposed new relief, where the balance of your estate is subject to IHT, the rate will be 36%, rather than the current 40%.

### *How does the relief work?*

The relief operates so that the legacy still results in some cost to the beneficiaries, compared with not leaving anything to the charity, but that cost can be reduced. At the moment, if you make a qualifying legacy, the minimum loss to your non-charitable beneficiaries is 60% of the amount of the gift – that is, the amount they would have received less the 40% IHT charge. Under the new provisions, their minimum loss would be 24% of the amount gifted.

Because the reduced IHT rate will be dependent on you having made a sufficient charitable legacy to pass the 10% test, there's a cliff edge effect so that where you're giving an amount close to that critical 10% point, a small difference to the amount could have a larger impact on your estate's IHT liability. It's important to take this into account when drafting or reviewing your will.

### *Will this discourage giving?*

When considering the simple estate we've mentioned, the relief appears straightforward. But we do wonder whether this will discourage lifetime giving, particularly if you're in a position where you don't have sufficient lifetime income or gains to attract Gift Aid relief on significant donations.

The proposed relief only applies after taking account of the nil-rate band, the spouse exemption and reliefs such as business property relief. Our experience suggests that if you remain liable to IHT at that point, you're likely to have a more complicated estate. The consultation document suggests ways of dealing with a range of these issues but the proposed operation of the relief becomes correspondingly difficult – to the extent that we wonder whether the complexity outweighs the potential benefits.

### *What should you do next?*

If you do want to take advantage of this relief, your first port of call is likely to be your lawyer. You might anticipate that there'll be a standard will clause to allow you to maximise the relief, along with the benefit of your nil-rate band. But recent cases have demonstrated that it can be difficult to draft wills which distribute even a straightforward estate between charitable and non-charitable beneficiaries as you intended. The more complicated the final rules of the relief, the more difficult the task will become.

If you'd like to know more about the proposed changes to the IHT rules, you can contact:

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# The problem with risk

*We'd all like to think that there's a simple answer to minimising risk when investing. But after being asked to write about investment risk, a quick poll amongst colleagues revealed a few interesting tales and extracted some nervous laughter. It was evident that the problem with risk is that it means different things to different people.*

Risk can be characterised in a number of ways, such as inflation risk, interest rate risk and a multitude of other types, which often confuse the investment decision-making process. In reality, your investment objectives are most effectively addressed when risk is viewed in two of its most basic forms: volatility and default.

Even though these risks are very different, and upon further investigation some of the conclusions drawn may appear counter-intuitive, it's very interesting to apply these concepts in practice with reference to recent experiences here in the UK.

## No return guaranteed by default

Like an eager contestant on *The Weakest Link*, when you ask any investor what holds less risk, cash in the bank or investing in the UK equity market, you'll arguably hear a single response: 'bank'.

But the reply may be dramatically different if you introduce the question with an account of investors' experiences that had placed significant sums with Icelandic banks, versus those who had invested in a broad-based index such as the FTSE 100.

## What volatility?

Heightened volatility may ultimately lead to default but, generally speaking, owning a wide range of asset classes lowers the overall probability of them all going bust at once. Conversely, during the 2008 financial crisis, there seemed to be few safe havens and almost all investments lost ground.

Broadly, an investment's volatility is the extent to which its return varies over time. Investors generally measure volatility through standard deviation, with relative risk-adjusted measurements such as the Sharpe ratio measuring return for the amount of volatility experienced. Modern portfolio theory (MPT) has shown that volatility can (in theory) be reduced by investing in assets or asset classes which respond differently to the same market events. So the best answer to the question above is very plain, very boring, very tired, yet very true: diversification.

Diversification and volatility become even more important when the investment horizon is shortened. Requiring access to funds in an undiversified portfolio during a downward cycle may see your available money not meet your needs.

## So, how can you be wise with your money?

You can challenge commonly held beliefs as to what constitutes a safe investment. You can also ignore advisers who try to confuse your financial matters by distracting you with the latest buzzwords and jargon.

And most importantly, don't put all your eggs in one basket – invest in a diverse range of assets that will reduce your exposure to risk.

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# *Meet our people*
# Darrel Poletyllo

*In this issue we meet Darrel Poletyllo, Head of Wealth Advisory.*

Darrel Poletyllo

Darrel advises a number of leading entrepreneurs in the UK and overseas. He and his team spend a great deal of time talking with, listening to and working alongside their clients to find the best possible solutions for their businesses and their private investments. We sat down with Darrel to hear more about his open and direct approach to investment advice, his interests outside PwC and his love for Dundee United.

