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CASH BASIS RULES FOR LANDLORDS

Landlords have suffered unwelcome tax changes in 2016 with further changes taking place in 2017. However, HMRC's latest proposals, which have recently been subject to consultation, appear to offer better news. While these latest proposals are unlikely to reduce the tax bill they will change the timing to most landlords' advantage and also simplify record keeping.

Broadly, if the new rules are implemented, it will mean that those individuals, or individuals in a partnership with no corporate partner, who let property (either residential or commercial) will be able to work out their taxable profit using the cash basis, i.e account for income received and expenses paid instead of any rent that is due or any expenses that are payable. This means that rent will only count as income in the tax year in which it is actually received rather than in the tax year in which it is due. So, for such clients with tenants who often fall into rent arrears, opting for the cash basis is likely to be advantageous.

It should be noted that the cash basis will not affect the restriction to basic rate tax relief on mortgage interest to be phased in from April 2017.

The consultation closed on 7 November 2016 and HMRC is currently analysing the position. Nonetheless, it will be interesting to see whether these changes are implemented and made law by Finance Act 2017.

THE PUBLIC ACCOUNTS COMMITTEE HAS BEEN LOOKING AT TAX RELIEFS

The consultative document on the reduction in the money purchase annual allowance, issued alongside the Autumn Statement, contained the following statement:

‘The cost of tax and National Insurance contributions relief on pension savings is one of the most expensive sets of relief offered by the government. In 2014 to 2015 this cost around £48 billion, with around two thirds of the tax relief going to higher and additional rate taxpayers.’

By coincidence, just over a week later the House of Commons Public Accounts Committee (PAC) published its review of HMRC’s performance in 2015/16. Among the topics on which the PAC focused was tax reliefs. It made the followings points:

- There are more than 1,100 tax reliefs. For its part, HMRC recognises a total of 400 reliefs and publishes cost data on 180 of these each December.

- HMRC stated that it had two main responsibilities in relation to tax reliefs: managing their administration and monitoring and reporting the costs involved. However, HMRC noted that it would be for Ministers to decide whether “a wholesale review of tax reliefs” was required.

- The PAC found that the organisational structure of HMRC was based around “customer groups” (eg small businesses) and specific behaviour types (eg avoidance) rather than specific tax reliefs. Nevertheless, responsibility for administering tax reliefs, including monitoring the cost of the reliefs, rests with the relevant tax area “product owner”.

- HMRC says that it routinely monitors the costs associated with tax reliefs wherever it could. But it emphasised that there was a trade-off between gathering the data required to monitor costs and the burdens imposed on businesses. In addition to the routine monitoring, there was periodic monitoring of certain tax reliefs, particularly if Ministers were interested in reforming a specific area.

- The PAC’s concern was whether there was sufficient information available to policy makers and analysts to enable them to assess the effectiveness of tax reliefs, citing the problems with the cost of entrepreneurs’ relief which the National Audit Office (NAO) first highlighted. Only after the NAO’s intervention did HMRC act.

- HMRC acknowledged that data it has published on tax reliefs were scattered over several different publications, and agreed to consider collating and publishing all tax reliefs data in its annual report.

COMMENT

Given the government’s self-imposed triple lock on income tax, NICs and VAT rates, it would not be surprising to see more focus on a cost/benefit analysis of tax reliefs, with pensions at the top of the list.

INCOME TAX AND NATIONAL INSURANCE ALIGNMENT – A FURTHER REVIEW

The Office of Tax Simplification (OTS) has published its further review on the closer alignment of income tax and National Insurance, reaffirming its call for this outdated system to be reformed to make it fit for the future.

This review builds on the OTS's first report on this subject published in March 2016. This report concluded that aligning the way the two taxes are calculated would create a simpler, more transparent and fairer system for taxpayers and employers, and set out a 7 stage programme for bringing the two taxes closer together.

