MACFARLANES

PRIVATE CLIENT UPDATE

ISSUE 3 - MARCH 2016

Welcome to the spring issue of our Private Client Update. Through this, we aim to keep you informed about recent legal developments that may have an impact on you.

In this issue, we give an overview of issues to consider before the current tax year ends on 5 April 2016. We have an article on the new, additional 3 per cent rate of SDLT, which will come into force on 1 April and an article on the impact of the widely reported decision in *Ilott v Mitson* (concerning a challenge to a will). Finally, we look at the new simplified process for creating lasting powers of attorney. As ever, please do not hesitate to contact me or your usual Macfarlanes contact with any questions.

JONATHAN CONDER
PARTNER
DD +44 (0)20 7849 2253
jonathan.conder@macfarlanes.com

If you are not already on the mailing list, but would like to receive future copies of this publication, please email contact@macfarlanes.com

10 ISSUES TO CONSIDER BEFORE THE END OF THE 2015/16 TAX YEAR

1. Couples should ensure that (where available) both spouses/civil partners use their entire personal allowance (£10,600 for 2015/16) and that, if possible, both use their basic and higher rate bands also. For those expecting to receive income of between £100,000 and £121,200 in 2015/16, the impact of the phased withdrawal of the personal allowance results in a very high effective tax rate of up to 60 per cent. Those in this position may wish to consider additional pension contributions, charitable contributions or salary sacrifice options.
2. You should also ensure that, if desirable to do so for investment reasons, ISA contributions are maximised. The individual limit for 2015/16 is £15,240 and this cannot be carried forward to 2016/17.
3. Capital gains tax annual exemptions (£11,100 per person for 2015/2016) are lost if not used in the current tax year.
4. The taxation of dividends will change significantly with effect from 6 April 2016. Everyone will be entitled to an annual £5,000 tax free dividend allowance but the rates of tax payable by higher and additional rate taxpayers will be increased. Any taxpayer with less than £5,000 of dividend income in a tax year will pay less tax than at present. Conversely, basic rate taxpayers with more than £5,000 of dividends and higher/additional rate taxpayers with more than £22,000 of dividends will pay more. For some taxpayers, there may therefore be limited scope to accelerate dividend payments before 5 April. Advice will be needed in each situation if this is being contemplated. The Government is also consulting on the taxation treatment of certain types of more complex company distributions.
5. Pension contributions should be re-visited at least annually and anyone likely to be affected by the reduction in the lifetime allowance from £1.25m to £1m in April 2016 should take urgent specialist advice. Those with incomes of over £150,000 will also need to be aware of the reduced annual allowance with effect from April 2016.
6. Anyone looking to purchase residential property imminently should be aware of the wide scope of the new 3 per cent additional rate of SDLT in force from 1 April 2016, covered in detail later in this newsletter.

7. Gifts of up to £3,000 can be made each year entirely free of inheritance tax and this annual exemption can be carried forward for one tax year only. A couple who have previously made no gifts could between them make gifts to their children of £12,000 prior to 6 April 2016 using both their 2014/15 and 2015/16 allowances and a further £6,000 after 6 April without affecting their inheritance tax nil rate bands.
8. The Annual Tax on Enveloped Dwellings (ATED) threshold will be lowered further with effect from 1 April 2016, so that properties owned by "non-natural persons" and valued between £0.5m and £1m will fall within the regime for the first time. Those affected should take advice on whether "de-enveloping" is appropriate for their individual circumstances.
9. Those owning let residential property and claiming the wear and tear allowance will no longer be able to do so from 6 April 2016 and so, in some circumstances, delaying costly replacement items until 2016/17 may be beneficial.
10. The tax reliefs available for investments in VCT, EIS and SEIS schemes remain considerable following the changes made in 2015 and may be of interest to individuals looking for tax-efficient returns. In particular, these schemes may offer a suitable alternative tax-efficient investment to those affected by the reduced annual pension allowance. Those considering VCT, EIS and SEIS schemes will require specialist investment advice.

