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PAYE

Demands for underpaid tax
Additional rate taxpayers

There has been much publicity over the latest HM Revenue & Customs (HMRC) "blunder". Depending on the source of information, between 5.6 and 6 million people have paid the wrong amount of tax through the Pay As You Earn (PAYE) system. Around 4.3 million of these have paid too much and are due a refund, but 1.4 million have underpaid and will have to hand over an average of £1,428 each.

Dave Hartnett, the HMRC Permanent Secretary responsible for tax, initially denied there had been any errors, and said that there was "no need to apologise", a statement which was met with what some papers described as "fury" amongst politicians, and so it was swiftly followed by another, that he was in fact "deeply sorry".

The following explains the position as a number of clients may seek advice.

What about the people being asked for the extra tax?

HMRC has sent out the first 45,000 letters to people who are affected, around 30,000 of whom are due a rebate, while 15,000 have underpaid tax - it is understood that, in some cases, individuals may face both under and overpayments, which could cancel each other out. The remaining people affected will be contacted between now and Christmas.

It has been reported that people who have underpaid and owe less than £2,000 will be able to have the money deducted via PAYE, ie. from their salary on a monthly basis, during the 2011/2012 tax year.

But those who owe more than £2,000 will have to pay it to HMRC in a lump sum. This does not seem particularly reasonable but HMRC's excuse is that such sums would generally be only demanded from higher earners who "can afford it". It has been reported recently that HMRC has told MPs that those who owe more than £2,000 and who have difficulty paying will not face interest charges, currently at 3%.

If a person is asked for extra tax, what should they do before paying it?

The first thing to do is to check that the demand is in fact correct. Next, even if the amount is correct, consider whether HMRC is actually entitled to recover the tax. The rule is that HMRC must issue demands for underpaid tax within 12 months of the end of the tax year in which it became aware that people had underpaid.

So if a taxpayer provided HMRC with all the information they needed to get his or her tax code right, HMRC should have used this information within 12 months of the end of the tax year in which it was received to claw back the extra money. If HMRC failed to do this, taxpayers can ask for an Extra-Statutory Concession, known as ESC A19, to apply.

Extra- Statutory Concession A19

It is worth quoting ESC A19 in full.

"A19: Extra-Statutory Concession

Giving up tax where there are Revenue delays in using information

Arrears of income tax or capital gains tax may be given up if they result from the Inland Revenue's failure to make proper and timely use of information supplied by:

- a taxpayer about his or her own income, gains or personal circumstances;
- an employer, where the information affects a taxpayer's coding; or
- the Department for Work and Pensions, about a taxpayer's State retirement, disability or widow's pension.

Tax will normally be given up only where the taxpayer:

- could reasonably have believed that his or her tax affairs were in order; and
- was notified of the arrears more than 12 months after the end of the tax year in which the Revenue received the information indicating that more tax was due, or was notified of an over-repayment made after the end of the tax year following the year in which the repayment was made.

In exceptional circumstances arrears of tax notified 12 months or less after the end of the relevant tax year may be given up if the Revenue:

- failed more than once to make proper use of the facts they had been given about one source of income

- allowed the arrears to build up over two whole tax years in succession by failing to make proper and timely use of information they had been given."

The latest round of errors date back to April 2008, meaning anyone who provided HMRC with all the relevant information that affected their tax code before the start of the new tax year in April 2009 may be able to rely on the concession.

Claiming the concession

When claiming the concession it will be necessary to provide the following information:

- which tax year and underpayment the claim relates to

- what information HMRC failed to make proper and timely use of and any supporting information

- what date this information was provided

- reason(s) why the taxpayer thought his or her tax affairs were in order prior to receiving the tax demand.

The Low Income Tax Reform Group has published draft standard response letters depending on the circumstances, including one claiming the A19 concession. They can be found on their website: www.litrg.org.uk

Additional rate taxpayers

In addition to the above, HMRC is facing fresh accusations of incompetence after it emerged that its system cannot deal with the new 50p rate of income tax. When the new rate for high earners (called the "additional rate") took effect from April 2010, it apparently failed to issue a new PAYE code to some of those affected, namely those with more than one job and whose combined income takes them over the £150,000 threshold for the new top rate.

A bulletin for employers on HMRC's website in August stated: "Because we do not currently have an appropriate 50 per cent tax code to apply to second or multiple employments, if you have employees, directors or pensioners with multiple sources of income then their tax deductions may not be accurate when their various incomes are combined and they become liable to tax at 50 per cent."

For people in this category the unpaid tax will have to be recovered when the individuals concerned complete their self-assessment forms by 31 January 2012.

BONUSES UNDER THE SAYE SCHEME

Under the approved Save-As-You-Earn (SAYE) share option scheme, bonuses are added at the end of 3 years, 5 years or 7 years as selected by the employee when he enters the SAYE contract. This bonus is equal to a specified number of monthly contributions.

