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Tax Update

Our summary of the latest tax issues

Inheritance tax changes

In our Autumn 2013 Tax Update we informed you of changes to Inheritance Tax (IHT) which were introduced in the Finance Act 2013, including new rules governing the extent to which liabilities can be deducted in calculating the taxable estate on death.

"If you are concerned about your own IHT exposure, or that of relatives, contact your usual UHY adviser."

The rules remain unchanged, but HMRC have since re-written large sections of their internal guidance manuals giving some valuable insight into their interpretation and intended implementation of these new rules.

The new guidance set out in their manuals IHTM28010 to IHTM28032 includes a number of examples which could apply to situations affecting you.

Nil Rate Band trusts

Prior to the introduction of the transferable Nil Rate Band (NRB), use of a NRB discretionary trust written into a Will was a common approach to ensure that no NRB was wasted on the first death of married persons, in situations where the majority of the assets were being left to the surviving spouse.

Commonplace are situations where the trustees sell the assets left to the NRB trust (often a share in the marital home) to the surviving spouse in return for a debt, usually either interest bearing or index linked. The idea was that whilst the surviving spouse benefitted from the home for the remainder of their life, the debt owed to the trustees would minimise the IHT being charged on the asset in the event of this spouse's death.

As illustrated in the example of Wendy and Harvey, HMRC now envisage that the executor(s) of the second spouse will need to take steps to physically repay this debt to the trustees in order for the loan to be deductible against the deceased's taxable estate.

Continued on page 2

Continued from front.

Using life insurance proceeds

Life insurance policies are often written into trust in order that any proceeds are outside of the deceased's estate for IHT purposes ie. the insurance pay-out is not charged to IHT itself.

HMRC's example of Kevin envisages that the executors will arrange repayment of the mortgage on the deceased's property in order to ensure relief from IHT is available. It confirms that borrowing from insurance proceeds that have been paid out to trustees would be an acceptable way to deal with this.

These measures are fairly typical of anti-avoidance legislation. Whilst being targeted at perceived abuses of the system, the legislation creates administrative hurdles and tripwires for taxpayers who were never intended to be targeted.

Where borrowings are used to acquire relievable or excluded assets (those qualifying, for example, for business or agricultural property relief) and especially where either subsequent lifetime gifts or partial repayments are made, the allocation and tracing rules serve to complicate matters. This will not be helped by the ever present issue with IHT, that the person undertaking the transaction has now died and cannot answer any questions or resist any HMRC attack.

The message seems to be that previously straightforward and widely accepted planning, such as ensuring that loans were secured on IHT chargeable assets rather than relievable ones has become less acceptable to HMRC, and so more complicated to implement.

A good understanding of the rules will be necessary before entering into any long term borrowings or financial restructuring and keeping a record of the transaction for your executors should help them to defend any subsequent challenge by HMRC. The full HMRC guidance can be found if you go to: www.hmrc.gov.uk.

If you are concerned about your own IHT exposure or that of relatives, or you find yourself having to deal with IHT as an executor or trustee, contact your usual UHY adviser.

Graham Boar, Letchworth

A good idea, spoilt

In 2011, HMRC launched their Managing Deliberate Defaulters (MDD) programme. The programme was introduced to tackle tax evasion and to focus on deliberate defaulters with a view to improving tax compliance. Of course, HMRC were also looking to generate positive media attention by being seen to be taking a stand against those abusing the tax system.

Two years on, in April 2013, the regime was re-badged as the Managing Serious Defaulters (MSD) programme and the scope for being placed within the regime has been widened by the inclusion of a single new criteria.

Under the previous MDD programme, deliberate defaulters were those who had been:

- identified as presenting a continuing high risk to HMRC;
- successfully prosecuted for a tax matter;
- charged a civil evasion penalty for dishonesty;
- required to give a security deposit to HMRC against potential future default; or
- successfully pursued for recovery of assets following an insolvency.

Fairly serious stuff.

The MSD scheme now captures anyone who has been charged a penalty for a tax error where the behaviour leading to the penalty has been judged to be deliberate regardless of the value or serenity of the error.

Deliberate behaviour

Deliberate behaviour might sound quite serious, but the HMRC penalty regime concerns itself with only three types of taxpayer behaviour spread across four penalty bandings.

Worryingly, a trend seems to have developed over the last 9-12 months of HMRC inspectors defaulting to a presumption that errors have been caused by deliberate behaviour rather than carelessness, forcing taxpayers into arguments about their behaviour.

