Tax Insider
HOW TO BEAT THE TAXMAN AND BOOST YOUR INCOME!

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Now you see it, now you don't - Planning Gain Supplement Returns?

By James Bailey

For a couple of years, the Treasury has been playing cat and mouse with property developers over a new tax, Planning Gain Supplement.

There have been various consultation documents setting out the form of this new tax. Essentially, it was designed as a replacement for the "Section 106" bribes that local planning authorities are able to impose on developers - "you want to build a supermarket here? Well, you can, but we want a new swimming pool and a leisure centre as well, built at your expense for us to run".

The PGS was going to centralise the bribery process so that the developer had to pay a tax on the increase in value of his land as a result of obtaining planning permission. The tax was to be payable at the time the development work started - it was to be a condition of the planning permission that the payment was made.

Local authorities were less than keen on this innovation because, of course, it meant that the cash went into the Treasury's coffers, rather than the local authority's. The theory was that the Treasury would then pay the cash out to the local authorities (if they hadn't lent it to a failing bank first), but that was seen as much less satisfying than making the developer jump through the "Section 106" hoops.

When you looked at the detail of the proposals, it was clear that like many of our erstwhile Chancellor's bright ideas, it was ludicrously complex, uncertain in its effect and

probably impossible to administer. We heard whispers that even Gordon realised it was a tax too far and wanted to drop it - or perhaps he thought he would never get it past Parliament.

In his Pre-Budget Report, the new Chancellor announced that PGS was to be scrapped. Apparently, the responses to the consultation documents had persuaded his controller that the tax was unworkable. Instead, he announced that local authorities would retain the power to impose planning conditions and be able to collect local planning taxes.

The property industry breathed a sigh of relief but they had not seen the legislation then. When the Planning Bill was published, it included details of the "Community Infrastructure Levy".

This empowers local authorities to impose a tax charge on the developer of a specific site in their jurisdiction. The Bill (Clause 163) also empowers the "Communities Secretary" to make regulations empowering any planning authority to impose CIL - any planning authority, including the Secretary of State.

The power to impose CIL can therefore be extended to central government by making regulations - so much easier and simpler than all that annoying debating in Parliament, where MPs disagree and ask awkward questions.

This is not a trivial procedural point. The ability to impose taxes by regulation rather than by statute should be very tightly limited - a good example of an appropriate use of this mechanism is the PAYE regulations where the legislation sets out the basic concept ("If you employ someone, you must deduct tax and NIC from their wages") and leaves the fiddly details to be sorted out by regulation. The PAYE regulations deal with how to collect the tax, not with how much tax is due, which is properly the responsibility of Parliament.

The 2007 Finance Act included another example of the incorrect use of regulations - it allowed HM Revenue and Customs to decide whether a company was "listed" or "unlisted" for tax purposes. The distinction is a very important one for various tax purposes, most notably for the fact that shares in an "unlisted trading company" are "business property" for inheritance tax purposes, and thus are effectively exempt from IHT. Currently, shares quoted on the AIM are "unlisted" for tax purposes, but since FA 2007, HMRC could change that without Parliament having a say.

We should not be complacent about these changes. It is a fundamental tenet of a democracy that taxes are imposed by Parliament, by those who have to answer to their electorate. The job of the bureaucrats is to collect the taxes from those who owe them, not to decide who shall pay what tax.

TAX INSIDER TIPS

- There are rumours that the Public Commercial and Services Union (to which 80% of HMRC staff belong) is considering calling a strike to protest at the redundancies and office closures that have been taking place. What day will this strike occur? Why, 31 January 2008 of course, the deadline for self assessment tax returns. This is not good news for those who habitually rush round to their local tax office on 31 January with their tax return - there may be nobody at home to receive it!

- If you are a widow or widower who may benefit from the new transferable nil rate band for inheritance tax (see the October 2007 edition of Tax Insider for details), it would be wise to get the paperwork from your deceased spouse's estate together and store it with your Will so that your executors will be able to claim the extra nil rate band with the minimum of fuss.

