Tax update - 30 September 2015

In this edition of the tax update we look at:
1. HMRC telephone performance
2. HMRC Trusts and IHT newsletter
3. Tax Avoidance: HMRC publishes its view that contractor loan schemes do not work
4. Partnership CGT: HMRC publish an update to SP D12
5. Adjudicator publishes annual report on 15 September 2015
6. CIS payment scheme and Island Contract Management case

1. HMRC telephone performance

I listened to Woman's hour a couple of weeks ago and heard that the BBC had tested the time taken to answer a call and found it to be 36 minutes. That is so unacceptable that we should be writing to MPs and complaining. I conducted my own experiment on Tuesday 22 September 2015 and was advised that the lines were busy and I could expect to hold for around 35 minutes. Unlike the BBC which waited for the call to be answered, I disconnected. There is something seriously wrong with HMRC management and performance when such performance measures are accepted.

Of course agents can use the agent phone lines and obtain a better and more rapid response. HMRC's unacceptable and poor performance deserves criticism and represents an enormous waste of human resource. HMRC claim to deal with 70 million calls each year and have an average waiting time in September 2014 of 10 minutes 53 seconds. That is 12,716,665 hours that HMRC is responsible for wasting each year because of delays in answering the phone. In October 2015 with a National minimum wage of £6.70, it suggests that by improving its performance HMRC could save over £85 million. Of course if the waiting time is actually 35 minutes the wastage is actually £273 million. Employing an extra 1500 staff to improve response times would cost a small fraction of that figure.

It is a false economy to tolerate HMRC's abysmal phone performance. What the figures will not show is how many people, dissatisfied with HMRC failing to answer a question, proceed as best they can but make mistakes and do not pay the right tax.

How can we improve this? Someone needs to be accountable and instead of talking about new digital services and appointing temporary staff at peak times, HMRC need to offer a service that has realistic, reliable and acceptable performance standards.

2. HMRC publishes its newsletter on Trusts and IHT

On 27 September 2015, HMRC published its newsletter on trusts and IHT. The content includes:

1. **Finance (No.2) Bill 2015**
2. **IHT Online**
3. **IHT treatment of usufructs**
4. **IHT403 and Normal Out of Income Exemption**
5. **Form 41G (Trust)**
6. **Trusts and Estates Manuals**

In my view, IHT is a difficult area and with the nil rate set at £325,000 and everything in excess of that taxed at 40% it is worth planning to minimise the incidence. This newsletter gives more detail about the residential nil rate band (RNRB) which will start after April 2017. An extra residence nil-rate amount will be introduced for deaths on or after 6 April 2017. This will be phased in over a period of 4 years so that for deaths in 2017 to 2018 the maximum additional amount will be set at £100,000, rising to £125,000 for 2018 to 2019, £150,000 for 2019 to 2020 and to £175,000 for 2020 to 2021 - it will be indexed in line with the Consumer Price Index (CPI) from 2021 to 2022 onwards.

The essential features of RNRB are as follows:

- it is only available where the deceased's residence, or a share in a residence, is inherited by direct descendants
- direct descendants includes children, step-children, adopted children, foster children, grandchildren, great-grandchildren etc. - it does not apply where the residence is left to parents, siblings, nephews, nieces or other relatives
- a direct descendant inherits property when they become absolutely entitled to it, or beneficially entitled to a qualifying interest in possession in the property, or the property is held on trust for a bereaved minor, or on 18-25 trusts
- it applies to a single residence that is part of the deceased's estate on death, whether owned directly by the deceased, or to which they are beneficially entitled through a qualifying interest in possession or gift with reservation (GWR)
- the residence must have been lived in by deceased at some stage but it does not have to have been their main residence
- the amount of RNRB will be the lower of the value of the residence, or share of it, and the maximum available amount, if the value of the residence is more than the maximum amount, the excess can be added to other assets in the estate and the existing nil-rate band is applied in the usual way - the value of the residence does not have to be greater than the existing nil-rate band (or transferable nil-rate band)
- it only applies to the estate on death, so it is not taken into account when calculating the tax payable on any failed potentially exempt transfers (PETs) or other lifetime transfers
- if RNRB is not used when the first of a couple dies, or to the extent that it is not used by a transfer on the death of the first of a couple to die, the unused proportion may be transferred to the surviving spouse or civil partner - limited to 100% of the RNRB available at the survivor's death - this applies irrespective of when the first of the couple dies
- the personal representatives of the survivor must make a claim to transfer any unused RNRB
- for larger estates, RNRB available will be tapered away where the net estate (assets less liabilities but before exemptions and reliefs) exceeds £2m at a rate of £1 withdrawal for every £2 of value over £2m
- where the first of a couple dies before 6 April 2017, the personal representatives of the survivor will be able to claim an increase in RNRB of 100%, irrespective of the circumstances that applied on the earlier death - all that is necessary is that the survivor was married to, or in a civil partnership with the individual who died first when they died
- however, the taper will still apply to RNRB that is transferable from a pre-6 April 2017 death, so if the net estate exceeded £2.35m, there will be no RNRB to transfer
- there will be a technical consultation in the autumn about how RNRB should work where a person has downsized or ceases to own a residence after 8 July 2015

As part of this measure the nil-rate band is to remain frozen at £325,000 until April 2021.

