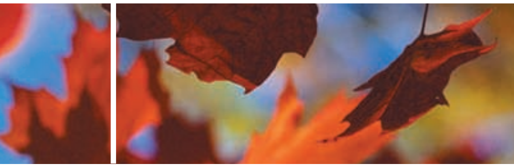
2011 AUTUMN NEWS



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Ace service?

Recently the HMRC chairman met with the accountancy bodies to discuss 'HMRC service delivery'. HMRC, like all public bodies, compile statistics to show how well they're doing. The chairman said they've improved the time taken to answer post. He acknowledged that his stats are not always 'reflected in the actual experience of taxpayers and agents'. To put it another way, if you're still waiting for a tax refund or a reply to a query, the numbers seem a bit hollow.

The good news is that the taxman seems to be committed to making things better – the department is running a project where tax agents spend time in HMRC offices and make suggestions, and HMRC staff spend time in accountants' offices to better understand the frustrations of hanging on our end of the phone. They've promised to make the results public and explain the action they'll take as a result.

One recent service problem seems to belong in the world of comedy. HMRC send out statements of account in July to remind people of what they owe under self-assessment on 31 July. This year they admitted in early August that they hadn't managed to despatch half a million statements in time for taxpayers to pay by the deadline. They said the number of forms they were supposed to send had 'risen out of all proportion to previous patterns' – but why couldn't they see that coming, as it must be based on the tax returns they received up to January? It's been suggested that they didn't order enough paper. If your statement didn't arrive until August, they've agreed to waive interest up to 27 September.

While the taxman checks the stationery cupboard and looks for ways to improve the service, we will carry on working to help you pay the right tax at the right time, and keep you informed about ways to save time, trouble and money. This newsletter describes some of the latest news on tax. If any of it strikes a chord with you, please get in touch. •

In the family

If a husband and wife jointly own an asset which produces income, the law provides that the income is split 50:50 for tax, even if that isn't actually the case. You can tell HMRC on a particular form that the real split is different, but they only apply it from when you sign it – and you have to send it to them within 60 days of that date.

On the other hand, if your under-18 children have assets which came from you, and the income is more than £100 a year, you pay the tax on it as if you received the income directly – you don't get the benefit of the children's personal allowances.

In a recent case a man hadn't reported any income on his tax return from a joint account with his wife or from accounts he said belonged to his children. HMRC assessed him on 50% of one and all of the other. The Tribunal confirmed that he couldn't get out of the tax on the joint income until and unless he filled in the form and sent it in; but they accepted his evidence that the money in the children's accounts had come from their grandfather, not from him, so he wasn't taxable on the interest.

If you are not sure which family members have to pay tax on family income – or which family members would pay less tax – we can advise you. •

Flat interest

After losing a case earlier this year, HMRC have confirmed that they don't expect small businesses which use the Flat Rate Scheme to account for any VAT on bank interest received. Most FRS users haven't paid this VAT in the past – it was something that only HMRC seemed to think was due – but if you have, you will be able to claim it back for the last four years. If you think this might apply to you, we can check. •

Deadlines, deadlines

You may already know that HMRC have changed the penalties for late filing of tax returns and late payment of tax, but in case there's anyone who hasn't picked up on this yet, we're going to keep repeating it. The new penalties are much more severe than they were – in particular, the penalty for late filing will apply even if there is no tax outstanding for the year. If the return is over 6 months late, the penalty will be at least £1,300. Surcharges of 5% of the tax will apply to a balancing payment due on 31 January 2012 that isn't paid within 30 days – as well as the interest that always applies to late payment.

Remember that the first £100 late filing penalty will apply if you file a paper return for 2010/11 after 31 October. If you've always filed on paper in the past, and you might miss that deadline, maybe this is the year to switch to online filing. Then you'll have until 31 January – although we wouldn't recommend waiting until the very last moment, in case something goes wrong.