**How did you first get into professional services?**

"I was always fascinated by businesses and the markets they operate within. After recovering from the sharp disappointment that I would fall short as a professional footballer, owing largely to an absolute lack of ability, I joined an investment firm in London and never looked back

I found myself immediately at home in the investment world and, unlike so many things in life, it made perfect sense. I also very quickly realised that there are glaring issues with not only the investment markets but also how clients receive advice. I am as fascinated now as I was back then, by the dynamics of the investment world and how so few businesses were built around clients."

**Did you have a particular career in mind when growing up? Did you think you'd end up working for an accountancy firm?**

"As I said, I was always very interested in business and I technically started my business career when I was 13. I set up a gardening business, servicing the houses around our school. We were quite successful and ended up with a team of five guys. When we got so busy that truancy was the only way to maintain service standards, the regulator/rector moved against us and we were forced out of the market. So my approach to clients is relatively entrepreneurial and that's what I enjoy most about working with entrepreneurs. I love listening to how people have built their businesses and the important decisions they had to make. It's genuinely fascinating!

Our approach when we're investing for clients is to keep their money safe, to protect it from inflation and make sure it's tax efficient. So we're really custodians of wealth: we're not investment managers who are going to double their client's wealth – but then I'm never convinced that such people exist! I don't think that's what our clients are looking for. They want to be given the right advice, they don't want someone who thinks they're smarter than their clients. I'm definitely not smarter than our clients who've made a billion pounds in their own lifetime. If I was, I'd have a billion pounds which I'd spend on getting Dundee United into the Champions' League.

I think the emperor's new clothes fable that we learn as kids is a hugely important lesson that we re-learn as adults. Investment firms will tell their clients 'Don't worry about it, it's a wee bit complicated. You probably don't understand it' and the client has to take that on faith. Quite often it's rubbish. Clients can make their own money and what we do is provide safe custody for that money. We're as intelligent and as academic as anyone else when deploying this capital, but there isn't alchemy involved in good investment management."

**You worked for two other big professional services firms before moving to PwC. How different are the cultures between the different firms?**

"The main difference is the access you have to clients. Some firms work in a quite a distinct and separate manner, whilst PwC genuinely tries to bring together the strength of all of its offerings for the benefit of the client. That's particularly valuable and useful for those of us working with private individuals, where we can introduce our clients to all the relevant specialists across PwC. Introducing entrepreneurial clients to each other is also a particularly valuable thing that we do."

**Do you have any particular hobbies, sports or leisure activities that help you to unwind after a busy week?**

"I do like sport a great deal. I watch a reasonable amount of football and I support Dundee United. My favourite fact about Dundee is that they've played Barcelona four times in Europe and have never been beaten by them.

I read a lot too. I collect art and first edition books. Specifically, my favourite authors are Graham Greene and Oscar Wilde – they're the two writers I'd read more often than not. As far as more modern authors go, I quite like Christopher Brookmyre, the Scottish crime writer. I've got all of his books as unedited proof copies, so if anyone else ever cottons on to the idea that he's any good, they might be worth something. I've also got some paintings by the Scottish artist Peter Howson.

I like music and comedy as well. I go to comedy nights a lot and I enjoy taking clients to comedy clubs. When I was in Edinburgh I used to take clients to all sorts of dingy, little basement comedy clubs. I like the kind of edge you get in these places. It's life affirming.

I have a one-year old daughter who lives in Scotland, so at the end of the week I get to go home and be a dad. During the weekends I spend all my time with her."

**What's the most fulfilling thing about working with so many high profile entrepreneurs?**

"I think the best thing about working with entrepreneurs is being treated as a partner rather than an adviser. When we're working with them to invest their money, rather than saying 'here's our proposals', we'll design our offering specifically for them.

One of the main advantages of working somewhere like PwC is the freedom. When I started the Wealth Advisory practice we were given a blank piece of paper to design an investment proposition. And we did that with our clients. We wanted to know what these guys actually needed and the only way to do that was to talk to them. So we sat down with lots of clients and asked them what they really need from an investment adviser and then we shaped our investment proposition around that.

Effectively, we're running a series of small businesses for our clients and those businesses are simply investing their wealth. That's really the main difference between us and the big investment houses – everything we do is entirely bespoke for each client."

**What's the best thing about working for PwC?**

"I think it's the independence, to be honest. When I came to PwC I wanted to build the best investment advisory practice in the market – the firm let me do that. We're still working with our clients to design new aspects to the proposition and we're always keen to internationalise our business within the PwC network. We're looking at having investment people and investment hubs in several different worldwide locations, but centred from London. So the engine of the business will be in London, but with offshoots that can give local advice.