The new reduced bonus rates applicable from 12 September 2010 are as follows:-

Contract	New rate	Old rate
3 year	NIL	NIL
5 year	0.9 x monthly contributions	1.8
7 year	3.2 x monthly contributions	4.9

The rate of interest paid on any refund of contributions to early leavers is unchanged at 0%.

MUTUAL WILLS

High Court upholds the principles behind the use of mutual Wills

A recent case before the High Court has upheld the principles behind the use of mutual Wills.

Mutual (or mirror) Wills are those where testators, usually two and usually husband and wife, each leave their property to the other on the condition that the second to die is obliged to leave all their property, including that inherited from the first to die, to an agreed third party, eg the children of their marriage. It is possible for the survivor to change their Will after the death of the first to die. However, even though this is legal the new Will can be challenged in court. There have been cases in the past where it has been decided on the first death that a trust of the property of both parties has been created for the benefit of the survivor and the third party who is to ultimately inherit.

Mutual Wills are not common these days. However, the High Court has recently held that mutual Wills made by two elderly sisters many years ago were binding on the survivor's estate, even though there was no documentary proof of mutuality.

The case (Charles v Fraser) is only the third successfully contested mutual Wills case in the last 80 years. It concerned two sisters, Ethel Willson and Mabel Cook, who executed mutual Wills in 1991. Each left their entire estate to the other along with a statement that the second to die would leave the remaining assets to certain of their friends and family.

Mabel died in 1995 and all assets passed to Ethel, who survived until 2006, by which time she was 92. It then transpired that two months before her death she had executed a second Will leaving the £400,000 estate to her hairdresser, Jill Fraser, who was also executrix of the new Will.

The claimants (disinherited family members) asked the High Court to void the new Will. They asserted that the sisters' 1991 Wills were mutual and thus binding on the survivor, even though no formal written statement to this effect could be found. The family declared that the sisters had often stated orally that they regarded their agreement as binding.

The judge found for the claimants on the basis of "considerable evidence" that there was a formal agreement between Ethel and Mabel. He criticised the draftsman of the 1991 Wills for not explicitly recording whether the Wills were meant to be mutual.

Mrs Fraser will now have to return the assets, probably by accepting a charge on her home which she bought with the inheritance last year.

Care needs to be taken by solicitors when drafting new Wills. However, they may not always be presented with details of previous agreements. Of course, one way around this mutual Will problem is to leave property subject to an interest in possession trust for the survivor – though this will, of course, limit the survivor's use of that property (unless it is possible to appoint capital).

PRE-BUDGET REPORT (AUTUMN 2010)

It has been reported by the Financial Times that the Chancellor of the Exchequer has announced (apparently to cheers in the House of Commons) that the Government is to scrap the Pre-Budget Report (PBR) and replace it with a slimmed down Autumn statement.

It was suggested in July that the Treasury was looking at dropping the PBR, which was introduced by Gordon Brown in 1997, with the stated aim of making the Treasury more transparent.

The Financial Times reports that an Autumn statement will instead be made in late November or early December which will see the Office for Budget Responsibility give an economic forecast and may also include some consultation papers.

By law the Government has to update its forecasts - now delegated to the Office for Budget Responsibility - twice a year. A Treasury spokesman said: "An economic forecast and statement will be presented to Parliament in the Autumn. Further details will be announced to Parliament in the usual way."

NATIONAL INSURANCE HOLIDAYS FOR NEW BUSINESSES

The Government details the National Insurance Holiday Scheme

In the emergency Budget of 22 June 2010 the Coalition government announced that it was introducing a region-dependent NICs "Holiday" for new businesses.

The Government has now issued a technical note giving the details of the scheme. It is expected to be introduced in a National Insurance Bill in the Autumn, which is expected to receive Royal Assent in early 2011.

Running from the date of the emergency Budget until 5 September 2013, it targets new businesses who are also employers and who start up outside Greater London, the South East and the Eastern regions of the UK. Until Royal Assent any benefit already obtained from the Holiday can start to be received from 6 September 2010.

The Holiday will work by allowing a deduction against the amount of Class 1 NICs that an employer is required to pay to HMRC each month or each quarter.

For the first ten qualifying employees that a new business employs in its first year of business, following start up, it will be entitled to an individual Holiday for each of these employees. The period will last for the shorter of the employee's first year of employment and the time left until the scheme ends on 5 September 2013.

Applying to all relevant earnings paid to a qualifying employee during the first year of the employee's employment there will be a maximum saving of £5,000 in employer NICs in respect of each employee for a qualifying year.