- At the time of writing, we are still waiting for the Chancellor to clarify his plans for CGT. Anyone contemplating selling their business in the next year or so should look out for any announcements on this, as it may be possible to crystallise the capital gain before 5 April 2008 and take advantage of Business Asset Taper Relief before it is abolished (if it is!) on 5 April.

- Major changes to capital allowances for investment in machinery and plant take effect from 5 April 2008 (31 March for limited companies). If you are contemplating buying plant, check with your tax adviser to see if you would do better to buy it now or to wait until April.

- We are assured by HMRC that there is no evidence that the infamous discs containing details of all UK families receiving child benefit have fallen into criminal hands. How strange, then, that on 4 December 2007 HMRC posted a warning on their website that people have been telephoned by fraudsters telling them that they are due a child benefit rebate and trying to get identity details from them!

- Grant Thornton, the accountants, have published a report saying that there is a "black hole" in the Chancellor's finances, and that it equates to approximately an extra £200 for every household in the UK. It should be an interesting Budget speech in March!

A Difficult Customer - a Cautionary Tale

By James Bailey

I have just settled an "Employer Compliance Enquiry" for one of my clients and I think it should serve as a warning to all employers, and indeed to all those who are the subject of a Revenue Enquiry of any sort.

You will have to forgive me if I do not go into the technical details of the points that were disputed - to do so might identify the business involved, and in any case, this article is not about the technicalities (fascinating though some of them were, including studying a tax case heard in the previous century involving payments to Scotland Yard detectives!).

An "Employer Compliance Enquiry" involves two main aspects. The "Employer Compliance Officer" (ECO) will check that the PAYE regulations have been properly applied to payments to employees - in the case of larger employers like the one I was dealing with, this is mostly done electronically, by interrogating the payroll software. The ECO will also look at expenses payments and benefits in kind provided to employees to ensure that these are properly reported and taxed.

My client has a very competent accounts department and they took the view that they could handle this apparently routine enquiry without my help. I was not so sure, but the customer is always right so I contented myself with warning them to check with me before they agreed any additional tax was due.

The PAYE side of things went fairly well. Apart from a few slip-ups (inevitable in the case of a large payroll), there was only one significant mistake which was largely due to a weakness in the proprietary software the client used for their payroll. So far, so good, and we put our hands up and paid the tax due.

It was when the Enquiry turned to expenses and benefits that things got ugly. The ECO homed in on two main issues: travelling expenses and accommodation provided for employees. Her letter to the client asserted that tax was due on most of the travelling expenses and nearly all of the accommodation, and required the client to provide her with details for the last six years so that she could calculate how much tax was due. The biggest problem was the accommodation - the tax at stake was in the hundreds of thousands of pounds when you looked back over six years.

The ECO's letter simply asserted that the tax was due. Asked why, she quoted from HMRC's instruction manuals, not from the legislation itself. Now, although HMRC's manuals are generally quite good at summarising the law, they are not in fact the law and in some cases they generalise too much. My client's circumstances were very unusual and were not covered by the manual.

The client rang me up and asked me to look at the assertions the ECO was making about what was taxable. To cut a long story short, after a spirited exchange of letters and "referring the matter to my Head Office" from the ECO, she eventually agreed that none of the accommodation was taxable and that a large slice of the travelling expenses were also free of tax.

I do not tell this story to brag about how good I am at tax (though I reckon I'm pretty good!), but to draw attention to a serious problem with the way the tax legislation is enforced. ECOs are not experts in the finer points of tax legislation - witness the fact that most of my arguments had to be "referred to Head Office" - but this does not stop them from looking at a situation and demanding tax based on a generalised overview of how the legislation works. I remember that culture from when I was a Tax Inspector - at an early stage in my training, I was told "if in doubt, disallow the expense or say the payment is taxable and let them try to argue it's not".