There are so many deadlines that HMRC have at least published a helpful document listing some of the main ones – they are trying to leave us all with no excuse for missing them. If you are not sure what you need to do by which date, we will be happy to help you. •

Save the day!

Mr Osborne will deliver his Autumn Statement on 29 November. He seems to be moving away from Gordon Brown's 'pre-Budget report' which included advance notice of tax changes coming the following March, but there will probably still be some tax information in with the gloom on finance and spending. He'll probably close down some tax saving schemes, and HMRC will release quite a lot of next year's rates and allowances. Don't expect any giveaways this year (or next, or the one after that...). •

Capital ups and downs

For the last few years, businesses have been able to claim the full cost of some of the plant and machinery they buy for the business, rather than the depreciation charged in the accounts. Anyone spending more than the 'annual investment allowance' (AIA) deducts 20% or 10% writing down allowances (WDA) on the balance – the rate depends on the type of plant.

Up to April 2010 the AIA was £50,000. Then it went up to £100,000, but it's falling again to £25,000 on 6 April 2012 (1 April for companies). The way this works can affect expenditure even before that date. Suppose you've started the year to 30 September 2012 – in round terms, half before and half after the change. Your AIA will be $^{6}/_{12}$ x £100,000 + $^{6}/_{12}$ x £25,000 – £62,500. So you can't spend £100,000 in March 2012 and expect to get a full allowance because you've beaten the deadline.

What's worse, expenditure in the part of the period after the change can't get AIA if it exceeds that fraction of the £25,000. Taking the example on, if you don't spend anything up to 5 April 2012, you will be restricted to AIA of $^{6}/_{12}$ x £25,000 = £12,500 in the following 6 months.

To add to the problem – or further subtract from the allowances – WDA will fall to 18% and 8% from the same date, with a similar hybrid calculation for periods that span the change. So anything above the AIA will enjoy smaller allowances.

If you spend more than £25,000 a year on plant, or intend to make a substantial investment in the near future, these are important rule changes. We can help you understand how to get the best tax relief for your money. •

Hot wheels

It's hard to believe what people get up to sometimes. It's even harder when you find the taxman blaming you. A recent tax case saw a car dealer accused of taking part in a surprisingly common scam. Cars can be bought VAT-free by wheelchair users if the vehicle is permanently adapted to enable them to drive it. This may not cost very much and may not be very permanent: some unscrupulous people turn up in a wheelchair, buy a £36,000 car for £30,000, then sell it shortly afterwards to someone who will pay say £34,000 for something with just a few miles on the clock.

HMRC asked a dealer for details of cars it had sold to wheelchair users. The taxman recognised some of the names – they'd been busy buying and selling. The dealer claimed not to know anything about a scam – it had accepted the buyers at face value and acted in good faith.

The Tribunal accepted the dealer's word and decided that the evidence collected was acceptable, given that the dealer had no particular reason to be suspicious. It seems that HMRC expect everyone to treat claims for VAT relief the way they sometimes seem to – as an improper suggestion. •

A cunning plan?

Blackadder's assistant Baldrick constantly suggested cunning plans which were doomed to failure. Plans for avoiding tax are usually better thought out, but anyone using one should be aware that HMRC are likely to argue that they don't work. You have to weigh the possible tax savings against the possible inconvenience and expense of arguing about them, and the chance of having to pay the tax anyway. HMRC will be celebrating victories in the Tribunal against a couple of cunning plans to create tax-deductible losses which didn't reflect the real loss made by the taxpayer. Tax relief wasn't due for what was only a paper loss.

If someone tells you that there is a magic way of making tax disappear, be sceptical. We can advise you on what works and what doesn't. •

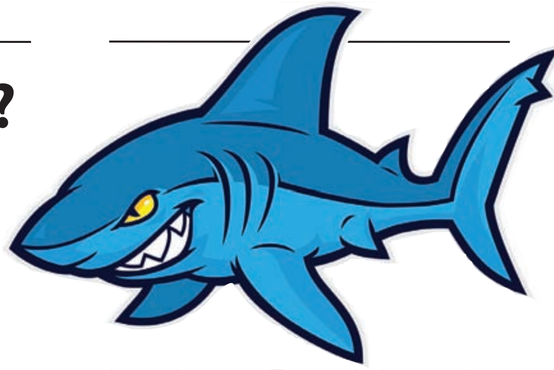
The buck stops where?

