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## Buy to Let - Get Your Tax Return Right!

HM Revenue and Customs are concerned that many buy to let landlords are not paying enough tax. It is estimated that up to 80,000 have overstated their deductions for tax purposes by including the capital element of mortgage repayments (not allowable) as well as the interest on the sum borrowed (allowable). The key point here is that if the mortgage on your buy to let property is of the repayment type (which may not be the most tax-efficient way to finance it!), make sure the sum you claim on your tax return as a deduction for interest paid does not include the capital repayment.

The taxation of rental income is complex, with a variety of different rules applying depending on circumstances. The rules relating to the treatment of losses also vary depending on the type of rents you receive. For example, there are different rules for all of the following types of residential letting:

- rent a room receipts for rooms let in one's own house;
- furnished holiday lettings;
- furnished lettings; and
- unfurnished lettings.

It is also worth mentioning that the responsibility for asking for a tax return if you have taxable income and do not receive one lies with the taxpayer. If you are not sent a tax return and have taxable income not subject to PAYE, you should request one or face a possible penalty.

Also, there is usually also considerable scope for tax planning to mitigate the effect of Capital Gains Tax on the disposal of let properties.

It is always worth taking professional advice to make sure that your investments of all kinds are managed in a tax-efficient way. Contact David Wright for further advice.

## CGT and Non-Business Assets

Much has been made of the Capital Gains Tax (CGT) changes, announced in the pre-budget report in October, regarding the taxation of business assets, due to the abolition from 6 April 2008 of 'taper relief'. However, the CGT position regarding non-business assets will also change significantly from that date.

At the moment, CGT is payable on gains exceeding the annual 'CGT-free allowance' (currently £9,600) in any year. The effective rate is the marginal Income Tax rate of the taxpayer, which means the CGT payable can be as much as 40 per cent of the chargeable gain. From 6 April 2008 CGT will be payable at a flat rate of 18 per cent.

However, one big change is that CGT 'indexation relief' will be abolished completely. This will greatly increase chargeable gains on assets which were acquired many years ago. At the moment, indexation relief acts to remove the effect of inflation from the date of acquisition (or 31 March 1982 if the asset was acquired prior to that date) to the date of disposal of the asset by applying an uplift to the notional cost. Although indexation relief stopped when taper relief was introduced, the indexation relief up to April 1998 (when the Retail Price Index was 162.6) was preserved, which significantly reduced the chargeable gains.

If you have assets the disposal of which would trigger CGT, you should give consideration to your tax position. Assets in this category would include stocks and shares, second homes and so on. Your principal private residence continues to be exempt from CGT.

## HMRC Publishes Nil Rate Bands

The recent Inheritance Tax (IHT) change which allows the transfer of 'unused' nil rate bands from spouse to spouse or from civil partner to civil partner has been generally welcomed, but it has caused some consternation as determining the 'old' nil rate band that applied on the first death can be tricky.

It is widely thought that the balance of the allowance available is based on the current allowance but, in reality, it is based on the proportion of the allowance that was unused in the tax year during which the first death occurred. Therefore, to work out the available amount of nil rate band which can be offset on the second death, it is necessary to know both the value of the estate transferred on the first death and the amount of the nil rate band for that year. The available allowance on the second death is the deceased's own allowance plus the unused percentage of that of the first spouse times the allowance in the year of the second death.

In an attempt to make the calculations easier, HM Revenue and Customs (HMRC) have published nil rate band tables for IHT and for its predecessor taxes (Estate Duty and Capital Transfer Tax), for all years from August 1914 to date.

HMRC have also published on their website further guidance, in the form of frequently asked questions, about the transfer of the nil rate band: see the 'What's New' pages of HMRC's website at http://www.hmrc.gov.uk/cto/iht/whatsnew.htm



## Probate Team Biography details

**Michael Wills** Michael joined Moss Solicitors in August of 1959 and qualified as a Legal Executive in June of 1968 on his 25th birthday - the earliest possible date. In March 1998, very shortly after the Society of Trust and Estate Practitioners (STEP) was founded, he became a member of the society and a TEP. Michael is exceptionally experienced in all aspects of private client work.

**Jayne Parsons** Jayne has been with the firm for over 25 years and qualified as a Legal Executive in 2000. She is currently undertaking the Legal Practice Course, to enable her to qualify as a solicitor.

**Karen Ward** Karen is a paralegal who joined Moss Solicitors in 2005. Karen is part way through her STEP diploma course.