The problem is that revenue officers these days present themselves to their "customer" (their own ridiculous word to describe the person they're seeking to tax!) as being fair and neutral - "we only want to make sure you pay the correct amount of tax". For some inexplicable reason, people still tend to think that government officials know what they are doing and believe they would not demand money unless it was due. They are wrong. A revenue officer, confronted with something that may or may not be taxable, will work on the basis of claiming tax and letting the "customer" make the running if they disagree.

Of course, in many cases they are right, but never assume they are without taking expert advice. Most of all, remember that they are not on your side - I am not advocating that you behave in a hostile manner, just that you take proper advice before you accept what they tell you. When I am acting for a client, I really am on their side, because they really are my "customer". Revenue officials now also call you a "customer" - if he could talk, my cat might as well call the local mice his "customers"!

EISy Does It - A Tax Shelter for the intrepid investor

By James Bailey

The "Enterprise Investment Scheme" (EIS) is the latest incarnation of a series of schemes offering tax breaks to those prepared to invest in trading companies.

Its grandparent was the "Business Expansion Scheme" launched in the early 1980s. Like most schemes involving tax relief, the EIS has been tinkered with and amended in successive Finance Acts, and the detailed rules are extremely complicated, but the basic concept is simple.

The EIS offers tax breaks to individuals who subscribe for new shares in UK trading companies. In particular:

- An income tax repayment of 20% of the amount invested, up to a limit of £400,000 investment per tax year (so a maximum repayment of £80,000)
- Exemption from CGT when the shares are sold, provided they qualified for the income tax relief referred to above
- The ability to defer paying CGT on any other capital gains in the year, to the extent that the gain is reinvested in EIS shares - unlike the other two reliefs, there is no upper limit to the gain that can be deferred. When the EIS shares are sold, the old gain becomes chargeable again

EIS Companies

There are a number of rules that an EIS company must obey. Essentially, it must be a company trading in the UK, not a subsidiary of another company, not listed on the Stock Exchange and the trade it carries on must be a "qualifying business activity".

There are also limits on the size of the company, so companies with substantial assets will not qualify.

"Qualifying Business Activity"

This is defined by exclusion, and the basic idea is to weed out trades that are too "safe" because, for example, they are backed by an investment in land. Hotels do not qualify (though, curiously, pubs and restaurants do) and nor does property development or farming.

There are other restrictions too, which I tend to think of as the "yuppie traps". They date from the old BES scheme of the 1980s and prevent tax relief for investment in such "safe" things as fine wines and fine art.

There is no space here to go into the finer details, but HMRC do operate an informal clearance service in cases of doubt. The company can ask HMRC to confirm that its trade does or does not qualify for EIS status.

Quarantine Period

Most of the conditions for getting EIS relief apply for a period that begins one year before the investment is made, and continues until three years after the shares have been issued. This can lead to problems. I have seen too many cases where the company was so busy trading and expanding (or struggling and shrinking!) that it forgot the various rules it had to obey to avoid its shareholders getting their tax relief clawed back.

The "connection" Rule

In order to qualify for income tax relief (and thus the CGT exemption) the investor must not be "connected" with the company during the quarantine period.

The main way to become "connected" is if you (or you and your close relatives between you) own more than 30% of the company.

You will also be "connected" if you are made a director of the company, although there is a rather complicated exemption from this rule for so-called "business angels" who invest in companies they have not previously had anything to do with.

Note that this "connected" rule does not apply to the CGT deferral relief described above. You can be as "connected" as you like and still defer a capital gain, but you will not get the income tax repayment or the CGT exemption.

"Receiving value"

An EIS investor is not allowed to "receive value" from the company during the quarantine period. There are some exceptions to this rule, but in general it pays to be very careful not to take anything out of the company without checking with a tax adviser first.

Ask an Expert

If you are contemplating investing in a company and you think you might qualify for one or more of the EIS reliefs described above, talk to a tax adviser before you do anything else.

