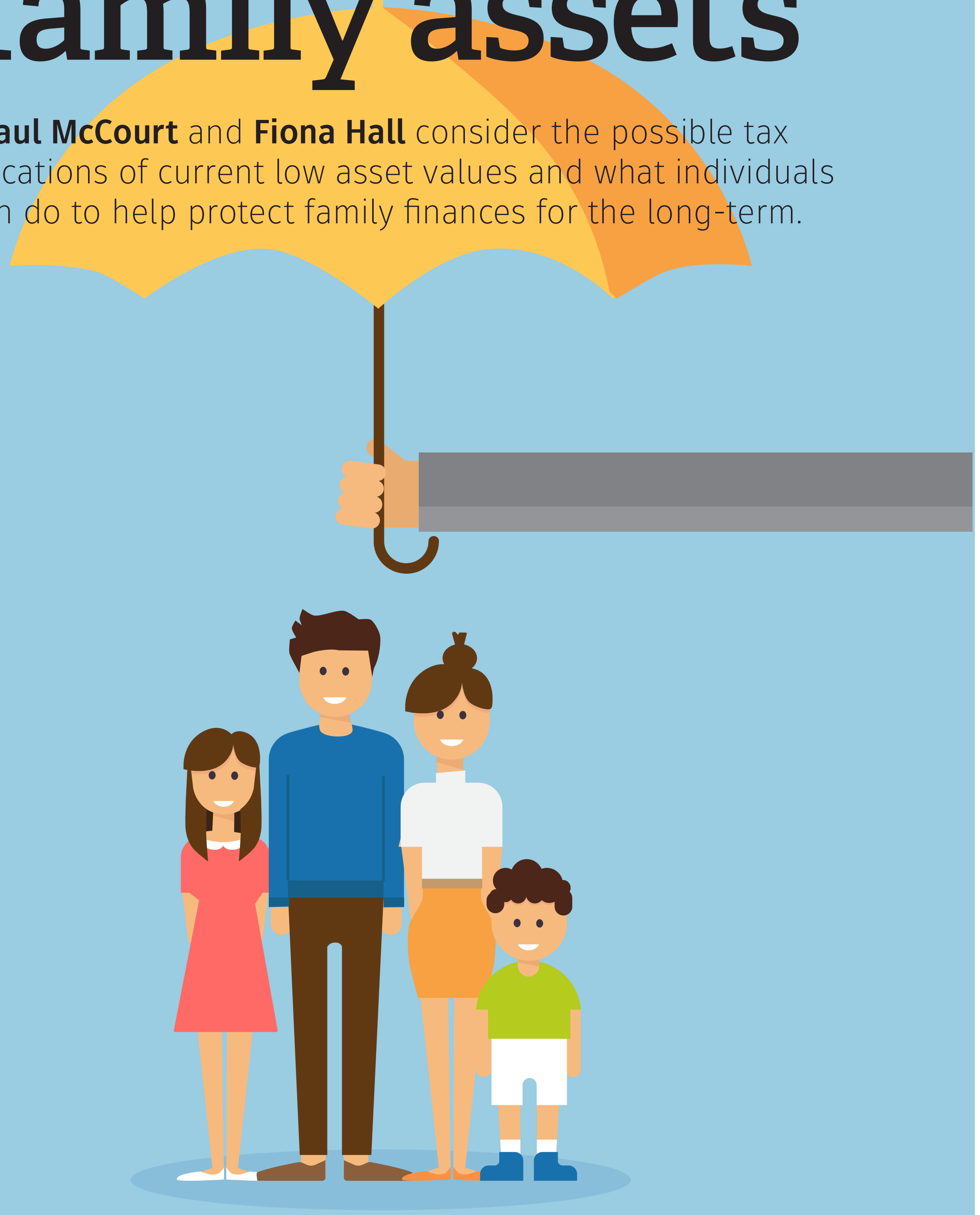
PROTECTING family assets

Paul McCourt and **Fiona Hall** consider the possible tax implications of current low asset values and what individuals can do to help protect family finances for the long-term.



