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Ashmole & Co

Chartered Certified Accountants & Registered Auditors

Head Office: Williamston House, 7 Goat Street, Haverfordwest, Pembrokeshire SA61 1PX
Telephone: 01437 765556 Fax: 01437 767125 email: haverfordwest@ashmole.co.uk

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www.ashmole.co.uk

Newsletter

Just say no!

HMRC like to talk directly to taxpayers but it has always been HMRC policy that, where an agent has been appointed by a taxpayer, HMRC raise any questions that they may have via the agent.

However, in a worrying development HMRC increasingly appear to be trying to cut accountants out of the system. The first example is Business Records Checks. The approach here seems to be aimed at asking people questions about their records by way of a 15 minute questionnaire. If HMRC do not like the answers they state that they will pay the business a visit.

In another recent announcement, HMRC are now saying that where they have any sort of question, the initial letter will go to the taxpayer, not the accountant, who will be given seven days to tell HMRC if they wish to deal directly with them. If HMRC do not receive a reply, HMRC will then contact the agent by phone within 14 days to progress the case. If contact or progress cannot be made, then HMRC will go back to the taxpayer.

At the end of the day, tax can be complicated, which is why accountants are needed! Please, if you get any contact from HMRC, let us know immediately and we can then discuss the best course of action.

WINTER 2013

RTI developments keep on coming

It is probably fair to say that the biggest change to the PAYE system has gone quite well for those employers that prepared for it. The technology seems robust and there have been no 'crashes' of the system. However, it is also clear that many smaller employers have not really started to get to grips with RTI.

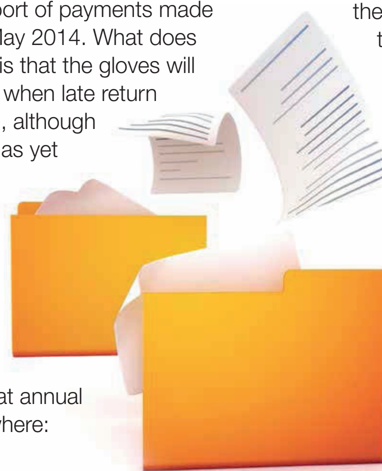
HMRC also know this, which explains the announcement that the temporary relaxation of the new rules for businesses with fewer than 50 employees has been extended until April 2014. The effect of the relaxation means that a small business paying employees is permitted to submit only one report under RTI a month, rather than all the reports which may be required. However, this is all a bit of a red herring, as HMRC has previously announced that there will be no penalties for late filing of RTI returns for 2013/14, provided that the employer has submitted the final report of payments made to employees by 19 May 2014. What does appear clear, though, is that the gloves will be off from April 2014 when late return penalties will be levied, although the level of penalties has yet to be announced.

In a second development, HMRC now appear able to process requests for annual PAYE schemes. HMRC are keen to emphasise that annual schemes only apply where:

- ALL the employees are paid annually in the same month and
- the employer is required to pay HMRC annually.

This reduces the number of RTI returns required from 12 to only one.

Finally, it has always been clear that the RTI system is not directly linked to the HMRC system that records PAYE payments. Over time this will happen but RTI highlights the tax which is due and when it is due. There are stringent PAYE late payment penalties which are structured on a sliding scale. The more late payments in a tax year, the larger the percentage penalty applied to the aggregate of the late payments. The first default in any year is disregarded altogether. The remaining defaults trigger a penalty of 1%, 2%, 3% or 4% depending on their number. A 4% penalty is payable if there are ten or more defaults during the tax year. The penalties can be large and HMRC also have the power (although it has not started yet) to impose interest on the late paid PAYE. The moral is clear - ensure that PAYE is paid on time before the chickens come home to roost.



There are many PAYE related issues that occur, so if we can be of help with these or any other matters, please do not hesitate to contact us.

Surely knowing what is tax deductible from my rental income is easy?

No is the surprising answer. What qualifies for a tax deduction for a rental business is based on the principles and rules which apply for a trading business but there are differences. Most of these arise from the fact that capital allowances are not available for expenditure on 'plant and machinery' bought for use in residential property. The common types of expenditure under this heading would be beds, furniture, fridges, cookers and fitted kitchens.

