



Hopes for holiday lets just castles in the air

Tax reforms have not been kind to owners of furnished holiday property in recent years. Tax relief for losses was restricted in 2011, and the qualifying conditions for the remaining income tax and capital gains tax (CGT) benefits were tightened up in 2012.

Now an Upper Tribunal (Tax and Chancery) decision has dashed hopes of most furnished holiday homes qualifying for inheritance tax (IHT) business property relief (BPR). The decision in *HM Revenue & Customs v Pawson* overturns the 2011 First-tier Tax Tribunal decision.

HMRC previously accepted that BPR was normally available where lettings were short term and the owner, or their agent, was substantially involved with the provision of services. But this changed to a stricter interpretation a few years ago, with the emphasis on the level and type of services rather than who provided them. The original First-tier decision would have meant that relief was available despite only minimal services being provided – so virtually all furnished holiday homes would have qualified.

BPR is available in respect of a property business, but not where it consists wholly or mainly of making or holding investments. The Upper Tribunal decided that where the principal business activity involves deriving income from the occupation of land, then the starting point must be that the business is mainly one of investment. Only at the upper end of the spectrum of possible letting businesses will the extent of services provided be more significant than the investment aspect.

The property in question in the *Pawson* case was a typical holiday let; it was fully furnished and let for long weekends or one or two weeks at a time. But the services provided – just cleaning between lettings and a gardener – were fewer than those offered by most holiday lettings. Despite this, the decision is likely to mean that very few holiday lettings now qualify for BPR.

The question is, just what level of service is required to override the assumption that holiday letting is an investment business? HMRC currently accepts that a bed and breakfast establishment or a hotel will usually qualify for relief on the basis of the level of services provided, but is there really that much difference? Some holiday lettings provide a breakfast service, and in a hotel this might be just on a self-service basis. For now, however, it's bad news for owners of holiday lettings.

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Two steps forward for business – and one step back

The Chancellor insists that “Britain is open for business,” and his March 2013 Budget contained two measures that will be of interest to businesses large and small – even though you will have to wait for them to take effect. But now a measure in last year’s Budget has just started to bite.

One of the items of good news is the introduction of a unified rate of corporation tax. For the current financial year, the small profits rate is 20% and the main rate is 23%, while profits between £300,000 and £1.5 million suffer an effective marginal rate of 23.75%. Next year, the main rate will come down to 21% and the marginal rate will be 21.25%, before the single unified 20% rate applies from 1 April 2015. This is quite a drop from the top marginal rate of 32.75% that was charged just a few years ago.

The second bit of good news will particularly benefit smaller businesses. This is the announcement of an annual £2,000 employment allowance which, from April 2014, all businesses will be able to set off against their national insurance contributions (NICs) bill. At current rates, a business will be able to employ four workers on the minimum wage without any NICs cost.

Will the allowance change the ‘salary versus dividend’ decision for owner-managed companies, which currently is heavily skewed in favour of dividends? It does narrow the difference, but dividends still win out – although the difference will completely vanish for those over state pension age who do not pay employee NICs.

The decision as to whether or not to incorporate will depend on the level of profits, and how those profits are withdrawn after incorporation. With a profit level of £40,000, a self-employed person would have a total tax and NICs bill of a little more than £9,000. The bill would currently be just over £10,000 if the business was incorporated, with £25,000 withdrawn as salary. The £2,000 employment allowance therefore reverses the outcome.



And then comes the bad news. Of more immediate concern for entrepreneurs is the limit that now applies to setting off loss relief and getting a tax deduction for loan interest. The limit is set at the higher of £50,000 or 25% of income. It may be possible to restrict the impact of the limit for loss relief by disclaiming capital allowances, and any restricted loss can still be carried forward against future profits.

But the limit will have more serious implications where it restricts the deduction of loan interest, because the tax benefit of any restricted interest will be permanently lost. This might be a continuing problem, and could mean that individual borrowers will need to restructure their finances as a matter of urgency. Please contact us if you think you may be affected.

Which way for the state pension?

The state pension system is the subject of some radical reforms, with the current two-tier state pension being replaced with a new single-tier pension that is higher than the current basic state pension. The current system is made up of two elements.

The basic state pension (BSP) is normally paid from the date when you reach state pension age (SPA), which varies according to your sex and date of birth. You currently need 30 qualifying years’ worth of national insurance contributions (NICs) in order to qualify for the full BSP, which for 2013/14 is set at £110.15 a week for a single person. You can defer the start date to receive a higher pension or a taxable lump sum.

