2014 SUMMER NEWS

ROSS McCONNELL

CHARTERED ACCOUNTANTS

3 High Street
Kinross
KY13 8AW

Tel: 01577 865885

Email: ross@mcconnell.uk.net

Take That tax tangle

Tax avoidance is not illegal. Some commentators may regard it as immoral, but using an artificial scheme that is fully disclosed to HMRC, to reduce one's tax bill, is not against the law.

If the tax scheme fails to achieve the promised tax savings, the scheme users will have to pay the tax avoided plus the cost of fighting HMRC in the Courts. Interest and penalties may also be due where the tax is paid later than it would otherwise have been.

This is the situation that Gary Barlow and his colleagues, among others, have found themselves in. The First-tier Tax Tribunal decided the scheme they used did not produce relievable tax losses, so further tax may be due. However, the individuals can appeal to the Upper Tax Tribunal and the higher Courts, so it could take many years to finalise their tax bills.

In the meantime the taxpayers will suffer a good deal of worry and uncertainty about what tax will eventually be due, and how much they will have to pay in legal costs. HMRC are also unhappy about unfinished business, as in general they can't get their hands on the disputed tax until a case has concluded.

However, the Government is about to change the law to force taxpayers who use marketed tax avoidance schemes 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. The taxpayers will not be able to appeal against this HMRC ruling and will have to pay the tax due until they can prove the scheme passes scrutiny by all levels of the Courts.

If you are worried by the press reports and the prospect of receiving a tax demand from HMRC, talk to us about your situation. We can help you assess your tax risk, against the cost of possibly years of legal wrangling. That's something worth avoiding! ●

Benchmarking businesses

'Benchmarking' is the process of comparing the attributes of one business to the average for the trade sector. The taxman is starting to use this technique to nudge small businesses – maybe like yours – into adjusting their reported expenses, without going to the bother of formally investigating the business.

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

The taxman has used benchmarked net profit ratios as part of tax investigations for years. Where the profit ratio of the business under investigation is less than the trade benchmark, the tax inspector will claim this 'proves' the business is hiding sales receipts. Of course it doesn't prove any such thing, as there are many valid reasons why a particular business may not be typical. For example it may operate in a difficult geographical location, or it may not open for the same hours as other local businesses.

If you receive one of these benchmark letters, we can help you review your reported income and expenses. But don't assume the taxman has any hard evidence that your reported business profits are incorrect. ●

A matter of principal

VAT can be very complicated when there are three people involved in a transaction. A recent case in the Supreme Court involved a website where customers could book hotel accommodation around the Mediterranean. HMRC reckoned the company bought hotel rooms and sold them on to the British public; the company argued that the hoteliers supplied the rooms – it only acted as an agent, arranging the deal. The Court of Appeal unanimously agreed with HMRC that the company was a principal, but the Law Lords unanimously overturned that decision. That just shows how hard it can be to get it right.

On a different scale, a taxi firm collected fares from account customers and handed them on to its self-employed drivers. The drivers paid rent to the firm for the use of its cars. HMRC argued that they were effectively employees in respect of account fares, so the firm would have to pay VAT on the whole amount paid by the customer. Cash fares paid direct to the driver weren't VATable because the drivers were below the VAT threshold. Cases have gone both ways on this, but here the Tax Tribunal decided all the money belonged to the drivers – the firm was just collecting it for them. There was VAT on the rent for the car, but not on the fares.

If your business is involved in this kind of triangular deal, we can help you decide whether you are an agent or a principal, and what the correct VAT treatment is. ●

It's not cricket!

A not-for-profit sports club doesn't have to charge VAT on its subscriptions to members, or on anything else it charges for taking part in the sport, including coaching and hire of equipment or facilities. The English Bridge Union claimed that it ought to benefit from this exemption, arguing that the International Olympic Committee has recognised bridge as a sport (although it's still not part of the Olympic Games).