3. Tax avoidance: HMRC publishes its view that Contractor Loan schemes do not work

There is little doubt in my mind that the attitude towards tax avoidance is changing. While tax avoidance is legal, the public attitude to avoidance has hardened. HMRC have additional powers to collect the tax at dispute.

HMRC published on 16 September another **Spotlight (26)** in which HMRC claims that contractor loan schemes will not work and will be challenged by HMRC. These contractor loan schemes are sold by promoters who claim that the scheme will reduce the amount of tax the contractor pays on income by making payments which purport to be 'loans' from a trust or a company. Normally, a contractor would receive the contract income directly and pay tax on it. These arrangements artificially divert the income through a chain of companies, trusts or partnerships and pay the contractor in the form of a 'loan'. The 'loans' are claimed to be non-taxable because they don't form part of a contractor's income. However, in reality the 'loans' aren't repaid and the money is used by the contractor as if it were his or her income.

If someone asked me whether such schemes work, I would refuse to answer. But what I would say is that HMRC will be informed of the scheme being used and the taxpayer is going to face a challenge. Such a challenge is going to be time consuming and expensive and if the HMRC challenge succeeds it is going to prove a very expensive exercise indeed.

4. **Partnership CGT: HMRC publish an update to SP D12**

The **Statement of Practice D12: Partnerships**, published on 14 September, sets out the agreed practice for dealing with partnership CGT. Its contents include:

1. **Valuation of a partner's share in a partnership asset**
2. **Disposals of assets by a partnership**
3. **Partnership assets divided in kind among the partners**
4. **Changes in partnership sharing ratios**
5. **Contribution of an asset to a partnership**
6. **Adjustment through the accounts**
7. **Payments outside the accounts**
8. **Transfers between persons not at arm's length**
9. **Annuities provided by partnerships**
10. **Mergers**
11. **Shares acquired in stages**
12. **Elections under TCGA92 Schedule 2, paragraph 4**
13. **Partnership goodwill**
14. **Entrepreneurs' relief on transfer of a business, "roll-over" relief and business asset gift relief**

The changes are for clarity and completeness and do not represent any change to HMRC's approach.

5. **Adjudicator publishes annual report on 15 September 2015**

As a taxpayer, I find that HMRC's performance is so poor as to deserve criticism. An organisation which takes 35 minutes to answer a phone and is therefore responsible for wasting millions of pounds of taxpayer's valuable time is unlikely to have the right culture to supply a decent customer experience.

I recommend the **adjudicator's report** as an interesting read for practitioners. In 2014-15, The Adjudicator recommended HMRC pay a total of £243,967 in compensation to complainants for worry and distress and poor complaint handling (£246,094 in 2013-14). She also asked HMRC to reimburse £123,605 for direct costs (£180,615 in 2013-14). The Adjudicator recommended that HMRC give up liability for tax and overpaid Tax Credits amounting to £2,629,197 (£3,942,549 in 2013-14).

For those complaints with which the adjudicator has dealt, her role is important and does redress the balance. However, she does not look at the fundamentals of HMRC performance, I think that she should.

6. **CIS payment scheme did not work in Island Contract Management**

In **Island Contract Management (UK) Ltd v Revenue and Customs [2015] UKUT 472**, the Upper tribunal has upheld the decision of the First tier tribunal that the company failed to withhold the tax which it ought to have deducted and paid to HMRC.

In addition to withdrawing the CIS certificate allowing the company to receive payment gross, HMRC issued further notices of determination in respect of £8,440,689.60 and a further two tax years 2007/2008 and 2008/2008 plus the period May 2009 to February 2010 requiring payment of a total of £34,313,619.14. The determinations were valid. HMRC successfully challenged a scheme which sought to circumvent obligations under the Construction Industry Scheme (CIS).

Derek Allen
27 September 2015

Set your diaries for the next edition of the general tax update which will be published at the end of October 2015

The views expressed in these podcasts are Derek Allen's personal views and do not necessarily represent AAT policy or strategy.