

Tax Update

Our summary of the latest tax issues



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Thinking of disposing of a subsidiary or division?

Some recent simplifications of the capital gains rules have provided a number of opportunities for groups to dispose of subsidiaries and any unwanted divisions or branches in a more straightforward and tax efficient manner.

As the legislation was previously drafted, when an asset left a group within 6 years of being transferred from another group company, it was possible that an 'exit' charge would arise based on any previous gain that was avoided by virtue of the previous transfer being between two group companies.

This created the anomaly that an 'exit' charge could arise and tax be payable when a subsidiary was sold, even if the sale of the shares in the subsidiary qualified for the substantial shareholdings exemption (SSE) and was otherwise free from tax.

The mechanics of the new legislation are that any 'exit' charge is now added to the consideration received by the vendor when preparing the capital gains computation. In practice this means that if the disposal qualifies for SSE, then no exit charge will be payable.

In another related change it is now possible for companies to dispose of a trading branch or division of their business in a tax efficient manner. Until recently, whilst it was technically possible to structure such a disposal in a tax efficient manner, the commercial and legal steps that had to be achieved often made it unattractive.

However, the recent changes have significantly simplified the process through which a trading company could dispose of a trading branch or division free from tax. This is due to a change in the SSE ownership period rules that allow a company to transfer trading assets to a newly incorporated company and still claim SSE on an immediate sale of this new company.

The other SSE conditions will still need to be met and the new legislation does not apply to intangible assets, so if any disposal includes a significant amount of goodwill then the recent changes will be of limited benefit. Speak to your usual Campbell Dallas partner to see how this change in capital gains legislation will affect your disposal.

Rental property pot-pourri

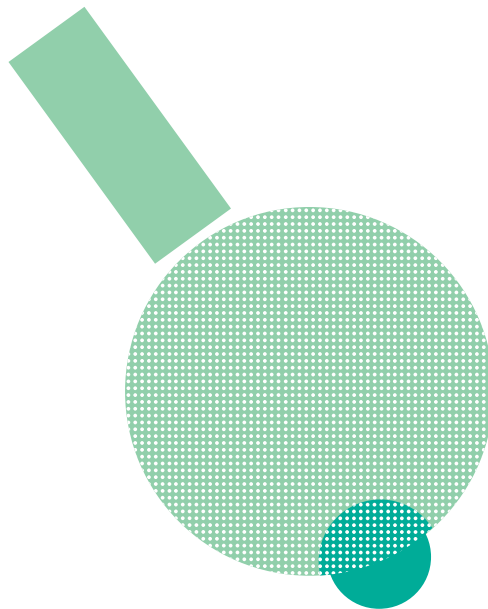
If you are a landlord there are a number of tax planning points you should consider before letting a property.

Jointly owned property - joint owners of property can split the income other than 50:50 if they wish to for income tax purposes. This can save tax if one is liable at higher rates than the other for instance, but the income must actually be split in that proportion, and it does not affect the underlying ownership. However special rules apply to married couples and civil partners if they wish to do this. They will need to make a legally effective transfer of the actual ownership of the property and send an election in to HMRC. This does not necessarily mean a conveyance, but the transfer can be made via a 'declaration of trust' which can be drawn up by a solicitor. Such a change would also affect future Inheritance Tax and Capital Gains Tax. However until HMRC receive the relevant election, the income will still be assessed as 50:50 for tax purposes.

Furnished lettings – if you rent out a property as 'fully furnished' residential accommodation, you may be able to claim an annual deduction of 10% of the rent received (after deducting council tax and rates if you pay these as landlord) to cover 'wear and tear' of soft furnishings. You cannot claim capital allowances nor the cost of the items when they are first purchased – but you can either claim the cost of them when they are replaced, or the 'wear and tear allowance' instead. The wear and tear allowance covers movable furniture or furnishings such as beds or suites, televisions, fridges and freezers, carpets and floor-coverings, curtains, crockery and cutlery, cookers and washing machines etc. You don't need to provide every item, but to HMRC a furnished property is one that is "capable of normal occupation without the tenant having to provide their own beds, chairs, tables, sofas and other furnishings, cooker etc".