Several requirements need to be met to qualify for the relief. These include:

- The starting of a new business – only new businesses will qualify. If the person applying for the Holiday has at any time in the six months before the start of the business carried on another business consisting of most of the activities which will be carried out by the new business, or a person transfers activities of an existing business from one person to another, those will not count as a new business. For example, business incorporation or sale of an existing business to someone else will not count.

- Qualifying employees - all employees, including directors, part-time staff, casual workers or any worker earning below the secondary NIC threshold will be treated as an employee for the purposes of the ten employee threshold.

- Place of business – the principal place of business must not be in an excluded region. If, during the Holiday year, the business moves into an excluded region then the Holiday will cease immediately.

It is clear from the list of excluded areas that this Holiday is aimed at promoting the development of small businesses from the Midlands northwards. It will be interesting to see its effectiveness when counterbalanced by the rise in VAT that many of these businesses may suffer directly or indirectly.

THE TRANSFERABLE NIL RATE BAND AND FORM IHT400

Transfer of the nil rate band and form IHT 400

It has been reported that personal representatives may soon be excused from submitting a form IHT400, the full IHT return for an estate on death, where the assets of the estate pass free of IHT under the transferable nil rate band rule.

Section 256 of IHTA 1984 allows HM Revenue & Customs to exempt certain estates from submitting full IHT accounts. At the moment, the exception applies only where the gross taxable value (after deducting the spousal exemption and charity exemptions) is less than the IHT threshold, currently £325,000.

Apparently, HMRC now proposes to extend this to some cases where the first spouse to die has not used all or some part of his or her IHT nil rate band and this unused proportion is claimed on the death of his/her surviving spouse/civil partner. This rule was introduced in late 2007 and is currently being used in 27,000 full estate returns each year.

Not all such estates will be excepted from submitting accounts, though. HMRC wants to restrict it to cases where the full nil-rate band is transferred from the first death; and then only where there has only been one previous pre-deceased spouse.

HMRC estimates this will apply in three out of every four cases where transfer of the nil rate band is claimed. In all other more complex cases a full estate return will still have to be completed.

HMRC is conducting a limited consultation on the proposed changes in all four UK jurisdictions.

TRUSTEE EXEMPTION CLAUSES

The Government confirms its support for the Law Commission's recommendations on trustee exemption clauses

On 14 September the Parliamentary Under-Secretary of State for Justice announced the Government's acceptance of the recommendations made by the Law Commission in its 2006 report "Trustee Exemption Clauses" (Law Com 301).

Briefly, the Law Commission recommended that the Government should promote the adoption by professional and regulatory bodies in the trust industry in England and Wales of a model rule of practice relating to the inclusion in trust documents of clauses limiting the liability of trustees for the consequences of their actions. The recommended model rule provides that a paid trustee or trust draftsman proposing to include such a clause should take reasonable steps to ensure that the person creating the trust is aware of the meaning and effect of the clause before the trust is created.

Model rules to this effect have already been widely adopted by leading regulatory and professional bodies but the Government will be promoting further uptake by writing directly to the relevant regulatory and professional bodies to urge them to adopt the approach recommended by the Law Commission.

COMMENT

Most, if not all, professional trust draftsmen these days use liability exemption clauses recommended by their professional bodies and ensure that the implications of the relevant clauses are explained to the settlor. For an adviser looking at a draft trust, the clause to look for is one that deals with the liability of paid trustees - a modern clause will not exempt such a *trustee from liability for negligence. In older trusts clauses may still be found exempting trustees from liability for all acts except fraud. These days it would be highly unusual for a paid professional person to suggest that he should not be liable for his or her own negligent acts or omissions.*

FINANCE (No2) BILL 2010 PUBLISHED

A third Finance Bill for 2010 was published on 29 September. This is called the Finance (No2) Bill 2010. The Finance (No2) Act 2010 received Royal Assent on 12 July. Therefore, the Act resulting from this Bill is likely to be called the Finance (No3) Act 2010.

This latest Bill addresses technical tax measures inherited from the Labour government.

COLLECTIVE INVESTMENT SCHEMES CENTRE

Contact information published

The Collective Investment Schemes Centre (CISC), based in Sheffield, deals with the following:-

- Authorised Investment Funds (ie unit trusts and OEICs) including property authorised investment funds, qualified investor schemes and tax elected funds
- Investment trust companies
- Unauthorised unit trusts
- Pension fund pooling schemes
- Offshore funds – distributing and reporting funds

The CISC has recently published a comprehensive list of contact points which can be viewed on www.hmrc.gov.uk/collective/cis-centre.htm.

INCOME WITHDRAWAL RATE FOR OCTOBER 2010

The appropriate gilt yield, used to determine the "relevant annuity rate" from HMRC's tables for an adult member commencing income withdrawals (or reaching an income withdrawal review date), in October is 3.5%.