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Tax Contagion: Funding Covid in the U.K.



BY ANDREW SAMS

The vast economic impact of Covid has been, and continues to be, immediately apparent—substantial monetary and fiscal measures have been introduced to provide wide-ranging forms of Government-backed support including the delivery of various funding packages in staggering amounts.

As a result, the deficit and the debt-to-GDP ratio is reaching levels not seen since the Second World War. In addition, it is likely public pressure will be placed on government to increase spending on health and social care to achieve the goal of “building back better” (to borrow the UN’s terminology). Such pressure is further compounded by the gloomy 11.3% predicted contraction of the economy and various public sector pay freezes as announced by finance minister Rishi Sunak in his public spending review.

In light of such events, the debate about how to bridge the gap between government spending and revenue will heat up, leading to inevitable changes to the U.K. tax system required to boost the public coffers and reduce the rapidly increasing national debt.

Other than the simplistic general increase in tax rates or reductions in allowances, there are two areas of taxation that should be of particular focus for ultra-high net worth individuals and their families (UHNWI). These two areas are increasingly applicable to UHNWI and the growing public consensus for establishing such changes will ease the political strain of implementing them. They are:

■ **Establishment of a Wealth Tax**—the methods for implementing such a tax varies, but typically takes the

form of an annual percentage-based charge levied on the total value of assets held by an individual; and

■ **Alignment of Capital Gains Tax (CGT) to Income tax (IT)**—this is a huge change that would more than double the existing tax rate applied to capital gains, thereby eliminating the disparity between how we tax capital and labor.

Mounting Pressure for a Wealth Tax

Wealth taxes in their various guises have been, and continue to be, used across multiple jurisdictions with many lessons to be learnt from what does (and what does not) work in terms of policy, implementation, and collection.

According to research undertaken by the Wealth Tax Commission, aggregate private wealth in the U.K. is now over six times GDP. As such, even a modest tax rate could generate significant sums. Add to this the backdrop that over the course of the last 25 years, wealth has become increasingly concentrated, it is easy to see that a popular vote winner (or at least vote preserver) among the masses would be the introduction of a wealth tax, as it seemingly only taxes the few, and those few are the “rich.”

Despite Prime Minister Boris Johnson and Chancellor of the Exchequer Rishi Sunak’s resistance to engage in dialogue as to the potential introduction of a wealth tax during the Summer Statement, the economic impacts of Covid have persisted, and look set to continue for years to come. In further support of the likelihood of the introduction a wealth tax in the U.K., a recent Tax Justice U.K. poll indicated that 63% of Britons backed a wealth tax on those with a net worth of over 750,000 British pounds (\$1.02 million) and a report by Demos found that 63% of the British public supported a one-off 10% tax on wealth over 2 million pounds (\$2.71 mil-

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lion), excluding main homes and pensions. In addition, the Final Report from the Wealth Tax Commission (WTC) published Dec. 9, has recommended a one-off wealth tax, potentially payable in instalments, modelled using individual thresholds of 500,000 pounds (\$678,000), 1 million pounds (\$1.36 million), and 2 million pounds (\$2.71 million). The WTC calculated that a one-off tax at 5% on new wealth per individual in excess of 500,000 British pounds (\$678,000), payable by over 8 million individuals, would generate approximately 260 billion pounds (\$353 billion) of tax revenue. A tax on net wealth in excess of 2 million pounds (\$2.71 million) would raise at least 80 billion pounds (\$108 billion).

With such strong public pressure and appealing quantum of revenue generation outlined by the WTC, Sunak and Johnson may soon change their tune. If or when this happens, how it would impact some individuals with particularly illiquid or hard-to-value assets, as well as other policy and implementation issues, remains to be seen. But as it becomes closer to reality, it raises many questions such as:

- What should count as “wealth”?
- How do you enforce it and have visibility over complex asset holding structures?
- Will the wealthy simply leave the U.K.?
- How do you value certain assets, particularly complex assets and assets intertwined in family co-investment structures and cross-border assets?
- How do you tax asset rich and cash poor individuals with clear liquidity constraints?

The answers to such questions are beyond the scope of this article but worthy of serious reflection and national debate prior to the incorporation of any policy changes and highlight the far from simplistic nature of introducing a wealth tax. But, even with so many questions outstanding, there are steps UHNWIs should be thinking about to prepare.

Wealth Tax-What Should UHNWIs Do?

Whilst no formal policy has been announced for the implementation of a wealth tax, given the level of public appetite and revenue that could be generated, it may simply be a matter of time. Without outline rules as to how the U.K. may implement a wealth tax, execution of any planning at present would be premature. However, there are certain considerations worthy of further thought (and perhaps adoption) by UHNWIs so they are ready to act should an impending introduction of wealth tax be announced:

- **Succession planning and inter-generational transfers**—now may be an appropriate time to consider inter-generational wealth transfers to spread the wealth across multiple individuals and entities. In particular, in many jurisdictions, assets held in offshore inter-generational trusts tend to fall outside of the scope of wealth tax. This may be a good time to accelerate conversations and implementation of existing succession plans, particularly if provisions of wealth taxes specifically disallow immediate adoption of such plans in anticipation of a wealth tax.

- **Asset situs**—in certain jurisdictions’ wealth tax regimes, a key component is the situs of the assets in question (such as the levying of French Wealth tax on French holiday homes/ski chalets even when held by non-residents and non-domiciles of France). As such, it

may be worth reviewing global assets and their holding structures to understand what a U.K. based exposure may look like.

