

LEGAL ALERT

PRIVATE CAPITAL BULLETIN

Rollits
SOLICITORS

PASSING ON YOUR FAMILY BUSINESS

Owners of family businesses face particular problems when deciding if, how and when to pass the business down to the next generation. Some younger family members may already be actively involved in the business and have a legitimate expectation that they will one day be given control. Others may not wish to be involved and will need to be compensated in some way – where the business is the main or only family asset, this can be difficult to achieve.



Valuable reliefs from inheritance tax (IHT) and capital gains tax (CGT) are currently available. For IHT, business property relief (BPR) at up to 100% may apply to owners of businesses whether as sole proprietors, partners or holders of shares in private companies, but there are pitfalls and it is important to ensure that the business will qualify for the relief. If BPR is available, gifts of business assets to the next generation (either absolute or into trust) should be considered to capture the relief now. However, great care must be taken to ensure that in saving IHT, one does not create a CGT liability. In particular, if a sale or floatation of the business is likely in the short term, CGT taper relief will need to be preserved and other measures to save IHT may need to be considered.

The cornerstone of any estate planning exercise is a properly drafted and up to date Will. Further planning will depend on each client's particular circumstances although trusts will often play an important role enabling gifts to be made for tax purposes with no loss of control, as the settlor and spouse can be trustees. Depending on the type of trust used, decisions as to who should benefit, how and to what extent can be postponed maintaining maximum flexibility. Combined with suitable life assurance arrangements, a solution to suit the whole family should be achievable.

Tax planning for the business owner can be a complex area but the key is to start as early as possible, to maintain flexibility and to keep everything under review. Having worked hard to build up your business, take the time to plan how it can be passed down to the next generation.

NEW LASTING POWER OF ATTORNEY SET TO REPLACE THE ENDURING POWER OF ATTORNEY

It has long been recognised that any individual can, through illness or old age, become unable to take care of his or her own assets and finances. In the past an Enduring Power of Attorney, (EPA) has been available to ensure that in the event of this happening, assets (including property) can be taken care of by a person or persons (an attorney) already nominated by that individual.

However, the Enduring Powers of Attorney Act 1985 is now to be replaced by the Mental Incapacity Act 2003. The new legislation will create a new vehicle called a Lasting Power of Attorney (LPA). The new LPA will allow an individual (the donor) to confer powers on a donee (formerly the attorney under the old legislation) to make decisions about both the donor's personal welfare and finances.

LPA's are a wider form of the current EPA as they grant greater powers to the donee. Crucially, a donee under an LPA will have the power to make decisions about the general welfare of the donor including healthcare matters and the consent or refusal to medical treatment.

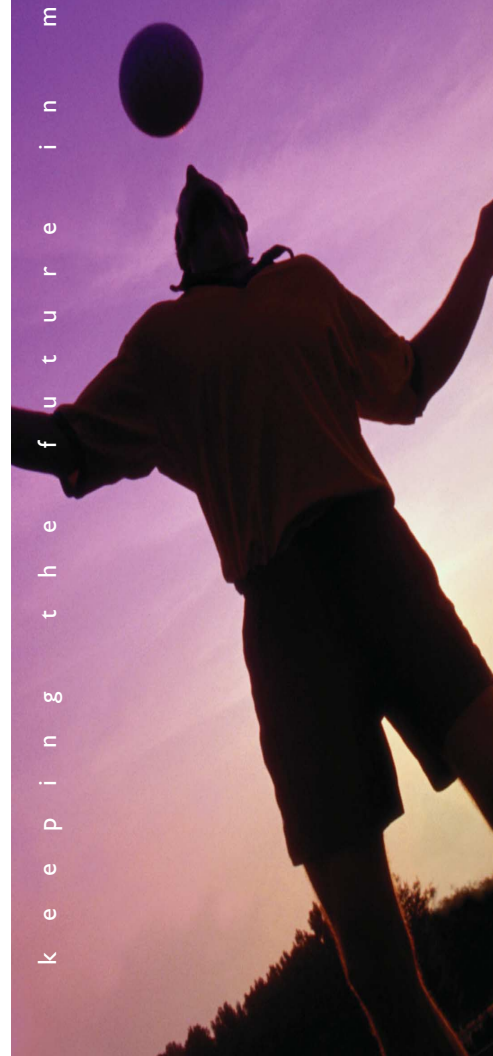
The donee will still have the power to make decisions relating to the donor's assets and financial matters, which includes dealing with the donor's bank accounts and property.

As many people already have EPAs in place, the draft Bill provides for existing EPAs to continue to be effective. However they will not have the extended powers relating to the donor's personal welfare, and clients wishing to ensure that such decisions are dealt with by a person appointed by them are advised to execute an LPA as soon as these become available which is likely to be in the very near future.

