

Tax Angle



Andrew Shaw,
National Tax Managing Partner

Income tax at 100% (or more)

When I first started in tax, we were still dealing with the Labour Government of the late 1970's with income tax at 83% on earned income, with a further 15% surcharge on investment income, 98% in total. Many clients chose to go into business renting trailers for articulated lorries. The idea was that you bought the trailer and in the first year claimed an allowance of 100% of the cost, you had no income as it was bought on the last day of the year. The loss was carried back and you recovered tax at 98p in the Pound. HM Revenue & Customs ("HMRC") paid you interest as well, so you ended up with about 107p for every 100p lost. The client therefore had no worries about how much rental income he or she might receive on the trailer. Unfortunately the man running the rental business only had one trailer; he just sold it several hundred times!

“Good tax legislation creates certainty as to how income or capital is taxed and works in a way that changes are small and gradual”.

Thirty years later we now have a top rate of tax in excess of 100%; i.e. raise your income but take home less! Imagine you earn £160,000 a year and pay £50,000 into your pension scheme. Your company then gives you a £10,000 pay rise, on which you pay £5,000 in Income Tax and National Insurance of £150, leaving you with a net increase of £4,850. However, your pension contribution will now only get 30% tax relief instead of 40%, so this costs you £5,000 ($£50,000 \times [40\% - 30\%] = £5,000$). Therefore you are £150 worse off than before you had the pay rise – a marginal rate of 101.5%.

It's nonsense, complete and utter rubbish, who thinks up such a crazy tax system?

There has been a furore in professional circles about the stupidity of the proposals and how the forestalling provisions worked. Although the Budget announced the changes only applying from 2010, in practice for many taxpayers, including myself, the effective date was 22 April, 2009. For those that were not alert enough to pay their annual pension contribution between 6 April and 21 April 2009 the new rules were effectively retrospective.

There has been much lobbying over the changes to these rules but most of it was ignored by Parliament and the Finance Bill was largely enacted as announced, except the de minimus limit for the forestalling measures rose from £20,000 per annum to £30,000 per annum. Where it is still wrong or patently unfair, then hopefully there will be further changes in the years to come.

Good tax legislation creates certainty as to how income or capital is taxed and works in a way that changes are small and gradual. In that way taxpayers can act responsibly and respond to Government plans.

The Government encourages taxpayers to save into pension plans with generous tax allowances. The taxpayer does not then expect the Government to complete a volte-face and punish them for acting in accordance with Government wishes. The Government either wants people to save for their retirement or they do not but then people are making long term decisions and they need certainty that the tax rules will remain constant.

On another note, Capital Gains Tax was 40% (or 10% with Taper Relief on business assets) and it is now 18%, with income tax rising to 50% next year. Any significant discrepancy between the levels of tax on income and capital will lead to distortions in the investment market and taxpayers choosing to invest in ways that minimises their tax exposure. So how long will the 18% CGT rate last? My guess is about 12 months!! Tax Revenues will continue to fall as earned income and investment income gets hit by the recession and the Bank of England's decision to reduce interest rates to nominal levels. In these circumstances the Government will have to raise tax rates just to keep the revenues flowing.

Andrew Shaw

Changes to the penalty regime and enquiry window

Much of the debate surrounding this year's Budget has quite rightly centred on the rise in the top rate of Income Tax and the proposed changes to tax relief on pension contributions for higher earners.

However, various announcements were made in that Budget which will affect many more taxpayers, regardless of their income levels. A brief summary of these are as follows:

Penalty for late submission of Self Assessment Tax Returns

Up until now it has been possible to avoid a late filing penalty if all the tax due by 31 January following the year of assessment was paid on time, or a refund was due.

The new regime, which comes into effect from April 2010, means that a £100 penalty will be imposed for late submission, with no abatement if the tax due has or has not been paid. Returns that are three months late will attract daily penalties of £10, up to a maximum of £900. After six months, penalties will be tax geared, starting at 5% with a further 5% at twelve months and then 70% where information has been withheld from HM Revenue & Customs (HMRC) preventing them from determining the tax payable. It could rise to 100% if the information has been withheld deliberately and also concealed.

This penalty regime will also apply to Corporation Tax and Inheritance Tax.

Enquiry Window

A taxpayer, up until now has been able to assume that, provided his return was submitted by the normal due date and he has made a full disclosure of material facts that

apply to that Return, then HMRC have only twelve months from the filing date to raise an Enquiry into that Return, unless they claim that they have made a 'Discovery'.

