2014 AUTUMN NEWS

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Their hands in our pockets

The taxman can now demand payment of disputed amounts of tax from people who have used a tax avoidance scheme, even if the courts haven't yet ruled that the scheme technically fails to save tax. This is tough for those people who have used fancy tax saving schemes, as we discuss below.

However, the taxman doesn't want to wait for taxpayers to write him a cheque – he has asked for the power to take money directly out of their bank accounts. That would include accessing joint accounts and savings accounts such as ISAs.

It is proposed that the taxman would use this power to collect debts of £1,000 or more, where the taxpayer has refused to respond to letters or calls from HMRC on at least four occasions. Note that the debt doesn't have to be disputed or avoided tax – it could be overpaid tax credits, estimated amounts of any tax including PAYE, penalties, or even tax owed to another country which HMRC has agreed to collect.

There will be no requirement for the taxman to prove the debt is actually due before he asks the bank to freeze your account, and then after 14 days collects the money he claims is owed. This would give HMRC advantage over other creditors who have to apply to the County Court for an order to collect debts.

These proposed new powers for HMRC would side-step the courts completely. Currently, HMRC can seize a debtor's goods and possessions without a court order, but not money in a bank account.

These new powers will not come into effect until the law has been passed by Parliament. However, as a General Election has been timetabled for 7 May 2015, it is possible that a Finance Bill containing these powers will be rushed through without much scrutiny in order to clear the decks before Parliament is dissolved for the election.

You can protest about these proposed powers by signing this petition: http://epetitions.direct.gov.uk/petitions/68384, or by writing to your MP. ●

Pensions death tax

George Osborne has announced another major change to the taxation of pensions. The details will follow later, but the initial impression is surprisingly generous.

Currently, if you die before you've started to draw your pension, your pension savings aren't included in your estate. The fund is usually paid to your dependants without IHT. However, if you've started your pension, or if you're over 75, there can be 55% income tax to pay on a pension fund passing under your will.

From April 2015, the 55% charge will go. If you die before age 75, you'll be able to pass on undrawn pension funds with no tax to pay, and the beneficiary won't be taxed on accessing the fund.

If you die at 75 or over, drawings from the inherited fund will be charged at the beneficiary's marginal income tax rate in the year in which they receive the money. That's a maximum of 45% and could be only 20% or 40%.

If you die having bought an annuity with your pension savings, there is no fund to pass on, unless the annuity contract provides for a lump sum to be paid on your death.

These changes are really going to shake up pensions and IHT planning. Talk to us about your options. ●

More about MOSS

Do you know who and where your customers are? If you sell digital products such as software or music over the internet, and you are not VAT registered, you don't have to worry about whether your customers are businesses, or where they are based. But that needs to change from 1 January 2015.

From that date, when you sell electronic services, broadcasting or telecoms to non-business customers in other EU countries, the sale will be treated as if it was made in the country where the customer is located. This means you will have to register for VAT in those countries, and apply the local rate of VAT to your sales.

The easiest way to complete your VAT obligations in other countries will be through the VAT-MOSS ("Mini One Stop Shop") system on the HMRC website. This will be open for registration from October 2014.

However, to use MOSS you must first be VAT registered in the UK. This means you must pick one of these options:

- register for VAT in the UK;
- stop selling to non-business customers outside the UK; or
- sell to consumers only through online stores or other businesses, so all your sales are "business to business".

If you sell your digital products to a distributor, that company will supply to the final consumer and it should sort out the overseas VAT. However, check what your contract with the distributor says, as some may act as your agent, just taking a commission on the sale.

Talk to us if you are unsure what to do. ●

Doctors' status?

The taxman has been writing to doctors engaged by NHS trusts on a self-employed basis, asking for a meeting to discuss their employment status. Those targeted are mostly hospital doctors and consultants, rather than GPs, whose self-employed status is well established.

The doctor is advised that he does not have to attend the meeting, but doing so will speed up HMRC's decision about his employment status. The letter also says the meeting is not part of a formal tax investigation. However, any meeting with HMRC should be treated seriously, as one question can lead to another.

Our tax investigation experts can help you decide whether a meeting with HMRC will be worthwhile and support you through it if necessary. ●

NIC on rent?

If you are self-employed, the taxman expects you to pay class 2 National Insurance Contributions (NIC) at the flat rate of £2.75 per week. Each full year of paying NIC gives you a qualifying year for the state pension. You currently need 30 qualifying years to get the full state pension.

