Spring conference

Personal tax | General Features



01 May 2015

Lynne Poyser and Pauline Lonsdale summarise this year’s CIOT spring conference in Cambridge

As first-time visitors to the CIOT spring residential conference in Cambridge we weren’t sure what to expect. However, with plenty of time to network as well as listen to the excellent technical lectures, I’m sure it won’t be our last visit.

In a packed three days, skilfully and entertainingly chaired by CIOT Deputy President Chris Jones, we fitted in 14 hours of CPD, three small group discussion sessions, two drinks receptions and a formal dinner.

We can report on just a selection of the interesting points noted in the lectures. However, one of the advantages of attending the CIOT conferences is that, as well as receiving the slides in your delegate pack, you also receive full typed-up notes on each session.

Tax investigations – getting the best outcome from HMRC enquiries

Dawn Register (BDO) reminded us that HMRC now hold more data in their CONNECT computer system than the British Library. The data includes information from other government departments (including Land Registry, Companies House and the Electoral Registration Office) and income declared for mortgage applications. HMRC use mathematical techniques to search information and detect relationships between seemingly unconnected individuals. This explains the rise in so-called 'means to live' enquiries as well as the usual issues such as overdrawn directors' loan accounts, salary/dividends to family members and employment status.

Dawn suggested that, in an enquiry, advisers should spend more time worrying about managing the client than managing the HMRC officer; making sure that the client does not have unrealistic expectations of how quickly the enquiry will be resolved; and understands how much work is involved in going back through records, for example. To avoid nasty surprises for the client, it is also important for advisers to be upfront about the professional costs in an enquiry.

Providing several methods to resolve an enquiry that has become a stalemate, Dawn recommended that all advisers read the HMRC Litigation and Settlement Strategy. This explains that all enquiries must be resolved within the law and that 'package deals' are not possible.

Private client and trust update

For those practitioners liable to panic at the mere mention of trusts and IHT, Chris Whitehouse (Barrister, 5 Stone Buildings) always has a calming influence. For the

past three years, the government and the profession have wrestled with proposals to simplify the calculation of IHT charges on trusts. Chris gave a clear account of the suggested options, those that have been dropped, those implemented and those still in the balance. However, the simplification agenda has shifted somewhat in favour of countering avoidance, specifically the use of pilot trusts to obtain multiple nil rate bands for settled property.

We now have a situation where the government's latest attempt to simplify charges and deal with pilot trusts has been published as draft legislation scheduled to become law on 6 April 2015, but it has not been included in FA 2015. Instead it has been put on hold for a future Finance Bill. However, this means that from 6 April 2015, advisers are supposed to calculate an IHT charge on a 10-year anniversary in accordance with new rules which are not yet law and may never become law in their present form. Chris felt it was doubtful whether the government will be able to enforce the implementation dates retrospectively.

Chris also explained the new exemption from IHT for the estates of emergency services staff, which is an extension of the death on active service exemption for members of the armed services. This has been included in the Finance Act. The exemption has been broadened for all personnel to include the additional charge, which arises on PETs or chargeable transfers within seven years of death. Interestingly, the definition of an emergency includes circumstances likely to cause death or serious injury to an animal. Chris wondered how many exemptions would be attributed to the classic scenario of a firefighter rescuing a cat stuck up a tree.

Top 10 risk areas for tax practices

No one sets out to make a mistake but, as Paula Tallon (Gabelle LLP) reminded us, you don't know what you don't know. Compiled from real-life situations she has encountered as a consultant for other advisers, Paula ran through a number of common areas where mistakes can occur.

Most advisers are aware that there is a two-year time limit for making a main residence election for principal private residence purposes if the client has more than one residence. If the deadline is missed, it can be reopened by changing the combination of residences (perhaps by renting out a residence so it is no longer available). However, for those with an election in place it is important to be aware that a new election must be made if the combination of residences is changed; the

previous election is invalidated.

For research and development relief, it is worth considering the rules on qualifying expenditure when advising the founders on profit extraction. Paula gave an example of a start-up company who had been advised to take small salaries and supplement this with dividends. However, the adviser had not considered that salaries and employers' class 1 national insurance contributions qualify for R&D relief, whereas dividends do not. There is a fine balance between taking a salary and taking dividends in this scenario and calculations may be necessary to determine the most tax-effective combination.