The state second pension (S2P) is related to your actual or deemed earnings and provides a top-up to the BSP. S2P was the successor of the state earnings related pension scheme (SERPS). Self-employed people do not qualify for S2P and in the past many employees have been contracted out of S2P/SERPS through their membership of various occupational or personal pension schemes.

The new single-tier pension will be introduced from 6 April 2016 – one year earlier than originally announced. You will receive the new single-tier pension if you reach your SPA on or after the start date. However, if you reach your SPA before then, your pension will be paid under the existing rules and you will continue to receive the BSP and, if you qualify, S2P/SERPS.

The amount of the single-tier state pension will be decided shortly before it is introduced and it will be set above the level for means-tested support (£145.40 a week in 2013/14). To qualify for the full single-tier state pension you will need 35 qualifying years’ worth of NICs. It will still be possible to defer starting to receive the new single-tier pension, but you will only be able to earn extra pension, not a lump sum.

If you will reach your SPA after the start of the single-tier pension, your national insurance records under the old system will be translated into a simple single-tier starting amount, known as ‘the foundation amount.’ If you have a foundation amount less than the full level of the single-tier pension, you will be able to build up entitlement to the full level. If your foundation amount is more, you will receive the foundation amount, inflation adjusted, but not accrue any further state pension under the new system.

The abolition of the S2P will bring an end to contracting out. If you are a member of a contracted-out salary-related occupational pension scheme, you will pay the full rate of NICs once the single-tier pension is introduced.



Alternative investment market (AIM) shares already receive preferential tax treatment – they are exempt from inheritance tax if held for two years, but their status should be further enhanced next year. From April 2014, no stamp duties will be payable when buying shares listed on the AIM (the rate is currently 0.5%). The Government is also consulting on permitting the inclusion of AIM shares within stocks and shares ISAs for the first time, possibly from 2014/15. However, various other tax reliefs are available where AIM shares qualify under the enterprise investment scheme or seed enterprise investment scheme, and these may be lost on such investments made through an ISA.

'Employee shareholder' status to go ahead

A controversial new employment status, 'employee shareholder', will now become law after the House of Lords accepted final concessions.

The idea is to encourage employee share ownership under a 'rights for shares' scheme whereby those adopting the new status receive tax advantaged shares in exchange for giving up certain employment rights. An employee shareholder will be allotted or issued with at least £2,000 worth of shares in their employer's company. The shares will form the consideration element of the agreement.

The first £2,000 worth of shares is free of tax and national insurance contributions. Corporation tax relief is available for the cost of the shares issued under the agreement. Any gain on the disposal of up to £50,000 of employee shareholder shares is exempt from capital gains tax.

The tax advantages are subject to meeting a number of conditions and there are various anti-avoidance measures to prevent exploitation.

The shares come at a price. Those who adopt the new employee shareholder status are required to forfeit certain employment rights in exchange for the shares. This has proved to be a controversial proposal. For example, an employee shareholder can be unfairly dismissed (except where the dismissal would be automatically unfair, such as for whistle-blowing) and also does not have the right to:

- request time off for training;
- request flexible working;
- receive a redundancy payment.

In addition, an employee shareholder must give 16 weeks' notice, rather than the usual eight weeks, of their intention to return to work early after maternity or additional paternity leave.

As announced in the 2013 Budget, the intended start date for the new employee status is



1 September 2013. This is, however, dependent on the necessary legislation making it to the statute books.

Tracking down missing homes

The latest 'anti-avoidance' campaign is aimed at people who have undeclared capital gains from disposals of residential property, either in the UK or abroad.

Such a gain could have arisen on a holiday home, a property that has been rented out, or even a main home that has been sold without full private residence relief. Anyone who decides to take advantage of this campaign must inform HMRC of their intention to make a disclosure by 9 August 2013, and make the disclosure itself by 6 September 2013 – which is also the deadline for paying the outstanding tax.

The campaign is primarily aimed at those gains made in the period between 6 April 2007 and 5 April 2012. More recent gains should be disclosed as normal under self-assessment. But earlier gains of up to 20 years old are disclosable if they were not declared deliberately.

However, there is a catch. HMRC must also be informed of any other undeclared income or

gains, including any income from the property in question. There may be interest and penalties payable, and the campaign does not offer any special penalty mitigation.

After 6 September 2013, HMRC will use the information it holds on property sales to identify people who have not paid the correct amount of capital gains tax. The penalties will be higher than they would have been under voluntary disclosure.

