TAX PULSE

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RAWLINSON & HUNTER

CONTENTS

WELCOME

Welcome to the Spring edition of Tax Pulse. We hope that your year has started well and that 2023 proves a successful, happy and healthy one for you. Just as green shoots pushing up through the soil into the light herald the season of growth, so will Jeremy Hunt be hoping that measures announced in his March Budget will produce similar green shoots for the UK economy and blossom into much needed growth.

In this edition of Tax Pulse, we take a look at the use of Family Investment Companies as an increasingly popular and practical way of spreading wealth across a family group. Prompted by the increasing contribution of Inheritance Tax to the exchequer, we go back in time and examine the origins and evolution of this unloved tax. In the second of three articles on UK residential property, we take a look at some of the tax issues associated with owning and letting residential real estate. We are delighted to include as our guest article a piece by Richard Jennings, a founder and director of investment consulting specialists JTFM, on the subject of setting investment parameters and monitoring manager performance. In US Tax Corner, we focus in this edition on investment into the US and in our final and more whimsical article, Rawlinson & Hunter Tax Manager Yugna Shah has written a truly mouth-watering piece on her other life as a part time chocolatier.

We hope that you enjoy reading Tax Pulse and if you have any feedback to give us or suggestions for future items, please direct your comments to the editorial team.

The Partners

KEEP IT IN THE FAMILY!

Family Investment Companies and their use in Succession Planning

In a previous edition of Tax Pulse (Issue 1) we considered the use of "investment wrappers", vehicles designed to reduce the tax impact on investment returns. One such "wrapper" was the Family Investment Company (FIC).

This brief note mainly considers FICs' estate planning potential.

FICs have become popular in recent years, partly due to the attraction of benefitting from corporate tax rates which are still significantly lower than higher rates of personal income tax and because of their potential in succession planning and Inheritance Tax (IHT) mitigation.

FICs have been viewed as a potential solution for family succession planning since major changes were effected in 2006 to the tax treatment of trusts. With effect from 22 March 2006, almost all gifts to trusts are chargeable lifetime transfers, giving rise to an immediate 20% IHT liability on asset value which, when aggregated with other chargeable lifetime transfers by the same donor in the previous seven years, exceeds the nil rate band (currently £325,000).

The immediate IHT charge has discouraged individuals from establishing and funding lifetime trusts since March 2006. However, these changes have not removed demand for a method of making controlled gifts, without immediate IHT, which stops short of placing capital at the outright disposal of young family members. The FIC is a vehicle which is intended to meet this demand. Trusts may still be a preferred option where the initial IHT charge does not arise, for example, where assets transferred qualify for IHT relief as business property.

What is a Family Investment Company?

The FIC is a private limited (or unlimited) company the share capital of which is held by different generations of the same family. Typically, it will have several share classes.

The FIC's founders, usually the parents who fund the company, would be the directors and are likely to have shares with all the voting rights but little or no dividend rights. This would give the parents control at Board and shareholder level. Other share classes would have all or most of the economic rights to dividends and capital on a winding up (except nominal capital attaching to the voting shares). The economic share classes can have different rights as to the timing and amount of dividends, as required by the family's circumstances.

If the parents funded the initial share capital, the economic share classes (or the cash to subscribe for them) could then be gifted by the parents to younger family members. On the basis that the share capital had nominal value, the gifts would result in no capital gain and for IHT purposes the gifts would be Potentially Exempt Transfers (PETs), albeit of a nominal value and so fall outside the parents' estates if they survive seven years from the date(s) of the gifts.

Typically, the FIC would then be funded by the parents transferring cash or assets in return for interest-free loans repayable on demand (although It should be noted that the transfer of assets might give rise to Capital Gains Tax liabilities). This would freeze the value of the loan in the parents' estates for IHT purposes at the nominal value of the loan whilst leaving a mechanism for future withdrawal of funds by way of loan repayment. Any future growth in value of assets and investments within the FIC would accrue to the value of the economic shares held by the family's younger generations while the parents retain control of the FIC's investment strategy and dividend distributions. This is a typical description for illustrative purposes. However, FICs are flexible and can be made bespoke for different family circumstances.

How Does a FIC Work?

The FIC operates like any other company. Typically it will pursue an investment strategy with portfolio investments under the management of its Board of Directors. This has several advantages.