In the past the taxman has argued that property letting is not "self-employment": it counts as an investment activity rather than a business. So he would not allow people who manage their buy-to-let properties on a full-time basis (or thereabouts) to pay class 2 NIC, and hence qualify for the state pension.

However, lately the taxman has been writing to landlords who have a number of let properties, asking them to pay class 2 NIC for the past six years, and to set up a direct debit for future payments.

This is confusing, as HMRC has not announced a change in policy regarding income from let properties. Such rental income must be reported on the property income pages of the self-assessment tax return, effectively as investment income. In contrast income from a business of running a hotel or guest house should be reported as self-employment, and thus is automatically liable to classes 2 and 4 NIC.

If you receive a demand from HMRC for class 2 NIC and/or a questionnaire about your letting activities, talk to us about whether you should be paying the NIC or not.

If you have no other earnings, paying class 2 NIC may give you access to the state pension. On the other hand if you have already paid in for more than 30 years, or have significant employment income, you don't need to pay more class 2 NIC to qualify for the state pension. ●

Cost of contents in let property

Many landlords are not aware that the rules for deducting the cost of furnishings and goods used in residential let properties changed in April 2013.

For periods before 6 April 2013 (1 April for companies), HMRC allowed a deduction for the cost of renewing carpets, curtains, furniture and free-standing "white goods" in all let residential properties on a concessionary basis. Alternatively landlords could claim a wear and tear allowance equal to 10% of the rent (net of some expenses) where the property was fully furnished.

This "renewals" concession was withdrawn with effect from 6 April 2013, but the wear and tear allowance remains for fully furnished let properties.

HMRC say that property is "fully" furnished when it contains sufficient furniture, furnishings and equipment for normal residential use. This is a bit vague, but a property that contains the big stuff such as beds, sofas, table, chairs, cooker and fridge should count as fully furnished. The 10% allowance is designed to cover the cost of replacing all those items, but not the initial cost of fitting out the property when it is first let.

Wear and tear can't be claimed where

the property is unfurnished or partly furnished. So there is no deduction for the cost of replacing items such as carpets, curtains and white goods which are not built-in.

The cost of repairing or replacing any items fixed to a let property such as bathroom fittings, or a built-in hob and oven in a kitchen, are deductible for furnished or unfurnished properties. However, any replacements must be on a like-for-like basis. Where fixtures are replaced with higher quality items, the whole cost must be treated as an improvement to the property, and added to the capital cost of the building.

Talk to us about your plans to refit or refurbish your let properties so we can sort out what's tax deductible in advance. ●

Gross interest

Someone whose tax-free allowances cover, or mainly cover, their "general income" (salary, rent or pension) can pay only 10% tax on up to £2,880 of interest income, even though banks deduct 20%. The maximum reclaim is £288 (10% x £2,880) – but many people don't know or don't bother.

From 6 April 2015, this "starting rate band" goes up to £5,000, and the rate falls to zero. The maximum benefit rises to £1,000 (20% x £5,000). Pensioners with savings are likely to be among the main beneficiaries.

If all your interest income will be covered by the new 0% rate, you can tell the bank not to deduct any tax by completing HMRC form R85. If your other income is covered by your tax-free allowances, this is worth looking at. We can help you check the numbers and do the paperwork.

HICBC accusations

The taxman has been writing to innocent parents accusing them of not declaring the high income child benefit charge (HICBC) on their 2012/13 tax return. This charge claws back child benefit paid to the family since 7 January 2013.

The tone of the letter is aggressive. When read quickly it appears to instruct the taxpayer to amend their 2012/13 tax return immediately, in order to pay the tax charge. However, in the detail of the text the taxman admits the tax charge may not be due – in which case no action is necessary.

So how did he get it so wrong?

He has sent these letters to taxpayers who have reported income of over £50,000 for 2012/13, but he didn't check the relevant facts about the family first, such as whether:

- child benefit was actually received in 2012/13;
- the highest earner in the family has already paid the HICBC; or

- the taxpayer's adjusted net income is less than £50,000.

Adjusted net income is not the same amount as headline taxable income. Deductions must be made from taxable profits (or gross earnings) for trading losses, the gross value of gift aid donations and pension contributions.

If you have received one of these HICBC letters, please let us know, as the taxman won't have sent us a copy. ●

New RTI penalties

From 6 October 2014 employers with 50 or more employees will receive an automatic penalty of £300 or £400 if they file more than one RTI return late in the tax year. Smaller late filing penalties of £100 or £200 will apply to other employers (those with up to 49 employees) who file RTI returns late from 6 March 2015.