**Anthony Benskin** Anthony qualified as a solicitor in 2003 having joined Moss Solicitors as a Trainee in 2001. He advises on a range of Private Client matters, including wills and trusts, probate and inheritance tax planning.He has recently passed the STEP foundation exam.

**Diane Green** Diane provides Estate/Trust accounts and tax return services for the firms' clients.

Further details on all the services that we provide can be found on our website at **www.moss-solicitors.co.uk**


MOSS
SOLICITORS

80-81 WOODGATE LOUGHBOROUGH LEICESTERSHIRE LE11 2XE
**T:** 01509 217770 **F:** 01509 233698
**E:** ENQUIRIES@MOSS-SOLICITORS.CO.UK **WWW.**MOSS-SOLICITORS.CO.UK



WOODGATE
FINANCIAL SERVICES LTD
an associated business of Moss Solicitors

80-81 WOODGATE LOUGHBOROUGH LEICESTERSHIRE LE11 2XE
**T:** 01509 635467 **F:** 01509 233698
**E:** ENQUIRIES@WOODGATEFS.CO.UK **WWW.**WOODGATEFS.CO.UK





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# THE 'SEVEN YEAR RULE' FOR IHT

It is widely known that when assets are gifted by one person to another a potentially exempt transfer (PET) arises for Inheritance Tax (IHT) purposes. Once a donor has survived for seven years, the PET falls out of charge and can no longer affect the IHT payable by the estate. Whilst this is widely understood, it isn't strictly correct!

The problem arises if there is a PET which fails (i.e. becomes chargeable due to the donor failing to survive for seven years). If that occurs, transfers made in the seven years prior to the date of the failed PET are indirectly brought into the computation also.

In practice, this may mean that a recipient of a gift made (say) five years prior to death may face an IHT liability as a result of an earlier gift.

The planning point here is that until there is a clear period of seven years after a PET is made, it can be brought into account for IHT purposes and the resulting sum payable will depend on earlier PETs, if any have been made within seven years of the failed PET. Secondly, unless the donor survives the full seven years after making a gift, the recipient may face an IHT charge on it. The amount of that charge will depend on the amount and date of earlier gifts. Potentially, the final IHT position may be affected by a gift made any time within the 14 years before the date of death.

IHT planning needs to be approached with great care and should only be undertaken with expert professional advice - there are many pitfalls. Contact us for advice on all IHT planning matters.

## In Brief

### Estate Returns - Random Checks

HM Revenue and Customs (HMRC) have announced that they are to commence carrying out random reviews of returns lodged with them for Inheritance Tax (IHT) purposes. According to a recent newsletter, reviews will concentrate in particular on looking at gifts made by the deceased in the seven years prior to death. Such gifts, unless covered by one of the IHT exemptions, need to be taken into account when calculating the value of the estate for IHT purposes.

## Case Sounds Foreign Will Warning

A man who died in Barbados leaving a will there as well as a will made in the UK created a problem for his family. The will made in Barbados was drawn up after his English will and contained the usual clause 'revoking all former wills and testamentary dispositions'. The will contained details of various bequests and dealt with the man's property in Barbados, but it made no mention of any arrangements for his interment or his UK assets.

The court accepted that the later will was an additional will, intended only to deal with the man's assets in Barbados, and therefore his English will was the basis under which his other assets should be distributed.

The important issue here for people with assets (such as a holiday home) abroad is that whilst it is normally very sensible to create a 'local will', this should specify the assets it covers. In the worst case, an inappropriately drafted will may revoke an earlier English will, but at the very least, as in this case, it may add time and expense to the administration of the estate.

Contact us for advice on estate planning, wills or any related matter.

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## IHT and the Pre-Budget Report - Traps Still Remain

It is likely that the changes in Inheritance Tax (IHT) announced in the October pre-budget report were motivated more by Chancellor Alistair Darling's desire to steal the Tories' thunder than a recognition of the true problem, namely that rising house prices have plunged many people of modest means into a tax regime originally designed to affect only the rich.

Be that as it may, the changes - hailed widely as a 'doubling of the IHT nil rate band' - were seized upon with great enthusiasm. On closer inspection, however, there seems less to cheer about than was first thought.