Commercially, it allows investments to be pooled and managed together. From a succession planning perspective, it can be used as a vehicle to protect family wealth by not allowing it to dissipate, which might be the case if the assets passed directly to younger family members. It also allows younger family members to become involved with the management of the family's assets without the older generation ceding control. FICs can in other words be an educational tool, allowing younger generations to learn about managing investments and over time to help shape the family's investment strategy with their own insights.

From an IHT perspective, it enables growth in value of the family's wealth to accrue to younger family members, rather than to the parents. This can have significant benefits, over time.

An additional IHT advantage may be that when valuing a family member's interest in the FIC, a discount may apply (due to restrictions in the share classes and inability of minority shareholders to realise value from their shareholdings), such that the shares are worth less than a pro rata interest in the underlying assets. When considering family members as a whole, the cumulative effect of such minority discounts could be significant.

FICs may be set up using a limited or unlimited company vehicle. An unlimited company is not required to file accounts with Companies House so there is greater privacy. However, this is at the cost of creditor protection (although if the only assets held are unleveraged investments and not, for example, real estate or trading assets there may be limited exposure).

How is a FIC Taxed?

If the FIC is a UK tax resident company it will pay corporation tax on its profits. The main rate of corporation tax rises from 19% to 25% on 1 April 2023.

In addition to lower rates of Corporation Tax (compared with potentially higher rates of personal income tax of up to 45%) there are other potential tax advantages of FICs:

- Most dividends received by a UK company are exempt from Corporation Tax.
- If the FIC pays interest, it will be able to deduct the interest against its profits provided it is paid on a loan used for the purposes of the FIC's business.
- The FIC is allowed to deduct expenses incurred in managing its investments and operating its business.

Whatever IHT advantages FICs may have, it is worth noting that using a FIC may result in two layers of tax on its profits – once to Corporation Tax as they arise within the FIC and secondly to Income Tax or Capital Gains Tax on distribution to shareholders. So, one needs to consider whether profits are likely to be extracted and, if so, what the combined corporate tax liability and then the personal tax position of the individual shareholders will be.

There are also tax traps for the unwary. For example, dividends paid to minor children may in certain circumstances be taxed on their parents.

For Whom Are FICs Suitable?

FICs are likely to appeal to high net worth families looking to undertake medium term IHT and succession planning by re-distributing family wealth in a controlled way.

Foreign domiciled individuals who have not yet acquired deemed domicile status or individuals with assets qualifying for IHT relief (farmland, business property) may find that a trust remains the most effective option.

The Future?

FICs are not immune to future legislative or policy changes.

Tax rates may change, which may favour or discourage the use of FICs. The increase in the main rate of Corporation Tax to 25%, for example, is likely, prima facie, to make FICs less attractive than previously.

Following a review, HMRC announced in July 2021 that they had found no evidence that taxpayers who used FICs were in any way non-compliant with their tax affairs. However, HMRC's policy towards FICs might change and indeed a future government may see things differently.

Nevertheless, while Corporation Tax rates remain low by comparison with higher rates of personal income tax, FICs remain a popular option (among others) for medium term succession and estate planning.

Please speak to your usual R&H contact if you wish to discuss any aspect of this article.

INHERITANCE TAX – A HISTORICAL PERSPECTIVE

A Ticking Time Bomb

If there is one UK tax which irritates people more than any other, it is Inheritance Tax. The attitude of many who are exposed to it can be summed up by the comments of (perhaps ironically) Liam Fox, former Secretary of State for International Trade:

'It is not right to tax people's incomes, then their savings on that income, to tax the movement of assets through capital gains tax, stamp duty and tax them again though inheritance tax if they have the audacity to die.'

Yet an increasing number of people have been sucked in to the Inheritance Tax net through the effects of a surge in property values and the 'fiscal drag' effect of freezing of the nil rate band. This was increased to £325,000 with effect from April 2009 and is destined to remain at that level until April 2028 (at the earliest); had it kept pace with inflation since 2009, it would now be around £500,000. In spite of the introduction in April 2017 of the 'residence nil rate band', HMRC collected £6.1 billion in Inheritance Tax in 2021/22, an increase of 14% on the previous year and this is a trend which is set to continue.

A Labour politician Roy Jenkins said in 1986:

'Inheritance Tax is, broadly speaking, a voluntary tax paid by those who distrust their heirs more than they dislike the Inland Revenue.'

