Autumn 2014

Talking Tax

Guiding you to lifelong prosperity

Welcome

Welcome to our "autumn" edition of Talking Tax. When writing this, we considered if we could still get away with calling this the autumn edition, given the impending cold and wintry nights. However, with the announcement by George Osbourne that the "Autumn Statement" would take place on the 3 December, we thought we were on safe ground. Further research has confirmed this theory, as officially winter does not begin until 21 December, so don't dust off your hat, scarf and gloves just yet!

In this edition we look at HMRC's confusion over class 2 national insurance on rental income and our view on their apparent change in policy. We also look at a number of new and proposed changes in respect of non-residents as well as common pitfalls in the Construction Industry Scheme.

Other articles include one on common questions and practical considerations on employee shareholder status a year on from its introduction and a recent case on the DIY VAT refund scheme.

If you have any comments or questions about any of the articles, or if there is anything you would like to see covered in a future edition, please speak to your normal Hazlewoods contact.

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DRIVING LIFELONG PROSPERITY

Bags are packed

With the cold setting in and travelling to and from work in the dark, thoughts may be turning to sunnier climes! Before you pack your bags and set off into the sunset without a backward glance, a thought should be spared for your UK tax position. "I'll look at it later", I hear you say, but with some recent changes and proposals in the pipeline it should not be ignored.

Tell me that you'll wait for me

This might not be something you will be saying to the tax inspector as you emigrate, but if you still have some ties remaining in the UK, such as a UK property or pension, you will still be subject to the UK tax regime.

> "As things stand, most individuals leaving the UK would still be eligible to receive their personal allowance one way or another (e.g. under UK statute or through double tax treaties)."

However, the government are now proposing to restrict the entitlement to the personal allowance for non residents which, they say, will bring the UK in line with most other countries. As the UK now offers one of the highest personal allowances (currently £10,000 and increasing to £10,500 from April 2015), they seem to be following other countries' leads and tightening the purse strings.

Exact details have not yet been finalised but it is expected that only non-residents with most of their income arising in the UK (likely to be between 75% and 90% of worldwide income) will retain their personal allowance.

Provisions are likely to be put in place for other individuals who could be adversely affected by the removal of the personal allowance where tax relief in their home country would be restricted. For example, those with low global worldwide incomes may not have sufficient overseas tax to offset a UK liability which could arise following the removal of the UK personal allowance. A suggested proposal to address this is to set a de minimis global income with the entitlement to the UK personal allowance not being withdrawn if below.

Leaving on a jet plane

As you head off to pastures new, you may decide to hold on to your UK home in case things don't work out quite as planned. However, this could have significant tax consequences in the future.

Firstly, rental income received on the property may be subject to UK tax. Currently, if this was the only UK income you would be receiving and it was below £10,000, your personal allowance would most likely be available to cover it and no tax would be due. However, under the proposals for the personal allowance as set out above, you may end up having an unexpected tax bill. In reality though you would only end up worse off if you could not get tax relief in your new country of residence.

Secondly, HMRC are currently working on proposals to impose capital gains tax on the sale of UK residential properties by non-resident individuals. Some reliefs may be available, such as an annual exemption, but with the choice of selling your home before you leave with no tax charge, versus selling it further down the line and being hit with a big tax bill, it may not be a difficult decision! Sadly, however, this will leave you with less flexibility and we wonder how many non-residents will begin to withdraw their investment in the UK, or fail to invest in the future, as the tax benefits once afforded are taken away.

Don't know when I'll be back again

"If you are planning to come back to the UK at some point, the ideal period for UK capital gains tax purposes is five years."

Broadly, provided you are non-resident for at least five years, you will not be subject to UK capital gains tax on any assets you held prior to leaving the UK that were disposed of whilst non-resident. The rules have subtly changed in this respect for departures from the UK after 5 April 2013 with the five year period now being measured from the date you left the country rather than five complete tax years.

