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Published by Technical Connection Ltd,
7 Staple Inn, London, WC1V 7QH.
Tel: 020 7405 1600 Fax: 020 7405 1601
E-mail: enquiries@technicalconnection.co.uk
www.techlink.co.uk

PENSION CONTRIBUTIONS MADE BY PROPERTY COMPANIES

One of the tax changes introduced by George Osborne was that which prevents an individual from fully offsetting mortgage interest against rental income on a buy-to-let property. In effect, the relief is being phased out over a period of four years. In 2018/19, 50% of mortgage interest can be set off. In 2020/21, no mortgage interest can be set off. Instead the taxpayer will be entitled to a basic rate tax credit for the interest that is not offset.

All of this means that those buy-to-let investors who are higher rate taxpayers (or are close to being higher rate taxpayers) will suffer and their net income from their buy-to-let business will reduce.

To deal with this issue more and more buy-to-let investors are considering the use of a company to hold a new buy-to-let property. The advantages of a company are:

(a) a lower rate of corporation tax on rental income (19% as opposed to a top rate of 40/45% income tax for an individual);

(b) the ability to fully offset mortgage interest in cases which involve borrowing to invest in the buy-to-let property.

The problem is that having used a company to purchase the buy-to-let property, how can the individual extract the rental income from the company for his or her own benefit?

Here the main approach would be to make a dividend payment from the company to the individual. In this respect, on the basis that the individual shareholder does not have other dividend income, a payment of up to £2,000 each tax year will be tax free because of the dividend tax allowance (DTA). Amounts over and above the DTA will be taxed at the individual's marginal rate(s) of income tax on dividend payments – 7.5% (basic rate taxpayer), 32.5% (higher rate taxpayer), 38.1% (additional rate taxpayer).

Indeed, for a shareholder who is a higher (or additional) rate taxpayer, the taking of a dividend payment could be highly tax inefficient because the rental income would be taxed twice – once at the corporation tax rate and again as dividend income at 32.5%/38.1%. Because the corporation tax paid is not taken into account in calculating the personal income tax this can result in an overall rate of tax of nearly 50%.

Where other family members are shareholders/directors of the company, dividend payments may be an attractive way of using the DTA.

Because the shareholder is also a director of the company, the question arises as to whether the company can make pension contributions for the director. As we know contributions to registered pension plans are very tax efficient.

The general rule is that (subject to the annual allowance) pension contributions can be made personally up to the level of their relevant UK earnings or £3,600 per annum if less. On the other hand, (and apart from the annual allowance) there is no such restriction with regard to employer contributions for an employee. But that is the position for trading companies.

On the basis that a property company is unlikely to include any element of trade it is likely to be viewed as an investment company and so contributions by such companies will need to be made in respect of that company's investment business to be relieved as an expense of management (section 1219 of CTA 2009).

The payment of a contribution to a registered pension scheme is generally part of the costs of employing staff – effectively as part of their remuneration package, (and therefore an expense of management). It will be rare in the context of pension contributions to have to consider whether there is a non-business purpose for the employer's decision to make the contribution since a pension payment by an employer will normally be made for the purpose of managing the investment.

Whether the expenditure relates to the investment business will be a question of fact, but in most cases it is thought that HMRC will accept that the contributions will be made in respect of the company's investment business.

The question, therefore, is how much will be permitted as an expense of management? Provided the payment is not excessive then it is thought that it would be permitted as a management expense.

Excessive in this context is likely to be tested against the amount that the company would pay as a pension contribution for a director who is not a shareholder and carried out the same level of duties for the company.

At the end of the day, it will be the company's accountant, and possibly HMRC, who will determine what is an acceptable figure as a pension contribution. It is thought that payments of up to £3,600 per annum should be acceptable.

IHT INVESTIGATIONS ROSE BY 300 IN 2017/18

UHY Hacker Young has published the latest HMRC data on investigations into IHT returns.

In 2017/18, HMRC launched 5,400 investigations into IHT returns against 5,100 in 2016/17. The 5% increase matches the rise in the number of estates liable to IHT to 24,500. Do the maths and HMRC is investigating almost 25% of estate returns.

The accountants reckon that the main area attracting HMRC's attention is the value placed on residential property which is transferred directly to heirs. There is no sale price to work from in such circumstances, which raises the possibility (or temptation) of an underestimation of value. Through the District Valuer, HMRC may also have access to more detailed information than was available to the executors at the time the IHT paperwork was completed. The latest statistics from HMRC (for 2015/16) show that "UK residential buildings" accounted for 49% of gross estate value across all estates subject to IHT, with the proportion reducing as estate size increases.