AUTHOR

CLAIRE TILBROOK
SENIOR SOLICITOR AND
PROFESSIONAL SUPPORT LAWYER
DD +44 (0)20 7849 2434
claire.tilbrook@macfarlanes.com

PROPOSED SDLT SURCHARGE ON PURCHASES OF "ADDITIONAL" RESIDENTIAL PROPERTY FROM 2016: THE LATEST INCARNATION OF THE RULE OF THREE

Psychologists have long known that, as the journalist and author Alex Bellos has put it, "three is the largest quantity – when it comes to collections of items - that we can grasp without counting". Indeed, it may be no coincidence that three is an iconic number in civilisations across the globe and in particular in Western thought, theology and rhetoric. The number three however may be about to take a tumble in our estimation as it comes to represent the additional stamp duty land tax (SDLT) which the Government is proposing to levy on the purchase of so-called "additional" residential property. The plan is that the change should take effect for transactions completed from 1 April 2016.

On 28 December 2015, the Treasury published a consultation document which describes the proposed architecture of the policy and its purpose and concludes with 21 questions to which any interested party is welcome to give responses. A key headline is that the policy has an unwarranted impact on locals with a second home abroad and on resident non-domiciliaries retaining a property abroad in (say) their country of origin.

SOME ANCIENT HISTORY

By way of background, in 1995/6 stamp duty (as the tax was then called) was chargeable at 1 per cent on total values over £60,000. There was no charge below that figure.

In 2005, the base threshold doubled to £120,000 to assist first time buyers and the various thresholds created in 1997 and the top rate of 4 per cent, first applied in the year 2000, were maintained. The top rate applied to transactions exceeding £500,000. In 2011, a top rate of 5 per cent was brought in for transactions over £1m while 7 per cent came in for transactions over £2m in 2012. The rates and calculation method for the tax were completely reorganised in December 2014 to remove the so-called "slab" effect and apply the tax at graduated rates going up from 2 per cent on values over £125,000 to 12 per cent on transaction portions exceeding £1.5m.

An independent rate of 15 per cent now also applies to acquisitions by so-called "non-natural persons" on chargeable consideration exceeding £500,000 with effect from 20 March 2014 (the threshold for the rate having previously been set at £2m). Clearly, governments of all colours have realised that residential real estate in the UK is capable of being something of a cash cow.

WHY? AFFORDABLE HOUSING IS THE 'NEW BLACK'…

The Chancellor's Autumn Statement and the consultation document show how political the property market has become and not simply for its revenue raising possibilities: the basis for the policy announced by the Chancellor is a so-called five point plan, one of whose features is an attempt to extract more revenue from the buy-to-let and second home sector, with a view to improving the availability of affordable housing, equity loan and help-to-buy and equivalent schemes.

WHAT ARE THE NEW MECHANICS?

How does the policy aim to achieve this? In simple terms, the plan is to apply a 3 per cent surcharge on the otherwise headline SDLT rates where the transaction giving rise to the SDLT has certain features. The Government estimates that the policy will not affect 90 per cent of conveyancing transactions and in particular will not affect the iconic first time buyers purchasing their first property or even homeowners moving from one main residence to another. It is also not intended to affect large scale investors or multiple purchases (which will be more leniently treated).

In simple terms, the Chancellor wants to levy an extra 3 per cent SDLT on transactions where at the completion date the buyer holds more than one residential property (with limited exceptions for scenarios where the buyer is "replacing" a main residence). There are no special exceptions for different uses of the property (e.g. a second home or a split main residence versus buy-to-let): the only qualification is that it be residential property. Equally, there will be no capacity to elect which is your "main residence" (unlike for CGT).

WHO IS AFFECTED?

Those who will be affected, however, are those who may have several properties they occupy, those who have one main residence and other buy-to-lets or co-investments and those who have exclusively buy-to-lets.