A 'Discovery Assessment' could only be made where an Officer discovers that an assessment is or has become insufficient. Such an assessment could not be made after the close of the enquiry window if at that time an officer could, on the basis of information then available to him, reasonably have been expected to have been aware of the insufficiency.

Two recent tax cases have turned this approach on its head. In one of these cases the Special Commissioner suggested that an HMRC Officer can raise a discovery assessment only if he newly comes to the conclusion that it is probable that there was an insufficiency and at the relevant time he could not reasonably have been expected, taking into account the general knowledge and skill that might reasonably be attributed to him, and on the basis only of the information contained in the Return or claim made either initially or under the normal Enquiry process, to have concluded that it was probable that there was an insufficiency.

It is believed that following these cases HMRC will seek to open many more discovery assessments, using the defence that there was insufficient information provided to enable them to do so within the normal enquiry window. It is difficult under these widened circumstances to know what a "a competent Officer of the Board" is or is not expected to know or glean from the information laid before him.

This now moves away from the degree of certainty clients had previously, once the enquiry window closed.

Marsha Haywood – Assistant Tax Manager
marsha.haywood@btg-tax.com

Furnished Holiday Lets

Up until Budget Day a Furnished Holiday Let (FHL) had to be located in the UK and satisfy several conditions to be afforded fairly generous tax advantages compared to normal rent from letting UK property.

The conditions to be satisfied were that:

- The business was carried on commercially
- That the property had to be available for commercial letting as holiday accommodation to the public for at least 140 days and actually let for 70 days during a relevant 12 month period

- That no more than 155 days must fall during periods of longer term occupation i.e. a continuous period of more than 31 days during which accommodation is let to the same person

The tax advantages over 'normal' rental property were that the business was viewed as a pseudo trade and so:

- Any losses arising could be set against other income of the same year
- It was possible to claim capital allowances on the furniture, fixtures and fittings of the property
- Certain Capital Gains Tax reliefs, such as Business Asset Taper Relief, relief for gifts of business assets and business asset rollover relief were potentially available

- Depending on the circumstances, Business Property Relief for Inheritance Tax purposes could be available at 100% and
- The profits were treated as relevant earnings for pension purposes

The UK has been under some pressure from within the EU because of its perceived discriminatory tax relief in limiting FHL to UK property. It has responded to this by widening the availability of the treatment to countries within the EU, Norway, Iceland and Liechtenstein.

This means that if you have a property located within these countries and you can meet the above conditions, then you can retrospectively make loss relief, capital allowances or capital gains tax claims.

Such claims can be made within the normal time limits for amending returns and so for the 2007/08 tax year, this is until 31 January 2010. However, claims for the 2006/07 tax year are out of time but by concession, HMRC agreed

that they would accept claims up until 31 July 2009. If the time limit for amending a return has passed, it may still be possible to make a claim, if that claim is still in date. Such claims would be in respect of holdover relief, rollover relief and relief for losses carried forward. It should however be remembered that the time limit for such claims will change from 1 April 2010.

The ability to claim Business Asset Taper Relief on the sale of such a property could potentially reduce a taxpayer's tax liability from £100,000 to £25,000 on a gain of £100,000 where the property had been owned for two years. It is therefore worth considering carefully whether a claim for earlier years is viable.

The bad news, however, is that from 6 April 2010, HMRC will abolish the tax advantages afforded FHL, so what they give with the right hand they take away with the left!

James Collins – Tax Consultant
james.collins@btg-tax.com

Have Your Cake And Eat It

Chocolate fudge cake, strawberry gateau, lemon drizzle cake. All perhaps more pleasant thoughts than the article I wrote in the Autumn 2008 edition of TaxAngle where I tackled the subject of Inheritance Tax (“IHT”) planning and making gifts whilst asset values are low. Nevertheless, nine months later, asset values remain low and it is still a perfect time to be carrying out IHT planning by making gifts.

The problem some people have with such IHT planning is that they think the benefit of the gifted asset must necessarily be given up and, in these financially testing times, many will not want to see their income or capital levels fall. This article touches upon a couple of ways in which individuals can have their cake and eat it.

The advantage of making gifts is that, once 7 years have elapsed, the value of the gifted assets falls outside the individual's estate for IHT purposes. There is anti-avoidance legislation which exists to seek to prevent individuals from getting the IHT benefits of gifting the capital whilst still keeping the income generated from that capital. However, such is our love of cake here at BTG Tax that we have some tax planning solutions that allow individuals to feast on it.