Tax-efficient business structures for owner-managers

Rebecca Benneyworth discussed the drivers for incorporation in light of the FA 2015 changes to entrepreneurs' relief on goodwill and the removal of corporation tax relief on amortisation of goodwill within the company.

She concluded that there are still modest tax savings in operating through a company, with around £2,500 saved on profits of £40,000 (assuming a salary set at the lower earnings limit with the rest of the profits taken as dividends). However, whether incorporation is right for a sole trader will depend on the situation because the costs of operating through a company may erode the tax benefits and operating through a company may not suit all traders.

It is worth considering whether a spouse or civil partner could be employed in the business. It is important to bear in mind the work done by the spouse and the size of the business in order to justify the expense should it be challenged by HMRC; would a business of that size need to employ outside staff? If, in the case of an unincorporated business, this will necessitate setting up the payroll and registering for RTI for the first time, then operating as a partnership with the spouse might be more attractive. Although this gives rise to settlement considerations, Rebecca's view was that, if the spouse bore the risk and the partnership were to fail, this should be enough to prevent the spouse's profit share being taxed on the trader.

Budget 2015 – the highlights

Tim Good (Professional Training Partnership) explained the benefits of the new starting rate for savings. He showed how £42,385 can be extracted free of tax and national insurance by a director, charging director's fees of £8,000, receiving interest from the company of £7,600 (balance of the personal allowance plus the savings rate threshold) with the balance up to the basic rate threshold as dividends. He suggested that the interest rate on the capital lent to the company could be set at up to 15% a year, taking into account the fact that the loan would be unsecured and considering the third party peer-to-peer interest rates.

He also suggested that it may be worth considering issuing shares of a different class to a minor. Once the child turns 18, dividends can be paid tax-free up to the basic rate band and can be used to support the child's university education or to build up a deposit for a first home.

BEPS – will the OECD's work change the international corporate tax landscape

CIOT Vice-President Bill Dodwell covered the G20/OECD Base Erosion and Profit Shifting project. BEPS now has more than 55 countries contributing to the output, since the OECD and G20 countries have been joined by a dozen developing countries, including Kenya and Jamaica. The intention of the BEPS project is that multinationals should pay more corporate tax. Some of this will come from new limits on interest deductibility; some from lowering the threshold for recognising a taxable presence; and the balance from changing transfer pricing approaches, especially on intangibles.

The discussion draft on interest proposed limiting the global interest deductions for a multinational to its global third party net interest expense. However, Bill was concerned that the methods put forward could easily limit deductions to something less than third party costs. It would be surprising if the UK were to keep its rules in the face of an agreed BEPS proposal – although this would be a matter for the next government.

There's a lot of work still to be done, including country negotiations over the package, but the main outputs are expected to be delivered to the G20 in October. The next phase will then begin as the working parties develop detailed guidance for countries as others start to introduce BEPS into domestic law. Bill concluded by

noting that BEPS changes were expected to take effect globally in 2016–18.

Corporation tax issues for owner-managed companies

Ros Martin highlighted how some of the more complex corporation tax provisions can affect the small owner-managed company.

The first topic Ros considered was the substantial shareholder exemption (SSE), which exempts investing companies from corporation tax on the gain when they dispose of shares in an investee company, in which they have held more than a 10% holding. She illustrated how the exemption can be obtained on the disposal of trading assets by re-organising the assets within a group. The case study was about a small group of companies that manufactured items for Christmas, Easter and other special occasions. A purchaser wanted to buy the Christmas business and SSE was achieved by transferring those assets into a new subsidiary and selling the shares.

Owner-managed companies are not immune to the frequent publicity attached to international companies that avoid UK tax by being non-resident. They want to know why they can’t ‘go offshore’ to prevent the government putting its large shovel into what they regard as their own money stores. Ros took us through the company residence rules, reminding us of the features that will determine where central management and control is exercised. In conclusion, for the average small company in the UK, there is no real practical likelihood of ever being able to prove control outside the UK.

Fiscal share valuation

On Sunday morning, Jenny Nelder and David Bowes (Bruce Sutherland & Co) talked about valuations for fiscal purposes. Arriving at a reliable valuation can be the most difficult part of establishing a tax liability. It was therefore welcome to have the subject de-mystified.

