SUMMER 2014

inside

Baxter & Co

CHARTERED CERTIFIED ACCOUNTANTS

Welcome to our summer tax newsletter

In this newsletter we cover some of the key tax developments over the last few months which we hope will be of interest and relevance. Please contact us if you would like more information on, or to discuss, any of the items below.

MORE ON PENSIONS

We are in the midst of a fundamental overhaul of the pensions regime, with further measures announced in the Queen's speech on 4 June 2014 including the introduction of Dutch type pooled pension schemes.

In addition, over the next two years many more businesses will come within the auto enrolment regime. The reforms have opened up a whole new array of opportunities, tax savings and, for employers additional costs.

Making employer pension contributions has always been one of the most tax-efficient ways of extracting funds from your company. These reforms only increase the attractiveness of such pension contributions, as the requirement to purchase an annuity from your pension savings will be entirely removed as from 6 April 2015.

A common strategy in many businesses is to build up cash reserves which are then accessed on retirement by liquidating the business and taking advantage of the entrepreneur's tax rate of 10%. The risk in this strategy is that if a cash surplus is too high the company may lose its 'trading' status, which is needed to qualify for the 10% rate. HMRC consider the long-term retention of surplus funds to be an investment activity (i.e. not trading) if those funds have not been preserved for a particular trading purpose, even if the cash reserves are unlikely to be generating much interest in a corporate deposit account.

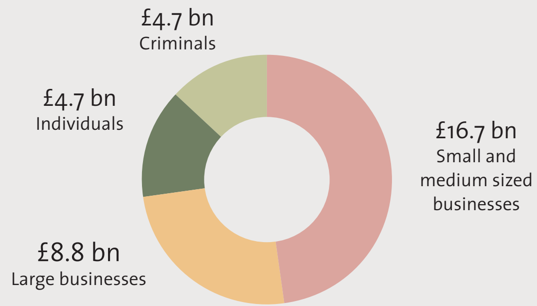
Using cash reserves to pay pension contributions can then help reduce this risk. In addition, as the company will generally obtain a corporate tax deduction, tax losses can be generated in the final years of trading, which can be carried back to generate tax refunds. However, you need to be careful not to exceed the annual allowance for pension contributions or the lifetime limit for your pension fund, now £1.25m. The annual allowance is now £40,000 per year, but you can bring forward unused allowances from the three previous tax years which can boost that limit up to £190,000 for 2014/15.

Whether you are a business owner or employee this is the time to review your pensions strategy.

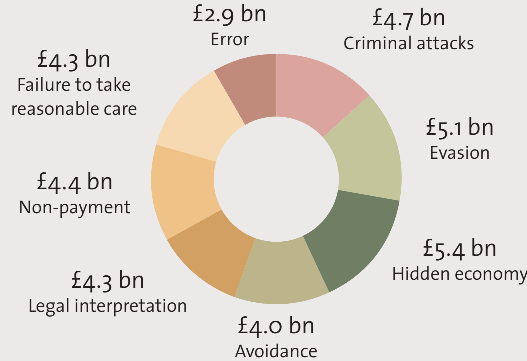
GETTING IT RIGHT

It cannot have escaped the attention of many that over the last few years the Government has put increasing resources into closing what is known as the 'tax gap'. Broadly this is the difference between the amount of tax revenue that the Government collects, against the amount of tax revenue that it thinks it should collect if everyone was paying the 'right' amount of tax. Over the last couple of years research has been undertaken by HMRC to quantify this number. For the last tax year for which figures are available, the gap is estimated at £35bn, around 7% of all tax revenues. The more of this amount the Government can collect, the more flexibility it has to either not increase, and ultimately to reduce, taxes.

VALUE OF TAX GAP BY CUSTOMER GROUP



VALUE OF TAX GAP BY BEHAVIOUR



Source: Measuring tax gaps 2013 edition - HMRC

The approach of HMRC has been to tackle the tax gap by focusing on 'behaviours' and types of taxpayer. Behind all this activity, is the Connect computer system. This system, which has won industry awards, was first brought into use in 2009 and was designed by defence contractor BAE Systems. Over time it is becoming more successful and accurate, leading to significant increases in the tax yield from investigations. Essentially it sifts through large volumes of data, collected from an increasing number of sources, looking for matches.