There are exceptions to this rule for property which falls within the definition of a 'furnished holiday letting' and expenditure on assets which are used in the non-residential part of a block of flats, for example the hallways.

Also some expenditure may qualify for a tax deduction as it can be regarded as a 'repair' to the house or flat. It is therefore revenue not capital expenditure. Consider this example. The fridge has broken down. It is not economic to fix it, so a new fridge is purchased and put in the same place as the old fridge. Are we going to have a tax write off for the expenditure?

Part or whole

The first issue we have to consider is whether the fridge is a 'fixture'. If something is a fixture then it has become part of the building. It is a fundamental principle of tax that the replacement of a part of an 'entirety' is repair expenditure and is tax deductible. So an integrated fridge in a fitted kitchen is a fixture as part of the kitchen and the kitchen is a part of the house. Replacement of the fridge is therefore tax deductible.

If a fridge is merely plugged into a wall socket in a kitchen and the attachment is no more than is necessary for the object to be used and enjoyed, then it is not a fixture and remains a separate asset (i.e. an entirety). Replacement of the fridge is capital expenditure.

Whether this capital expenditure gets relief depends on the type of rented property. For some types of letting the rules have changed from 6 April 2013:

Type of letting	Pre 6 April 2013	From 6 April 2013
Furnished holiday	Capital allowances	Capital allowances
Unfurnished property	Cost of replacing the item (known as the 'renewals basis')	Renewals basis no longer available so no relief
Furnished	Renewals basis or 10% of net rents ('wear and tear' allowance)	Only wear and tear allowance
Partly furnished	As for unfurnished property	As for unfurnished property

The key change is that you can no longer use the renewals basis for the current tax year onwards. The change has come about because HMRC is required to bring concessions into law and the 10% wear and tear and the renewals basis were concessions. Wear and tear has been put on a statutory basis but not the renewals basis.

Please contact us if this affects you to see whether we can reduce the problem that this may cause.

Partnerships - a kaleidoscope of change?

HMRC issued a consultation document 'Partnerships: A review of two aspects of the tax rules' earlier this year. We are currently awaiting further response from HMRC and possibly draft legislation at some point in Finance Bill 2014.

This article outlines the potential scope of these changes and how these might affect you.

Salaried members of LLPs

An LLP (limited liability partnership) is an alternative corporate business vehicle that gives the benefits of limited liability but allows its members the flexibility of organising their internal structure as a traditional partnership. The LLP is a separate legal entity with liability for the full extent of its assets but which accords its members the benefit of limited liability. However, for tax purposes, the LLP is usually taxed as though it were an ordinary partnership with its individual members taxed on their profit share on a self-employed basis.

Individual members are taxed as a self-employed member even if their role in the LLP would ordinarily mean that they would be regarded as being in an employer-employee relationship. They may, for example, bear no risk within the LLP and enjoy a fixed salary which they are guaranteed to receive. HMRC are concerned this results in an individual member receiving a more favourable treatment in respect of their income tax and National Insurance Contributions (NIC) position compared to an employee of the LLP (or any other business) on similar terms.

From 6 April 2014 the proposals will prevent members of an LLP benefitting from the default position of self-employment status if the reality is that their terms of engagement amount to an employee-employer relationship. As a result, the salaried member will be liable to both PAYE and employee Class 1 NIC. Additionally, the LLP will have to pay employer NIC at 13.8%. These rules will apply where specific conditions apply.

Profit and loss allocation schemes - all partnerships

The principal arrangements under the microscope are where partnerships with mixed members or partners i.e. individuals and companies arrange the allocation of profits and losses in such a way that a tax advantage is obtained. Typically this means the allocation of sometimes substantial profits to corporate members that will pay a lower rate of tax rather than to an individual member. A corporate member may pay a 20% rate of corporation tax whereas an individual member may have an income tax rate of 40% or 45%.

Alternatively, where losses are incurred the arrangements are such that the losses are allocated to the individual member who will obtain relief at a higher rate of tax!