If you have assets that you do not want to hold on to following a move abroad, and you are not planning to return for at least five years, it may be worth hanging on to them a little while longer. Although this will depend on the tax rate for capital gains in the country you are going to reside in. Care must be taken, however, that arrangements are not put into place to sell the asset before you leave as HMRC may challenge that UK tax should still be payable. This is also subject to the proposed changes in respect of residential properties as discussed above.

Tax-is waiting

In summary, it is getting increasingly more difficult to get away from the UK tax system and the benefits previously afforded to expats are being squeezed. We do not want to put a dampener on your plans and the exciting times ahead as you look to a new life abroad, but we would strongly recommend that you discuss your tax position before you jump in the taxi to the airport.

Tax trap for international workers

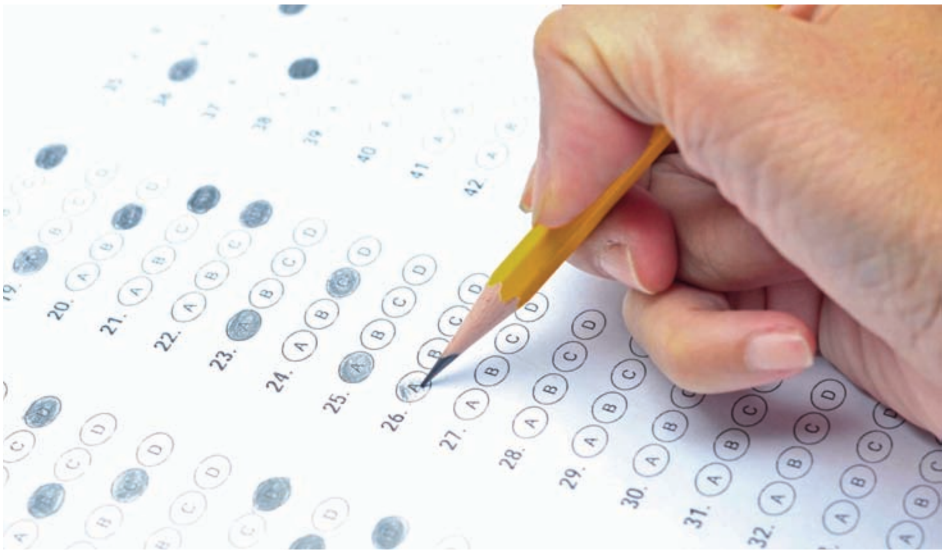
Continuing with the International theme, from 6 April 2013, the Statutory Residence Test (SRT) came into force, significantly changing the rules to determine residency for UK tax purposes.

The 2013/14 tax returns will be the first to be filed under the SRT, and as many individuals will not have filed that return yet, some surprises may be in store.

The SRT comprises a three tiered structure:

1. Automatic non-UK residence (5 tests)
2. Automatic UK residence (4 tests)
3. The Sufficient Ties Test

"The problem arises for internationally mobile workers or travellers, who have overseas income, but spend substantial time in the UK and other countries on a regular basis."



Under the old rules, they may have been non-resident, but the nature of their activities means that they will likely not pass any of the automatic tests, and will have to rely on the results of the Sufficient Ties Test to determine their residency.

Before 6 April 2013, many overseas workers were advised that an individual who was not present in the UK for more than 91 days on average would be non-resident. The SRT removes this assumption entirely, and the Sufficient Ties Test determines the status of individuals who regularly travel cross border. The number of days an individual needs to be present in the UK before they are considered resident depends on the number of ties they have with the UK. The ties are as follows:

i. A Work Tie (at least 40 days work performed in the UK)
ii. 90 day Tie (90 days or more spent in the UK in either of the two previous tax years)
iii. Family Tie (broadly, a spouse, civil partner or children in the UK)
iv. Accommodation Tie (a home in the UK)
v. Country Tie (presence in UK is greater than presence in any other single country)

The precise number of days required to determine residence depending on the above is beyond this article, however to illustrate a major pitfall for the unwary:

Mick works for a foreign employer, and under the old rules is non-resident, though during 2012/13 he was present for 92 days. His wife is in the UK, living in the family home, and he works when he is in the UK. Mick has four ties, (family, accommodation, work, and 90 day tie). Under the SRT an individual is resident in these circumstances if they spend more than 45 days in the UK. Therefore if Mick continues spending approximately 90 days in the UK each year, he will be resident for UK tax purposes for 2013/14.