Anyone who agrees to help run a voluntary organisation is probably letting themselves in for a lot of unpaid hard work. A recent case highlighted something worse – the possibility of having to cough up for the organisation's bills.

A rugby club contracted with a builder to do some work. The bills weren't paid and the builder sued... the club's president, who had countersigned the contract. He claimed that it wasn't his liability, but the court held that potentially it was. The constitution of the club gave the committee authority to enter into contracts, which meant that every member of the committee was jointly liable. The president could ask for contributions from the others, or argue that the builder didn't deserve to be paid, but he couldn't simply walk away.

That's a scary reminder of how onerous an unpaid position can be – you have been warned! •

Loan sharks?



Default surcharge is the penalty for paying VAT after the due date, and it's nasty – you can add up to 15% on top for being a day late. It could be cheaper to borrow from the local mafia so you can pay the VATman on time.

Given the state of the economy, it's not surprising that the Tribunal is full of people trying to get out of paying surcharges. Many of them failed to realise that they had a problem – HMRC kindly don't charge for the first two late payments by a small business, and they don't collect 2% or 5% surcharges if they are less than £400. So you can be on your fifth default before they ask you for money – and then it's at 10%, with a history of poor compliance to reduce the Tribunal's sympathy if you appeal.

It's important to realise that the surcharge isn't supposed to be interest – if it was, it would obviously be unreasonably high. It's a slap on the wrist for breaking the rules, not compensation to the government for not having the money. Twice in the last year the Tribunal has said the penalty was so unfair that it ought to be cancelled, but in general the harshness of the charge won't get you out of it. One company was a day late paying £1.35m because an accounts clerk had told the bank to pay £11.35m and the bank had queried it – so they tried to pay £10m too much and ended up paying nothing until the next day. The surcharge of £22,700 was confirmed.

Surcharge warnings are printed on yellow paper to try to get traders to notice them. If you receive one, don't ignore it – we can advise you on the best way to make sure it doesn't cost you money. ●

Reasonable mistake?

HMRC have for years accepted that they shouldn't collect tax if the taxpayer reasonably believed that everything was in order, and the department had failed to make prompt and proper use of information provided or had failed to ask for information when it should have done. In two recent cases they have refused to apply this concession.

In the first, the taxpayer was elderly and disabled, and didn't use a tax agent. He changed jobs and received a wrong PAYE coding notice. As he had paid tax under PAYE for years, he thought the right amount would be collected. The trouble was that HMRC seem to have noticed their mistake: they sent him a tax return to fill in after the year in question, and he had no excuse for not filling it in and putting the record straight.

In the second, the taxpayer took early retirement. He had three sources of income, but he received a total of 14 notices of coding in a two-month period. These notices confused him and didn't collect the right amount of tax. HMRC asked for an underpayment of £800 within 8 months of the end of the tax year, and refused to apply the concession. The Tribunal hasn't finally decided that one yet, but it seems likely that HMRC acted quickly enough to correct the mistake.

In another case, the taxpayer had to pay the tax, but the Tribunal accepted that he shouldn't have to pay a penalty on top because he reasonably believed that his liability had been settled under PAYE. The employer had made the mistake and he shouldn't be blamed.

HMRC don't like giving up tax that's legally due. But if you think you have given them all the right information at the right time and they haven't done anything with it, you may be entitled to assume that everything's settled. If this affects you, we can discuss the likely outcome. ●

Eating cake and having it

An employee's contract should say what happens if it's terminated. Usually there is a notice period, and sometimes it's explicitly stated that the employer can pay salary instead. If that's the case, there is no doubt that the payment in lieu is fully taxable – you don't get the first £30,000 tax-free as you do with some ex gratia payments.