In spite of allowing the exemption to darts and billiards, HMRC wouldn't play ball – they persuaded the Tax Tribunal that 'sport' involves 'some significant element of physical activity'. Even though the mental activity in bridge promoted health and well-being, it was a game, not a sport. ●

HMRC go campaigning

HMRC wants to collect tax on all the income and gains which has previously been missed off tax returns for one reason or another. To this end they have launched various 'campaigns' targeted at specific trades or professions, such as plumbers and doctors.

The latest campaign has a broader reach: it is aimed at employees who have a second source of undeclared income. This could be through earning income from a hobby, say by selling home-made craft items, from a self-employed trade as a consultant, or a number of other activities.

You have probably paid tax on all your earnings. But if your main income is taxed under PAYE, you may not receive a tax return to complete every year, so you may not have realised you needed to declare 'freelance' earnings.

Someone who wants to use the Second Incomes Campaign must first notify HMRC either by completing an online form, or by calling 0300 123 0945. When HMRC responds with a disclosure reference number, the taxpayer will have four months in which to make a full disclosure of untaxed income and pay all the tax, interest and penalties due.

There is no published deadline for notification to use this campaign scheme – maybe the opportunity to disclose will remain open indefinitely, but in the meantime HMRC will be looking for people who have not come forward. If you think you might be affected, we can help you work out if you have a profit or loss to disclose. ●

How much should I PAYE?

As the owner of a micro company, you may well take a small salary of just under the starting threshold for NICs (£7,956 for 2014/15). This gives you a credit towards the State Pension but no National Insurance is payable by you or your company.

In previous years that made sense, but the new employment allowance of £2,000 per year means it's worth rethinking. That allowance will cover the bill for employer's NIC on a single salary of up to about £22,450, although employee's NIC would still be payable. Some businesses who provide public services, such as family doctors, don't qualify for the employment allowance – so ask us to check if your company does qualify.

For 2014/15 you have a tax-free personal allowance of £10,000 (more if you are aged over 66). You could take a salary up to that amount and pay no income tax, assuming you receive no other taxable benefits from the company, such as a car.

Your company will get a deduction for the full £10,000 salary, reducing its corporation tax bill by £2,000. This is an additional saving of £410 over the corporation tax deduction of £1,590 for a salary of £7,950. You will pay employee's NICs of £245 [(10,000 – 7,956) x 12%] on your salary. Overall you and the company save £165 by taking a salary of £10,000 rather than £7,950.

The best salary level for you will take into account all your other sources of income. We'll be happy to advise you and crunch the numbers. ●

Flipping marvellous

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 at any time to achieve the best result for tax purposes. This is known as 'flipping'.

People who live overseas (not resident in the UK for tax purposes) 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.

The Government wants to change this, so overseas owners 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 no 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 both UK residents and non-residents, 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 facts that indicate that one home is used more than another, or on the number of days each property is occupied in a tax year.

If you have more than one home, we can review your plans for that property in order to protect the maximum amount of gains from CGT. This is particularly important if you live abroad for a large part of the tax year. ●

Car value traps

It's time to start completing those forms P11D to report expenses and benefits given to employees. If your company has a 'dispensation', this can remove the need to report the reimbursement of on-the-job expenses, but the provision of a company car must always be reported on the employee's P11D each year.

The first hurdle is to establish the list price of each car. This is almost certainly not the amount paid by the company, as it represents the price to be paid for a single car purchased from a dealer 'as new' with no discounts. So where the car was purchased second-hand, or with a fleet discount, you need to hunt around for the vehicle's correct list price.

Then you need to add in the value of any options and accessories for each car. Most cars have some extras, even if it's only a fancy radio. Remember to deduct the VED (car tax) paid when the car was first registered, as that's not part of the list price.

We can help complete the P11Ds for your business to ensure your employees – and the business, which has to pay Class 1A NIC on car benefits – are taxed on the right values. ●

Pensions: the long view

Sometimes it's good to stand back and take the long view, and pension planning is one of those situations.

If you have been accumulating money in your company, hoping to extract it when you pack up the business with only 10% tax (using Entrepreneurs' Relief – 'ER'), you should think again.