Data is collected from the Land Registry, Companies House, banks, employment history, voting and local authority rates registers, online sites such as e-bay and auto-tader, third party data from hospitals, pharmaceutical companies, insurers, DVLA records, Civil Aviation Authority and even gas SAFE registrations. More recently HMRC now has the power to collect debit and credit card transactions and will shortly be adding to this bank transactions from offshore banks from the 44 countries with which information sharing agreements have been reached, many of these are 'tax havens' such as Jersey, Guernsey and Liechtenstein. The system matches all the data to individuals or organisations and compares it to tax records and returns, or the lack of such records.

All this activity is yielding results, for the tax year 2013/14, HMRC have reported raising an additional £23.9bn and the number of tax enquiries and investigations opened is reported to be double the number of two years ago, over 237,000. Whilst HMRC is targeting specific individuals, given the potential numbers involved and the costs of formal investigations, the approach has been to encourage voluntary disclosure. This has advantages to both the taxpayer and HMRC.

For taxpayers it provides a relatively unobtrusive and quick way of bringing their tax affairs up to date, often with the incentive of a reduced penalty. We have helped a number of clients to successfully make such disclosures and so close off potential future enquiries and investigations.

ON THE CAMPAIGN TRAIL

In addition to the offshore disclosure facilities which are open until 2016 and on which we have commented in the past, there are two significant current campaigns, one targeting employees with a second source of income, the 'Second Incomes Campaign', and the other landlords, the 'Let Property Campaign'.

Employees can have a second source of income from, for example, a hobby, say by selling home-made craft items, from a self-employed trade as a consultant, or a number of other activities. They have probably paid tax on all their earnings. But if their main income is taxed under PAYE, they may not have received a tax return to complete every year, so may not have realised the need to declare 'freelance' earnings.

The Let Property Campaign is aimed at individual landlords who have failed to declare rental income from residential properties. People who take the opportunity to come forward and settle arrears of tax will benefit from reduced penalties. This campaign can be used to declare income from UK or foreign residential properties, and from letting rooms in your own home, where that income exceeds the rent-a-room exemption of £4,250 per year.

On a related matter and as part of HMRC's information gathering, if you run a property management service, you may have received a letter from HMRC asking you to provide details of your customers and the income collected on their behalf. This request is entirely legal and there are penalties if you fail to respond. You cannot refuse to provide your customers' details on the grounds that such personal information is protected by Data Protection Act 1998. HMRC has powers that overrule the Data Protection Act in these circumstances.

Given the sensitivity of the data, if you have any doubts about the validity of a request for information, please do contact us.

BENCHMARKING

With all this data HMRC have been able to improve the accuracy of their benchmarking. 'Benchmarking' is the process of comparing the attributes of one business to the average for the trade sector.

HMRC is starting to use this technique to nudge small businesses into adjusting their reported expenses, without escalating the matter to a formal investigation.

Tax Inspectors have begun writing to a number of unincorporated businesses in selected trades, quoting benchmarked profit ratios for their particular trade sector. The letter asks the business to review the figures of turnover and expenses before submitting the 2013/14 tax return.

Benchmarked net profit ratios have been used as part of tax investigations for years; the difference now is that HMRC have a much larger and more sophisticated database collected from thousands of businesses across all sectors, sizes and parts of the country. Where the profit ratio of the business under investigation is less than the trade benchmark, the tax inspector will want to know the reason. If you receive one of these benchmark letters, please contact us.

TAX AVOIDANCE?

The above activity is aimed at tackling the non or under reporting of income and gains. The tax gap estimates also include a sum for tax avoidance which is a much more controversial area. Tax avoidance is not illegal. Investing in an ISA is tax avoidance, as by doing so you are not paying tax on interest or dividend income which you would have done if you had made the same investments outside of an ISA.

This though is 'sanctioned' avoidance, the result is intended by Government and the tax incentive is there to encourage taxpayers to save money. When the Government refers to tax avoidance they are referring to using the tax system to avoid paying tax in a way that was not intended or foreseen. Typically, this is done through using 'tax schemes' which are often highly contrived. HMRC's approach to tackling this 'tax loss' has been to challenge such schemes in the courts. In this they have largely been successful. The courts have tended to show little sympathy for the taxpayer.

The most recent high profile case has been that of Gary Barlow and his colleagues who entered into complex schemes to generate tax losses from the exploitation of intellectual property rights. The schemes were held by the First Tier Tax Tribunal to fail as it was held there was no genuine trade. The schemes involved some £336m of tax losses going back over six years to 2004/05. The taxpayers can appeal to the higher Courts, a process which could take many more years.

Whilst the cases go through the court process, HMRC generally cannot claim back the tax in dispute, so whilst HMRC are enjoying success they are not immediately seeing the additional tax revenue.