Rent a Room relief – if you rent out a room(s) to a lodger in your own home, it may be beneficial to use the Rent a Room relief scheme rather than claiming on the actual expenses you incur (such as a proportion of electric, mortgage, or repairs). The scheme exempts the first £4,250 of rent that you receive – any excess is taxable, but the exemption cannot create a loss. The lodger may live in a single room or share some of the family rooms. The room must be furnished, but not be a separate residence in its own right. If your property is jointly owned, the allowance is shared. You can use the scheme even if you rent the property yourself, but check if your rental agreement allows you to do this.

Don't overlook these planning points if you are letting a property. As always, check with your usual Campbell Dallas partner to see if this applies to you.

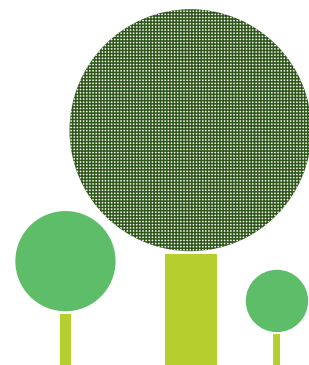


Last chance for 150% tax relief on polluted land for companies

Beware that Land Redemption Relief will be abolished after 31 March 2012 under proposed legislation. For companies with sites that were purchased in a contaminated condition, you should consider the cost of beginning to clear the site up before 1 April 2012. After that date relief will only be given at 100% rather than the enhanced 150% rate. The facility to surrender any losses which are attributable to this expenditure for a cash payment from HMRC is also lost after this date.

If you are considering making the type of expenditure which qualifies for enhanced relief, it may be wise to consider bringing it forward to before 1 April 2012.

Qualifying land is that which has been contaminated from a previous industrial process and is causing, or there is a serious possibility of it causing, harm to humans or animals, or pollution to waterways. Other non-industrial contaminants can also qualify, such as Japanese knotweed or asbestos within a building, and relief can include demolition costs. Speak to your usual Campbell Dallas partner to plan how you can take advantage of the 150% tax relief before it is abolished.



Paradigm shifts in VAT procedures

Major procedural changes to the VAT system tend to be few and far between, but the last couple of years have seen long-established VAT procedures replaced by new ways of doing things. Despite lengthy consultation beforehand, many complex problems are being thrown up by the new regime.

This article looks briefly at two of those changes; the new penalty system that now applies across all taxes and the new appeals and review procedures.

Penalties

Previously, there were a range of different penalties for mistakes across different taxes. Many of these were automatic penalties relying solely on arithmetic tests for their imposition. From 1 April 2009 these have been combined into a single penalty system that even now, over two years later, is still to be fully understood. VAT has been at the forefront of this simply because of the more regular filings of VAT returns whereas direct taxes, with their annual filings several months after the period-end, are only now experiencing its implications.

The new penalty system has, at its core, the fundamental principle that simple mistakes will not attract penalties. However, any other form of error will be penalised on the following sliding scale:

- Mistake (reasonable care) – no penalty
- Careless (failure to take reasonable care) – penalty up to 30% of the error
- Deliberate errors – penalty up to 70% of the error
- Deliberate and concealed – penalty up to 100% of the error

The most fundamental change is that when HMRC identify an error in a tax or VAT return, they are now obliged to investigate the taxpayer's behaviour at the time, even though the enquiry could be up to four years or more after the mistake occurred. The new concept of 'reasonable care' has very little guidance from the Courts and early pilot exercises highlighted

the difficulties HMRC were experiencing with the new regime.

Thankfully, the tests for smaller businesses will be lower, but HMRC's guidance is at best unclear and it will be some time before anyone can confidently understand where the boundaries are. Although it has been established that when an error is identified HMRC have to objectively determine the taxpayer's behaviour at the time and seek his agreement, the penalties are imposed under Civil Law not Criminal Law. HMRC, therefore, only have to decide on the balance of probabilities, rather than beyond reasonable doubt, so there remains vast scope for disagreements.

Unfortunately, cooperation is one of the mitigating factors to reduce the penalties so we can only advise clients to be wary of HMRC offering a carrot and stick approach to suspend the penalty for agreeing they were careless. A suspended penalty will stay on your record but if the error was a simple mistake then there should be no penalty at all.

Appeals and reviews

Previously, when faced with a decision by HMRC, a taxpayer could seek reconsideration by a more senior Officer. The reconsideration process was widely derided by the tax profession since most decisions simply rubber-stamped the original one.

In April 2009, HMRC introduced an independent review team that was designed to counter some of the criticism towards the reconsideration process. Initially, the review team did seem to operate as an independent unit remote from the original Officers and its decisions were technically more proficient than before.