- **Relocation**—for some individuals, a new wealth tax may prompt a relocation from the U.K. While this is a significant step, recent history has proven that it’s a serious consideration for families to explore and potentially undertake. My firm, TwinFocus, has experienced multiple families altering their plans to stay in the U.K. or accelerating plans to leave the U.K. following the extensive 2017 U.K. tax changes. Further punitive tax changes may result in a similar outcome again.

- **Valuations**—it may be prudent to consider undertaking or accelerating any plans for existing valuations of assets, especially in light of likely Covid-related enhanced value depression of private equity and real estate assets so that contemporaneous documentation is available to lower the base against which any future wealth tax may be levied. Ownership conventions and structures may also impact how assets are valued and discounted against an otherwise arms-length transaction.

Signs of CGT Reform

Capital gains tax reform was already a hot topic and public discussion exploded even more after the Office of Tax Simplification’s (OTS) first report released on Nov. 11, and the emotive headlines from multiple media channels that followed. Some of the OTS recommendations include:

- Aligning CGT with IT rates
- Addressing “boundary issues” between CGT and IT (i.e. inhibiting income like returns from being characterised as capital and thereby achieving a lower tax rate)
- Reviewing taxation of rewards based on labour vs. capital investment and reviewing share-based awards (i.e. potentially bringing share options/schemes within the scope of employment tax)
- Potential removal of CGT base cost uplift on death
- Altering based asset disposal relief (f/k/a entrepreneur’s relief) and removing investor’s relief
- Changing the level of exemptions and availability of various allowances
- Reviewing the interaction of CGT and Inheritance Tax (IHT), to remove the ability to access a relief or exemption to both IHT & CGT on death

In short, CGT reform could be a potentially substantial blow to business owners, private equity executives (who have already suffered substantial tax changes in recent years relating to carried interest and management fees) and investors.

CGT Reform-What Should UNWIs Do?

It is important to note that the OTS recommendations are “just” recommendations and are not, by contrast, confirmation of policy change. That being said, given the current climate, need to finance the various government backed support packages and general trend in tightening of fiscal policy, this may be something that informs policy change. Prior to the recent U.K. national lockdown, such change would most likely have been announced or implemented through the next budget, anticipated in March 2021. However, it may now be the case that, as the U.K. could well still be in a national

lockdown at such point in time, the budget, in its usual format, is postponed until autumn, with any such major tax policy changes, such as CGT reform, not being introduced until April 2022.

Until further announcements, it may not be wise to implement any planning solely for the purpose of trying to mitigate potential future CGT changes without the aim of achieving wider objectives (such as succession planning). However, some of the actions UHNW families may wish to begin considering are:

- **Establishment of a Family Investment Company (FIC)**—disposal of most assets held in a U.K. FIC would be subject to the current rate of 19% corporation tax. This would mitigate CGT being aligned with the current 45% IT rates and the “boundary issues” of more items being treated as income as opposed to capital. It would also provide the benefit of tax-free dividend receipts by the FIC (as opposed to a rate of up to 38.1% in the hands of U.K. tax resident shareholders) alongside the wider opportunity to carefully structure the shareholdings of the FIC to achieve asset protection and succession planning objectives.

- **Locking in current lower CGT rates**—whilst this would clearly bring with it commercial, family and investment considerations, it could be achieved in several ways including:

- Expediting any existing plans to sell assets to both crystallise a tax charge and lock in access to certain CGT reliefs (such as business asset disposal relief) prior to a tax rate change. This could also be achieved through the use of unconditional contracts, which would lock-in a fixed disposal point for CGT purposes but may contain various conditions subsequent (care not to be conditions precedent, otherwise this planning would be ineffective) to allow for various operational matters to be undertaken without putting additional pressure on the timing of the sale. Previous planning arrangements have included the use of rescindable contracts, but this and the wider commercial implications need careful consideration to minimise the risk challenge by way of the application of the General Anti Abuse Rule (GAAR), wider anti-avoidance provisions and the potential enactment of anti-forestalling provisions in any newly introduced changes.

- Transferring assets onto a trust or other structure to crystallise a tax charge—this would give rise to a “dry tax charge” (i.e. a tax charge but no disposal proceeds with which to pay such tax). However, it would give an uplift in the basis of such assets

thereby reducing the quantum on which any future increased CGT rate could apply. It would also provide the opportunity to realise wider succession planning objectives, particularly with the use of a family trust structure that could benefit children, grandchildren and wider family members.

- **Reviewing the basis of existing reward structures for working family members**—given the focus on “boundary issues” and reviewing taxation of rewards based on labor (such as many share options schemes and carried interest arrangements employed in family businesses) it may be time to revisit the structure, mechanics, and objectives of such rewards.

- **Review wills and existing succession planning**—especially in light of how a removal of CGT step-up in basis and/or removal of IHT reliefs such as business relief would impact both the estate’s and each beneficiary’s position.

Conclusion

It is a near certainty that substantial fiscal changes are on the horizon, with wealth tax and CGT reform being at the top of the list of potential fiscal levers the government could pull to fund the impacts of Covid-19. As such, a total balance sheet approach becomes vital to effectively oversee and structure all assets, including private business interests, traditional investments, hedge funds, real estate, tangible/intangible assets, philanthropic interests and more in order to provide a bespoke wealth planning solution that can be quickly adapted to such an evolving and dynamic landscape. However, despite just talk, it’s not too late to begin having conversations and taking initial pre-emptive planning moves in anticipation of more tectonic movements in tax regimes.

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