Keeping you up to date with events in your sector.

Welcome

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Welcome to the summer edition of Tax Briefing. Regular readers will note that we have slightly revamped the format, and we hope you like our new style. In line with many organisations, we have become more aware of our environmental 'footprint' and of the consequences of our actions. With this in mind, we have consciously contracted the production and distribution of our Briefing with an organisation that is set up to be carbon neutral by planting trees in the UK to offset the carbon produced.

As expected, the 2009 Budget focused on raising taxes and reducing spending. There was limited additional relief for businesses that are experiencing recessionary trading conditions. Many of the changes will come into force in future years – including a new 50% top rate of tax for high earners, which was previously expected to be 45%, together with a restriction on pension premium relief for those same individuals. However, thought will need to be given now to tax planning for those individuals. This edition of our Tax Briefing brings together the key points of the budget for both individuals and businesses.

Pensions tax relief

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From 6 April 2011, it is proposed that tax relief on pension contributions made by individuals with taxable income in excess of £180,000 will be restricted to basic rate income tax. Between £150,000 and £180,000, the rate will be on a sliding scale, with higher rate relief available only to those earning up to the lower threshold.

The good news (?)

Prior to the Budget speech, a number of stories (with unidentified sources….) intimated that higher rate relief might be withdrawn entirely – the suggestion being that tax relief would be the main victim in paying for the recession. In retrospect, this appears to have been a softening-up exercise with a far less drastic outcome.

The bad news - interim measures

In addition to the obvious impact on pension planning for higher earners from April 2011, the Finance Bill also introduces forestalling measures to prevent individuals from taking advantage of the current rules over the intervening two years. Higher rate tax relief on contributions will apply as normal from 22 April for most people – BUT the Government has introduced a 'special annual allowance charge', effective from the date of the Chancellor's Budget speech. This will apply for the tax years 2009/2010 and 2010/2011, with the tapered scale applying for 2011/2012 onwards.

The special tax charge is applied through self-assessment. For the 2009/2010 tax year, it is a maximum of 20% of the amount by which total pension input exceeds £20,000.

Broadly the charge applies to:

- individuals with 'relevant income' of over £150,000, or who have had 'relevant income' of over £150,000 in either of the two preceding tax years
- people whose total pensions contributions or benefits exceed £20,000
- those who make regular pension savings (or benefit from benefit accrual) after 22 April 2009, which do not fit into their normal pattern of contributions or benefits before this date.

Of particular importance here is the definition of 'relevant income' in determining whether you are affected by these changes. 'Relevant income' means all potentially taxable sources of income – not just earnings or 'remuneration' – and includes dividends, and any redundancy settlement or aggregated pension contributions to an occupational scheme, which were deducted from gross pay. It also includes the value of any salary or bonus sacrificed by the individual in exchange for a 'non-cash benefit', where the agreement was not in place before 22 April 2009.

Of particular importance here is the definition of 'relevant income' in determining whether you are affected by these changes.

This gross calculation can be reduced by any relevant income tax deductions, but only personal pension contributions up to £20,000 and the grossed-up amount of qualifying gifts under Gift Aid.

Planning

So what can be done for individuals affected by these changes?

The interim measures are covered in great detail in several lengthy documents, and it is evident that the Government is determined to close any loopholes, which might otherwise allow individuals to avoid the new restrictions. This means that any pension planning that appears to provide a solution to the above should be considered **very** carefully.

At the time of writing, we are still awaiting clarification of 'regular pension savings' as previously 'single and annual pension inputs' did not fall within this definition. It would, however, be remarkable if single pension payments were allowed to fall outside of the scope of the special annual allowance charge.

Members of company schemes are not exempt from these changes, as the source of the pension input is immaterial. So the initial excitement in potentially introducing salary exchange arrangements, whereby the company takes on personal contributions and reduces salary accordingly (with a reduction in NICs), faded very quickly and there is very little available to fill the gap.

Other investments, which attract income tax relief, such as EISs and VCTs, offer relief on subscriptions but at a lower level than the current higher rate and generally with a higher degree of investment risk. After all, tax relief is typically granted as an incentive to invest, whether to save the Welfare Budget from over-reliance on the State pension or to encourage investment in smaller businesses.

These are early days in what we might consider to be a new, overly complex regime, but it seems clear that the Government believes that higher earners benefit disproportionately from tax relief on pension benefits, and this is just one of those battles that they will not lose.

This is a summary of our current understanding of the proposals and the legislation, which is in draft form and may be subject to change before the 2009 Finance Bill is enacted. The benefits of pension investment and the tax relief available depend upon individual circumstances. More detailed information can be made available upon request.