Firstly, the IHT nil rate band will not be doubled, except in cases in which two spouses or civil partners die in the same tax year. In other cases, the amount available on the second death will be the amount of the IHT nil rate band in the tax year in which the second death occurs plus an amount calculated on the proportion of the IHT nil rate band which was not used up on the first death. An example will illustrate how this works. Suppose a man died in September 1991, leaving an estate of £100,000. The IHT nil rate band for that tax year (1991/1992) was £150,000. Two-thirds of the 1991/1992 nil rate band was therefore used up on the first death. If the man's widow were to die in the current (2007/2008) tax year, IHT would be payable on her estate above £400,000. The current nil rate band of £300,000 plus an additional one-third based on the 'unused proportion' remaining from the first death. The first problem arising here is that unless past records have been retained, it might be difficult to know what the value of the earlier estate was and hence the value of the unused nil rate band. This would be especially so if the value of the estate was low enough to make the filing of a return unnecessary. Also, where the IHT nil rate band was largely used up on the first death (and the nil rate band amounts were much lower in the middling past) the 'extra' relief could be rather small. In any circumstances, the maximum nil band available on the second death is twice the single nil rate band.

Secondly, the new limits will apply only to spouses and civil partners. Cohabiting couples (presumably because a review of the law relating to them is ongoing) obtain no benefit from these proposals and no nil rate band is transferred between them. Indeed, they will not even inherit each other's estates unless they have wills.

Thirdly, the emphasis on IHT deludes many people into thinking that if they know they will not have an IHT liability, they will be able to pass their entire estate into the hands of their family, untrammelled by the state. Regrettably, for hundreds of thousands of families, this is merely false optimism. The spectre that faces many families is the rising cost of care for the elderly, which can destroy the wealth of a family of modest means. The reason for this is that currently (2007/2008) a person with assets exceeding £21,500 normally pays the whole of the cost of any long-term residential care they receive, which can amount to over £1,000 a week.

Says Anthony Benskin, "Our concern is that people will seize on the IHT changes as a reason for neither making a will nor undertaking planning to preserve family wealth and will unnecessarily end up transferring assets to the state, rather than their family."

## Warnings about will-writers

In a recent debate at Westminster, Lorely Burt, Liberal Democrat spokeswoman for business, enterprise and regulatory reform asked that the government should consider regulating the will-writing industry. She called for stricter rules in the industry and possible regulation. Ms Burt, MP for Solihull, said that there were a number of ethical businesses in the industry, but fraudsters had taken advantage of a lack of statutory regulation.

"It is no exaggeration to say that will-writing has become a happy hunting-ground for the incompetent, dishonest and the fly-by-night operator," she said. The rules were different for financial advisers and solicitors, leading to widely varying standards in the industry, she claimed.

Earlier in the week, Citizens Advice warned people to be wary of adverts and cold-calls promising cut-price wills. The charity said increasing numbers of people were being attracted to will-writing deals for about £24 advertised in local newspapers or at the door, but which later escalated to much higher costs.

Susan Marks, the charity's consumer affairs policy officer said "Citizens' Advice Bureaux around the country are seeing people who have been conned into parting with their cash by people advertising will writing on the cheap. Will-writing services can be a useful alternative to solicitors, but will-writing firms are not regulated by the Law Society, so there are few safeguards if things go wrong."

However the government says there is still no compelling case for regulation, and discussed will-writers signing up to an approved, but voluntary, code.

All of these points are perfectly valid, but do not consider certain, vital, issues. If a will is incorrect, it is too late for changes to be made. The mistakes will not be found until the testator has died - or indeed the mistakes may never be found.

If a will-writing firm is no longer in business, it may not be possible to even trace the original will. This leaves the testator's family in a potentially difficult legal position - adding to their burdens at a time when they are grieving.

The promise of a cheap will may be an attractive proposition, but it will only be cheap if it is correct. There is no substitute for professional, regulated advice in a matter so crucial as your will.

# Farmer Who Worked For Free Gains Share of Will

A farmer who helped a relative run his farm for more than 20 years has been awarded the property he helped to run.

David Thorner was the son of Peter Thorner's cousin. He helped Peter to run his 400 acre farm in Somerset when Peter began to suffer from ill health. What started as a temporary measure became a lifetime of commitment, as David spent the next 25 years working on the farm without taking a holiday and sometimes working up to 18 hours a day. He was never paid for his work, only receiving a modest allowance from his parents.

The two men had an understanding that on Peter's death, David would inherit the farm. However, Peter destroyed the will he had made in 1997, which left the farm and most of his estate to David, and never made another. This appears to have occurred because Peter had a falling-out with one of the other beneficiaries under the will. On Peter's death in 2005, no will could be found, so the laws of intestacy applied. In such cases, the estate passes to the nearest relatives, who in this case were Peter's nieces.