There may, of course, be sound commercial reasons for having a company as a member of the partnership. However, HMRC has seen an increasing number of such arrangements where it considers profit sharing ratios are artificial.

The proposed changes to the rules are intended to deter arrangements that exploit the tax treatment of mixed member partnerships. Subject to specific conditions being met, HMRC would be able to counteract the arrangements and allocate all or part of the profits that have been allocated to the corporate member to individual members with a restriction in tax relief in the case of losses.

The consultation document states that these rules would apply with effect from 6 April 2014 in relation to profits and losses that arise on or after that date.

As you can see these are fundamental proposals which could impact on you. We will keep you informed on any developments in this area and how they may affect you.

Intertwined - records and residence

6 April 2013 saw the start of a brand new way of determining the UK tax residence status of individuals. Known as the Statutory Residence Test (SRT) it provides a series of tests which, when correctly followed, will enable a definitive answer to be given to the question ‘Am I resident in the UK?’

The tests cover a wide range of issues including:

- days spent in the UK
- employment or business activities both in the UK and in other countries
- the existence of a home, whether in the UK or overseas
- the residence of a spouse or live-in partner and
- availability of accommodation.

This article cannot consider the detail of the rules but we can supply you with more information on the likely application of the rules to your situation.

What is clear is that anyone wishing to claim non-resident status should be aware that such a claim will require evidence to support it. In the absence of sufficient evidence, HMRC will be entitled to reject the claim and regard the individual as UK resident which may have significant, adverse consequences. We understand that keeping detailed records can be a bit of a pain especially when coping with a modern business life which is hectic and stressful. However, finding that you have a significant tax bill because HMRC will not accept a claim for non-residence could be a very high price to pay for not spending just a few minutes each day recording some basic information.

What records?

There is no set list of records but we consider that the following evidence would be the minimum that is likely to be required by HMRC.

All individuals should keep records to show their movements in and out of the UK and in other countries. The minimum requirements will be to record:

- days when you were in the UK at midnight
- identify any days where you were in the UK at midnight but only because circumstances beyond your control meant that you had to remain in this country
- identify also any days when you were in the UK at midnight but were simply in transit on to another country (provided you did not have any business in the UK during your transit period)
- days when you were in the UK during any part of the day but not at midnight
- if you were not in the UK at midnight, where were you?

If you have a home overseas (you don’t have to own it) you will need to record all the days on which you were present in that home in each tax year. HMRC may wish to see evidence to justify why you think a particular property should be regarded as a home for this purpose.

Individuals who are working either as employees or as self-employed individuals in their own business should have copies of any employment contracts or contracts for their services and will also need to have records of:

- the hours spent working in the UK on any day
- the hours spent working overseas each day
- days when you were on annual, sick, or parenting leave from your work overseas.

The list looks formidable but can be reduced to a basic spreadsheet. Armed with that information it will be possible to give advice on your residence status for UK tax purposes. Without it the advice would be very provisional and the position could well be challenged by HMRC.

Passing on the family business tax efficiently

Imagine this scenario. Mother and father have been running their business as a company for many years. Some of the children are taking more responsibility in the business and it is time perhaps for the parents to let the children take control. The parents would like the profits which may have been accumulated in the company to be paid out to them if it can be done tax efficiently.

Both these objectives can be achieved by using tax legislation which gives favourable tax treatment to an individual when a company purchases some of its own shares.

In broad terms the steps are:

- The next generation is given some shares in the company. This may be a minority holding say 30% of the company and may be done several years before the parents want to relinquish control. No tax charge should arise for the parents or the children due to the availability of tax reliefs where it qualifies as a trading company.
- Sometime later, when parents want to retire, the company buys back their shares. If done correctly the proceeds received by the parents will be taxed as capital receipts for the sale of their shares (rather than subject to income tax). Entrepreneurs’ Relief may be available where both the individual and the company meet certain conditions so the tax charge is only 10% on the receipts less the original cost of the shares.
- Under company law, the company will cancel the shares with the effect that the shares held by the next generation are the only shares in issue. This means they now own 100% of the company.

Are there any problems? Yes there are but we are here to help manage the process.