HMRC powers

Far reaching changes have come into effect from 1 April 2009 in regard to the powers HM Revenue & Customs (HMRC) has. These include a new penalty regime for incorrect tax returns and failure to notify taxable activities, compliance checks, payments repayments and debt, penalties for late filing of returns and late payment of tax and interest harmonisation.

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Some of the matters mentioned above were announced in the 2008 Budget and have come into effect from 1 April 2009, some are being phased in from 1 April 2009 to 2010 and measures introduced in the 2009 Budget will come into effect from April 2010.

The new penalty regime is intended to provide a single regime for all taxes and is geared to taxpayer behaviour. Thus where mistakes are made, there will be a 30% penalty where the taxpayer failed to take reasonable care. This will increase to 70% for a deliberate understatement and 100% where the deliberate understatement is coupled with concealment. Previously, penalties were imposed with different percentages for each element of the failure and related to aspects such as co-operation, gravity, size etc. The new regime will apply to return periods commencing after 1 April 2009 where the returns are due to be filed after 1 April 2010.

In addition, HMRC has changed its compliance checking in respect of bookkeeping requirements, access to records and information. The access to records also brings together the various strands of the taxes under the management of HMRC that were previously administered by other agencies. Thus the powers in relation to VAT, PAYE, National Insurance, Income Tax, Capital Gains Tax and Corporation Tax will be aligned and for businesses this could result in one visit covering PAYE, NI, VAT and Corporation Tax. These powers become operative for obligations from 1 April 2009.

Assessment time limits and taxpayer claim time limits are to be aligned and changed with the majority of mistake assessments and taxpayer claims now being harmonised at 4 years. This is a significant change for taxpayers who previously were able to go back for up to 6 years if they had made an error in favour of HMRC. HMRC have the

…there are far-reaching powers for HMRC being introduced…

right to assess up to 6 years if there was a failure to take reasonable care or 20 years for deliberate understatements. These time limits will become fully operative from 1 April 2010 after a transitional period from 1 April 2009.

The 2009 Budget introduced new penalties for the late submission of returns relating to Income Tax, Corporation Tax, PAYE, NIC, Inheritance Tax, the Construction Industry Scheme, Stamp Duty Land Tax and Stamp Duty Reserve Tax. These are to be phased in over a number of years from April 2010, starting with late payment of PAYE.

The new regime will, for the first time, impose penalties on a monthly basis for the late payment of taxes and deductions collected through the PAYE system. This will be quite complicated as it will depend upon the number of defaults made by the taxpayer in any 12 month period. The first default does not trigger a charge, but the second and subsequent late payments in a default period will attract a penalty of 2% of the tax unpaid rising to 5% of the unpaid tax. Tax unpaid after 6 months and 12 months will attract further penalties of 5% of the unpaid tax.

At a time of low interest rates and taxpayer struggling with cash flow difficulties due to the recession, these penalties are severe. Where taxpayers are struggling to meet their obligations they can approach HMRC and discuss a realistic timetable for payment, which will be agreed on a case by case basis. In this situation, if a taxpayer agrees a late payment timetable with HMRC, the late payment penalties will not be imposed and this will be on a statutory basis rather than by concession.

Interest rates on late payment of taxes are to be harmonised, but as this requires changes to HMRC's computer systems, these will be phased in from the date that the 2009 Finance Bill receives Royal Assent.

In conclusion, there are far-reaching powers for HMRC being introduced and whilst a number of them are being introduced under the guise of "harmonisation" or "alignment", most are not favourable to the taxpayer. Great care will need to be taken in the preparation and submission of returns to HMRC and attention given to prompt payment of liabilities if taxpayers are not to be penalised.

Furnished Holiday Lettings
– addition of properties within the EEA

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As part of this year's Budget, it was announced that the Furnished Holiday Lettings (FHL) rules would be repealed with effect from 6 April 2010. The rules will remain in place for the rest of this tax year, however, providing an opportunity for those clients with holiday homes available for rental, particularly where those properties are in continental Europe.

The type of property affected is residential accommodation that is let on a commercial basis with a view to making a profit, and is:

- **made available** for letting for at least 140 days during the year
- actually **let** for at least 70 days during the year
- lettings of more than 31 days to the same person account in total for less than 155 days of lettings during the year

Previously, the accommodation had to be in the UK. HM Revenue & Customs (HMRC) have now accepted that property anywhere in the European Economic Area (EEA) qualifies

– that is all countries currently within the European Union as well as Iceland, Liechtenstein and Norway.

The FHL rules grant some useful tax benefits. Generally, property letting is not a trade, but the FHL rules grant landlords some of the tax privileges available to traders:

- losses on FHL properties can be offset against other income
- capital allowances can be claimed for equipment in FHL properties (though the 10% 'wear and tear allowance' can't be, nor can Landlords Energy Saving Allowances)
- capital gains reliefs are available, including
  - business asset taper relief
  - entrepreneurs' relief
  - roll-over relief
  - relief for gifts of business assets
  - relief for losses on loans to traders
- any letting profit counts as relevant earnings when calculating the maximum pension contribution allowable for an individual.