Being at PwC gives you an extraordinary toy chest to play with – you've got access to all the experience and knowledge in our network. If one of my clients is looking to open a business in China, for example, then it's very easy for me to tell them the tax consequences of that, who to speak to in China, who should be our investors. At PwC, we're in a unique position of being able to do that."

# Wrapped-up

**The foreign company in which I own a few shares has offered me the option of receiving further shares instead of a dividend. If I take up the offer, will the receipt of the shares be subject to income tax?**

The number of international mergers and take-overs in recent years mean that you're not alone in receiving this sort of offer. It's becoming increasingly common for investors to hold shares in overseas companies and for those companies to be on the look-out for ways to give you returns in a tax-efficient way.

**What would the benefit of overseas shares be?**

It was established some years ago that stock dividends paid by any company to its UK resident shareholders were not a taxable income receipt under general rules. Because of this, specific legislation was then brought in which imposes an income tax charge on stock dividends from a UK company. This means that, broadly speaking, the value of the new shares is taxed as if it was a dividend. But these provisions only apply to UK resident companies and there's nothing which brings stock dividends into the general charge to income tax on foreign dividends.

Another advantage is that the provision of stock (rather than cash) means that there's generally no deduction of overseas withholding tax. So, if you're subject to UK income tax at the additional rates and take up this offer on, say, a £90 net dividend, you'll receive £90 worth of new shares with no income tax charge – as opposed to £57.50 cash after offshore and UK tax charges. Whether this is of long-term benefit to you will depend on the ongoing value/returns of the new shares.

For capital gains tax purposes, taking up the foreign stock dividend will be treated as a reorganisation of share capital. This compares with UK stock dividends, where it's not treated as a reorganisation and the dividend you've foregone forms part of the acquisition cost.

**A good alternative to a dividend?**

Most brokers seem to have picked up on the different tax treatment but it's important to check such distributions when you come to review your tax return. In particular, there's an important caveat to this general principle. You do need to check that the stock option is an alternative to, rather than a reinvestment of, the cash dividend. If what actually happens is that you become entitled to a cash dividend which is then reinvested into new stock, that dividend will be subject to income tax.

*If you have a question that you would like answered in the next issue, please email it to emma.thomas@uk.pwc.com or send it to: Emma Thomas, PwC LLP, 1 Embankment Place, London WC2N 6RH*

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**I've seen that businesses now have to submit their VAT returns online. Is this true, does it apply to all businesses and are there any penalties if I choose to continue submitting paper VAT returns?**

Since 1 April 2010, the majority of VAT registered businesses (including individuals) have been required to submit VAT returns online and pay any VAT due to HM Revenue & Customs (HMRC) electronically.

This requirement doesn't currently apply to all businesses and until now HMRC has taken quite a 'light touch approach' in respect of this issue; i.e. not seeking to impose penalties on those businesses which have incorrectly continued to submit paper VAT returns.

But HMRC has recently advised that penalties will now be levied on businesses which fail to submit their VAT returns online when required to do so; so it's important that you now review your business' position and are aware of your obligations in respect of online filing.

**Who's required to submit online VAT returns?**

At the moment, your business is only required to submit online VAT returns and pay electronically where:

- your business has registered for VAT prior to 1 April 2010 and has had an annual VAT-exclusive turnover of £100,000 or more in the calendar year ending 31 December 2009, or
- your business registered for VAT on or after 1 April 2010, irrespective of the level of turnover.

But from 1 April 2012, the requirement to submit online VAT returns will be extended to cover all VAT registered businesses – i.e. irrespective of the level of turnover.

**What's the penalty for incorrectly submitting a paper VAT return?**

If your business is required to submit online VAT returns, HMRC will charge you a penalty for each paper VAT return which is submitted for VAT periods ending on or after 31 March 2011.

The size of the penalty will be dependent on the level of turnover (excluding VAT) of each business in the 12 months up to and including the VAT return period which triggered the penalty – more specifically:

| Annual VAT-exclusive turnover | Penalty per VAT return |
|---|---|
| £22,800,001 and above | £400 |
| £5,600,001 to £22,800,000 | £300 |
| £100,001 to £5,600,000 | £200 |
| £100,000 and under | £100 |

**How do I change to online VAT returns?**

Signing up and changing to online VAT returns is relatively straightforward. You can register for HMRC's online services directly through their website and, once registered, you'll also have access to some of the other online VAT services which HMRC offers – e.g. automatic VAT return reminders, online submission of EC Sales Lists, online refund service in respect of VAT incurred in other EU Member States etc.

If you'd like to find out more about online VAT returns, you can call:

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