Two important categories of buyers are particularly adversely affected. The first are life interest trust beneficiaries and the second are buyers who already have a property outside the United Kingdom.

IMPACT ON TRUSTS

Starting with trust beneficiaries (in the widest sense), the plan is as follows:

- bare trustees: the acquisition will be treated as though it were made by the individual, so whether the 3 per cent surcharge applies or not depends entirely on the status of the individual;
- life interest trusts (otherwise known as interest in possession trusts): the relevant beneficiary will be treated as the owner and so again it is the status of the beneficiary which determines whether the 3 per cent charge applies or not;
- discretionary trusts (and equivalent interests such as remainder interests): whilst the Government does not intend to attribute the status of a beneficiary here, they nevertheless intend to apply the full 3 per cent surcharge to the trustees.

Accordingly, there will be scenarios with bare trusts or life interest trusts where the surcharge does not apply (because the property acquired by the trustees is the only property attributed to the relevant underlying beneficiary). This sounds like good news; however, as soon as that beneficiary separately acquires in his or her own name another property, be it another main residence or a buy-to-let property, the new 3 per cent surcharge will be applicable to the acquisition made in their own name unless there is an exception (such as replacement). The same will be true if the beneficiary already owns residential property before the trust makes the acquisition.

DOES THIS ONLY APPLY TO PROPERTY IN HMRC'S JURISDICTION?

The consultation paper deals specifically in paragraph 2.12 with property bought or owned in Scotland or the rest of the world (since SDLT only applies in England and Wales and Northern Ireland). The consultation paper contains the unhelpful sentence "property owned globally will be relevant in determining whether a property purchase in England, Wales or Northern Ireland is an additional property".

The examples given in the consultation demonstrate that the simplistic logic of the policy applies entirely predictably: for example, the exemption which is available for "replacing" a main residence will apply if the replacement property is in England, Wales or Northern Ireland and the property being replaced is outside the UK entirely. At the same time and conversely, if (for domicile or other good reasons) you retain a property outside the UK, that will count in measuring whether or not the policy gives you a 3 per cent surcharge on your UK acquisition.

It is clear therefore that (as the policy is currently constructed) the Government intends by implication that a resident non domiciliary acquiring a property in the UK whilst retaining a property overseas will suffer the 3 per cent charge at the higher rates (see table below).

Band	Existing residential SDLT rates	New additional property SDLT rates
£0 - £125k	0 per cent	3 per cent
£125K - £250k	2 per cent	5 per cent
£250k - £925k	5 per cent	8 per cent
£925k - £1.5m	10 per cent	13 per cent
£1.5m+	12 per cent	15 per cent = company rate

COMPARISON TO SDLT PAID BY COMPANIES

The SDLT on the top band will amount to the same rate of SDLT that is paid by a "non-natural person" acquiring, albeit a non-natural person pays 15 per cent on the total amount. Nevertheless, it is clear that (subject to the unusually-worded paragraph 2.20 of the consultation) the differential between corporate and non-corporate acquisition has narrowed considerably if the policy is implemented as described. Paragraph 2.20 suggests that, to prevent a potential tax avoidance opportunity arising, the first acquisition by a company (however that may be defined) will attract the 3 per cent surcharge: this presumably means even if it is below the rate at which a company already pays 15 per cent, but does it mean that on a purchase over £500,000, a company would pay 18 per cent?! Watch this space.

OTHER UNHELPFUL SIDE-EFFECTS (JOINT ACQUISITIONS ETC)

Another unhelpful feature of how the policy operates is that married couples and civil partners (unless formally separated) will be adversely affected: they will be within the ambit of the policy as a couple if one of them has a second property. That second property will be attributed to the couple in the count of properties at the end of the relevant transaction. To give an example, if civil partners A and B acquire a main residence and at the end of that transaction civil partner A retains his former property, A and B together will be deemed to have two properties and the 3 per cent surcharge will apply, even though A's property does not belong to B.