The ability to move liquid assets down generations by making lifetime gifts as 'Potentially Exempt Transfers', introduced in 1986, might have justified such an observation at the time. However, Inheritance Tax ceased to be a tax exclusively on the wealthy some time ago, as more and more property owners (especially in London and the South East) have come within its scope.

But Who is to Blame For This 'Iniquitous Tax'?

To quote from the famous scene in 'Life of Brian':

'What have the Romans ever done for us (well, apart from the sanitation, the medicine, education, wine, public order, irrigation, roads, a fresh water system and public health.....)?'

We can make a case for blaming the Romans for Inheritance Tax too. One of the earliest examples of an estate tax was introduced in 10AD under Augustus: the Lex Julia de Vicesima Hereditatum made provision for a 5% levy on the value of inheritances to provide land for retiring legionaries. There were, however, generous exemptions for inheritances from close relatives.

And What Were its Origins In Britain?

Although a probate duty was introduced in 1694 for estates in excess of £20, it was at a fixed rate of 5 shillings. It was not until 1780 that Lord North, motivated by a desire to provide funding for the American Revolutionary War (more commonly known now as the American War of Independence), converted it to a graduated rate, which depended on the size of the estate (Lord North was clearly 250 years ahead of his time, since this graduated probate fee is not dissimilar in concept to what the UK Government proposed in 2016 but subsequently mothballed).

Also in 1780, he introduced a tax on legacies (Legacy Duty). Against the tumultuous backdrop of looming warfare in Europe, this was expanded in 1796 to include 'every share of residue of the personal estate of any person dying and leaving such estate of the clear value of £100 or upwards'. Rates of duty were quite modest by today's standards, at 1% for legacies to lineal descendants or parents, and 3% for legacies to siblings. Real estate was initially excluded, but was brought within charge in 1805. The provisions were expanded in 1815 to include estates administered under intestacy law.

The Tax Evolves

Where the rules appeared to be inadequate, further provisions and taxes were bolted on to what was there already. In 1853 William Gladstone introduced Succession Duty, to catch situations which fell outside Probate Duty and Legacy Duty. Account Duty was brought in to catch lifetime gifts made in the three months before death, property passing to the survivor under joint tenancy (which therefore fell outside the Will) and property passing by way of lifetime gift where the settlor reserved the right to take back an absolute interest in the property (which can be seen as the forerunner of the current Gift With Reservation of Benefit anti-avoidance rules).

By 1894, the various interacting taxes could reasonably be described as a dog's breakfast, as reflected in the opinion of William Harcourt, the Chancellor of the day:

'The Death Duties have grown up piecemeal, and bear traces of their fragmentary origin. They have never been established upon any general principles, and they present an extraordinary specimen of tessellated legislation. Various measures have been made at different times to redress some of their inequalities. Here a patch, there a patch, but each successive modification has only left confusion worse compounded.'

It is natural to sympathise with Harcourt from the perspective of present day tax advisers operating in an era when it is not difficult to find similar examples of the 'here a patch, there a patch' approach to tax law! It is only regrettable that he was not himself more successful in devising a system free of such faults. Instead, he introduced Estate Duty to operate alongside Succession Duty and Legacy Duty. The rates in 1894 were relatively inoffensive, starting at 1% and rising to 8% on estates valued at more than £1 million. However, these were tinkered with on a regular basis and by 1949, the rate was 80% on taxable amounts above £1 million.

The Chancellor Stafford Cripps abolished Succession Duty and Legacy Duty in the 1949 Finance Act, leaving Estate Duty in place. Although this may have simplified and rationalised the law, its effects were no less severe since the highest rate by 1969 was a crippling 85% on amounts above £750,000.

The Modern Era

One of the criticisms of Estate Duty was that it could be circumvented by the timely making of lifetime gifts. Denis Healy, the Labour government's Chancellor of the Exchequer, addressed this in 1975 by replacing Estate Duty with Capital Transfer Tax (CTT). This was effectively two different taxes: a tax on lifetime gifts made more than 3 years before death and an inheritance tax on the value of the estate and gifts made in the period of 3 years before death. The rate on lifetime gifts was in most cases half the rate on estates, except on gifts over £500,000 when the rates came together at 65%, rising to 75% on transfers over £2 million.