IN THIS ISSUE

- PASSING ON YOUR FAMILY BUSINESS ●
- NEW LASTING POWER OF ATTORNEY SET TO REPLACE THE ENDURING POWER OF ATTORNEY ●
- PENSIONS TAX SIMPLIFICATION TO PROCEED ●
- INHERITANCE TAX AND THE FAMILY HOME

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PENSIONS TAX SIMPLIFICATION TO PROCEED

The recent Budget confirmed that the proposals initially made by the Inland Revenue in December 2002 and revised in December of 2003 for the simplification of the taxation of pensions will be implemented. Significantly, the proposals are to be implemented from April 2006, allowing employers and providers time to make the necessary preparations.

The December 2003 proposals indicated that they were subject to consideration by the National Audit Office as to whether the proposed lifetime allowance of £1.4 million was equivalent to the maximum pension available under the current earnings cap, and whether the government's estimate of the number of individuals likely to be affected by this lifetime allowance (ie 5,000) was realistic.

Not surprisingly, the National Audit Office broadly agreed with the government's figures.

The government has taken on board some of the concerns raised in consultation, and in setting a commencement date of April 2006 has increased the initial lifetime allowance to £1.5 million, and pre-announced annual increases in that allowance up to 2010 (when the allowance will be £1.8 million), together with a review of the lifetime allowance and indexation every 5 years (the first review taking place in 2010).

Additionally, the annual contribution allowance has been set initially at £215,000 rising to £255,000 by 2010, such figures also being reviewed every five years.

The basic proposal is to replace the existing eight separate tax regimes covering pension provision with a single regime, where benefits up to the lifetime allowance receive favourable tax relief, and the value attributed to pensions within the annual allowance will not be charged to tax (ie contributions or the value attributed to a defined benefit pension for the year). Tax relief on employee contributions for the year is available up to 100% of earnings or £3,600, whichever is greater).

Defined benefit (final salary) pensions are to be valued at a factor of 20:1 for both the annual allowance and the lifetime allowance. The lifetime allowance would equate to a defined benefit pension of £70,000 per year on this basis.

It will be possible to protect the value of benefits in current pension schemes above the lifetime allowance as at 5 April 2006, by being granted an uplifted lifetime allowance equal to the value of the accrued rights, increased in line with RPI. Alternatively, all benefits at 5 April 2006 can be protected (including any future salary and investment growth) so long as there is no future accrual and no contributions made after that date.

The lifetime allowance is tested only when benefits are taken. If benefits at that point exceed the lifetime allowance, the excess will become subject to a recovery charge of 25%, with the remaining amount also being taxed at the individual's marginal rate. This equates to an effective tax rate for higher earners of 55%, and the excess may be drawn as a lump sum subject to this 55% tax.

In addition, members of all pension schemes will be able to take a tax-free lump-sum of 25% of the value of their benefits. Previously most members of final salary schemes were limited to less than this amount, depending on which tax regime applied to them.

The new regime will also allow for individuals to be a member of both an occupational and a personal pension at the same time. It also will allow benefits to be taken whilst still in employment. This has been the case for personal pensions, but had not previously been allowed in occupational schemes.

Much detail will need to be added to the proposals, but now that the government is committed to implement the tax simplification, this should be forthcoming over the next few months.

INHERITANCE TAX AND THE FAMILY HOME

Over the last few months there has been a good deal of press coverage of schemes designed to allow parents to give their houses away, continue in occupation and escape inheritance tax on their value. These schemes have had various names including "the Home Loan Scheme", "the Double Trust Scheme" and "the I.O.U. Scheme".



Perhaps not surprisingly, the Government has taken steps to outlaw these arrangements, not only to deny the tax advantage to new schemes, but also to penalise existing schemes that are not dismantled within the next 12 months.

Two points come out of this.

First, and most obvious, everyone who has undertaken such a scheme should take careful advice as to what steps should now be taken to protect their position.

The second point is less obvious, but nonetheless important. The fact that this particular scheme has been attacked does not mean that it is impossible to take some or all of the value of the family home out of the inheritance tax net through the use of less provocative tax planning devices.

Depending upon individual circumstances it is possible to shield up to £1/4m of value from IHT using fairly simple steps, and it is still possible for the whole of the value of the home to be sheltered at a relatively modest ongoing cost. This cost can be mitigated even further where grandparents are looking at IHT planning at the same time as wishing to make provision for grandchildren, for example through the provision of school fees.

INFORMATION

**If you have any queries on any matter detailed in this bulletin please contact:
John Lane on (01904) 625790 or
Caroline Hedges on (01904) 688524**

This bulletin is for the use of clients and will be supplied to others on request. It is for general guidance only. It provides useful information in a concise form.

Action should not be taken without obtaining specific advice.

We hope you have found this bulletin useful. If, however, you do not wish to receive further mailings from us, please write to Mrs. Pat Coyle, Rollits, Wilberforce Court, High Street, Hull, HU1 1YJ.

The law is stated as at 18 March 2004

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