HMRC will warn you that an RTI return is late by way of an electronic message within the PAYE online system. You need to go to the PAYE online section of the HMRC website to read those electronic messages, or view them using the PAYE desktop viewer (PDV) software.

The full payment submission (FPS) is late if it is filed after the date on which the employees are contractually due to be paid. This contractual date should be recorded in your payroll software as the "payment date" – the actual date on which the funds are transferred to the employee is somewhat irrelevant. However, employees will get disgruntled if they don't receive their pay at the time they expect it.

Until 6 April 2016 micro employers (with no more than 9 employees), who were registered for RTI at 6 April 2014, can submit just one FPS by the last payment date in the tax month, irrespective of the actual number of occasions on which they pay employees in the month.

HMRC have defined eight reasons it will accept for submitting an FPS later than the payment date, coded "A" to "H". If you know your FPS is late, insert the relevant code letter in the "late reporting reason" field on the FPS. This should avoid a penalty notice being issued. Reason "G" is for a "reasonable excuse" which tends to be strictly interpreted by HMRC.

If you receive an RTI penalty notice please tell us immediately. ●

IHT traps

The net value of what you own when you die is subject to inheritance tax (IHT), subject to a number of reliefs and exemptions. Shares in private trading companies usually enjoy one of those reliefs: a 100% deduction applies even if you hold shares in a non-trading holding company which in turn owns the trading company.

However, if the trading company shares are held through a partnership or Limited Liability Partnership (LLP) in place of a holding company, the IHT exemption does not apply. This is a strange anomaly which HMRC acknowledge, but is not going to change.

Family companies can fall into this trap if the business uses a property which is owned outside the trading company by the shareholders. Where the property is held directly by the individuals it will qualify for 50% relief from IHT, but if it is held through a LLP no IHT relief will be due.

Let us review how you hold your shares and properties to ensure the maximum IHT relief will be available. ●

EBT opportunity closes

A surprisingly large number of small companies used employee benefit trusts (EBTs) to avoid paying PAYE and NICs on loans made available to employees and directors.

The law changed in 2011 to make it clear loans through EBTs were taxable. HMRC offered employers the opportunity to settle disputed tax liabilities involving EBTs on favourable terms. However, those favourable terms will be withdrawn from 31 March 2015. All agreements under the EBT settlement opportunity must be finalised by 31 July 2015, with the tax due also paid by that date.

To minimise the penalties that apply when tax schemes go wrong, some tax investigation experts recommend using the Liechtenstein Disclosure Facility (LDF).

HMRC believe the LDF has been abused by employers who have used EBTs and who are now attempting to settle their tax affairs under the favourable conditions of the LDF. To prevent this abuse, the terms of the LDF have been changed so it cannot be accessed by users of EBTs which are already under enquiry by HMRC.

If you are still wondering what to do about an EBT you used before April 2011, our tax investigation experts can help point the way to a reasonable settlement. ●

PAYE underpayments

The RTI computer frequently asks employers to pay amounts of PAYE they don't owe. These apparent underpayments of PAYE can be generated by mistakes the computer makes, such as misallocating PAYE payments, or ignoring claims for set-off of statutory payments or CIS tax.

The phantom PAYE debt can include a "specified charge", which is imposed when the computer thinks it is missing an RTI return. The specified charge is not a penalty for non-submission of an RTI return – it is simply an estimated amount of PAYE. The charge should be removed once the missing RTI return is submitted.

If you disagree with an apparent underpayment of PAYE, and you are certain you have submitted all the RTI returns required and paid all the PAYE due on time, the matter needs to be referred to the HMRC Disputed Charges Team. We can help with this. If HMRC's debt collection arm start demanding payment of the PAYE, telling them you've done this should satisfy them.

The next thing to do is to wait, and wait. HMRC has said that an update on the disputed debt, or possibly even a solution, will be provided within three months of the referral to the Disputed Charges Team. Don't hold your breath. ●

EC sales lists

The EC sales list (ESL) form generates no payment or repayment of VAT for your business – it is merely a statistical return required by the Government. But don't ignore it, as you could end up with penalties.

You must complete an ESL if your business is VAT registered and sells goods or services into other EU countries. If you only sell services into other countries and not goods, HMRC will not send you an ESL form, but you still need to complete one.

Most businesses have to do this for every calendar quarter (ending 31 March etc.), which may not align with your VAT quarters. The deadline for submission is 14 days from the end of the quarter for a paper ESL, or 21 days for an electronic version.

If you submit annual VAT returns you can ask for permission to submit an annual ESL, but your turnover must be below £145,000, with EU despatches of less than £11,000. Businesses which despatch goods worth more than £35,000 per quarter must submit an ESL every month rather than quarterly.