Under the Thatcher government, there were reductions in rates and a lifetime gift accumulation period of 10 years before death was introduced. Nevertheless, the imposition of a tax on lifetime transfers had the unsurprising effect of deterring the transfers of wealth. Nigel Lawson, in his 1986 Budget speech, explained:

'By deterring lifetime giving, it has had the effect of locking in assets, particularly the ownership of family businesses, often to the detriment of the businesses concerned. Accordingly, I propose to abolish entirely the tax on lifetime gifts to individuals…..In recognition of the radically changed nature of the tax, I have decided to rename it the inheritance tax.'

And So To The Present Day…..

No matter how iniquitous Inheritance Tax may seem now in its present form to the increasing number of people in the UK who have to contemplate its effects on their estates, history tells us that it could be much, much worse. A fitting way to end this piece is to call a second time upon 'Life of Brian':

Always look on the bright side of life………

BRICKS AND MORTAR - UK RESIDENTIAL PROPERTY AS AN INVESTMENT

Read this article if you currently own and let UK residential property

Individuals who let UK residential property are subject to various ongoing compliance and admin requirements, some of which have been explored in this article.

Generally, profits generated by rental businesses are, by default, calculated using the cash basis. This applies where the gross property income does not exceed £150,000 in any given tax year. If this threshold is exceeded, the property income profit is simply determined using the accruals basis.

The cash basis involves a simple calculation per tax year, whereby income and expenses are accounted for when money is actually received or paid. Profit is determined by subtracting allowable expenses from the rental income.

Where the cash basis does not apply, property income is determined using the accruals basis. This involves analysing rents receivable, rather than rents received and similarly allowable expenses payable, rather than actually paid.

Allowable Expenses

Once a basis of assessment has been adopted (cash or accruals), any allowable expenses can be deducted from rental income to arrive at a profit/loss amount.

Usually expenses are only deductible from rental income if they are incurred 'wholly and exclusively' for the rental business.

Examples of allowable expenses include:

- Agent's fees and commissions
- Repairs carried out to the property
- Ongoing maintenance costs
- Water charges or council tax paid by the landlord
- Insurance premiums paid by the landlord

A clear distinction that needs to be made when looking at expenditure incurred on a rental property is whether it is 'capital' or 'revenue' in nature.

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Capital expenditure is not deductible against rental profits and records should instead be maintained for possible use when the property is eventually sold. Capital expenditure is identified as being costs which enhance or improve the property and can be distinguished from genuine repair expenses.

Capital expenditure may be incurred where an improvement to the property takes place, but even if repairs are extensive and involve an upgrade, they are not necessarily capital if the asset remains the same. For instance, technological advancements such as replacing single glazing with double glazing are not generally considered capital improvements. However repairs required to make a property habitable after it is acquired are treated as capital expenditure.

All other genuine property repair costs are deductible when arriving at rental profits.

Another beneficial relief where a property is let furnished is for ‘replacement of domestic items’, where relief is not available for the initial cost of furnishings but the cost of replacing those items may subsequently qualify, under both the cash and accruals basis. Domestic items include furnishings, furniture, and certain household appliances and kitchenware.

Loan Interest Deduction

Another common deduction against rental income was with respect to interest paid on a loan or mortgage taken out to acquire a rental property. To qualify, the loan has to be ‘wholly or exclusively’ in relation to the rental property.

With effect from 6 April 2017, the loan interest deduction formerly allowed against rental income in calculating profits began to be phased out over a 3 year transitional period. From 6 April 2020, the deduction was replaced entirely by a tax credit given as a reduction in the tax liability on rental profits. The amount of credit is limited to the basic rate of income tax (currently 20%) and is given on the lowest of the interest amount, the property income for the year (less any eligible losses) and adjusted total income.

Broadly, relief (in the form of the credit) is obtained with respect to loans taken out to purchase the respective rental properties. Full credit is given on loan interest even in the scenario that capital is withdrawn from the rental business, as long as the loan remains lower than the capital employed in the business.

It should be noted that relief can be obtained for additional borrowings, but only to the extent that those funds are used for a rental business purpose. Loans used for any other purpose will not qualify for relief.

Maintaining Sufficient Records

As with acquiring a property, the ongoing compliance requirements of renting residential property create a need to maintain sufficient records, should evidence be required at some later point (perhaps in the context of HMRC enquiry).