Jenny explained a general approach to valuing unquoted shares for tax purposes and focused on some of the quirks of valuing employee shares. She gave some useful tips on dealing with HMRC.

For example, if you need to value a minority holding in a company, you do not need to go to the expense of a professional valuation before submitting it to HMRC. Prepare a reasonable valuation based on published information, then wait to see whether it is challenged. A control holding will need a fuller examination, taking account of the ‘story’ behind the figures. In either situation, it is advisable to take the lead in the information process and anticipate what HMRC will want to know. The hard-pressed shares and assets valuation division will be pleased to receive something they can check and tick.

David talked about the intricacies of valuing goodwill in association with other business assets. The rule of thumb in valuing many trades and professions is to take a multiple of sales or billings. It follows that, if you use this rule for a particular business, the value of goodwill is calculated by deducting the value of tangible assets from the total value. As a result, HMRC have argued that a business with a higher value of net assets will have a lower value of goodwill than a similar business with a smaller value for net assets. Although logical, this view does appear to be intrinsically nonsense. David explained that the principle was successfully challenged last year in *Wildin v HMRC [2014]* UKFTT 459 (TC). Readers may find this First-tier Tribunal case particularly relevant because it concerns the valuation of an accountancy practice.

FRS 102 and its impact on tax computations

Malcolm Greenbaum (Greenbaum Training & Consultancy Limited) took some of us out of our comfort zones by talking about the relationship between tax and financial accounts. His focus was the new UK GAAP in the form of accounting standard FRS 102, which imposes new rules on company accounts for the recognition of profit. The tax implications are that, if profit is to be measured differently, it will have a direct effect on the tax liability unless it is one of those items ignored for tax purposes, such as depreciation or entertainment.

Where FRS 102 requires a change of accounting policy, we may expect a prior year adjustment in the accounts. For tax purposes this adjustment is treated as an additional receipt or expense in the current year. Most of the changes relate to timing differences: income or expenditure relating to an asset is recognised over a number of years, and the accounting standard determines how it is to be allocated. Consequently, the effect of a change is to defer or advance the tax liability.

Malcom illustrated the point with the leasing of equipment. The accounting treatment under the old UK GAAP is usually to treat the lease as an operating lease and deduct the payments as an expense as they arise. Under the new FRS 102 standard, it is more likely that the leased asset will be capitalised as a finance lease. The change in treatment will tend to increase the tax-deductible interest expense at the beginning of the lease term with a gradual reduction in tax relief as the liability decreases.

Latest developments

Peter Vaines (Barrister, Squire Patton Boggs) pointed out that the new remittance basis charge of £90,000 a year for those who have been resident in the UK for 17 of the past 20 years could produce some strange results. Imagine a non-domiciliary who has been UK resident for 20 years who then leaves the UK and becomes non-resident for three years before returning and becoming resident again. This individual is not liable to the £30,000 or £60,000 (increased from £50,000 in FA 2015) remittance basis charge, due to not having been UK resident for seven out of the previous nine years or 12 of the previous 14 years. However, the individual is liable for the £90,000 charge!

In relation to the statutory residence test, Peter gave us an interesting true example where a spouse's UK day count in a tax year before she had even met the client caused him to be resident in the UK. In the illustration the client had made a large gain in 2013/14 and the sufficient ties test was the deciding factor in establishing his residency. This meant the spouse's residence status had to be determined and, in order to do this, it was necessary to look back three years to the 2010/11 tax year. It turned out that, due to her UK days in 2010/11, the spouse was UK resident in 2013/14 and this extra tie from having a resident spouse caused the client to become UK resident in the year as well. This shows that it may be necessary to review the position of the spouse or civil partner in detail to determine the client's residence status and this would need to be factored into any fee quote for this work.

And finally

The conference remit is broad and by Sunday lunchtime our heads were teeming. We learned a lot, met old friends, put faces to names we knew, and made new acquaintances. We took comfort too from Saturday's after-dinner speaker,

businessman, motivational speaker and former chief executive of defunct jewellery chain Ratners, Gerald Ratner, who entertained us with charm and humour, and proved that you can recover from even a very bad mistake if you’ve got friends.

If you haven’t yet been to a CIOT conference, do join us soon. The autumn residential conference is at the University of Warwick on 18 to 20 September 2015, with the spring residential conference in Cambridge slated for 18 to 20 March 2016.