The implications of deliberate behaviour being acknowledged include:

- higher penalties;
- longer time limits, allowing HMRC to collect tax from otherwise out of time years;
- no possibility of having penalties suspended;
- automatic enrolment into the MSD programme; and
- the possibility of being 'named and shamed' where the tax underpaid exceeds £25,000 and where certain other criteria are met.

Who is affected?

It is not unusual for a small business to be selected for a compliance visit where, for example, a minor error of £1,000 has been found (direct tax, PAYE or VAT). As a prompted disclosure, the minimum penalty levels for this error would be 15% for careless behaviour and 35% for deliberate behaviour. Having endured the HMRC compliance check and agreed the £1,000 of tax owing, most taxpayers would not be inclined to argue over a penalty difference of £200. Almost certainly the professional fees of doing so would outweigh the cash benefit of succeeding.

But now, by accepting the penalty for deliberate behaviour you will automatically be enrolled into the MSD programme and you will be monitored as a serious defaulter.

Implications of being monitored

The implications of being enrolled in the scheme can vary according to HMRC's assessment of the level of risk the taxpayer presents.

As a minimum, taxpayers will be enrolled for two years, with HMRC carrying out an annual review of tax compliance (filing and payment within prescribed time limits, across all heads of tax). Depending on the quality of compliance, monitoring will either be extended or ended after two years.

Taxpayers are also exposed to an enhanced threat of announced or unannounced visits, compliance checks or contact from HMRC to delve further into the detail behind returns made. Additionally, any future penalties are likely to take into account the taxpayer's previous deliberate behaviour and it is reasonable to assume that taxpayers in the system will be stigmatised by HMRC.

For taxpayers considered to be a higher risk the implications can be extended to impose additional filing or reporting obligations or to withdraw businesses from special schemes (such as VAT cash accounting or annual accounting). These measures are applied on a case by case basis.

It is our opinion that the extension of the criteria to include all taxpayers who have been charged a penalty for deliberate behaviour will result in the MSD programme being flooded with inappropriate taxpayers. Not the minority that exist in the murky fringes of the tax system and who the system was designed to force into compliance, but the average business owner who has been on the receiving end of an over-zealous tax inspector and either could not afford or face appealing penalties charged as a result. The obvious risk is that the system becomes stretched to breaking point, becoming a box ticking and paper pushing department without the resources to manage the hard liners it was set up to target.

What can you do to protect yourself?

Unprompted disclosures are always preferable to HMRC discoveries. You can better control the process, and HMRC assessment of behaviour is likely to be more sympathetic, reducing the risk of penalties in the deliberate band. If you are aware of deficiencies in your tax reporting then consider a disclosure to HMRC.

If HMRC launch an enquiry or compliance visit, seek professional advice…even if this is limited to some pre-visit briefing as to how to handle the process or assistance with any post visit correspondence. Involving an adviser once tax or penalties have already been verbally agreed makes our task an awful lot harder.

Fee protection services can insulate you from the professional fees of dealing with an HMRC intervention. Accordingly, the appealing of penalty levels can usually be done without the worry of costs outweighing the saving being sought.

Contact us if you are drawn into the MSD regime. An experienced adviser can help ensure that any additional obligations imposed are both reasonable and minimal, and that HMRC do not overstep their powers in monitoring your business.

If you are concerned about your situation, would like more information on our fee protection scheme or would like further general information in this area, please contact your usual UHY adviser.

Graham Boar, Letchworth

Travel to work expenses

Most people can clearly identify their travel to and from their normal place of work and are aware that it is not deductible for tax purposes. Although there are differences between the tax rules for employees and the self-employed, HMRC and the Courts have for many years taken a very narrow and literal view of what is allowable work travel, and what amounts to "commuting" to or from home.

The findings of two recent cases, however, could pose problems for you if you have both employment and self-employment.

In the first case a locum doctor worked partly for the NHS, and partly as a self-employed consultant, and travelled by car between his home, the NHS hospital and his private consulting rooms.

After an exhaustive and detailed analysis of his travel patterns, the tribunal eventually diagnosed that all of his travel to and from the NHS hospital, from his home to his consulting rooms, and between the hospital and his consulting rooms was not allowable for tax.

As such, his travel expenses were described as not having been incurred in the furtherance of his business, but rather arose from where he lived.

In the second case, a self-employed flying instructor claimed to be operating from his home and that his travel to the two airfields where he gave lessons amounted to business travel in the course of his trade. The Tribunal decided that both airfields were his regular places of work and that no deduction was due for his travel to or from them.