The COVID-19 outbreak is having a range of effects on families and individuals, with many investors seeing family finances suffer and the value of their assets fall in recent months. An important factor to remember at this point is that when an individual makes a gift, it is the current market value of the asset being gifted that applies for both inheritance tax (IHT) and capital gains tax (CGT) purposes.

Trusts

The creation of a trust to hold assets for the benefit of the wider family or dependants has been a long-standing solution for many individuals seeking to pass assets to the next generation. Settling a trust is generally a chargeable IHT event. However, if the settlor's nil rate band is fully available, individuals can transfer £325,000 of assets into the trust without incurring an IHT liability. This could increase to £650,000 for married couples jointly settling a trust with the availability of two nil rate bands. CGT hold-over relief may also be available so that the gift to trust does not trigger a CGT liability.

For those considering using a trust, or who have already established one, now may be the time to gift or sell assets. When assets pass out of the trust to a beneficiary, either by way of an entitlement or an appointment by the trustees, any IHT and CGT liabilities are based on the current market value of the assets passing. Trustees may wish to consider whether the trust continues to meet its objectives and whether it is now appropriate to appoint assets out to trust beneficiaries.

Personal gifts

Gifting an asset to another individual is often a potentially exempt transfer for IHT purposes. As such, if the donor survives for seven years from the date of the gift, it falls out of their IHT estate. However, if the donor does die in this period, the value of the assets gifted at the time the gift was made could become taxable.

Where a gift fails the seven-year rule, subject to reliefs and the IHT nil rate band (currently £325,000), IHT could be payable on the gift (by the recipient or the executors) or the value of the estate. Making a gift when asset values are low will mitigate the potential IHT exposure for the individual considering gifting an asset.

A gift is treated for CGT as being a disposal of the asset at market value by the donor. This could trigger a capital gain if the value exceeds the allowable cost unless the assets qualify for business assets hold-over relief.

When asset values are lower, the likelihood of a gift triggering a gain is reduced, or a gift may give rise to a loss. Care should be taken in generating a loss on gifts, as any losses arising from the disposal of an asset to a connected person can only be set against gains that arise from other disposals to that same person. Capital losses generally carry forward to future years, but not back so timing is vital.

Crystallising 'paper' losses

Individuals may consider crystallising a current 'paper' or book loss on an investment and repurchasing a similar asset. Any such loss can then be offset against capital gains arising on asset disposals made in the same, or later, tax years. It is important to note, however, that 'bed and breakfasting' of shares is often ineffective for tax purposes and particular care is required with transactions conducted personally, via an ISA or between spouses.

As with any investment decisions, independent investment advice should be sought before proceeding.

Exercising share options

Where an individual exercises an option to acquire shares in an employer through a non-tax-advantaged share plan, income tax is charged on that exercise on the difference between the market value of the shares at the date of exercise and the amount paid for the shares under the option. If the shares acquired are 'readily convertible' (i.e. easy to sell for cash or shares in a subsidiary company) National Insurance Contributions will also be due on the exercise of the option.

Exercising such options while the value of a company is temporarily reduced could reduce tax liabilities in the longer-term. However, this is clearly a risk-driven investment decision on which independent investment advice should be sought before proceeding. One of the key benefits of holding an option is that it would often be exercised before an exit event (e.g. the sale of the company) so that there is an immediate return of value. In the absence of such an event, the implications of becoming a shareholder in the company, and the risk to the value thereby invested, should be considered carefully.

Pensions – lifetime allowance

An individual whose pension pot was previously above the lifetime allowance of £1,073,100 (and with no protection/enhanced protection) might choose to crystallise pension benefits now while the fund value is reduced to reduce/eliminate the lifetime allowance tax charge.

There are many financial, investment and IHT issues to consider carefully before proceeding, but acting now may save tax in the long-term. Action should only be considered as part of overall wealth planning, including advice from an independent financial adviser.

Short-term opportunity to achieve long-term goals

This is a difficult time, but any temporary reduction in asset values may allow clients to pass assets into trust or to the next generation at a lower tax cost than both a year ago and a year from now.

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