Playing by the rules

There are rules in company law which must be dealt with. If the rules are not followed, the effect can be that the purchase of shares is an invalid purchase and unfortunate consequences may follow.

There are also tax rules to follow. The two keys matters to establish are:

- that the company is a trading company for the purposes of Entrepreneurs’ Relief. This enables the proceeds from the sale of shares to the company to qualify for a 10% tax rate.
- that the purchase of shares is for ‘bona fide commercial reasons’. A clearance procedure is available upon application to HMRC.

And finally there are financing issues. What if the company has insufficient cash to pay for the shares in one go? This can trigger all sorts of problems for the unwary but it is possible in many cases to resolve the issues.

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A recent dispute between an individual and HMRC has recently ended up before a tax tribunal. One of the two shareholders wanted to exit the company as there was disagreement as to the running of the company. £120,000 was paid by the company for the purchase of his shares. The individual expected a capital gains tax bill at 10%. HMRC assessed him to income tax as the shareholder had only owned the shares for four years (one of the conditions for capital treatment is that the shares are owned for at least five years).

He was able to remove the income tax bill at the tax tribunal on the basis that the distribution was unlawful as the company had not complied with a number of company law requirements. The tax tribunal agreed that the £120,000 was not a valid distribution. However, this did mean that the £120,000 paid to him had to be returned to the company. The consequential effect is that the company is instead treated as having lent him the money which triggers off other tax consequences for the company (and him).

And he has to pay the costs of his professional advisers and other costs…..

Oh dear. Do please talk to us so that we can guide you through the minefield to a safe 10% tax bill.

Charity shops and Gift Aid

Many people make donations of unwanted clothes and other goods to charity shops. If you have done this in recent years you will almost certainly have been asked by the staff in the shop if you want to Gift Aid your donation. This may come as a bit of a surprise because you were of the opinion that Gift Aid applied only to gifts of money! Actually you were quite right - Gift Aid is only applicable to gifts of money. This does not mean that what the charity shop is asking you to do is to take part in some tax avoidance scheme but there are some misconceptions on both sides about what is actually happening here.

What HMRC have been prepared to do is to accept that if the charity shop is actually selling goods on behalf of the donor, and the donor is prepared to allow the shop to retain the cash proceeds then those cash proceeds can be subject to a Gift Aid claim. That of course helps the charity and can help the donor if they are a higher or additional rate taxpayer. Unfortunately it is clear that many volunteers in charity shops do not understand the system and that could lead to some problems for the charity concerned.

HMRC recently updated their guidance to charities on how to deal with these matters. The guidance is on the HMRC website at www.hmrc.gov.uk/charities/guidance-notes/chapter3/sectionf.htm. It is strongly recommended that if you are involved with a charity shop that you look at this detailed guidance and ensure that your procedures are compliant with it. Failure to do so could mean that HMRC take action to recover any tax wrongly claimed.

The guidance makes it very clear that what is happening in these situations is that the shop is selling the goods as agent for the donor who can actually do what they like with the proceeds. The shop should make clear to the donor the implications of the Gift Aid process.

Charity shops are being given different ways in which they can operate the Gift Aid scheme. There is not space in this article to cover all the details but the essential processes are:

- the donor gives a Gift Aid declaration when they donate the goods
- the shop marks the goods so that they can be identified as coming from the donor
- the shop will normally advise the donor of the net sale proceeds before a Gift Aid claim is made unless one of two methods (helpfully referred to as Method A and Method B) are used.

Method A involves the charity writing to the donor only where the total sums donated in a year exceed £100. Method B will be used where there is a trading company running the shop and replaces the limit with £1,000 as an annual sum. In both cases the details of the scheme must be explained to the donor at the time they donate the goods and the shop must have procedures in place to be able to track the sale of the goods and record the amounts for each donor so that letters can be sent out if those limits are exceeded. If a donor asks for details of the sums actually received by the charity so that they can make a claim for higher rate relief, then that information must be supplied to them.

Given that sales in charity shops are now approaching £1billion annually there are clearly significant benefits to charities in seeking Gift Aid but those benefits will be lost if basic procedures are not followed. The message from HMRC is to take the time to get the procedures right and the benefits will flow.

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