Affluent Compliance Team widens aim

HMRC has been expanding its Affluent Compliance Team, the unit dedicated to ensuring that better-off people meet their tax obligations. The team started work in 2011, and has so far brought in an impressive amount of additional tax. The original target group of taxpayers

consisted of individuals who pay the top rate of income tax and have wealth of between £2.5 million and £20 million. The lower wealth limit has now been brought down to £1 million.

A sign of HMRC's increasingly pro-active approach to tax avoidance is the pre-emptive strike against one particular avoidance scheme. Letters were sent to people who had signed up for the scheme even though no legal challenge had yet been made against it, which is the normal approach.

People who receive these letters have the choice of pulling out of the scheme or being treated by HMRC as a higher risk customer and having their tax affairs more closely monitored in the future.

PAYE reporting – Real Time easing

Real Time Information (RTI) reporting is now a fact of life for most employers, but a recent relaxation of reporting requirements might help some small businesses struggling with the increased frequency of PAYE filings.

Be warned that this is not a withdrawal of the reporting requirements, and reporting in real time is still required from the first payday on or after 6 April 2013.

The relaxation applies to businesses with fewer than 50 employees and it can only be used until 5 October 2013. Such businesses will be permitted to file on a monthly basis, even if their employees are paid more frequently (such as weekly or fortnightly).

Information must be sent to HMRC by the last payday in the month, but no later than the end

of the tax month (a tax month always ends on the 5th of a calendar month).

HMRC has said that it will continue to work with employer representatives to assess the impact of RTI on smaller businesses and will consider whether there is scope for further improvements.

But you should assume that the full reporting requirements will apply from 6 October 2013. Small businesses are advised to use the extra time to adapt their processes and ensure that they can report their PAYE position each time employees are paid.



All change at HM Revenue & Customs

HMRC is in the process of making several changes that might affect you. Most controversially, it is planning to close all of its 281 enquiry centres next year.

The aim is to provide a more modern and accessible service by having additional tax experts in its call centres, as well as offering home visits.

The number of visitors to the centres has halved in recent years, which is not surprising given the range of online services introduced over the same period. However, with the changes currently being introduced into the tax system – such as Universal Credit – the timing has been criticised. A five-month pilot will be run in northeast England to test the new services.

HMRC is moving its online content to the newly created domain gov.uk as part of the Government's initiative to create just one website for most government departments and agencies. The aim is to move everything over by 2014. The Directgov and Business Link websites already redirect to the new domain.

Remember also that HMRC now has just one bank account for employers, and it no longer uses the Shipley account. You should have received information about this change so that you are ready for 2013/14.

TAX CALENDAR Every month

1 Annual corporation tax due for companies with year ending nine months and a day previously, e.g. tax due 1 July 2013 for year ending 30 September 2012.

14 Quarterly instalment of corporation tax due for large companies (depending on accounting year end).

19 Pay PAYE/NIC and CIS deductions for period ending 5th of the month if not paying electronically. Submit CIS contractors' monthly return.

22 PAYE/NIC and CIS deductions paid electronically should have cleared into HMRC bank account.

30/31 Submit CT600 for year ending 12 months previously. Last day to amend CT600 for year ending 24 months previously.

File accounts with Companies House for private companies with year ending nine months previously and for public companies with year ending six months previously.

If the due date for payment falls on a weekend or bank holiday, payment must be made by the previous working day.

MAY 2013

19 File 2012/13 annual PAYE return online. Penalties are charged if forms are late.

31 Last day to issue 2012/13 P60s to employees.

JULY 2013

5 Last date to agree a 2012/13 PAYE Settlement Agreement

(PSA) with HMRC.

6 Deadline for employers to make returns of expenses and benefits (forms P11D, P9D and P11D(b)) for 2012/13 to HMRC and provide copies to employees.

14 Due date for CT61 return for quarter to 30 June 2013.

31 Confirm tax credit claims for 2012/13 and renewal for 2013/14.

Due date for second self-assessment payment on account for 2012/13.

AUGUST 2013

1 Penalty of 5% of the tax due or £300, whichever is the greater, where the 2011/12 return has not been filed.

2 Submit employer forms P46 (car) for quarter to 5 July 2013.

3 Second 5% penalty imposed on tax still unpaid for 2011/12.

9 Deadline to notify HMRC of intention to make a disclosure under the property sales campaign (PSC) for residential property sales on which CGT underpaid.

SEPTEMBER 2013

6 Deadline to submit a disclosure and make payment under the PSC.

OCTOBER 2013

1 National minimum wage rates go up.

14 Due date for CT61 return for quarter to 30 September 2013.