The fine detail of the EIS legislation is a minefield and it is all too easy to deny yourself the relief accidentally.

To take only one example, if you set up a new "off the shelf" company, you must generally get your EIS investors in and issue them with their shares <u>before</u> the company does anything else, and make sure that when you do issue the shares they are all issued together so that no-one gets his early and becomes "connected", because for a brief period he has more than 30% of the shares that have been issued so far.

EIS in Practice

EIS companies range from those set up by a group of friends with a new business idea, to more formal enterprises set up by professional company promoters.

If you are considering setting up a company, or if you have an existing company and are looking to raise new finance by issuing more shares, it is always worthwhile checking to see if the company could qualify as an EIS company.

Do It Online!

By Sarah Bradford

Self-assessment tax returns for 2007-08 must be with the taxman by 31 January 2008. As this does not leave a lot of time, it makes sense to make use of the technologies available to streamline the process.

One such option is to file the return over the internet using HMRC's free Self Assessment Online service. HMRC are keen to promote online filing, which has a number of advantages over submission of paper returns:

- sending information online is secure, convenient and quick
- returns can be filed at any time - day or night, weekday or weekend
- online filing is more efficient than paper returns and saves storage space, postage costs
- the system will calculate how much tax is owed and whether a repayment is due
- repayments are made quicker
- statements for the last three years can be viewed
- details of liabilities, payments and repayments can be viewed

Registering for Self Assessment Online

Before a return can be filed using Self-Assessment Online, it is necessary to register to use the service. This will take some time. In order to meet the filing deadline of 31 January, it is necessary to register by 22 January.

Registration for Self Assessment Online can be done at the `welcome to online service' page of the HMRC website. This can be accessed by choosing the self assessment option from the `do it online' box on the HMRC website home page (www.hmrc.gov.uk) and following the link.

To register as an individual, the taxpayer needs his or her unique taxpayer reference and either his or her National Insurance number or postcode.

There are five steps to the registration process:

- terms and conditions - which must be accepted to progress
- about you - full name and email address
- create password
- note user ID
- enter details
- receive activation PIN

It is important to keep a note of the user ID and password as this is required each time that the user logs on to the service.

Before the service can be used, it must be activated. The key to activate is the activation PIN, which is sent to the user through the post. The PIN should be received within seven days of registering. The activation PIN must be used to switch on the service within 28 days. After this time it expires and it is necessary to start the registration process again.

Using Self Assessment Online

Once activated, the service can be used to file a tax return over the internet. To do this, it is first necessary to log on using the User ID and password. It is important to enter these correctly because if the details are entered incorrectly three times, the system locks up for two hours, during which access is prevented. Replacement User IDs and passwords can be requested online if these are mislaid.

Self Assessment Online can be used to file the individual self assessment return (SA100), partnership self assessment return (SA800), trust return (SA900) and associated supplementary pages over the internet. PDF attachments can also be filed online, subject to certain technical constraints. Users can use either HMRC's free software or commercially available software. Details of commercial software packages that have been successfully tested to ensure that their return can be sent successfully over the internet are listed on the HMRC website at http://www.hmrc.gov.uk/efiling/sa_efiling/soft_dev.htm.

HMRC's free software allows you to complete the main return form and the employment, self employment, partnership and land and property supplementary pages. Third party products must be used for other types of income, including capital gains. However, the online return cannot be used if there are multiple chargeable event gains during the year.

Using the HMRC software is straightforward. You simply select the form that you need to complete and enter the information in the boxes provided. It is not necessary to complete the return in one go - information is saved allowing the return to be completed at a later stage. This is useful if you want to input the bulk of the information but are waiting on one or two numbers.

Once all the information has been entered, the user is given the option of saving the return and printing a paper copy. There are two printing options:

- HTML - this provides a black and white version of the form which is quicker to download and save, and which does not require any special software; and
- PDF - this provides a colour return in exactly the same format as the paper return. However, the PDF return takes longer to download and requires a PDF viewer, such as Acrobat Reader to save and print the return. Users are given the option of downloading a free copy of Acrobat Reader when using self assessment online.