Maybe that's why an employer recently paid someone 'an ex gratia payment equivalent to 3 months' salary' on dismissing her with 4 days' notice. She banked the cheque, then sued on the basis that her contract entitled her to 3 months. It seemed clear that the employer intended the 'ex gratia' payment to stand in for her contractual right – but the employment appeal tribunal went with the written words. They said the company had made her a gift which wasn't her contractual right; she was entitled to her contract as well.

When it comes to paying off someone who has no reason to see it your way – say what you mean and mean what you say! ●

Don't get involved

Dismissing an employee is always a risky business. If you get anything wrong, they may claim compensation for unfair dismissal – and there are so many things to get wrong. In a recent case, the appeal tribunal found that the investigation into a worker's misconduct was thorough and fair, but the decision to dismiss 'lacked objectivity'. This was because the same manager took all the decisions, and conducted the disciplinary hearing after already telling the worker he would be sacked. Even though he may have deserved the decision, he was awarded £2,500 in compensation.

ACAS (the Advisory, Conciliation and Arbitration Service) publishes guidelines on disciplinary procedures. This employer was found to have breached the ACAS code, and that was the basis of the claim. It's not enough to be fair – you have to be seen to be fair as well. ●

Counting the days

For years, the question of whether someone was 'resident' or 'not resident' in the UK could have a big effect on their tax, but the rules were a mess – HMRC published a guide to how they decided the issue, IR 20, and then appeared to move their own goalposts in some high-profile court cases. We're still waiting for the outcome of one of these – the taxpayers have argued all the way to the Supreme Court that HMRC's reinterpretation of their guide was unreasonable.

Now the government proposes to tidy this up by making a clearer set of legal rules which will apply in all circumstances. The new law is supposed to come into effect from 6 April 2012. It'll be crucial for people who emigrate or take a secondment abroad, or for those people currently living as tax exiles who have to keep a diary of days they spend in the UK.

Meanwhile, one of those people spent over 183 days in the country because his son was in hospital. He argued that this was an exceptional circumstance, but the Tribunal agreed with HMRC that he had become tax-resident.

If these issues affect you, we will be happy to go over the details – once HMRC have finalised them! ●

Card fees

You can pay your tax using a credit card these days – but, like budget airlines and theatres, the taxman will slap a charge on top for doing so. It's gone up from 1.25% to 1.4%. At least they are up-front with a warning on their website. Maybe if you earn loyalty points it's worth doing... but there's no charge for paying by debit card. Make sure you know the difference! ●

You can't take it with you

The tax-free threshold for inheritance tax has been fixed at £325,000 until 2015. More estates are likely to be hit with a 40% tax charge if property and share values recover. As part of the Big Society idea, George Osborne announced in the Budget that there would be an IHT incentive for people to leave more of their estates to charity.

There's always been an exemption for anything you give to charity in your will – it gets knocked off the estate before you calculate the 40% due. The new rule will cut the rate to 36% if you give at least 10% of your estate to charity. This makes for some complicated calculations, but if you are intending to make substantial gifts to charity anyway, it'll be worth revisiting your will to make sure that the 10% test is passed. The cut in the rate means that the rest of the beneficiaries also get more – only the taxman misses out.

If you want to discuss how this works for your will, we can advise you. We can also explain the incentives for income tax and CGT that are available for lifetime giving. ●

Making sacrifices

If you have a flexible pay package, you may be affected by a recent HMRC announcement. Where an employee agrees to take less pay in exchange for some other benefit – a 'salary sacrifice' – HMRC have in the past treated that as not VATable as long as it was a once-a-year decision and didn't appear as a deduction on the payslip. For example, salary could drop by £1,000, the employer would buy a bike for £1,000 and loan it to the employee under a 'cycle-to-work' scheme, and then after a year the bike would be sold at a knock-down second-hand value to the worker. There are advantages of this for income tax and national insurance, and there were also advantages for VAT.