Examples of such records include:

- Agent’s statements and breakdowns
- Receipts for any repairs or maintenance costs
- Copies of any utility bills settled with respect to the property
- Rental accounts prepared for tax return purposes.

Furnished Holiday Lets (FHLs)

Landlords with an FHL can benefit from certain tax advantages, if the following conditions are met:

1. The property is furnished
2. The property is based in the UK or EEA
3. The property is available for letting for 210 days in the tax year
4. The property is actually let for 105 days in the tax year.

A key benefit of a property meeting the FHL conditions is that a full deduction is allowable for any loan interest paid on loans taken out with respect to the property. Profits generated from the letting of an FHL also qualify as 'earnings' for the landlord for pension purposes. Finally, FHL status means that certain Capital Gains Tax reliefs such as Business Asset Disposal Relief may be available at a future stage.

Rental Losses

Profits and losses on all UK rental properties are pooled together to give an overall profit or loss.

If a rental business generates a loss, this loss can be carried forward in order to offset against property income from future years. This cannot be carried back or offset against other income.

The same 'pooling' applies to UK FHLs, overseas property rentals and overseas FHLs. A loss generated in respect of a regular UK rental property can be offset against profits of a UK FHL in the same or subsequent years, but not the other way around. The same applies to overseas regular rentals and overseas FHLs.

A loss incurred on an FHL property can only be offset against future income from the same FHL business. UK and non-UK FHLs apply their own pooling such that losses incurred on UK FHLs can only be set against UK FHL profits and vice versa.

And finally…… this article deals just with the holding and letting of property by individuals. There are many more considerations and obligations where a company or a trust holds property. This is an increasingly complex area of tax law requiring detailed advice.

INVESTMENT AND MANAGER MONITORING

Read this for an insight into setting the parameters for an investment policy and then monitoring performance

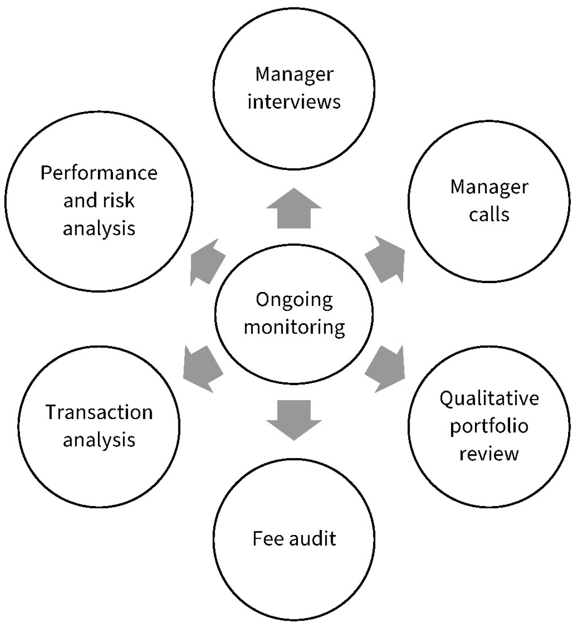
Overseeing and monitoring investments, together with the provision of independent advice on an ongoing basis, plays an important role in the investment management process. There are many inherent conflicts of interest involved with investing and for this as well as other reasons, independent oversight of third-party investment managers - and other investment assets that may be held directly (for example, private equity, commercial property etc.) - is critical in helping achieve successful outcomes.

The main purpose is simple: to establish whether the overall asset base is achieving the desired, as well as realistic, goals and objectives set by its owners; and, importantly, doing so in a way that complies and adheres to the owners' wishes, or a pre-agreed investment policy framework (often called an investment policy statement or IPS) that sets out the rules and parameters by which this may be achieved. In other words, are the arrangements fit for purpose and likely to remain so? The goal is to ensure that the consolidated whole remains relevant and effective in meeting the investors' ongoing needs and objectives.