Gifting assets to trusts has been and is still the preferred choice of many due to their asset protection qualities. Since 6 April 2008, lifetime gifts into any trust which exceed the Nil Rate Band (“NRB”, currently £325,000) are potentially subject to an immediate 20% IHT charge (an “entry charge”) to the extent of the excess. However,

because the NRB re-generates every 7 years, if individuals start early enough, they can actually eat a great deal of cake and get lots of value into trust for the eventual benefit of their family.

The long term strategy is to start young and bank the NRB every 7 years by making a series of nil rate band gifts into trust. The settlor of the trust can retain the benefit of the assets gifted for as long as required.

At a later date, when the settlor no longer requires the benefit of some or all of the assets contained in trust, the settlor can take specific action to remove the value from their estate and hold those assets in trust for, say, their children. Having eaten their cake all those years, they have now succeeded in getting significant asset value into trust for their family without having incurred an entry charge.

This planning is perfect for younger people who do not want to give too much (or anything) away just yet but may want to do so in the future. The current economic climate and low values makes it a perfect time to make a start.

A second idea relates to rental property portfolios. For those with such assets who would like to give away the capital but retain the income, there is a relatively little known provision in the legislation which allows you to have your cake and eat it. Rental properties can be gifted and, through careful tax planning, the rental income can be retained without the usual anti-avoidance provisions applying.

All that cake! Let's hope it's not Death by Chocolate.

If you or your clients wish to discuss specific circumstances, please contact me on 0121 452 1515.

Julia Rosenbloom – Tax Manager
julia.rosenbloom@btg-tax.com

Welcome to...

As new HM Revenue & Customs (“HMRC”) powers and growing scrutiny of the offshore tax arena hits UK companies and individuals, BTG Tax is continuing to expand its tax investigations department by making two further significant appointments.

Sue Bradshaw has joined BTG Tax in London as Director of Tax Investigations following 6 years with PricewaterhouseCoopers Tax Investigations team.

Notably before joining PwC, she spent 25 years working for HMRC where she investigated the more complex cases of tax avoidance and evasion and led the London Special Civil Investigations group of serious fraud investigators.

Sue has gained particular expertise in offshore arrangements using tax haven based affiliates and trusts.

She was a member of an HMRC national project team advising on the tackling of offshore avoidance.

Coupled with her extensive knowledge of the Revenue’s wide ranging information powers, she has successfully handled all manner of disputes for clients.



Sue Bradshaw
Director of Tax Investigations –
London

Also joining the tax investigations department in Manchester is Andrew McKenna. Andrew spent 15 years with HMRC working for the Special Civil Investigations (now Specialist Investigations) unit - scrutinising tax fraud enquiries. During his last three years at HMRC he led the Offshore Fraud Project Group.

After leaving HMRC in 2007, Andrew spent two years at PricewaterhouseCoopers in Manchester where he advised clients, individuals and corporates, on offshore tax issues, tax investigations and how best to deal with HMRC.

Andrew, now a Director of the firm, is CTA qualified and a member of the CIOT Taxes administration sub committee where he offers feedback on various HMRC consultancy documents such as compliance powers, penalties and the new tribunals.



Andrew McKenna
Director of Tax Investigations –
Manchester

Congratulations to...

Indu Gadhary, Rachael Trevenna and Mark Smith who were recently successful in passing their ATT examinations. Special congratulations must also go to Sohail Amir who

has now qualified as a Chartered Tax Adviser. All four members of staff, based in our Birmingham office, have been rewarded for their hard work in recent years.

An Invitation to...

A free seminar on Tuesday 29th September, 2009 at 5.00pm at The Institute of Directors, Pall Mall, London. Our speakers, Laurence Bard, Robert King and Jaysson Palmer, will discuss the UK and international tax benefits surrounding intellectual property in a business, including

R&D, international structuring and VAT.

This seminar is relevant to every business, and if you would like to attend, please contact Beverly Daniels on 020 7024 8370 or beverly.daniels@btg-tax.com.

www.btg-tax.com

BTG Tax is a division of BTG Tax LLP

Birmingham

19 George Road
Edgbaston
Birmingham B15 1NU

Tel: +44 (0)121 452 1515
Fax: +44 (0)121 452 1492

Bristol

Harbourside House,
4-5 The Grove,
Bristol BS1 4QZ

Tel: +44 (0)117 937 7130
Fax: +44 (0)117 937 7131

London

11 Haymarket
London SW1Y 4BP

Tel: +44 (0)20 7024 8370
Fax: +44 (0)20 7321 2189

Manchester

340 Deansgate
Manchester M3 4LY

Tel: +44 (0)161 837 1870
Fax: +44 (0)161 837 1871

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If you wish to receive this publication via e-mail or be removed from our mailing list, please send an e-mail to sara.nicklin@btg-tax.com