Further, by failing the residency test once, it becomes harder to lose UK residency in the following year, so unless he can shed some ties, he will be resident for 2014/15 if he spends more than 15 days in the UK.

As a resident, he will be taxed on his foreign earnings in the UK even if he has already paid tax on them in another country. If that country has a lower rate of tax, or no double taxation treaty with the UK, Mick will have a UK reporting requirement and will pay more tax.

Mick should seek advice immediately, non disclosure of foreign income may attract penalties of up to 200% of the tax due and, therefore, extreme care must be taken every year to either minimise his days of presence, or reduce his number of ties.

Individuals who have previously been considered non-resident should carefully consider their status in light of the new rules, and take the appropriate action now or face declaring and paying previously unplanned taxes in the future.

Are you paying

class 2 NI on rental income?

In the past few months we have seen a number of cases where HMRC are demanding Class 2 National Insurance (NI) from clients receiving property income. In some cases the letters have not been copied to us, as agent.

Class 2 NI on rental income

Class 2 NI is due where an individual is categorised as self-employed. The agreed and longstanding view is that Class 2 NI should not be due on passive rental income received from investment properties as this does not constitute a "business" and hence does not meet the definition for self-employment. This position has also been supported by case law.

However, it appears that HMRC have been writing to clients with property portfolios demanding Class 2 NI as a matter of course and, when questioned, stating that this is now their policy.

Although the tax at stake (currently £2.75 a week) may not seem very much, it soon adds up and that money could perhaps be used to buy 70 lottery tickets or 300 pints of milk a year instead! Regardless, the principle remains that you should only be paying taxes you are liable for, no matter how much (or little) the tax is.

Follow up

This is a watching brief at the moment and we are continuing to liaise with HMRC and other interested parties to resolve the issue. In the meantime, we would be very interested to hear from you if you have received a similar letter or are already paying Class 2 NI on rental income.

"An article was also recently published in Taxation magazine by a member of our tax team, Megan Bourke, a copy of which can be found on our website (entitled 'Twisted kNICkers) if you would like further reading on this subject!"

Construction Industry Scheme (CIS)

Identifying subcontractors and reducing risk

In most circumstances it is easy to identify whether the CIS should be operated on a payment to a subcontractor. Those individuals, partnerships or companies that you engage to undertake construction work on behalf of your business are clearly within the CIS. However, the scope of the CIS extends beyond a traditional contractor-subcontractor relationship and captures some payments that may be overlooked when determining if the CIS should be operated.

One particular example that we have seen overlooked is payments to labour agencies i.e. businesses that provide construction workers for your business.

"Where the contract is between you and the labour agency for the supply of a worker, the payments to that labour agency need to be subject to the CIS."

Please note that it is irrelevant whether the labour agency treats the worker as an employee or subcontractor for these purposes.

Where you contract with and pay the subcontractors who actually undertake the work direct i.e. the labour agency is simply an introducer, then the CIS will need to be operated on the payments to each individual subcontractor used, in the normal way, otherwise the CIS should be operated on payments to the labour agency.

In our experience, HMRC are taking a hard line against CIS defaults - too hard in our opinion. HMRC are unlikely to consider the commercial, social and political consequences of their decisions when finding errors in a CIS enquiry. They will stick to the letter of the law asserting no compassion for the small business owner. It is, therefore, imperative that the CIS is operated correctly to avoid potentially significant liabilities arising, should HMRC enquire into your affairs.