Establishing an appropriate investment policy at the outset is essential to the monitoring process; one needs to have targets and objectives with which to compare outcomes. A well thought out and well-articulated investment policy statement is key to this as it provides a 'blueprint' or road map to follow and refer to in this somewhat complicated piece of choreography. A typical policy document or statement will detail, amongst other things: the investment risk and return objective; time horizon; income or distribution requirements and liquidity needs; preferences; attitudes to ethics, environmental, social and governance issues; and tax status. Ideally this should be agreed and clearly communicated to the various stakeholders involved in the process, including investment managers, accountants and lawyers, amongst others. Having a clear idea of what one is aiming for at the outset and an agreed framework as to how it might or should be achieved, is critical when it comes to avoiding future misunderstandings. These can arise from the investment managers or the owners - particularly so when dealing with a varied and frequently changing cast of participants, for example groups of trustees. Verbally agreed or vague commitments made some time ago can easily be forgotten or misinterpreted. If everyone signs up to a plan (the IPS) and agrees what is achievable and how it is to be done, then assigning responsibility for achieving the desired outcomes becomes much clearer.

The easy bit of monitoring, the measuring of historic performance in relation to stated objectives is relatively straightforward; staying on top of warning signs that may have an impact on a manager's effectiveness and hence future results, is more challenging.

Approaches to monitoring clients' managed portfolios should ideally comprise the following elements:



In combination, as well as a quantitative review of the past, this enables one to form a qualitative view of the future. Much of this is an ongoing process, with more formal periodic reports perhaps once or twice a year, although sometimes more frequently if required. Such reviews and reports (tailored to meet clients' precise needs and circumstances) are not intended to replace those produced by the managers. Rather, they aim to be additive and enable a better understanding of what is going on and what it all means. Revealing the bigger picture and enabling one to see the wood from the trees, ensures a focus on those areas that, for whatever reason, may not be delivering as expected and hence require further investigation and action.

The monitoring report should show, as a minimum, the performance and risk characteristics relative to the agreed investment objective, together with a range of appropriate reference benchmarks (including peer-group comparisons and indices), ideally ones selected and agreed upon at the outset. This enables comparisons to be made on a like-for-like basis, at the individual manager level, for assets held directly, and on a consolidated basis. The consolidated picture is so important as this reveals the overall asset mix (revealing overlaps and other concentrations) and how it is performing in terms of achieving the desired results. Without this context it is often too easy for discussions to be hijacked by a focus on small issues that may have little impact on the overall outcome.

There are many other areas the monitoring process should seek to cover. For example, in addition to regularly reviewing the client's position and making sure that the investment policy is updated accordingly, it is also essential to review the position and characteristics of the investment managers. Often firms experience cultural changes, particularly following the movement of key personnel or a merger or takeover. Incentives and motivations of staff can change too. Likewise, and for similar reasons, investment processes evolve over the years and it is important to understand how this impacts clients. Are changes more to help the manager, maybe in response to a corporate imperative of some sort, or are they genuinely in clients' best interests?

In conclusion, the primary objective of a well-ordered investment monitoring process is to ensure that the clients' ongoing investment arrangements are fit for purpose and stand the best chance of meeting their needs and requirements in the future. Before the event, no one can pick what may turn out to be the best performing investments or managers, and it is often dangerous to think that one can. However, minimising the risks of avoidable accidents, mistakes and misunderstandings is an extremely important endeavor and one that is surely incumbent on all of us charged with assisting clients in preserving and growing their wealth.

Guest article by Richard Jennings, a founder and director of JTFM, investment consulting specialists

US TAX CORNER

Welcome to the fourth edition of US Tax Corner. In each quarterly edition of Tax Pulse, we take a key theme of US taxation and explore it in more detail.

All of our articles in US Tax Corner are written by our in-house UK/US tax team here at Rawlinson & Hunter LLP. In this quarterly edition, we will take a brief look at the onerous US tax and informational reporting requirements.

In the second of our two articles on investment, we look at inward investment into the US for a non-US person and some of the tax considerations. We have split this between the two most common scenarios that we see, being the investment into a trading business in the US and the purchase of a property for personal use, which you may let out.

Coming to America

When setting up a business in the US, there is often a discussion over the appropriate structure and from a domestic US tax perspective, it is common to have a solution which apportions the profit to the individual owner rather than a corporation (as we may do in the UK). This preference is rooted in high corporate tax rates, which until recently were 35% at federal level, plus State taxation. However, with a lower 21% federal corporate tax rate, plus State taxation, a corporation is perhaps not as unattractive as it once was.