Both cases point to the fact that a person's business or employment base is not always where they think it is. They demonstrate that HMRC and the Tribunals are making a greater distinction than in the past between travelling in the course of a business, and travelling to a place where their work is regularly carried out.

Whilst a place where you regularly perform your duties of an employment is reasonably defined in HMRC's guidance (broadly if you spend 40% or more of your working time there ie. two days in a typical week) the situation is more subjective if you are self-employed. If you regard your home as your base you may be particularly at risk of challenge if, in reality, you do a large part of your work somewhere else.

In a climate where HMRC are actively seeking to recover more tax, it is important that you consider whether your arrangements would stand up to scrutiny.

If you would like to discuss your position in more detail, please contact your usual UHY adviser.

Mike Crellin, London

Castles under fire again

Since we published our article, *"Your home is your castle, but HMRC think otherwise"*, in the Autumn Tax Update, describing the many recent cases HMRC have taken to court seeking to tax individuals on what they believed to be their personal private residence (PPR) (and therefore eligible for tax exemption), the government has announced further changes. These include the proposal to tighten the PPR rules and introduce further taxation of non-residents owning UK residential property.

The latter effectively extends the Annual Tax on Enveloped Dwellings (ATED) regime outlined in our Summer 2013 edition of Tax Update which taxes corporate owners of residential premises.

Non-residents

The proposal is to charge non-residents capital gains tax (CGT) from April 2015 in respect of a property used, or suitable to be used, as a dwelling. Unlike the existing ATED related charge on disposal, this gain will be taxed even if the property is held as an investment. Commercial and industrial premises should not be caught, however.

Although pension funds and real estate investment trusts (REITs) may be allowed an exemption, other owners such as trusts, partners, companies, or individuals will be chargeable. As far as non-resident companies are concerned it is not clear whether they will automatically be charged at 28% (the rate applicable if they are in the ATED regime), but it is thought individuals who are prepared to disclose their worldwide income may enjoy the lower 18% rate where applicable.

Charging tax on non-residents naturally brings practical problems and it is thought a withholding tax regime will be brought in to address this. The proposals may be similar to the existing stamp duty land tax (SDLT) process, with agents transferring funds within 30 days, but as the purchaser will not know the circumstances of the vendor it is difficult to see how this will work. However, it has been suggested that it will be operated alongside an option to self-report the tax due, thereby allowing non-residents an option to pay the actual amount of tax due (taking into account loss relief or the lower rate).

ATED

As reported in our 2014 Budget Summary, the threshold at which the ATED regime will apply is being reduced from £2million to £1million from April 2015 and merely £500k from April 2016. You should therefore consider restructuring your property ownership before it comes within the ATED regime.

PPR

Not only has the 2014 Budget reduced the final period of automatic exemption from CGT from 36 months to 18 months, but the consultation document regarding non-residents also contains proposals to change the PPR election rules. One suggestion is to remove the election, thereby limiting the PPR relief to the property which is demonstrably the main residence, ie. the equivalent of not having made an election. The alternative is to abolish the election whilst introducing a fixed rule to identify the main residence, such as the one in which the person has been present for most of the relevant tax year. Where an individual has three residences this could mean none qualify if the time spent is roughly equal in each.

If you have any questions about your position in relation to this article, please contact your usual UHY adviser.

Roy Maugham, London

Swiss/UK Tax Agreement is like the cheese – full of holes!

Under the terms of the Swiss/UK Tax Cooperation Agreement, most UK-resident holders of Swiss accounts were offered a simple choice between authorising the disclosure of their Swiss assets to HMRC or paying a one-off withholding tax in respect of 'the past' and further withholding taxes in respect of future income and gains.

While there was in theory an 18-month gap between the signing of the Agreement and the deadline for making that choice of 31 May 2013, the issue was brought to the attention of many account holders very late in the day and they were rushed into making a decision without an opportunity to take proper advice or even think things through properly.

Mind the gap

Despite appearances to the contrary, in many cases payment of the one-off withholding tax left a gap when it came to covering past tax liabilities associated with the account. HMRC guidance states that payment will clear liabilities to income tax, capital gains tax, Inheritance Tax (IHT) and VAT to the extent that these relate to the figure for capital used for the calculation (ie. the account balance at either 31 December 2010 or 31 December 2012). It does not cover:

- liabilities to other taxes, most notably corporation tax (relevant if the monies deposited in the account were extracted from a UK company); or
- liabilities attaching to monies that had previously been withdrawn from the account and were not included in the figure of capital.