"To reduce the risk of CIS defaults, we recommend a checking procedure is undertaken whenever a new supplier is engaged."

For each supplier not deemed to be within the scope of the CIS, evidence should be documented as to how this conclusion was reached, as well as a record of why that supplier is not deemed to be an employee if the subcontractor is an individual (this is another area that can easily be overlooked but can result in significant liabilities should HMRC conclude the wrong treatment has been applied). These procedures will assist in ensuring that the CIS is operated correctly, as well as providing evidence to HMRC that due care was taken when engaging CIS subcontractors. This approach will help to reduce any potential liabilities arising in the unfortunate event that your affairs are subject to an HMRC enquiry and errors are found.

We strongly recommend that you join our Tax Investigation Service if you operate the CIS, as challenges to HMRC's enquiries can be costly if you are not protected.

Employee Shareholder Status

- the ESSentials

Over a year has passed since legislation was introduced allowing employers to offer shares to their employees in return for them relinquishing certain employment rights. Contrary to the initial reservations and concerns, we have seen a number of employers offering Employee Shareholder Status (ESS) to their employees, helped particularly by the last minute revisions to the legislation to address such concerns.

What is it all about?

The employee gives up certain employment rights in exchange for shares in their employing company (or its parent), with a value of at least £2,000. The employment rights which are sacrificed by the individual include; unfair dismissal rights (excluding automatically unfair reasons e.g. discrimination), statutory redundancy pay, the right to request flexible working and certain rights to undertake study or training.

The employer benefits by incentivising key employees whilst reducing their exposure to certain potential employment claims. From the employees perspective, they still retain certain employment rights and receive shares with the potential for future growth and returns with preferential tax treatment.

The individual will only be subject to income tax and national insurance on the acquisition of the shares in respect of the value in excess of £2,000. Also, no capital gains tax will arise on sale, providing the shares were valued at less than £50,000 at the time of acquisition.

Who is offering ESS and why?

Interest has mainly come from private equity groups, looking to incentivise senior management in a tax efficient way. However, it can be just as beneficial to smaller, owner managed businesses, keen to incentivise key staff members.

The two questions we have been most often asked are:

1. **Q. How can we be sure we are giving shares with at least £2k value? This is important because if the shares are worth less than £2k, the tax benefits are withdrawn.**

   A. Late in the day of drafting the legislation, HMRC introduced an advanced valuation process providing agreement to the value of the shares. This can provide certainty and is a relatively quick and easy process. There are also ways to structure the shares such that the £2k value can be realised.

2. **Q. Why would we want to do it?**

   A. Again, a late, but important addition to the draft legislation, the employer can offer some of the rights sacrificed back in the employment contract. The individual may be left, therefore, in a position not too dissimilar to a "normal" employee, but with added incentivisation and tax benefits. This may also be an attractive option where the shares would not qualify for entrepreneurs' relief, although 0% is still better than 10%, even if the shares did qualify!

Other practical considerations

- The employee must agree to becoming an employee shareholder and the company is obliged to pay for the individual to take advice from a relevant independent advisor in respect of their contract agreement/written statement. If the employee is dismissed because they refuse to become an employee shareholder, this will be deemed to be automatic unfair dismissal.
- If the individual was to later sell their shares, their employee shareholder status (and hence employment rights) would not change unless a new employment contract was entered into.
- The main employment rights given up by the employee (e.g. statutory redundancy payment, right to claim unfair dismissal) require at least two years continuous service. Therefore, it is unlikely to be of benefit to the employer to offer ESS before this time. However, non-monetary reasons such as attracting, incentivising and retaining key staff may outweigh this.
- The company can retain control - they can choose which employees ESS is offered to and the shares issued can be of a different class and do not need to carry voting rights.

Where we can help

We can assist throughout the process including.