As the OTS recommended, further work was commissioned to get a fuller picture of the potential impact of the two key aspects of the proposals which are:

- the calculation of employee NICs on a similar basis to PAYE
- moving employer NICs to a payroll levy

Annual, cumulative and aggregate NICs

- The review considers what the impact might be across different demographics: earnings levels, ages, gender, industry sectors and location.

- About 5.5 million people would pay more NICs, £242 per year on average – mainly those who are paid more than £20,000 and those with two or more jobs.

- About 7.6 million people would pay less NICs, £169 per year on average – mainly lower earners and those working for only part of the year who still benefit from a full year's "NIC allowance".

- The link between NICs and contributory benefits, such as the state pension, would have to be considered, as would the link with Universal Credit entitlement.

- A new "NICs code" will be needed, similar to the PAYE code.

Employer payroll levy

The review sets out a number of options for introducing a payroll levy, without identifying a clear winner.

- A flat-rate payroll levy.

- Replacing the employer threshold with a cumulative annual employee allowance.

- Replacing the employer threshold with a full-time equivalent employee allowance.

- Linking the charge to a percentage of employee NICs.

COMMENT

With a further review necessary it is interesting to speculate what the outcome might be and when any change is likely to be implemented.

THE GOVERNMENT RELENTS ON LISA EXIT PENALTY FOR FIRST YEAR

The Lifetime Individual Savings Account (LISA), which will be available from April 2017 to anyone who is aged under 40, offers a 25% government bonus on savings up to £4,000 per annum.

Financial Secretary to the Treasury, Jane Ellison, has said the government will waive the "exit penalty" on its new LISA for the first year following its launch.

As originally planned, savers who accessed cash before age 60, for any other purpose than to buy a first home, would have faced a 25% penalty on any withdrawals unless they were terminally ill.

COMMENT

Waiving the penalty in the first year following the launch on 6 April 2017, while not a substantial benefit, is positive news for savers.

CHANGES TO THE SUCCESSION RULES IN SCOTLAND

The law of succession in Scotland has remained somewhat stagnant over the past 50 years and, whilst there have been changes in Scottish society, the law didn't provide for these changes. For example, step families have become more common and more couples are choosing not to marry. The results of these changes mean that those who you wish to benefit from your estate are not always the ones that do.

Given this background, in 2015 the Scottish Parliament introduced the Succession (Scotland) Bill to implement some of the recommendations put forward by the Scottish Law Commission Reports with the aim of modernising and clarifying some of the aspects of the law relating to the law of succession in Scotland.

The Succession (Scotland) Act 2016 makes various changes which cover the following key areas:

- establishing a process for the rectification of a Will in certain circumstances;
- removing the requirement for executors to obtain a bond of caution where the estate is uncontentious and small;
- abolishing the doctrine of donatio mortis causa (gifts in prospect of death), which has proved problematic in English cases;
- protecting trustees and executors and people acquiring title against liability for wrong distributions, provided they acted in good faith;

- clarifying that the Scottish courts can rectify a Will that does not reflect the testator's intentions, under certain conditions. This resolves the uncertainty in Scottish law created by the UK Supreme Court's decision in Marley v Rawlings;

- narrowing the per stirpes rule (where a legatee dies before receiving their legacy) to apply only to the testator's direct descendants; and

- modifying the survivorship rule to state that, where both spouses die in the same accident and it cannot be determined who actually died first, neither is treated as surviving the other.

It appears that the remaining recommendations of the Commission, including those on intestacy, legal rights, disinheritance and cohabitation, have been consulted on and the Scottish government is now considering whether these reforms should be taken forward in separate legislation.

CONSULTATION ON THE REVIEW OF THE FUNDING OF THE FINANCIAL SERVICES COMPENSATION SCHEME

The Financial Conduct Authority has issued a consultation paper setting out plans to raise the amount the Financial Services Compensation Scheme (FSCS) can pay out for successful claims against investment advisers.

Currently, clients can claim up to £50,000 per person per firm if they can prove they were mis-sold an investment product by an adviser which has gone out of business. The rules for the FSCS were last reviewed in March 2013.