Clearly there will be cases (for example, those where the funds in Switzerland have sat untouched for decades,) for which the certificate of payment of the withholding tax represents complete clearance. More common, however, will be those who have paid a significant sum in withholding tax and who would still be viewed by HMRC as non-compliant.

Upgrading to full disclosure

We have been approached by a steady stream of individuals who now want a clean slate with HMRC. In many cases they would have been better advised to make a full disclosure in the first place rather than pay the Swiss withholding tax, but in general the clock cannot be wound back. It is therefore a matter of making a formal disclosure – typically under the LDF – that deals with the outstanding liabilities. The Swiss payment is accepted as "franking" the liabilities with which it is explicitly associated, leaving the impact of any withdrawals from the account and any other liabilities to be dealt with. The interaction of the LDF and the Swiss Agreement can in some cases mean that there is no further tax to be paid, but it is still necessary to go through the process if clearance is to be gained.

Other issues

The trigger for Swiss banks to write to account holders was the presence of a UK address on their systems. There will be UK taxpayers who, deliberately or otherwise, have escaped the imposition of withholding taxes by using an overseas correspondence address. These individuals remain very much exposed to the risk of HMRC investigation – and the possibility of criminal prosecution. If you fall into this category, you should seek advice on your options as a matter of urgency (again, the LDF may be the most attractive route).

Those who signed up to the deduction of withholding taxes are not exempt from declaring Swiss income and gains on their UK tax returns. The associated liabilities may be covered by the tax, but a return missing this information is still incomplete. HMRC have also recently made the point that, while the one-off withholding tax covers any liability to IHT in respect of the Swiss assets where the account holder died before 1 January 2013, the existence of those assets may have an impact on the tax payable in respect of the rest of the estate. They must therefore be disclosed to HMRC and the IHT office must be provided with a copy of the clearance certificate from the Swiss bank.

This article does not address the rather more complex position of those who are not domiciled in the UK and who are claiming the remittance basis of taxation.

If you have any doubts about your position in relation to the Swiss Agreement, please contact your usual UHY adviser.

Mark Giddens, London

Disclose your second income

HMRC have announced a Second Incomes Campaign, the latest in a series of opportunities for non-compliant taxpayers to provide details of undisclosed income and reach a settlement on tax, interest and penalties on fairly generous terms. As on previous occasions, once the Campaign closes (on a date yet to be specified) they will use the information in their possession to identify and come down hard on those who they believe have something to disclose but who have failed to take advantage of the opportunity offered.

As the name suggests, the Second Incomes Campaign is aimed at those who pay tax on a first income (typically under PAYE) but who have not disclosed a second. Typical examples will be those who have a second trade or occupation – perhaps one that is cash-based – such as taxi driving or providing fitness training and those for whom a hobby has developed into a business such as making and selling craft items or trading via eBay.

The deal offered is that, if you make a full disclosure in the prescribed format (either online or by post) and this is accepted by HMRC, you will benefit from a six-year cut off in the case of innocent mistakes, penalties that are typically limited to 20% (this contrasts with the risk of 100% penalties or even higher should you fail to disclose and HMRC find you) and, if you are not in a position to settle your liability in full, an opportunity to negotiate a payment plan. Disclosure under this campaign does not offer immunity from prosecution but complete and unprompted disclosure is acknowledged as an important factor when HMRC are deciding whether to carry out a criminal investigation.

Prompt disclosure is required

Disclosures are unlikely to be accepted if HMRC have already advised you of an intention to open an enquiry or compliance check into your tax affairs. If you decide to take advantage of the Campaign, you will have four months from the date on which HMRC acknowledge your initial notification to them in which to complete and submit your disclosure.

If you have failed to disclose significant income we strongly recommend full disclosure at the earliest opportunity. The Revenue have significant investigative powers and large databases at their disposal – the chance that they will eventually find you is high and the outcome is unlikely to be pleasant. However, we also strongly recommend taking advice before you disclose. The Second Incomes Campaign may not be the best option for you, particularly if there is an offshore dimension to your non-disclosure. If it is for you, it is very much in your interests that you should make an accurate and complete disclosure within the time limit.

As you will have read in an earlier article on the managing serious defaulter's programme it is vital you fully disclose your position and avoid errors. To discuss your particular circumstances and the assistance that we can provide, please contact your usual UHY adviser.

Mark Giddens, London

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