Technical CONNECTION

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HMRC ISSUES DIVIDEND ALLOWANCE FACTSHEET

On 17 August HMRC issued a Dividend Factsheet on dividend taxation in 2016/17. Despite half a dozen examples, it is not that informative. One point of note, which is not spelt out in the Factsheet, is that the dividend allowance is ***not*** an allowance, but rather a specific nil rate band for dividends (similar in some respects to the starting rate band for savings income).

The non-allowance factor explains the slightly puzzling comment in the Factsheet that "Dividends within your allowance will still count towards your basic or higher rate bands and may therefore affect the rate of tax that you pay on dividends you receive in excess of the £5,000 allowance". The effect of this is shown in the last of the half dozen examples in the Factsheet which is reproduced below and based on 2016/17 tax allowances and thresholds.

'Example 6

"I have a non-dividend income of £40,000, and receive dividends of £9,000 outside of an ISA."

Of the £40,000 non-dividend income, £11,000 is covered by the Personal Allowance, leaving £29,000 to be taxed at basic rate.

This leaves £3,000 of income that can be earned within the basic rate limit before the higher rate threshold is crossed. The Dividend Allowance covers this £3,000 first, leaving £2,000 of Allowance to use in the higher rate band. All of this £5,000 dividend income is therefore covered by the Allowance and is not subject to tax.

The remaining £4,000 of dividends are all taxed at higher rate (32.5%).'

Had the dividend allowance been a genuine allowance then the £4,000 excess dividends would have been subject to 7.5% (basic rate) tax on £3,000 and 32.5% (higher rate) tax on the £1,000 balance.

The news that the allowance is not an allowance reduces its benefit marginally, as the example shows. It will also mean that for life policy chargeable event gains and capital gains tax calculations, the ***full*** dividend income still needs to be taken into account as both types of gain sit above dividends for tax calculation purposes.

AUTUMN STATEMENT DATE ANNOUNCED

The Chancellor of the Exchequer has announced that a joint Autumn Statement and Spending Review will be published on Wednesday 25 November 2015.

PENSIONS – CAUGHT BY THE CAP AND/OR TAPER

What are the options for employers and employees who are hit by next year's tapered annual allowance and reduced lifetime allowance?

A Freedom of Information request by Suffolk Life has revealed that in 2013/14 HMRC collected £94.2m in lifetime allowance charges, down about 4% from £98.0m in the previous year. Alas, there is no corresponding information for the annual allowance charge. However, it is probably a smaller figure as input is easier to control than pension fund growth/output. With the lifetime allowance destined to drop again to £1m next April along with the introduction of tapering of the annual allowance, the Exchequer could be looking forward to more inflow from pension allowance tax charges. But are these taxes worth paying if other benefits accrue?

Lifetime allowance charge

The lifetime allowance charge is 55% if excess funds are drawn as a lump sum and 25% if they are used within the pension to provide income (or triggered by the age 75 BCEs), scheme rules permitting. For a higher or additional rate taxpayer, the lump sum lifetime allowance charge is worse than receiving pay, even assuming the optimum circumstances that the original pension contribution is made by the employer and does not attract an annual allowance charge:

	Lifetime Allowance Charge £	**Income 40% taxpayer £**	**Income 45% taxpayer £**
Gross profit	10,000	10,000	10,000
Contribution	10,000		
Employer NICs		(1,213)	(1,213)
Salary		8,787	8,787
Tax	(5,500)	(3,515)	(3,954)
Employee NICs		(176)	(176)
Net benefit	**4,500**	**5,096**	**4,657**

However, the difference for the additional rate taxpayer is marginal and has to be offset against the other pension advantages of tax-sheltered roll up and favourable tax treatment of death benefits. As far as *personal* contributions are concerned, the lifetime allowance charge is a killer because the benefit of the non-payment of employer NICs is lost.