VENTURE CAPITAL TRUSTS - AN END-OF-YEAR SHORTAGE?

Some VCT managers are either not issuing any new shares or restricting capital-raising again this tax year. Earlier successful fund raisings and the new VCT investment rules are the culprits.

Just over two years ago we warned that there might be a shortage of VCT supply as the year tax ends. In the event, £435m was raised in 2014/15, £5m less than in 2013/14 and exactly the same as in 2015/16, according to HMRC statistics. When you consider the constraints that have been placed on pension contributions in the recent years, it is perhaps surprising that VCTs have not seen any real growth in new investment.

The 2016/17 tax year end is also facing a lack of supply from many of the main players. Baronsmead, which has been busy merging its five VCTs into two, says “it is unlikely that the [trusts] will seek to raise new funds in the current tax year, preferring to continue investing from the currently available cash resources.” That comes after the Baronsmead trusts paid out some bumper dividends because “the fiscal rules for VCTs do penalise the [trusts] for holding cash.”

Mobeus has taken a similar line with comments in the reports on several of its VCTs that ‘… there is no need to raise further funds in the current tax year’. Maven is raising up to £8m for one existing £16.5m VCT which, as at 30 September 2016, had £12.2m sitting in cash following last year’s fund-raising.

Northern Venture Managers (NVM) has said “We do not presently envisage that there will be … major public share offer[s] in the 2016/17 tax year.... However, in order to maintain a comfortable margin of liquidity for new investments, [its three Northern trusts] will launch a non-prospectus 'top-up' share issue … which will raise up to approximately £4 million for each VCT.” This may not stretch very far though, as NVM notes “It is intended that priority will be given to applications from existing investors.” Baronsmead adopted a similar tactic last year and only took money from its existing shareholders.

These big players are finding investment conditions more challenging under the new rules. To quote Baronsmead again, “The amount invested is lower than in previous years principally due to the introduction of new, more restrictive VCT rules in November 2015… in common with other VCTs, the rate of new investment has slowed since their introduction... The pipeline of suitable investment opportunities is improving, although it is now taking longer to establish compliance with the new VCT rules and the subsequent conversion to completed investments has proved difficult.”

COMMENT

The reforms to the VCT investment rules legislated for in the Finance (No 2) Act 2015 have had a significant impact on many established trusts. In 2016/17 care needs to be taken in choosing fresh VCT investments – the danger is that too much money will spend too long waiting to find a suitable home in those VCTs which are open for business.

INHERITANCE TAX PLANNING/WILLS – DIGITAL ASSETS

Readers of a leading Sunday newspaper were recently alerted to the question of dealing with their online accounts and, in particular, of the need to inform their family, or at least those who would be dealing with their assets in the event of serious illness or death, of their passwords to enable them to access their online accounts. It is surprising how many people do not give it a second thought. Indeed, it is not just a question of online accounts but of the so called “digital assets” in general.

This is, of course, a subject that did not arise until relatively recently and so, unsurprisingly, many people forget to specifically address this matter.

Many digital assets are predominately of sentimental value, such as photographs saved on a laptop or in the ‘cloud’. However, the term includes film, music and book collections purchased and stored electronically so can also have significant monetary value. Other such assets may include online accounts generating reward or frequent flyer points, or even investments in digital currencies, such as Bitcoin. So what happens to those assets after your death?

Apart from photos and digital content that has been purchased, a digital legacy also consists of social media accounts on sites such as Facebook, Twitter and YouTube, and this is where potential problems for executors may arise. It may come as a surprise to some that they do not in fact own their online content and actually only have a licence to use the website’s services. What happens to their profiles on death is governed by the website’s Terms of Use. Terms vary depending on the service provider, but often the licence to use the e-platform terminates and the deceased’s online data is non-transferable.