A company that holds a high level of cash reserves can risk losing its 'trading' status, which is needed to qualify for ER. 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.

One of the most tax-efficient ways of extracting funds from your company is for the company to pay an employers' contribution into your pension fund. This is tax deductible for the company, as long as your total remuneration package, including the pension contribution, is reasonable for the work you do for the business. The pension contribution also escapes both employers' and employee's NICs.

In the past you may not have been keen to lock your savings away in a pension fund, with the prospect of having to purchase an annuity to access 75% of the money. From 27 March 2014 the requirement to purchase an annuity has been partially withdrawn, and it will be fully withdrawn from 6 April 2015. This may make pension savings much more attractive, especially as a means of extracting money from your company.

However, you need to be careful not to exceed the annual allowance for pension contributions, or you could be landed with a penal tax charge. 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.

We can help you work out how much the company can safely contribute to your pension fund, whilst leaving enough cash to pay bills and fund business development. ●

'Mail order' gifts

If you give away promotional items, there are tax and VAT rules about whether you enjoy tax relief. For example, you can't take the cost of a customer's Christmas bottle of whisky off your income tax profits, but you can claim back the VAT, as long as the bottle costs less than £50!

A recent case highlighted a strange difference in the VAT rules for gifts which aren't 'goods' – in this case, retailer vouchers, which count as 'services'. The publishers of the Daily Mail and Mail on Sunday offered new subscribers up to £100 in Marks & Spencer vouchers if they took the papers regularly for a set period. HMRC accepted that the vouchers were bought for business purposes, so the publishers could deduct the VAT – but reckoned that giving them away triggered a VAT charge on 'private use' of the same amount.

The Tax Tribunal disagreed – HMRC had misunderstood the rules. If the purpose of the gift of services was 100% business in the mind of the trader, any private use by the person receiving it was irrelevant. No output tax was due.

If you want to make sure you do the right thing for direct tax and VAT with gifts and entertainment, we can advise you. ●

Really Tangled Information

There are still teething problems with the real time information (RTI) system, such as the creation of duplicate employment records within the HMRC computer. This can happen when an employee is reported as starting or leaving more than once, or where two or more items in an employee's personal identifiers are changed in a single Full Payment Submission.

For example: the employee marries and changes her name, and perhaps her payroll ID number is also changed. The RTI system thinks this is a new employee and sets up a new record, but carries forward the year to date figures for the 'old' employee on both the old and new records.

This leads to an apparent underpayment of PAYE. HMRC will pursue that underpayment unless the duplicate employment record is pointed out to them.

It's good practice to check the 'business tax dashboard' for your business regularly to see if the PAYE paid as reported on that service agrees with what you have actually paid. ●

Another HMRC campaign

HMRC have announced a 'Let Property Campaign' 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. Trustees and companies cannot use this campaign to make disclosures of untaxed income.

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. However, rent received from commercial or industrial buildings or land doesn't fall under this campaign.

If this is relevant to you and you want to use this disclosure opportunity, you first need to notify HMRC by completing a notification form or phoning the campaign helpline on 03000 514 479. We can do this for you.

HMRC allow the taxpayer three months, from the time they acknowledge a notification, to make a full disclosure of undeclared income. The tax due, plus interest and penalties, must be paid within the same period. We can help with submission of the disclosure form and calculation of the amounts to be paid.

HMRC is actively seeking information on landlords who have not fully declared their income. If HMRC find someone before undeclared rental income has been disclosed, a full-blown inquiry into the taxpayer's affairs is likely to follow. ●

Property particulars

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. Unfortunately this request is entirely legal. If you fail to respond within 60 days you could face a fine of £300, and potentially further penalties of £60 per day for additional delays.

You can't 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.

The information requested relates to the rents collected in 2012/13. You need to provide the address of each let property and the landlord's name and address in each case. This data must be sent electronically to HMRC in a pre-defined spreadsheet, although you can submit it on a CD or by secure electronic transit.