What does this mean?

For clients who had let foreign holiday homes in any tax year commencing after 5 April 2004

HMRC have said they are prepared to accept retrospective claims made on the revised basis. Clients who have let out their holiday homes in the past should review the details

…there may be scope to claim a repayment of tax…

they have previously returned to see whether there is scope for a worthwhile tax reclaim.

Where, for example, significant expenditure has been incurred on improving or refitting the property in the relatively recent past, there may be scope for generating or increasing losses through claims to capital allowances. More importantly, there may be scope to claim a repayment of tax by setting the loss against your other income, which has been disallowed up until now.

Where holiday homes have been sold and capital gains tax paid, there may also be scope to obtain partial or full repayment of that tax by using one of the many reliefs HMRC now say they will allow.

For clients who currently let UK or foreign holiday homes

Consider bringing into the current tax year any major project expenditure on refurbishing or improving the property. The aim would be to maximise your capital allowances claim and, maybe, to generate a loss which you can set against your other income. After this year, you will probably only be able to carry forward losses against future rental profits.

Consider sharing ownership of the property (or divesting yourself of it entirely) in order to take advantage of the various UK capital gains reliefs that will remain available until the end of this tax year. This will be particularly important for those owning properties in:

- the UK
- countries, like Italy, which do not levy capital gains tax on properties within their borders.

Particularly in the UK, the current depressed level of property values make this a very good time to share ownership of assets with the family to mitigate death duties, whilst taking care not to fall foul of anti-avoidance legislation, such as that relating to pre-owned assets.

For clients who are companies (including single-property owning companies)

The time limits and possible planning opportunities are slightly varied from those set out above, so it would be worthwhile seeking advice specific to your circumstances.

Most client circumstances will include a number of specific but unique considerations, so it will be worthwhile taking advice on your particular situation before taking action. In many cases though, action now may well give rise to a repayment of tax or a worthwhile estate planning gain. If you would like further information on how you can take advantage of this, please contact the author.

Relaxations in the tax regime

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Temporary extension of carry-back of losses

The temporary extension of carry-back of losses has been extended by a further year, to accounting periods of companies ending between 24 November 2008 and 23 November 2010. Previously, as announced in the Pre Budget report, the period was to end on 23 November 2009.

For unincorporated businesses, the extension will include the tax year 2009/10 as well as 2008/09

This relief allows losses arising in the above period to be carried back up to three years, with losses to be set against the profits of the most recent year first before carry-back to earlier years. However it should be noted that the amount of loss that can be carried back to the earliest two years of the extended period is to be capped at £50,000 in total. If a loss-making accounting period is less than 12 months, the £50,000 cap will be reduced pro rata.

The £50,000 limit applies separately to the unused loss of each 12-month period or tax year within the duration of the extension. For companies, this means a cap of £50,000 on the extended carry-back of losses incurred in accounting periods ended in the 12 months to 23 November 2009, and a separate £50,000 cap on the extended carry-back of losses incurred in accounting periods ending in the 12 months to 23 November 2010.

For unincorporated businesses, a separate £50,000 cap will apply to the extended carry-back of losses made in each of the tax years 2008/09 and 2009/10.

Extension of time allowed for paying tax

Because of the current economic climate, HM Revenue & Customs have introduced a Business Support Unit where taxpayers can agree delayed payment terms for all forms of business tax. This can include PAYE/NIC, Corporation Tax, Income Tax and VAT. Whilst payment can be delayed, it does not stop interest accruing on the outstanding liabilities.

For amounts below £100,000 and where the proposed payment term is less than a year, the payment schedule can usually be agreed by a simple telephone call. For amounts above £100,000 or where the aim is to agree a payment term of more than a year, the Revenue will normally require completion of a 'Debt Questionnaire' before giving a decision.

The above is a useful facility, rather than having to seek additional bank finance.

…taxpayers can agree delayed payment terms for all forms of business tax.

Enterprise Investment Scheme (EIS)

The Budget introduced some relaxation in the way EIS works, which was much needed after previous years' amendments had made it very restrictive and relief difficult to obtain.

The relaxations are:

- Funds raised had to be at least 80% spent in the first year and the balance by the end of the second year. Now the funds will have to be spent within two years without percentages applying.
- Funds raised on the same day as EIS funds were subject to the same spending limitations. Now there will be no restrictions on the use of non-EIS funds.
- The carry-back rules for investors have changed dramatically. Previously only half of the subscription for shares acquired by 6 October, up to a maximum of £50,000 subscribed, could be carried back to the previous tax year. Now any qualifying subscription during a tax year can be carried back to the previous year. Thus up to £500,000 can be carried back to the previous year.
- An anomaly regarding capital gains tax on a share-for-share exchange has been removed.