If third party software is used, the software provider will be able to provide details of how to print and save completed returns.

It is advisable to check the return carefully before submitting it as it is easier to rectify mistakes upfront. Once the user is happy with the return, it can be submitted to HMRC. An online acknowledgement that the return has successfully been received will be sent if the user stays online after sending in the return. However, during busy filing periods there may be a delay in receiving the online message. An acknowledgement will also be sent by email if the user has provided an email address to the Government Gateway.

When a tax return is filed online using either HMRC or third party software, the user's tax liabilities are calculated automatically. This is perhaps one of the main benefits of online filing as the user will know straight away how much tax he or she needs to pay.

The 31st January 2008 is a significant date for paying tax as well as for filing returns. Any outstanding tax for 2007-08 must be paid by this date as must the first payment on account for 2008-09. Interest is charged on tax paid late.

Reminders

The Self Assessment Online service also has a reminders facility to help ensure key deadlines are not missed. The reminders are in ICalendar format and a variety of reminder options are available to download from www.hmrc.gov.uk/taxisnottaxing.

Further information

There is a wealth of information on Self Assessment Online on the HMRC website. The service itself contains guidance on using the service and a number of frequently asked questions are published on the HMRC website at www.hmrc.gov.uk/efiling/sa-efiling/sa-faqs.htm.

The `tax is not taxing' pages of the website provide further help on self assessment and filing online (www.hmrc.gov.uk/taxisnottaxing/).

HMRC have also published a video podcast which provides a short introduction to the main features of Self Assessment Online and is available at www.hmrc.gov.uk/podcasts/index.htm.

Final thoughts

HMRC are increasingly requiring taxpayers to submit and receive information over the internet. For straightforward returns, Self Assessment Online is worth a look. The online service offers a number of advantages over the completion of paper returns, not least the facility to calculate tax liabilities automatically.

However, the clock is ticking. Those wishing to use the online service for 2007-08 returns will need to move fast. Potential users have until 22 January 2008 to register if they are to make the 31 January filing deadline.

VAT TIP - Why Not Consider Speaking For Yourself At A Vat Tribunal!

The recent tribunal case of *Martin Jamieson Motor Repairs* (VTD 20,269) was such a breath of fresh air and common sense that it almost restores one's faith in the tax system (though not in HMRC, alas). The decision is worth a read just because its whole tone will cheer you up, but in summary, it is about the circumstances in which a trader (in this case, a small garage doing MOTs) can treat expenses as VAT-free disbursements.

The trader represented himself, and it clearly did his cause no harm that the VAT Tribunal found him to be a *"transparently honest man who had been trying to deal correctly with his VAT affairs."* As a result, the Tribunal bent over backwards to come to the right decision, and had little time for pedantic and legalistic contentions put forward by HMRC, which it found *totally unrealistic", "fanciful", "quite extraordinary" and "stunning"*. The Tribunal also savaged VAT guidance as "extremely confusing at best, or otherwise just wrong".

To be fair, whenever the taxpayer represents himself, he loses in about 80% of cases, but when he has professional representation, he is successful in more than 50% of cases. This case, however, is an example of when it can work. The trader argued one relatively simple point where the guidance was confusing, and he had clearly done his best to comply. One small change to the invoices would have sorted the problem, but HMRC were clearly being pedantic. Sometimes in these types of cases, if the taxpayer turns up with a tax adviser and solicitor, the Tribunal may wonder how he could afford this representation when he did not take the relevant advice to begin with. Obviously, in cases where a particular technical legal matter is argued,professional representation can be essential.

We believe that there are at least two points for advisers to pick up from the case.

Point 1
Obviously, the first is the need to try to avoid the problem in the first place by ensuring that HMRC's detailed invoicing requirement for disbursements are met. It is quite evident that HMRC focused far too much on the form of the invoices, and far too little on what was actually the legal position: a minor change to the invoicing would apparently have prevented the case ever coming before the Tribunal.