- Advising on the corporate tax and individual tax implications of ESS
- Obtaining advance valuation clearance for the shares to be issued to the employee
- Drafting of documents and liaising with legal advisors to implement

Taxpayer victory in **DIY VAT case**

The First Tier Tribunal (FTT) released its decision in the case of Lady Henrietta Pearson v HM Revenue & Customs [2014] UKFTT890 (11 September 2014) VAT Builders [do-it-yourself] (DIY).

Background

HMRC refused a VAT refund claim of approximately £40k, submitted by the taxpayer, on the grounds that the residential conversion carried out by the appellant failed to satisfy the conditions under the DIY VAT Refund Scheme.

The FTT held in favour of the taxpayer. However, when HMRC made the refund, only part of the claim value was paid, on the basis that VAT on the conversion services was incorrectly charged at the standard rate instead of a reduced rate.

HMRC asserted that they were only able to refund the equivalent of the 5% VAT applicable to the conversion services and stated that the taxpayer should claim the difference from the contractors under some form of contractual claim.

"However, even if the taxpayer had some basis for claiming back the VAT charged in excess of 5%, the contractors would be unable to recover this VAT from HMRC as the 4 year period for adjusting wrongly charged VAT had expired."

It has to be noted that, under this scenario, HMRC would end up having collected, and then retained, a certain amount of VAT that ought not to have been charged.

FTT decision

The FTT, in arriving at their decision, considered that the initial trial was solely concerned with deciding whether the taxpayer was eligible for a claim under the DIY VAT Refund Scheme. At no point during the trial did either party discuss the eligibility of the amount being claimed.

On that basis, the FTT decided that HMRC had ignored its earlier decision when the tribunal allowed the taxpayer's appeal. As a result, the taxpayer was entitled to receive the full amount of £40,233.18. The FTT considered that HMRC did not raise this point at the original hearing and, as a result, could not use this argument now when they had to refund the taxpayer.

Comments

This case illustrates two things.

Firstly, a party cannot re-litigate a dispute by using arguments that were not raised at the initial trial. There must at some stage be finality to accept or reject a refund claim. If there are two grounds for pursuing or opposing a claim, the proper course is to raise both in the hope that at least one succeeds.

Secondly, DIY building work can sometimes take years to complete and, by the time it is completed and a claim submitted to HMRC, the four year cap for wrongly charged VAT may have already expired. This illustrates the importance of ensuring the correct rate is charged in the first place - the appellant "got lucky" in the case described.

Up, up and away **Is this the end of pilot trusts?**

There have been a number of consultations in recent years around simplifying trust charges. The most recent one published earlier this year, included two main proposals;

1. Introduction of a single "Settlement Nil Rate Band" (SNRB); and
2. A standard 6% tax rate for calculating the ten year anniversary and exit charges.

The main purpose of the first proposal is to tackle the use of 'pilot' trusts. Pilot trusts are multiple trusts set up on different days, with a nominal amount. The intention is that at a later date a larger sum will be received by each trust, but below the value of the nil rate band (currently £325,000). Each trust has its own nil rate band such that inheritance tax savings are realised and there is no limit on the number of trusts one settlor can set up.

This has previously been accepted planning by HMRC but, for the purposes of the ten year anniversary charge and exit charges, it is now proposed that the settlor will have just one SNRB (equal to the value of the nil rate band) and will have to choose how this is allocated across all of their trust settlements.

This could make it more beneficial for assets to be gifted outright as the SNRB, as currently proposed, would not renew every seven years as with general inheritance tax rules on gifts. This seems an odd result as it could leave the settlor with the tricky decision of gifting the asset outright, with it potentially being wasted by the intended beneficiary, rather than placing it on trust for their future benefit.