However, with HMRC still reviewing their own decisions, there remained a healthy degree of scepticism towards the new team. Indeed, experience of late shows a 'reversion to type' and there is growing concern that HMRC are again upholding

the original decision where there is the slightest reason to do so. Recent surveys have shown that the review team still overturns around half of all Officers' decisions. Whilst this is good news, it does highlight the number of decisions issued by HMRC that are fundamentally wrong and, remember, these are only the ones that taxpayers ask to be reviewed. This is only likely to get worse and taxpayers in dispute with HMRC should be prepared to seek a review or go to Tribunal to fight their case.

As a result of changes to the Tribunal system, taxpayers now have the right to appeal to the First Tier Tribunal either following the original decision or after review. The big change here is on the question of costs. Previously, winning taxpayers in VAT appeals were able to claim their costs against HMRC but, when HMRC were successful, they did not generally claim costs against the losing taxpayers. The new Tribunal system has no costs either way unless the case is complex or involves significant sums of money when it may be allocated to a process that has costs on both sides. There has been a significant drop in VAT cases coming before the Tribunal for this very reason and you should consider likely costs before embarking on an appeal.

The Ministry of Justice recognises this problem as being a barrier to justice and is consulting on it again, although the Government is likely to resist major changes. It remains deeply worrying that HMRC want to limit their liability to costs, because evidence from numerous appeals and reviews suggests that many of HMRC's decisions against small and medium-sized businesses are influenced by the likelihood of the business disputing it. To their credit, tax barristers are waking up to this and some are beginning to offer quite flexible terms for smaller appeals. For the moment, however, with the disputes and appeals process weighted heavily in favour of the State, appealing to the Tribunal can be a costly exercise for taxpayers and disproportionately so for small and medium sized businesses.

New legislation expands the reach of the Enterprise Investment Scheme (EIS)

EIS investments offer attractive incentives to individuals, providing specific criteria are met, in the form of both Income Tax and Capital Gains Tax relief.

At the time of subscribing for EIS shares, you will now obtain an immediate income tax credit amounting to 30% of the amount subscribed. Prior to April 2011, the income tax relief was limited to 20%. The maximum an individual can invest in EIS is also increasing with effect from 6 April 2012, from £500,000 to £1 million. In addition to the income tax benefit, any future sale of EIS shares is free from Capital Gains Tax.

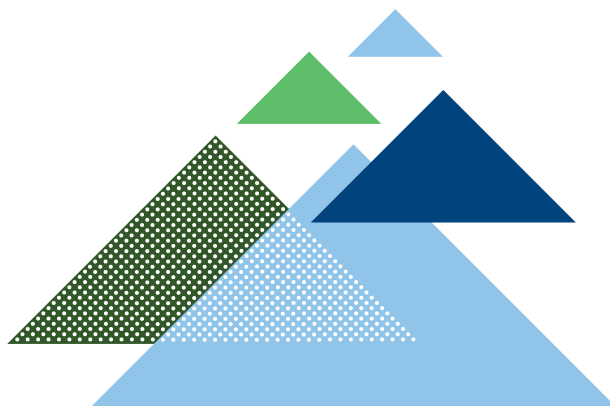
Further changes to the Enterprise Investment Scheme, which are due to come into effect in April 2012, will significantly increase the number of unlisted SMEs and AIM/PLUS listed companies or groups that will be able to issue shares via an EIS subscription.

The proposed April 2012 changes increase the size of companies and groups that are able to offer EIS subscriptions. The qualifying limits will be increased to 250 employees (from 50) and the gross assets limit at the time of subscription to £15 million (from £7 million). Also, companies can now raise substantially more funds via an EIS subscription with the annual limit increasing to £10m, from £1m.

In order to be an EIS qualifying company a number of stringent conditions have to be met. These conditions must not be breached in the years after the initial subscription otherwise the capital gains benefits will not be available and the previous Income Tax benefit can be withdrawn.

However, some conditions have recently been relaxed. For example, it is no longer necessary for the activities of the company to be conducted wholly or mainly in the UK. This change opens up the possibility of using an EIS subscription to finance overseas expansion, something that was previously not possible.

Given the impending changes, now is the time to consider whether your company or group meets the expanded EIS conditions and can therefore attract new investors keen to take advantage of the tax benefits that EIS offers them. Contact your usual Campbell Dallas partner for assistance in establishing your position.