Annual allowance charge

If you attempt similar mathematics for the annual allowance, things become rather more complicated. Assume again the optimum employer contribution to which the annual allowance charge applies in full and is deducted immediately under scheme pays rules. The residual amount is then taken as a UFPLS, ie 75% taxable at 40%:

	40% taxpayer		**45% taxpayer**	
	Annual Allowance Charge £	**Income £**	**Annual Allowance Charge £**	**Income £**
Gross profit	10,000	10,000	10,000	10,000
Contribution	10,000		10,000	10,000
Employer NICs		(1,213)		(1,213)
Salary		8,787		8,787
AA charge	(4,000)		(4,500)	
Residual fund	6,000		5,500	
Income tax	(1,800)	(3,515)	(1,856)	(3,954)
Employee NICs		(176)		(176)
Net benefit	**4,200**	**5,096**	**3,644**	**4,657**

Paying the annual allowance charge is thus generally to be avoided – more so than the lifetime allowance charge because of the effective double taxation.

If both the annual allowance charge and the lifetime allowance charge are triggered the situation is even worse – the net benefit falls to £2,700 (£6,000 x 45%) for a higher rate taxpayer and £2,475 (£5,500 x 45%) for an additional rate taxpayer.

So what are the options for anyone caught by either (or both) of these charges? There are many possibilities, including:

- In theory, additional rate taxpayers benefiting from employer contributions and subject only to the lifetime allowance charge could just grin and bear it, as the numbers above show. In practice this is something of a non-starter, as the additional rate taxpayer will almost certainly be caught by the annual allowance taper and is more likely than anyone else to have claimed or is intending claiming some form of lifetime allowance protection, thereby ruling out any future contributions.

- Business owners can choose to retain their profits, net of corporation tax (which will be 19% in 2017). This simple solution comes with its own drawbacks in terms of prejudicing full entitlement to IHT business property relief and entrepreneurs' relief.

- If profits are to be drawn by business owners, then dividends will still be the most attractive option, even in 2016/17.

- Employees may need to renegotiate remuneration packages, opting for more pay/benefits and less (or no) pension contributions. If the employer will not renegotiate the employee will just have to accept that something is better than nothing.

- Investment options for dividend or salary start with the usual suspects – ISAs, collective funds, VCTs and EISs. Note, however, that at present the venture capital promoters are still getting to grips with what the Finance Bill changes will mean to their business models.

COMMENT

Next year's tapering rules and lifetime allowance cut will swell the growing numbers of people effectively taxed out of making further pension provision.

TRUSTEE FORMS AND REPORTING REQUIREMENTS

Trustees have a number of duties to fulfil which include the need to satisfy certain compliance and reporting requirements during the duration of the trust. This article looks at trustee reporting requirements in light of what documentation needs to be completed and submitted to HMRC or given to a beneficiary.

Register a trust - Form 41G

Trustees will need to register a trust with HMRC to pay income tax and capital gains tax which can be done by completing a form 41G. This should be done by 5 October in the tax year following that in which the trust is set up. On receipt of this form HMRC will issue a unique taxpayer reference which will be needed when sending in a tax return.

Form 41G requires information such as the trust name, trustee details, details of the assets settled, details of the settlor or, if the trust is created by a will or the laws of intestacy, details of the deceased and the administration period.

This form will normally only be required for trusts which are taxable under the relevant property regime so would not include, for example, a bare trust. In addition, this form will not be required if the trust asset is non-income producing, for example where the sole trust assets comprise investment bonds or where there is no likelihood of income and gains arising. This is because there is no requirement to register when annual trustee returns would not be required.

Tax returns

Trustees must report trust income and capital gains in a trust and estate self assessment tax return after the end of each tax year and pay any tax due by the deadline, broadly 31 January following the end of the tax year.

The trustee tax return must be completed and submitted either electronically by 31 January following the end of the tax year, or a paper return (SA900) must be filed by 31 October after the end of the tax year.

In order to complete the tax return, trustees must keep relevant records, for example:

- bank statements for current and deposit accounts
- confirmation of interest paid into bank or building society accounts
- chargeable event certificates issued by life assurance companies
- dividend vouchers from companies and unit trusts
- details of any rental income and expenses
- details of all taxes and expenses paid by the trustees
- details of income payments to beneficiaries under a discretionary trust
- if assets have been sold, details of completion statements, contract notes, price received etc…

Notify beneficiaries about income and tax – Form R185

Trustees must provide a beneficiary with a statement of income by completing Form R185 (Trust income). This will include details of the amount of income and tax paid by the trustees. The beneficiary can then use the information provided to complete their own tax return.