Then the European Court decided that the worker was really paying for the employer to supply something. The case was about retailer vouchers, but it could apply to other situations where salary is given up for a range of benefits. If the thing supplied is VATable, the employer will have to account for VAT on the value of the salary forgone. HMRC are only changing their policy from 1 January 2012, to give people time to adjust, but there may be annual arrangements in place that won't have finished by then.

If this affects you as employee or employer, we can help you understand the consequences. ●

It's all in the timing

Small businesses have traditionally not had to worry about the accounting standards that companies have to use – SSAPs, FRSs and so on. They didn't have to produce accounts that showed a 'true and fair view'. Then in 1998 the law was changed so every trader had to calculate taxable profits using 'generally accepted accounting principles'. That doesn't mean a sole trader has to put in all the notes and details that a company does, but when you are working out the bottom line, you should do it the same way.

There have only been a few arguments in court about this over the years. In a recent one a building contractor booked a sale when the main contractor issued a valuation certificate – in effect, when his customer accepted that payment was due. HMRC argued that this was later than it should be – he should bring in work in progress as he did it, and he should record sales when he sent an application for payment. After all, he reckoned at that point that he ought to be paid, so he should reflect that in his accounts.

The Upper Tax Tribunal agreed with HMRC. Even a sole trader has to follow GAAP, and there was no justification in delaying the recognition of sales until the issue of a certificate.

It's a reminder that all traders need to follow acceptable accounting policies, and also that HMRC look at them. If you are not sure when to bring income into your profit and loss account, we can advise you. ●

Down on the farm

Suppose you run a VAT-registered business, but you have a small sideline that brings in a bit of extra income. If you are the owner of both, they both fall under the same registration, and you have to charge VAT even on the small takings of the second business. If a different person runs the second one – maybe a husband or wife, or a company – then it can fall below the registration threshold and be VAT-free.

The trouble is that HMRC don't like it. They may look closely at the businesses and argue that you really run them as one. Or they may accept that they are separate, but argue that they have been 'artificially split'. If they are closely linked together financially, organisationally and economically, HMRC can register them as if they were a partnership and make you charge VAT on everything in future.

It's rumoured that HMRC have been engaged in a campaign against farmhouse B&B operations, where the farm is VAT-registered in the name of the husband or a partnership, and the wife runs the accommodation with a turnover below £73,000. In a recent case, the Tribunal threw out HMRC's ruling that they had been artificially split – but only because the officer had not recorded a clear reason for the decision in his notes. He could still go back and try again.

If you have different activities and wonder if they all should be subject to VAT, we will be happy to advise you. ●

Old and new

As every company ought to know, HMRC will now only accept corporation tax returns online. The accounts and computations have to be filed in the iXBRL computer format. Companies House are moving towards the same system, but it's not yet compulsory – so you can computerise early and file online there as well, or you can continue to send paper in the post. Companies House have announced that they don't want to add further regulations for businesses, so they are going to work on making the system better rather than making it mandatory. The idea seems to be that in due course everyone will want to file online even if they aren't forced to. ●

Worst case scenario

A firm of solicitors advised a director on the sale of some shares. Three weeks later he died during a heart operation – he was in poor health, but the procedure was considered routine. The problem was this: the shares would have been completely free of inheritance tax if he had still owned them, but now he had cash, which hugely increased his estate's IHT bill. The daughters sued the solicitors for bad advice.

The court decided that the lawyers couldn't be blamed. They hadn't been asked to comment on the possible consequences of the director's death, and they hadn't been given any reason to suppose it was imminent. There are things that could have been done to minimise the risks, and maybe they should have suggested them – but that was above what the law required, and they had not been negligent.

If you are thinking about selling up your business and retiring, the sudden exposure to IHT is something to take into account – particularly if your health is not the best. We can advise you on the steps you can take to protect your assets. ●

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