Junior ISA

This new tax-free opportunity to invest up to £3,600 a year (cash or shares) for your children should be launched on 1 November 2011.

Whilst any child in the UK with their own income has the benefit of the same tax allowance as an adult, currently £7,475, tax rules mean that income of more than £100 arising from parental gifts is assessed to tax on the parent rather than their child. (This rule does not affect remoter relations, such as grandparents, making gifts). The Junior ISA avoids the problem with parental gifts, but is not restricted to parental contributions. ISAs have previously been restricted to those 16 or over, or 18 for sharebased ISAs. However, Junior ISAs will not be available to any child eligible for a Child Trust Fund, born between September 2002 and before 3 January 2011.

Also consider that a parent or grandparent can contribute up to £3,600 to a stakeholder pension for their child. Unlike an ISA the contribution will also receive 20% tax relief (but with no further tax relief for the contributor).



UK tax: all change for residence & domicile?

A lot has changed in the last few years in the world of residence and domicile and further changes are on their way.

Having previously taken what may be regarded as a relaxed approach to the subject, HMRC and successive governments have now looked to tighten things up considerably (with possible additional tax revenues being a clear motivating factor). HMRC have revised and updated their guidance and have become far more aggressive in pursuing residence arguments through the Courts. At the same time, the tax regime for those not domiciled in the UK has been significantly amended with new rules, and far fewer loopholes, applying from April 2008.

There are currently two consultations on further changes underway. The first is aimed at producing (at last) a statutory definition of residence. The second concerns a slight relaxation of the 2008 rules for non-domiciliaries.

What are the consequences?

While the possibility of a statutory definition of residence has been widely welcomed as likely to provide greater certainty, it is no surprise that what is intended is likely to tilt the scales further in favour of HMRC. In particular, some people who consider themselves not resident in the UK

– notably those who have left the country but continue to maintain certain links and also have some visitors from overseas – may find that the new definition suggests otherwise.

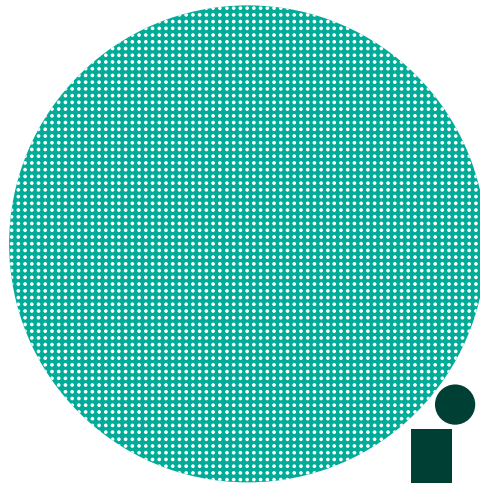
What should I do?

Because some of the tests for residence look back at previous years, those who wish to preserve/establish non-resident status in future should take advice now. Those who are not domiciled here and have significant assets abroad should take advice on the expected changes to the nondom rules – it may be worth deferring certain actions until these come into effect.

If you have previously claimed to be non-resident or non-domiciled but are now not certain of your status you should consult an appropriate professional. If your status has changed or if you have failed to make relevant claims and elections it may not be too late to rectify things. If you have failed to pay all the UK tax due on overseas income or gains – whether deliberately or innocently – you may be able to take advantage of the generous tax ‘amnesties’ currently available.

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Unfair employer PAYE penalties



An August tax tribunal decision said that HMRC unfairly penalised a late Employer's Annual Return form P35 by waiting until penalties had amassed to £400 before telling the taxpayer. The Tribunal said "In our judgement there is nothing fair or reasonable in setting a computer system so that it does not generate a penalty notice until four months have gone by from the date of default."

This procrastinating procedure is in fact HMRC policy, even though the minimum penalty is £100 and HMRC could tell an employer much earlier. The judgement is timely, as penalties for late employer's returns for the 2010/11 tax year will be issued this autumn.

If you receive a late filing penalty for your P35 Return, you should check your records as to whether the return was sent on time. If it is late, then you should still consider appealing against the amount of penalties as unreasonable (though we would still expect the minimum £100 fine to apply). You need to appeal within 30 days of the date on the penalty notice. Please speak to your usual Campbell Dallas partner for advice if you choose to appeal.

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