The most common business structure in the US remains a Limited Liability Company ('LLC'), which provides the limited liability protection for business owners, and can allow for the business owners to be taxed on their underlying share of the profit and loss, as you would with a partnership. The more domestic S-Corporation is only available to shareowners who are US persons, either residents or citizens, so is outside the scope of this Article.

For US tax purposes, a foreign person is taxed on US source income and gains from their investment. In a trading business, the profits (referred to as Effectively Connected Income or 'ECI') are liable to federal and State taxes. The US will have primary taxing rights over profits generated from a business conducted in the US. This primacy of taxing rights also extends to profits from the exploitation of land and property, as well as the gain on the sale of the business and the real property. The US enforces the payment of tax by foreign resident business owners by the application of strict withholding tax rules, so for the distribution of profits matched to ECI, this is 37% (which is the top rate of US federal income tax).

However, for a UK tax paying member of a US LLC, this creates potential UK tax concerns. It has been, and indeed remains, the view of HMRC that a US LLC should be treated as a corporation for UK tax purposes. This means that the nature of what is received by the member is typically a dividend and not a distribution of the underlying specific profit. This mismatch leads to potential double taxation where the underlying profits are subject to US federal and State taxation, with the distributions also being liable to UK taxation with no credit for the US taxation paid. This matter was the subject of litigation which ended up in the Supreme Court in 2015, the Anson case.

This involved an individual who was a member of a trading LLC, though UK resident. In this case, the UK tax returns had been prepared on the basis that LLC distributions were identified as underlying profit share of the LLC, effectively treating the LLC as a partnership (which avoided this mismatch) rather than an opaque corporate entity. In the final judgment, the Supreme Court allowed the taxpayer a credit for the federal and State taxes paid, contrary to the position taken by HMRC. Since then, HMRC has provided some very brief commentary that the Anson case is effectively being regarded as distinguished on its facts, and does not alter their view generally that most LLCs should be treated as corporations for UK tax purposes. We are in active correspondence with HMRC on this topic for a number of clients, though we await further guidance from HMRC or a potential case to be taken before the Courts.

Where clients have existing UK businesses and want to expand into the US, the question is often how to integrate them into an existing corporate structure. Here, this tends to be less fraught as the terms of the UK/US double taxation agreement are better set to deal with the onward distribution of profits out of the US. Where there is a UK parent and the US operation is run as a corporation, the dividend withholding tax rate on distributions out of the US is often just 5%, and is not taxed in the UK in the hands of the UK parent. Moreover, on the sale, the UK parent may be able to benefit from Substantial Shareholding Exemption in respect of the capital gain. When setting up in the US, there are a myriad of other considerations, including the location of the leaders of the business (if they are in the UK, have you made your US entity a UK resident company?), transfer pricing between the UK and the US entity to ensure that an appropriate revenue (and profit amount) is booked in each jurisdiction, as well as formation, accounting and administration of the US entity to name but a few matters.

Room With a View

For an individual who wants to purchase that pied-a-terre in New York, the California beach fronted condo or the slice of Big Sky, the common question is whether to incorporate or not. However, this plays into two main taxes, being Estate Tax and Capital Gains Tax, so an individual's motivations, plans and circumstances will dictate the appropriate structure. It also depends on whether you can access one of the few Estate and Gift Tax Treaties which the US has with other jurisdictions, including, for the purposes of this Article, the one with the UK.

The starting point from a taxation perspective is that the rental profits from a US property and the gain on the sale of the property are subject to US federal and State taxation, though not all States levy taxes. In addition, there is often a drive to have a structure that builds in limited liability for the owners, so the LLC is often mooted. Here, the concern is whether this leads to double taxation as highlighted above. The answer here could offer more comfort given the nature of the asset. Where a property is owned by an LLC, the next logical step following sale of the property is that the LLC is wound up as part of the process. So, if the LLC is a regarded as a corporation, the logic must be that the process of winding up the LLC is similar to a liquidation (as we may well understand this in the UK) and the proceeds are dealt with under the capital gains regime. This does lead to a position that a UK taxpayer may only get a deduction for the US federal and State tax paid on the sale of the property, rather than a credit. As noted above, in the Anson case the Supreme Court provided the taxpayer with a credit for his US federal and State taxes, so the argument still remains that this is a position which can be taken, following a careful review of the individual circumstances.