The same rule applies to joint acquirers who are not in such a relationship, e.g. siblings or parents and children. If, for example, mother and daughter acquire a property together as the daughter's first home, the mother retaining her original main residence, the transaction as a whole will face the 3 per cent surcharge. By contrast, the consultation document contemplates that the mother (in the alternative) lending the deposit and guaranteeing the mortgage will not bring the 3 per cent into play.

CONCLUSION

The policy consultation document contains much other detail, including in relation to partnerships (treated as joint owners) as well as exemptions for large-scale investors and multiple simultaneous transactions.

The consultation period closed on 1 February 2016 and the Budget is expected on 16 March 2016. It is unlikely that HMRC will have had time to assess in depth any consultation responses so it remains to be seen whether any serious changes to the policy will be adopted in the Chancellor's Budget. In the meantime, advice will be needed in relation to transactions completing on or after 1 April 2016 (unless the exchange of contracts in question took place on or before 25 November 2015).

AUTHOR

EDWARD REED
PARTNER
DD +44 (0)20 7849 2568
edward.reed@macfarlanes.com

THE LIMITS ON YOUR FREEDOM TO CHOOSE WHO INHERITS YOUR ESTATE

2015 saw a number of headlines in the English press along the lines of "Judges say that your will can be ignored" and "UK court overturns will of mother who had disinherited child".

Somewhat predictably, the media were overreacting to a case with extreme facts. However, the headlines were a useful reminder that a person's freedom to choose who inherits their estate is not unlimited.

When making your will, you should think carefully about whether anyone might be able to challenge the level of provision you are making for them and the steps you might take to ensure that your wishes are given effect.

The flow chart at the end of this article summarises when a claim can be made, and by whom.

THE 1975 ACT AND ITS IMPACT

Many countries around the world oblige people to leave a certain percentage of their estate to close relatives, most commonly their spouse and children.

English law has always taken a different approach and, strictly speaking, allows you to leave your estate to whoever you wish, even if this means disinheriting close family and other dependants.

In practice however, certain categories of people can challenge your will, or the rules of intestacy (if there is no will), if they do not receive "reasonable financial provision". Their rights derive from the Inheritance (Provision for Family and Dependants) Act 1975, commonly known as "the 1975 Act".

Disinheriting such people completely, or leaving them only a negligible inheritance, can therefore make your estate vulnerable to court proceedings after your death.

Even an unsuccessful claim may require your intended beneficiaries to defend their inheritances in court, delay the administration of your estate and result in significantly increased legal fees. Thinking about who might be able to make a claim under the 1975 Act in advance, and taking steps to guard against it, can help those you care about avoid this unpleasantness.

WHO MIGHT BE ABLE TO MAKE A CLAIM

A person must be one of the following at the time of your death in order to make a claim under the 1975 Act:

- your spouse or civil partner;
- your former spouse or civil partner (provided that they have not remarried or entered into a new civil partnership);
- someone who has lived with you for at least two years as though they were your spouse or civil partner;
- your child (or someone you have treated as your child); or
- a person you maintain in some way (the "maintenance" provided need not be financial and might, for example, include the provision of accommodation).

WHAT THE CLAIMANT MUST PROVE

A claimant must demonstrate that they have not received "reasonable financial provision".

This might be because:

- they have been excluded from your will entirely;
- they have received something under your will but not enough; or
- you have not left a will (known as an "intestacy") and they have not inherited under the statutory rules which take effect in such circumstances.

THE MEANING OF "REASONABLE FINANCIAL PROVISION"

What amounts to reasonable financial provision will depend on a range of factors, including your circumstances, those of the claimant and those of any other beneficiaries who would lose out if the claim were successful.

The law distinguishes between:

- a spouse or civil partner, who is entitled to whatever would be reasonable in the circumstances for a husband, wife or civil partner to receive, whether or not it is needed for their maintenance; and
- any other category of claimant, who is generally entitled only to such reasonable financial provision as is necessary for their maintenance.