Point 2
The second point is that your adviser may want to consider that in some cases the right strategy may simply be to let your client speak for himself before a VAT Tribunal or other appeal body. Blunt honesty (as in this case) can be much more appealing to an appeal body than the bland, legalistic assertions of faceless civil servants, or even, dare we say, the silver-tongued persuasiveness of slick tax advisers. Long may this option be open to all!

Andrew Needham

The Government's Proposed Changes To Vat Tribunal Structure Is Bad News For Small Businesses And Their Advisers

By Andrew Needham

The Ministry of Justice has been reviewing the operation of the Tribunals services across the board, but of particular interest to taxpayers will be the review of the VAT & Duties Tribunals, the Commissioners, and Special Commissioners.

In light of the amalgamation of the former Inland Revenue and HM Customs & Excise, it makes sense to bring together the appeals procedures so that there is a common system across the taxes. Unfortunately, that is where the good news ends. A consultation document has just been published and can be accessed at:

www.justice.gov.uk/publications/cp3007.htm

There are many proposed changes to the structure of the Tribunal service but the most far reaching in the VAT field is the question of costs. Currently, if a taxpayer appeals a VAT assessment or ruling and is successful at Tribunal, he is entitled to claim back his costs. Only fair and reasonable you may think, as why should he be out of pocket when challenging an incorrect assessment by HMRC? Unfortunately, this is not the case in the direct tax world, so, yes, you've guessed it; the consultation recommends that they do away with the provision of costs in VAT Tribunals.

In our experience, small businesses often get inaccurate assessments for relatively small sums (under £10K) and have appealed them on the understanding that they will get their costs back if successful. This will no longer be the case, and will surely result in many small businesses deciding that it is not cost effective to appeal, and simply paying the assessment. It will, of course, also mean that the advisers of business will not be asked to handle the appeal either, given the additional irrecoverable fees that this would inevitably involve. Given the ineffectiveness of the current reconsideration process, some businesses might try to defend the assessments themselves, with much reduced chances of success. So, in this brave, new world of spirit of fairness and equality for all, only large well-off businesses would actually have adequate recourse to the legal process!

Anyone wishing to respond to the consultation should do so through the Internet connection above, or, alternatively, they may wish to contact their MP directly.

The Tax Insider Gurus Answer Your Questions

Q.1 My husband took equity out of our main residence twice and used all the money to buy some buy to let properties.

So, can the extra interest that he is now paying on his main residence be set off against his tax/income?

A.1 Provided that the cash from the equity release was used only to acquire the buy to let properties, then the interest on the loan can be set against the rental income. I am assuming that the main residence and the buy to let properties are either both owned by your husband in his sole name, or are both jointly owned - if this is not the case, you need further advice.

Q.2 I want to buy a care home which has private accommodation for me. Do I pay stamp duty on the whole building?

A.2 Yes, Stamp Duty Land Tax is due on the full amount paid for the property.

Q.3 I bought a house tenanted by 4 people. 1 person left and I totally refurbished the downstairs of the house, moving a studded wall and turning the stairs around so that they went into the hallway and not the kitchen (for health and safety reasons as well as for cosmetic reasons). Is this classified as a capital or revenue expense?

A.3 Moving the stairs is almost certainly capital. I would need much more detail on the rest of the refurbishments to offer any comment on them.

Q.4 Are the legal fees that are incurred with the purchase of a buy to let property allowed as taxable expense?

A.4 Not as an expense against the rental income - they are treated as part of the cost of the property for the purpose of capital gains tax when it is sold.

Send your questions to: questions@taxinsider.co.uk for consideration in future editions.

Tax advice and help to solve your challenges at an affordable price!

The contributors to this e-zine are current practising specialists. They have made available an advice and helpline service to help resolve any UK and international tax matters.

Please visit www.taxinsider.co.uk for more information about this affordable service.

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