For the long-term property owner, the Estate Tax issues will be relevant and so what happens on the death of the property owner needs consideration. Under UK tax law, assets left to a surviving spouse or civil partner are treated as exempt from Inheritance Tax, but this is not of universal application in the US. The starting point is that a non-US person in possession of US situated assets valued at more than $60,000 on their death will be subject to Federal Estate Tax. To avoid this, it is common to have a corporate vehicle or vehicles between the individual and the US situated assets to act as a blocker for US federal estate tax purposes. This will often increase the capital gains tax due on a sale, so should only really be considered where there is no desire to sell.

However, there is some additional helpful (though limited) relief in the provisions of the UK/US Estate & Gift Tax Treaty, which can exempt the US property from US Federal Estate Tax where the deceased's assets are below the US Federal Estate Tax Exemption for US citizens and domiciled taxpayers (currently just under $13million). An election can be made on behalf of a deceased individual who was a UK national with the result that they pay US federal estate tax as if they were a US citizen, which may effectively exempt the US property from US Federal Estate Tax or at least reduce the liabilities. This does need some careful consideration as this plays into wider estate planning.

LIFE IS LIKE A BOX OF CHOCOLATES...

In our last article of Tax Pulse, we traditionally like to move away from matters of tax and finance, and instead focus on a member of our team involved in something interesting or unusual outside work.

Whether it's just for the love of it or for allowing us to express our creative side, hobbies play an important role for many of us outside of our professional lives. This couldn't be more true for Yugna

Shah, who recently joined the private client team as a manager. She has a truly mouth-watering way of indulging both her creative tendencies and her entrepreneurial flair!

Her love for sweet delicacies and passion in painting led her to experiment with colour and flavours to build a chocolate business – The Painted Peacock. All the chocolate bonbons are made by hand and painted using colourful edible cocoa butter. Each chocolate bonbon has an incredibly thin crisp outer shell that surrounds a centre of soft, velvety ganache made using high quality ingredients comprising of exotic spices, fresh garden herbs, nuts and fresh fruit purees (is your mouth watering yet?!). She also has a vegan range that has proved to be popular, taking advantage of the growing trend for vegan desserts.

Yugna grew up in Kenya and giving back to the less privileged was at the core of her family. Sometimes it would be giving food, sometimes it would involve painting the rooms of a children's orphanage. After moving to the UK, she has continued with supporting various orphanages and a portion of the profits from The Painted Peacock are donated towards various charitable work. The next project is to set up a self-sustaining bakery in a container and her recent summit to Mt. Kilimanjaro has allowed her to start raising funds for this.

Unsurprisingly therefore, it is crucial for Yugna that her chocolates derive from ethical processes. As well as only using recyclable packaging, she uses Colombian chocolate produced by Casa Luker, who use cocoa beans awarded with a Fino de Aroma classification. Their Granja Luker initiative upskills local farmers free of charge, providing the education and tools needed to farm cocoa beans. She is hoping to visit their farms later in the year when she travels to Colombia.

Yugna has explored several different avenues to promote her chocolates. She explains:

"In May 2021, I was extremely fortunate to have been selected to showcase my beautiful chocolates at a pop up shop on Oxford Street. It was truly wonderful to experience selling in a shop open to London's busiest shopping destination. The BBC did an article about 'Oxford street pop up shops to host online retailers'. Being featured in this article was a real pinch me moment! The Spirit of Christmas fair held at Olympia was one of my favourite places to sell at. I met so many people who loved our chocolates and ordered several gifts for their loved ones. Some couldn't believe they were chocolates, they thought they were marbles or jewels!"

She has several corporate clients who order with her for various gifts from "thank you" to clients, for relaunching their brand as well as Christmas gifting for their clients or staff. She particularly enjoys the challenge when the chocolates need to be bespoke with the brand colours which lets her fully customise the chocolates to the client's needs. She also caters for wedding favours.

Over the years, Yugna has streamlined a lot of her processes in running the business so that they complement her building a successful career in private client tax. She enjoys working with numbers and loves her client work, but the chocolate business gives her free rein to express herself artistically.

It is truly a treat for all of us when Yugna brings samples of her chocolates into the office. They look and taste fantastic! Although you might expect us to be biased, there is some market data to back this up since The Painted Peacock has also won the Great Taste Awards for a couple of their flavours.

If you fancy giving her chocolates a try or learning more about what she does, her website is:

www.thepaintedpeacock.co

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