In the past this has been interpreted as meaning that a spouse or civil partner would normally be entitled to whatever they would have received on a divorce, and that adult children could be disinherited safely unless the deceased owed them a particular moral obligation.

Recent judgments suggest that the analysis is far more fact specific and have highlighted the importance of taking advice as to what might be appropriate in your particular circumstances. At the time of going to press, one of the most high profile cases in this area, *Ilott v Mitson,* is being appealed so we may see further developments in the law in the near future.

THE LIMITATIONS OF THE 1975 ACT

There are two important limitations on the scope of the 1975 Act.

Firstly, the 1975 Act is only relevant if the deceased died domiciled in England or Wales. Deemed domicile for inheritance tax purposes does not count; nor is it expected that the general tax deemed domicile to be introduced from 6 April 2017 will affect the position.

Secondly, a claim must be brought within six months from the date on which the grant of representation is issued (i.e. from the date on which the deceased's executors or other personal representatives are confirmed). Whilst it is possible for the court to extend the time limit, it tends to do so only in exceptional circumstances.

HOW YOU CAN PROTECT YOUR ESTATE

The first step is to consider who might fall into the categories of person entitled to make a claim under the 1975 Act (or indeed, who might argue that they fall into one of those categories, even if you disagree).

You can then ensure that all potential claimants are adequately provided for (bearing in mind that circumstances may change before your death).

Of course, there may be good reasons why you wish to exclude someone, or limit their inheritance.

In that case you should prepare a detailed written explanation of your actions. Any court asked to consider that person's claim will then be aware of why you have chosen to benefit others over them and will be able to take this into account when determining whether reasonable financial provision has been made.

Ideally you would also warn the person in question that they do not stand to inherit under your will, albeit that clearly this will not always be possible or appropriate.

Whilst there can never be a guarantee of success, these steps can go a long way to keeping your estate out of the courts.