If the settlor has retained an interest in the trust the settlor will be taxable on the income. In this case the trustees must provide the settlor with Form R185 (Settlor) which will include details of the income and tax paid by the trustees.

Inheritance tax account - Form IHT100

The settlor will be required to complete and deliver an IHT100 account in respect of a chargeable transfer made to a trust (i.e a trust taxable under the relevant property regime) where:

- the value transferred is attributable to cash or quoted shares or securities and is above the settlor’s available nil rate band; or

- the value transferred is attributable to other assets, is above 80% of the nil rate band and the loss to the donor’s estate by virtue of the transfer is more than the settlor’s available nil rate band.

The settlor's available nil rate band is effectively the nil rate band at the time the trust is executed reduced by any chargeable transfers made by the same settlor in the seven years immediately preceding the creation of the trust.

Periodic and exit charges – Form IHT100

The position is more complicated under a relevant property trust where a ten-year anniversary charge arises or where capital is appointed out of the trust as it is necessary to look at the position in each case to determine whether or not a chargeable event occurs and a number of other factors need to be borne in mind, for example whether the settlor has created any other trusts on the same day, whether property has been added to the trust, whether any capital appointments had been made etc...

Broadly, in these cases an IHT charge would arise and in turn a form IHT100 would be required where the notional aggregate chargeable transfer exceeds 80% of the nil rate band (£260,000 for 2015/16). So, for example, on a ten-year anniversary charge, if the current value of the trust fund (assuming no capital appointments had been made and the settlor had not made any other chargeable transfers in the seven years before creating the trust) is in excess of £260,000 an IHT100 form would be required.

The responsibility for filing the form once the trust has been set up rests with the trustees as part of their ongoing administrative duties.

Other duties

Trustees will also be required to notify HMRC of any other changes to the trust and will have other duties to fulfil dependent on the type of trust.

COMMENT

Any adviser who is involved with recommending a trust as part of a financial planning strategy should have a broad understanding of the associated reporting requirements. Demonstration of this knowledge, even where the financial planner is not physically involved in the submission of the returns to HMRC, will also help in building relationships with the client's other professional advisers.

SELF-ASSESSMENT – PAID TOO MUCH OR TOO LITTLE TAX?

HMRC is simplifying the process for those who have paid too much or too little tax.

Taxpayers will be sent their P800 tax calculation by the end of October 2015 – this should be checked against the records the taxpayers hold, for example against their P60, P11D, bank statements etc… It is also possible to check whether the correct amount of tax has been paid through HMRC's tax checker.

Taxpayers need only contact HMRC if there is a discrepancy in the figures.

If the computation appears to be correct no action need be taken. In cases where too much tax has been paid, the taxpayer will receive a cheque within 14 days of receiving the P800. If too little tax has been paid, this will normally be collected by adjusting the taxpayer's tax code for the following year. HMRC will notify the taxpayer informing them of how any underpayment will be collected.

COMMENT

Simplifying the process will no doubt be a welcome change for taxpayers. However, advisers should encourage taxpayers to check their P800 tax calculation to ensure they have paid the right amount of tax – especially since they could be faced with penalties if the correct amount of tax is not paid on time.

VENTURE CAPITAL TRUSTS – DIVIDEND REINVESTMENT

Some VCT managers are withdrawing their dividend reinvestment schemes at short notice. It could bode ill for the end-of-tax year offerings.

One of the features of VCTs, which is rarely commented upon, is the automatic dividend reinvestment. Most, but not all, VCTs offer this and there are three main forms:

1. The dividend is automatically reinvested in new shares issued at net asset value.

2. The dividend is automatically reinvested in new shares issued at the market price (generally around a 10% discount on the net asset value).

3. The dividend is automatically used to purchase shares in the market, at market prices.

The first two options count as fresh share subscriptions and mean that the investor qualifies for the normal 30% income tax relief. This can be particularly attractive when the VCT is making a relatively large special dividend payment.