It remains to be seen whether these relaxations will generate investment in the companies targeted by EIS.

Action Points

Can you make use of?

- Extension of carry back of losses
- Additional time to pay tax
- Relaxation in EIS scheme

VAT Changes

On 1 April 2010, HM Revenue & Customs (HMRC) announced four important changes to the partial exemption standard method. Three of these are voluntary and one compulsory.

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A single calculation

The standard method requires tax payers to undertake partial exemption calculations each quarter. However, a VAT recovery is provisional until a final annual calculation is carried out, normally referred to as an annual adjustment. This calculation is carried out in the quarter following the end of the VAT year. Your VAT year will end in the March, April or May quarter, depending on stagger.

The first of the three voluntary changes is to allow taxpayers to undertake the annual adjustment and use this figure as their provisional recovery figure in the next year. This means that you do not need to undertake time-consuming partial exemption calculations for each quarter.

This change is very helpful for organisations with fluctuating taxable and exempt supplies – for example, a membership organisation which makes the most of its exempt supplies in the early part of the year through subscription income. In practice, very often such organisations requested this VAT treatment as a special method. Now it will no longer be necessary to contact HMRC to adopt this approach. If you would not benefit from undertaking a single calculation and would prefer to continue with five calculations per year (the four quarterly calculations and the annual adjustment) then you can continue under the old rules.

An earlier annual adjustment

The second voluntary change is that HMRC will now allow the annual adjustment calculation to be undertaken in the final return for the VAT year (that is, the March, April or May return) rather than on the following return. If your annual adjustment calculations result in you obtaining a VAT refund, it will clearly make sense to take advantage of this. If, on the other hand, your annual adjustment calculation usually results in you having to restrict additional input tax, it would make sense to defer the calculation until the next quarter.

Optional use-based calculation for new business

The standard method requires the value of taxable supplies to be compared with the value of total supplies. This can be a problem for new businesses that do not make any supplies during start up.

HMRC will now allow new businesses to adopt a use-based calculation when calculating their VAT recovery, subject to certain rules. They can then revert to a normal values-based calculation when they are up and running.

This change is to be welcomed and will reduce the need to apply for special methods for new businesses with long start-up periods.

Changes to Regulation 103

The fourth change is compulsory and relates to the treatment of VAT which is incurred in the UK and related to supplies made overseas. The VAT system used to allow such VAT to be included within the standard method for partial exemption. Unfortunately for HMRC, this led to a series of tax planning arrangements, and to overcome this, it

introduced Regulation 103. This required that VAT incurred on such overseas supplies should be apportioned separately from the standard method by a use-based calculation.

Since Regulation 103 was introduced, there have been a number of changes.

In particular, an override was introduced for the standard method, which means that if a normal values-based calculation results in excessively high recovery compared to the ‘use’, then a use-based calculation must be substituted. It follows that Regulation 103 was no longer necessary, and consequently HMRC has now effectively ceased to apply it, except for supplies of shares and bonds.

This change is to be welcomed, as Regulation 103 was often misunderstood and in practice many organisations did not undertake separate calculations for input tax that related to overseas supplies. Neither in practice did HMRC generally require it.

If you would like any information about how the changes affect your business, please contact the Chantrey Vellacott VAT team.

A silver lining...?

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There are very few things to be pleased about in a recession – but, if you are in the enviable position of still being able to afford to make large gifts, this could be a good time to do so.

18 months or so ago, share prices and property prices were at their highest levels for some time. But they are now, in some cases, 50% lower. Whilst this is generally not thought of as a good thing, it now means that more assets can be gifted away without exceeding the nil rate band for Inheritance Tax – currently £325,000. If you are of the opinion that values will eventually go up, then gifting at low values will remove growing assets from your estate.

To give an example, say you have shares in Royal Dutch Shell plc. In May 2007 these were traded at £4.70 per share, and so around 63,000 shares could be gifted without exceeding the nil rate band (then £300,000). At the beginning of May 2009, their share price was around £3.40, so around 95,000 shares could be gifted. A similar comparison could be made with investment properties.

This is particularly important where trusts are concerned, as almost any transfer into trust now is immediately chargeable to Inheritance Tax where the value of that gift exceeds the settlor’s available nil rate band. Far more assets could now be put into trust, or an investment property, which previously would have been valued in excess of the nil rate band.

Whilst this seems an ideal time for such gifts, one must always consider the downsides – such as losing the income generated from those assets, as well as having no access to that capital on a rainy day – and advice should be taken before any gifts are made. This is by no means an ideal solution for everyone.

Who to Contact

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