The Government is now changing the law to require taxpayers who use marketed tax avoidance schemes, such as the ones used by Gary Barlow, to pay the tax avoided up front. Later this summer HMRC is expected to write to around 16,000 people who have used registered tax avoidance schemes, demanding they pay the tax avoided because a similar scheme has been found not to work by a tax court. There is no right of appeal and taxpayers will have to pay the tax due until they can prove the scheme passes scrutiny by all levels of the Courts. This process typically takes many years.

YOUR HOMES AND CAPITAL GAINS

Currently any gain you make on selling your main home is exempt from capital gains tax. In contrast, you must pay tax on gains realised from selling a second home, and from any buy-to-let properties.

If you live in more than one home you can nominate which is to be your tax exempt main residence, and change that nomination from time to time to achieve the best result for tax purposes. This is sensible tax planning.

Currently individuals who are not resident in the UK don't pay UK tax on the gains they make by selling a home in the UK, even if that property is their second, third or even fourth home. There has been exception to this since April 2013 where expensive properties, more than £2m, are owned through a company or certain other entities.

The Government proposes to change this, so from next year overseas owners will pay tax on gains made on UK residential property on the same basis as UK residents. However, if exactly the same rules were imposed, all overseas owners would nominate their UK property as their tax exempt main home, and little additional tax would be raised.

For this reason, the ability to nominate which home is to be tax exempt is likely to be removed for everyone with effect from 6 April 2015. In its place a rule will be imposed to determine which property is the tax exempt main home. This rule has not been formulated yet, but it's likely to be based either on the factors that indicate whether one home is used more than another or on the number of days each property is occupied in a tax year.

It is not clear whether nominations made prior to 6 April 2015 will continue to have effect. However, if you have more than one home, this is the time to review any nomination made or whether to make a nomination now. In some circumstances it may be worth 'triggering' a capital gain now to utilise the benefit of the nomination.

FURNISHED OR UNFURNISHED?

If you let 'unfurnished' residential property you may provide some 'contents' such as curtains, washing machine, fridge and cooker. Up to 5 April 2013 you could claim a tax deduction when you replaced those large items.

That 'renewals basis' was a concessionary treatment and it was withdrawn on 5 April 2013. HMRC will not now accept renewals basis claims for these types of item.

If the property is let 'furnished' you can claim a 'wear and tear' allowance (10% of rental income) to cover the cost of replacing furniture and items such as carpets or white goods. This relief is given because you are not permitted to claim capital allowances for equipment or furniture used in residential properties.

A property counts as 'furnished' if it is let with sufficient furniture, furnishings and equipment for normal residential use. If the equipment is installed as a fixture, say as part of a fitted kitchen, the replacement of that item is likely to qualify as a repair, and so will be tax deductible. Another option might be to lease or rent equipment.

INTERESTING REFUNDS

Have you received a refund of payment protection insurance (PPI) premiums relating to a policy which was mis-sold to you?

Refunds of PPI are paid with compensatory interest calculated at 8%. That interest is taxable, so it needs to be declared on your tax return for the year in which you received the PPI refund. Whether you have any further tax to pay depends on how it was repaid, some banks deducted 20% tax from this interest and others paid it gross with no tax deducted. If no tax was deducted from the compensatory interest, or you pay tax at 40% or 45%, there will be further tax to pay.

It gets more complex: your bank may have added the original PPI premiums to the loan the policy was designed to protect. In that case the interest paid on the underlying loan will have been recalculated after the cancellation of the premiums, and some may be paid back in addition to the reduction in the loan. That refund of loan interest is not taxable. From October 2013 the law was changed so all banks and building societies must deduct 20% tax from interest paid on PPI refunds, which means basic rate taxpayers will have no further tax to pay on that compensation.

HOW DO I GET MY PAYE CODE FIXED?

Your PAYE code tells your employer how much tax to deduct from your salary. It should take into account all the taxable benefits you receive and your available personal allowance. Where your benefits have changed, or you have more than one job, your PAYE code may not reflect your current circumstances.

To avoid under or overpayments of tax, you should get your PAYE code changed. You can now do this by completing a standard email form on the HMRC website. There are a large number of boxes on the form, requiring some detailed figures. Alternatively, we can do this for you.

AND FINALLY...

With this newsletter we enclose a copy of our tax rate information for the current tax year. We have changed the format this year from a folded rate card to a desktop calendar which we hope you will find more useful. Please do let us know what you think.

We are here to help so please contact :

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