The changes are expected to apply from 6 April 2015 but the revised rules will apply to any new settlements created after 6 June 2014, as well as additions to an existing trust after that date. This could lead to further administration, as separate IHT rules may need to be applied to the same trust (i.e. for additions pre and post 6 June 2014). It appears that perhaps under the original guise of "simplification" and now "fairness", this proposal could, therefore, actually lead to added complexity...

In contrast, the second strand to the consultation does seem to be a genuine attempt to simplify IHT charges. A flat rate of 6% for calculating the ten year anniversary and exit charges on all trusts should apply from April 2015. This will take away the need to consider the historical IHT position of the trust and previous transfers to determine the rate to apply, which can be an extremely lengthy and costly process.

We are expecting an update on the outcome of the consultation along with draft legislation any day now, however, if you are looking to set up a new trust or add additional funds or property to an existing trust, we would recommend you seek professional advice up front.

Quick fire round - a brief overview of **other news** in the world of **tax...**

Accelerated Payment Notices (APNs)

The 2014 Finance Act introduced new powers for HMRC in respect of APNs. Covered in our previous edition, APNs are a demand for upfront payment of disputed tax where avoidance schemes have been used.

HMRC commented that APNs would be sent out over the following 20 months from the Act being passed, the first of which have been seen in September. If you receive such a letter, we can assist with advising you of the options available and our recommendation as to how you should proceed.

Direct recovery of debts

Whilst on the subject of HMRC powers, we also mentioned in the last edition proposals to increase HMRC's tax debt collection powers. There has been a significant backlash in respect of the proposals from professional bodies, practitioners and taxpayers.

With the new rules set to come in from April 2015, allowing HMRC to directly collect tax due from a taxpayer's bank account, we await to see in the Autumn Statement if this will be pursued by HMRC or set aside as the pressure is put on from key stakeholders.

EBT settlement opportunity

From 1 April 2015 it will not be possible for employers to apply to HMRC under beneficial terms of settlement, where an Employment Benefit Trust (EBT) had been used to avoid tax before 6 April 2011.

After this date it may still be possible to reach settlement but not under the beneficial terms currently available and HMRC have stated they will put further resource into litigation.

It will be interesting to see how the appeal by HMRC on the Rangers EBT case progresses as this could help set a precedent for other EBTs with similar fact patterns. However, as this is unlikely to be settled prior to 1 April 2015, a decision to settle or face going through the courts is going to have to be made in advance.

It's that time of year again...

The 31 January deadline for Self Assessment is approaching once again! The rush is about to begin so please could you let us have your personal tax return information as soon as possible.

The lucky winner of the 2014 tax prize draw, which included all those who submitted tax return information by 30 September 2014, is Gaynor Minshall. The prize includes a meal for two at Raymond Blanc's restaurant, Belmond Le Manoir aux Quat'Saisons and an overnight stay in a local hotel.

Tweet tweet

The Autumn Statement has been announced for 3 December. Follow us on Twitter @Hazlewoods_Tax and watch out for our live commentary on the day.

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General
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Assistance with tax investigations
Community Investment Tax Relief
Tax Investigations Service

Hazlewoods Tax Team

Nick Haines Partner
t: 01242 237661
e: nick.haines@hazlewoods.co.uk

Tom Woodcock Partner
t: 01242 237661
e: tom.woodcock@hazlewoods.co.uk

Ruth Dooley Partner
t: 01452 634800
e: ruth.dooley@hazlewoods.co.uk

David Clift Partner
t: 01452 634800
e: david.clift@hazlewoods.co.uk

Gloucester Office:
Windsor House
Barnett Way, Barnwood, Gloucester, GL4 3RT
Tel: 01452 634800 Fax: 01452 371900

Cheltenham Office:
Windsor House
Bayshill Road, Cheltenham, GL50 3AT
Tel: 01242 237661 Fax: 01242 584263

Staverton Office:
Staverton Court
Staverton, Cheltenham, GL51 0UX
Tel: 01242 680000 Fax: 01242 680857

www.hazlewoods.co.uk