When a person dies, their personal representatives will need access to these electronic records in order to administer the deceased's property, but few people plan for this. Accounts or other assets that are digital-based often leave no paper trail which makes it difficult for an executor to locate the assets or even know they exist. Even if an executor has knowledge of the assets, if they do not know the relevant passwords, they will be blocked from accessing them by layers of cyber security.

An additional problem is that accessing someone else's account without their specific authority arguably breaches section 1 of the Computer Misuse Act 1990 and may contravene the service provider's Terms of Use. As there is no specific UK legislation dealing with this, executors will have to consult the Terms of Use of each provider separately in order to establish their rights to access and manage the assets.

COMMENT

The potential pitfalls surrounding digital assets can be avoided by taking certain steps. An ideal occasion to discuss this with a client is when reviewing their Will. The following recommendations are likely to be appreciated:

- *Making an inventory of all digital assets and keeping the list up to date. This should be stored alongside the Will (although bear in mind that such information should not be included in your Will because it becomes a public document on death). It is also advisable to make a record of all password but, for security reasons, this should be stored separately.*

- *Updating a Will to include gifts of the digital assets. While sentimental assets (such as digital photos) can be gifted under a personal chattels clause in your Will, digital assets with a significant financial value or any associated intellectual property rights will need specialist treatment.*

- *For online assets, checking the Terms of Use to see if they specify what will happen to the account on the death of the account holder. Appropriate guidance can then be given to the executors. For example, you may want your Facebook profile to be changed to an 'in memoriam' page or deleted.*

- *Specific authority should be given to the executors to access and manage the digital assets.*

AN ONLINE CENTRAL REGISTER OF TRUSTS IN THE UK FROM 2017

The December 2016 edition of HM Revenue & Customs' trusts and estates newsletter describes HMRC's recently launched project to build an online central register of trusts, to be introduced in 2017.

The introduction of a register is a result of the consultation paper on the Transposition of the Fourth Money Laundering Directive (4MLD) issued by the Treasury last September. The register will act as a single point of contact for trusts and estates to comply with their registration obligations, replacing the current paper 41G form and the *ad hoc* process now used by trustees to notify changes. The aim is to allow HMRC to collect and hold adequate and up-to-date trust information centrally, in line with the 4MLD.

The new service will provide a single online service for trustees and personal representatives to comply with their registration obligations and notification of any changes. It should also improve the processes around the administration of trusts, and allow HMRC to collect and hold adequate and up-to-date information in a central register.

The above changes will affect those who need to register new trusts and estates with HMRC and existing trustees who will need to provide and update their details.

As well as implementing the requirements of article 31 of the 4MLD, the register will be in line with HMRC's digital strategy and provide greater tax transparency going forward.

COMMENT

Clearly this is something that all persons involved with trusts will need to be familiar with.

CONSULTATION ON PENSION SCAMS PUBLISHED

HM Treasury and the DWP have published a Pension Scams Consultation seeking views on measures to tackle what the government sees as the main areas of pension scams. This consultation closes on 13 February 2017.

The consultation sets out a package of measures aimed at tackling different areas of pensions scams:

- a cold calling ban will cut off a key source of pension scams whilst also sending a clear message to consumers that they should hang-up if they are cold called about their pension;

- current legislation gives pension schemes limited scope to refuse a transfer to a scheme which looks like a scam, even if they have legitimate concerns as to the safety of a member's savings. Consulting on clarifying the law will mean that firms can block pension transfers based on clear objective criteria;

- single-member occupational pension schemes currently require no registration with The Pensions Regulator and can be set up using a dormant company as the sponsoring employer. They are therefore an easy way for fraudsters to register a pension scheme with HMRC. For this reason HM Treasury and the DWP are consulting on making it a requirement that only active companies can register a pension scheme; and

- if a transfer is to be made to an occupational pension scheme it is proposed that there would be a requirement for the member to have to be in active employment with the sponsoring employer.

INCOME WITHDRAWAL RATE FOR JANUARY 2017

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 December 2016 is 2.0%.