However, after the three Northern VCTs announced special dividends in the Summer, they suspended their dividend reinvestment schemes at short notice, blaming the Summer Budget proposals and the need to consider "the possible impact of the proposals on … future investment activities". In late August, Maven followed suit in respect of its six VCTs. The managers used virtually the same reason as their counterparts at Northern.

The fact that VCT managers are avoiding the retention of cash by suspending dividend reinvestment schemes suggests that they may not be anxious to raise fresh funds in the 2015/16 "end-of-tax-year season". In 2014/15 Northern did not raise any funds, having raised £50m the previous year and Baronsmead raised only £4m (in a matter of days) against £40m in 2013/14. Both managers said that they had enough cash and did not want to add to their trusts' liquidity.

It may well be that 2015/16 will also see reduced supply as managers assess the new regime, which will not be settled until EU state aid approval has been given and the Summer Finance Bill receives Royal Assent. Certainly, the HMRC projections published alongside the Budget show it expects this to be the case. These suggest that the impact of all venture capital scheme changes (VCT, EIS and SEIS) will benefit the Exchequer to the tune of £85 million in 2016/17.

As the £85 million would mainly be derived from EIS and VCT subscription income tax relief, the implication is that about £285m less investment will be made than previously expected. The total VCT investment in 2014/15 was £429m. EIS figures are not yet available for last tax year, but for 2013/14 EISs raised £1,457m. However, the division of reduced investment is probably skewed towards VCTs as the changes are more likely to impact them rather than EISs.

It could be lean times for VCT investors in the run up to April. Attractive offerings may be small and sell out quickly.

LOWER RATE OF INHERITANCE TAX HAS SLOW START

Latest statistics from HMRC show that the number of estates where 10% or more of the net chargeable estate passes to charity is low compared to the number of estates chargeable to inheritance tax.

The reduced rate of inheritance tax at 36% applies where 10% or more of the net chargeable estate is left to charity. This reduced rate has applied since 6 April 2012 and, although the rules are somewhat complex, there is the potential to make tax savings where an individual wishes or is willing to leave part of their estate to charity. Furthermore, saving IHT in this way provides a legitimate means of planning which is worth considering.

HMRC statistics show that of the 16,412 cases which were chargeable to inheritance tax in 2012/13 only 1,558 (about 9.5%) benefited from the reduced rate of 36% (2012/2013 being the first tax year in which the lower rate of 36% was introduced). While this resulted in an inheritance tax saving of £27 million, it is a small fraction compared with the total inheritance tax payable of £3,501 million.
As a brief reminder, let's assume Frederick has a net chargeable estate of £500,000. Under the terms of his will he leaves his entire estate equally to his two adult nephews. In this case, inheritance tax will be payable on the whole amount at 40%, i.e £500,000 @ 40% = £200,000. His nephews will therefore benefit from £150,000 each.

Had Frederick decided to leave 10% (i.e £50,000) of his net chargeable estate to charity to take advantage of the reduced rate of inheritance tax on his estate, inheritance tax would have been payable at 36% based on £450,000 (i.e £500,000 - £50,000). This amounts to £162,000.

While this means that the estate available to the nephews reduces by £12,000 to £288,000 (£450,000 - £162,000), Frederick's estate benefits from a significant inheritance tax saving of £38,000.

COMMENT

As can be seen from the above, advisers should take the opportunity to remind clients that by leaving 10% or more of their net chargeable estate to charity, the estate will suffer a reduced rate of inheritance tax on their subsequent death. Financial advisers will need to bear in mind the reduced rate in calculating the potential inheritance tax liability on somebody's taxable estate for life cover purposes.

CORRECTION

In last month's issue there was an article on the proposed changes to the taxation of dividends. Page 8 carried an example of how the changes could impact on a business owner. An important piece of information was omitted from the introduction and that was that the taxpayer already took £7,500 of dividends from the company, which would have exhausted the £5,000 dividend allowance. This would have accounted for the fact that all of the net dividend is shown as being taxable.

Were the £5,000 dividend allowance available then tax would be £4,875 (ie. £15,000 x 32%).

We apologise for any confusion this may have caused.

INCOME WITHDRAWAL RATE FOR SEPTEMBER 2015

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 September 2015 is 2.25%.