In the past HMRC has ignored late submissions of the ESL, as long as the form arrived within ten days of the submission deadline. However, penalties can be imposed at a rate of £5 to £15 per day, for up to 100 days. The amount rises each time a late filing penalty is applied.

We are seeing HMRC impose these penalties more frequently, so don't ignore your ESL obligations. We can help you submit the ESL online or on paper. ●

Formal or informal?

When you receive an enquiry from HMRC about your tax affairs it should be a cause for concern, but can you tell whether the HMRC letter is announcing the opening of a formal tax investigation?

HMRC should say it is using its powers of enquiry by saying something like: "this is a notice to provide information under Paragraph 1 of Schedule 36 of the Finance Act 2008".

There are strict rules about when such information notices can be issued, who can be asked to provide tax information, when tax inspections can be carried out, and what penalties can be imposed.

Recently HMRC have been approaching taxpayers asking about tax returns which are now outside of the period in which a formal tax enquiry can be opened – a sort of informal enquiry. Those letters have been sent to a range of taxpayers from the wealthy to the low-paid. If you receive such a letter, contact us immediately, so we can rebut any unlawful requests for information. ●

Flat rate scheme

The VAT flat rate scheme for small businesses is supposed to be simple. The trader chooses the trade sector that best fits the majority of their business activities, then applies the flat rate for that sector (from 4% to 14.5%) to their gross sales in order to calculate the VAT to be paid to HMRC. No input VAT is reclaimed, with the exception of VAT charged on the purchase of capital assets (not services) that cost over £2,000.

If you use the flat rate scheme you should review your choice of trade sector every year on the anniversary of joining the flat rate scheme, and switch if the majority of your sales now fall within a different trade sector. HMRC won't advise you on which trade sector to use when joining the scheme, and say that they will not ask you to change trade sector retrospectively.

So why has HMRC been challenging oil workers in Scotland about their choice of trade sector for the flat rate scheme? Those affected have generally opted for "business services not listed elsewhere" at 12%, rather than "architect, civil and structural engineer or surveyor" at 14.5%. HMRC prefer the latter category as it brings in more VAT. Paragraph 4.4 of VAT Notice 733 says that engineers, consultants and designers should use that trade sector. However, that part of the Notice doesn't have the force of law – it is for guidance only, and the judge in a recent tax case agreed with the taxpayer that it was wrong.

If you use the flat rate scheme or are about to apply, we can help you decide the most applicable trade sector for your business. HMRC are keen to shoe-horn all sorts of businesses into "management consultancy" at 14%, when possibly "business services not listed elsewhere" at 12% would be more appropriate. ●

HMRC's accelerator pedal

HMRC now has the power to demand payment of disputed amounts of tax without having to prove the tax is actually due. It does this by issuing an Accelerated Payment Notice where either:

- the taxpayer has used a tax scheme which has been disclosed as a tax avoidance scheme; or
- a similar tax scheme to the one the taxpayer used has been ruled to be ineffective by a final Court judgment and HMRC has issued a Follower Notice; or

- HMRC believe the tax arrangements used by the taxpayer are abusive and has issued a notice under the General Anti-Abuse Rule.

In addition the taxpayer's tax return or tax claim concerning the disputed tax must be under enquiry, or else there is an appeal in progress regarding the disputed tax.

If you receive an Accelerated Payment Notice you can't appeal against it. You have little option but to pay up, but we need to discuss the following first:

- Can you afford to pay? – We may need to ask HMRC for a time-to-pay arrangement.
- Is the calculation of the tax due correct? – If not, we need to challenge this within 90 days.
- Do you want to settle the dispute with HMRC? – There may be penalties and interest charges to pay on top of the tax demanded.

Agreeing tax settlements and dealing with demands following failed tax schemes is a specialist area, so please ask our tax investigation experts for advice before plunging in. ●

Return of services

When you sell services to businesses in other countries, the sale will be outside the scope of UK VAT. You don't charge VAT, but you must report the sale value in box 6 on your VAT return.

If the sale is to a VAT registered business in another EU country, the sale must also be reported on the EC sales list (ESL). If your customer is not a business, the sale will not go on the ESL, but from 2015 such sales could affect your liability to register for VAT in the customer's country (see "More about MOSS").

If your customer is located outside the EU, you don't report the sale on the ESL, but the value of the sale must still go in box 6 on your VAT return.

These distinctions are easy to get wrong, so do ask us if you have any doubts about how to report international sales. ●