Ask us if you have any doubts about the instructions from HMRC. There are many scammers out there who would love to get their hands on this valuable data, so it's best to double-check if you think the HMRC letter could be a forgery. ●

Out of proportion

Default surcharge is the penalty for paying your VAT late, and it can be vicious – up to 15% of the VAT due, even if you are only a day late. That's equivalent to an absurd rate of interest, but the courts have held that it isn't really about the length of the delay – it's a slap on the wrist for failing to comply with the rules. The slap gets harder each time you miss a deadline.

A few years ago, a judge ruled that Enersys Holdings UK Ltd's penalty of £131,000 for being a day late was out of all proportion to the seriousness of the company's failure, so he struck it out. Many other traders tried the same defence, but they have all failed up to now – another court ruled that the circumstances had to be truly exceptional. The penalty is supposed to be harsh – if it doesn't hurt, you won't pay attention. That means a surcharge liability notice – a warning that the next late payment could lead to a penalty – has to be taken very seriously indeed.

Now Trinity Mirror plc has won the second case with a 'disproportionate penalty' defence. They were charged £70,000, 2% of their VAT, for being a day late. The judge decided that this was comparable to Enersys's 5% penalty, so the circumstances were equally exceptional. In general, you'll need a stronger excuse than 'it's unfair' – better still, make sure you don't pay your VAT late. If you receive a warning letter, don't ignore it – talk to us about how to minimise the risk. ●

Gather some MOSS

Selling services on the internet is supposed to be easy – everything is automatic. The customers pay to download your product from your server, and you can get on with something else. It's easy to forget that VAT can make this more complicated.

Up to now, if you sell internet services to non-business customers outside the UK, you have had to charge them UK VAT if they belong in the EU and no VAT if they belong outside. You haven't had to worry about French VAT for French customers and Polish VAT for Poles. From 1 January 2015, you do.

The law is changing so that 'business to consumer' supplies of electronic services, broadcasting and telecommunications becomes chargeable to VAT in the country where the customer receives the service. 'Business to business' supplies aren't affected, so if that's all you do, you won't see a change. But if you sell downloads to consumers, you will have to start gathering information about where they are, and you will almost certainly need to register using the MOSS – the 'mini-one stop shop' – that allows you to report all your EU sales to HMRC in the UK, before they share out the information and the money to other tax authorities.

This is a big change for internet businesses: if there is any chance that you are affected, you need to start planning as soon as possible. If you don't make such sales, you may still notice an increase in the price of downloads next January – some of the major players have based themselves in Luxembourg to take advantage of a special 3% VAT rate, which will go up to the UK's 20%. ●

Big data net

The taxman now has another tool to catch businesses that hide sales which have been paid for using credit or debit cards. He can request totals of all transactions processed on behalf of a particular business by the debit and credit card companies.

This sales data can be compared to the VAT and tax returns the business has submitted. However, these big data sets can contain errors. If you have been challenged by the taxman on the basis that your credit card sales show a different picture to your tax returns, don't assume the 'big data' is correct. We can advise you on the best way to respond. ●

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 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. We can submit it for you if you prefer. ●

Less VAT for cash now

If you offer a discount for prompt payment (a 'PPD'), you aren't sure how much your customer will pay when you raise an invoice – but you have to put a figure down for VAT. The UK law has always said that you assume the customer will take the discount, and you don't worry about it if they pay too late to qualify. So a bill for £100, with 3% off if you pay in 30 days, carries VAT of £19.40 – 20% of £97 – not £20.

There is a fairly obvious dodge here, but up to now the government has not worried about it – most PPDs were offered to trade customers, and most of them could recover the VAT they were paying anyway, so it didn't make much difference. Now they say that PPDs are increasingly being offered to consumers, particularly in telecommunications and broadcasting, and this could lead to an unacceptable loss of VAT.

So they've changed the rules for those supplies, if the customer can't recover VAT, from 1 May 2014 – and they're going to change the rule for all supplies from 1 April 2015. If you offer PPDs to your customers, you'll need to pay attention when the details of the changes are announced nearer the time. ●

This newsletter is written for the benefit of our clients. Further advice should be obtained before any action is taken.