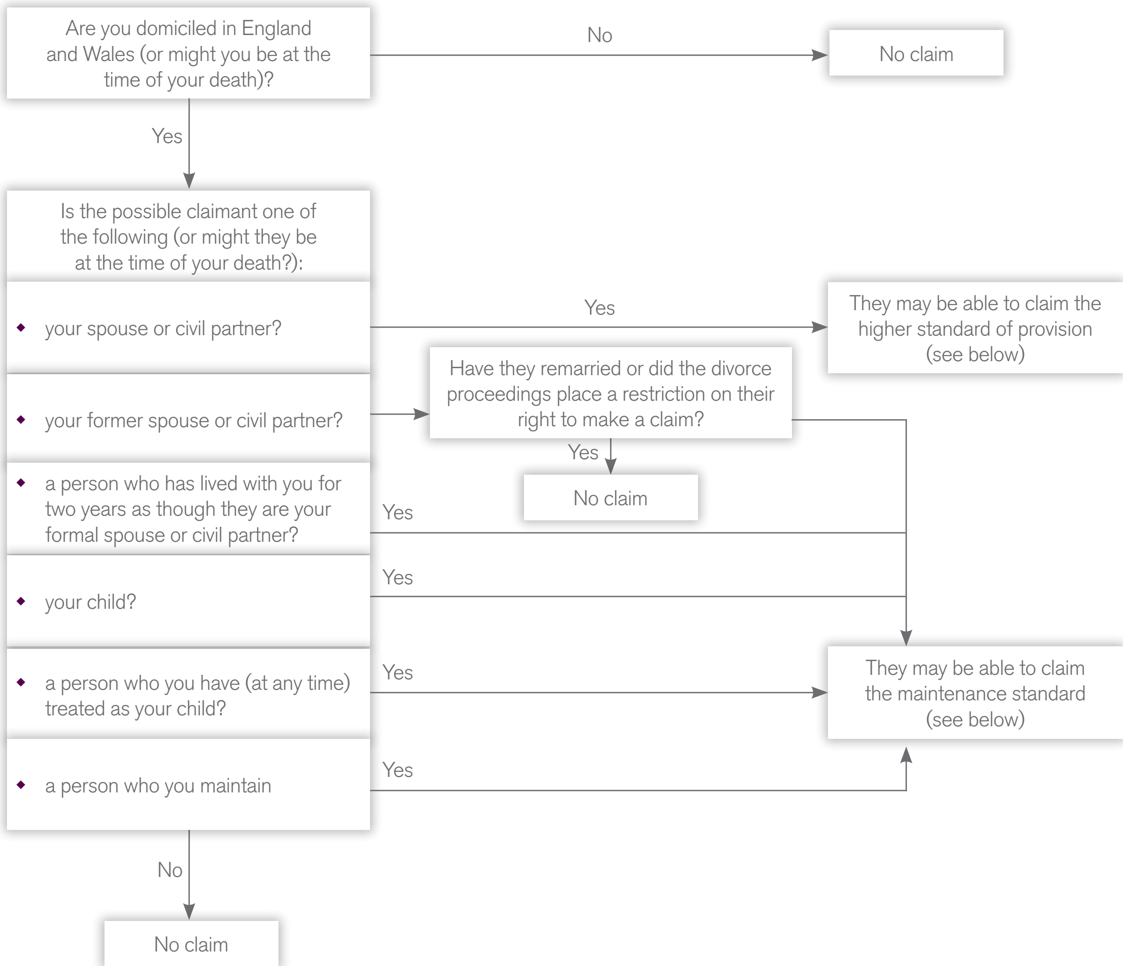
TOP TIPS

Make a will

Think about who might be entitled to make a claim under the 1975 Act and either:

- make reasonable financial provision for them; or
- leave a detailed explanation as to why you have chosen to benefit others over them.
- review your will regularly, say every five years, to ensure that you respond to changes in circumstances if appropriate.

WHO COULD MAKE A 1975 ACT CLAIM AGAINST YOUR ESTATE?



Level of provision

Higher standard of provision: “such financial provision as it would be reasonable in all the circumstances of the case for a husband, wife or civil partner to receive, whether or not that provision is required for his or her maintenance”

Maintenance standard of provision: “such financial provision as it would be reasonable in all the circumstances of the case for the applicant to receive for his maintenance”

AUTHOR

EDWARD HAYES
SOLICITOR
DD +44 (0)20 7849 2188
edward.hayes@macfarlanes.com

THE DIGITAL AGE OF LASTING POWERS OF ATTORNEY

Significant improvements have been made to the ability to make a lasting power of attorney. This is the document which allows you to appoint another person to act as your attorney to (1) deal with your financial affairs and (2) make decisions about your health and welfare.

Lasting powers of attorney continue to be effective after you have lost mental capacity and so it is an important document to have in place, just in case something was to happen to you and you could not look after yourself.

Since 2007, when lasting powers of attorney were introduced, the prospect of filling in and registering a lasting power of attorney with the Office of the Public Guardian was a rather daunting exercise and put many people off. Even when the forms were complete and everyone had signed up, there was always the worry that the lasting power of attorney forms would be rejected by the Office of the Public Guardian.

The forms and the process have been simplified and it is now possible to do most of the work using an online toolkit at www.lastingpowerofattorney.service.gov.uk/home. This toolkit completes the forms for you but it is still necessary to print off the form for everyone to sign and it needs to be registered with the Office of the Public Guardian before it can be used.

Hopefully these improvements will encourage people to complete a lasting power of attorney for their financial decisions and for their health and welfare and it will also make it simpler for solicitors to prepare them for clients.

AUTHOR

MELISSA LAWSON
SENIOR COUNSEL
DD +44 (0)20 7849 2474
melissa.lawson@macfarlanes.com

MACFARLANES LLP
20 CURSITOR STREET LONDON EC4A 1LT
T: +44 (0)20 7831 9222 F: +44 (0)20 7831 9607 DX 138 Chancery Lane www.macfarlanes.com