David relied on the principle of estoppel - in essence that it would be unfair to divide the estate according to the intestacy laws. He argued that the result of Peter's not having made a new will led to the unfair result that David would not inherit the farm as per their agreement. The claim was defended on the basis that there was no promise as such that David should inherit the farm and thus if he had any claim to having provision made for him out of the estate, it would be a much lesser amount. The court heard a great deal of evidence that Peter had an 'indirect' way of saying things - for example, saying, "What are you doing tomorrow?", when what he meant was "Can you help me tomorrow?" This was claimed to account for the lack of direct evidence for Peter's promise.

David applied to the court for provision out of the estate and was successful in his claim. The Court awarded the 'non-agricultural' assets of approximately £1m to the nieces and the farm to David.

Says Anthony Benskin, "Peter's failure to leave a valid will meant that the family faced two years of legal wrangling to divide up his estate. All of that expenditure was avoidable. If you have a relative who has assets and is intestate, they may not realise the benefits of making or the consequences of not making a will. The laws of intestacy are often not fair and in this case, had David not made a challenge, the whole of the estate would have passed to family members who had very little to do with the deceased."

# WIll Forgery Tests Burden of Proof

It is normally considered that in civil law cases the 'balance of probabilities' approach applies, so that if there is a 51 per cent probability that something claimed is true, then it is accepted. For criminal cases, the 'beyond a reasonable doubt' standard of proof applies, which clearly is a much more severe test.

However a recent case, involving a will which the civil court judge concluded was a forgery, has illustrated that the mere balance of probabilities test may not necessarily apply in such a simple form.

The case concerned a valuable 60 acre farm in Kent. Mr Supple, the owner of the land, died suddenly, aged 77, leaving two children. His daughter lived with him, and his son (with whom he was on good terms) did not. It was initially thought that he died without leaving a will but, to everyone's surprise, his daughter appeared at his solicitors bearing an alleged will of the sort one can buy from a stationery shop or newsagent. The will left her the entire estate, except for a bequest of £100 a year to her brother. She had previously been to see the family's solicitors and had told them that she believed her father had not left a will. The will which the daughter produced was said to have been discovered in a suitcase left with a friend for safe-keeping.

The son opposed the will, claiming it to be forged. The judge heard the evidence from all the parties, which included expert evidence from a handwriting expert who was of the opinion that the signature on the will was not that of Mr Supple. The judge found the evidence of Mr Supple's daughter and the witness to the will unconvincing. He ruled that the will was a forgery and that the case papers should be passed to the Director of Public Prosecutions.

The daughter's legal team argued that the burden of proof rested with her brother to show that the will was a forgery, but the brother argued that the lack of correspondence of the signature on the will with Mr Supple's known signature required his sister to give a convincing explanation of why that should be so.

It is extremely rare for a will to be ruled a forgery in circumstances such as this. However, wills can be successfully challenged on a number of grounds. The best insurance against a successful challenge to your will is to make sure it is correctly executed and evidenced. Contact us for advice.

# Flexible Pensions - A Wealth Planning Tool

There is a popular misconception that pensions are something you get 'at pensionable age' and that therefore saving by way of pension policies offers little in the way of flexibility. This is certainly true of the state pension, which is payable as of right at the statutory retirement age. The state pension can be deferred, but that is seldom advisable.

However, the reality relating to personal pensions is somewhat different. For example, if the pension scheme rules permit it and you were born before 6 April 1960, your pension fund can be used to provide a pension at any time (up to age 75, when it must be taken) after the age of 50. If you were born after 6 April 1960, you must wait until your 55th birthday. There are some circumstances in which retirement pensions may be taken at a younger age, but they are limited.

A personal pension can be taken without retiring, so if you wish to continue working past retirement, you can supplement your income by taking your pension. In some circumstances, it may even be possible to contribute to a pension plan whilst drawing benefits from it at the same time.

Most modern pension funds are split into sub-funds, which can be taken independently of one another, offering still more flexibility. For example, a pension fund split into ten sub-funds may be able to be taken as ten separate annuities, with a tax-free lump sum taken from each.

There is also a variety of options available regarding the draw-down of the pension funds, which permits a great deal of planning of income to be done.

The opportunities for using pension funds to maximise your after-tax income are limited after the age of 75. However, at ages below 75, pension fund planning and the planning relating to the taking of pension benefits can be a significant part of an income and wealth-planning strategy.

Says David Wright, "It is often worth considering a rapid draw-down of the pension fund if there are significant other assets that are available to use for funding retirement in later years. Such decisions should always be made with the benefit of professional advice. We can assist you to ensure your financial and wealth-management strategies are successful."