UHY Hacker Young highlight two other areas which draw HMRC attention:

- Claims for agricultural and business reliefs; and
- Omissions – deliberate or otherwise.

COMMENT

The level of investigations is a reminder that HMRC sees IHT as an area where scrutiny is most rewarding. Penalties of up to 100% of the tax at stake add to HMRC's incentive. It will be interesting to see if the forthcoming Office of Tax Simplification review of IHT simplification makes any comments on this aspect of tax administration.

STATE PENSION AND CHILD BENEFIT

In 2010, the Government announced that it would remove child benefit for high income households. In the Government's view such a household would be one where one of the partners has income of more than £50,000 and this is reflected in the legislation.

Child benefit is currently worth £1,076 per year for the first child and £712 for each subsequent child.

Where annual income of one of the claimants exceeds £50,000 there is a tax charge equal to 1% of the amount of child benefit for each £100 of income between £50,000 and £60,000. Child benefit is therefore tapered away until, when income hits £60,000, it is lost completely.

This has led to many partners who stay at home and don't work not bothering to register for child benefit. After all, what is the point of claiming a benefit that has to all be subsequently paid back because the other partner has income of more than £60,000?

For those parents who officially opt out of receiving child benefit but still register, they can still continue to receive a credit towards their State pension entitlement. However, for those who simply do not claim child benefit this may cause them to lose entitlement to part of their State pension.

Such people should, if they are responsible for a child under age 12, still fill in the claim form and tick the opt-out box to make sure they get their National Insurance credits which will count towards their State pension entitlement. These credits are particularly vital for stay-at-home parents who are unlikely to be contributing to any other type of pension.

COMMENT

Clearly this is a bit of a trap for couples where one stays at home and looks after the children and the other is out at work with an annual income of more than £60,000. The "at-home" parent should still register for child benefit – even though none will be paid.

PROBLEMS WITH THE JOINT OWNERSHIP OF PROPERTY

In this article we take a look at a couple of recent legal cases which illustrate problems where property is owned jointly and where ownership is not adequately dealt with when circumstances change.

The first case is the Court of Appeal decision in *Wall v Munday* [2018] EWHC 879 (Ch). Christine Munday and Bryan Wall married in 1969. They purchased a house in 1972 and divorced in 1974. The property was bought as joint tenants. Christine moved out of the property in 1973 and never returned. During the divorce there were some discussions in relation to the house but no settlement was reached and no formal steps taken to deal with its ownership. Bryan continued to live in the house which he treated as his own, insured it, maintained it and repaid the mortgage on it.

Bryan died in 2015. Following his death Christine filed a death certificate with the Land Registry so that the legal title to the property passed to her by survivorship in the usual way. But what about the beneficial ownership?

The executor of Bryan's estate claimed that there had in fact been an informal settlement whereby Christine had sold her interest to Bryan and so 100% beneficial ownership was with Bryan. The executor additionally claimed that the joint tenancy had been severed by mutual conduct and that there had been an agreement to change the beneficial ownership.

The Judge in the first instance found that there had been no agreement in relation to the property as part of the divorce proceedings. However, he did find that by mutual conduct between the parties the joint tenancy had been severed by the end of 1975. However, the Judge did not find that there was any intention to vary the ownership (i.e. 50% each) and therefore held that each party was entitled to one half of the beneficial interest in the property. The executor of the deceased appealed the decision arguing that he should have had 86% of the share of the property on the basis that the parties' conduct evidenced their intention to vary the beneficial interest, in particular because Bryan paid off all of the mortgage. The appeal was dismissed.

The second case is that of *Chapman v Ladwa* (2018) (Central London County Court, no law report) recently reported in the press. This case concerned a dispute over property between two women who had lived together for 16 years before they split in 2016. One of them, Ms Chapman, purchased the residence in 2007. This was in her sole name. However, she transferred it into joint ownership about a year later. After the split Ms Chapman claimed that the home was in fact her own and that she only put both their names on the deeds after being pestered by her partner (i.e.

claiming undue influence). It was clear that all of the expenditure on the house and their living expenses were funded by Ms Chapman, who was much the wealthier of the two, albeit that the purchase money came from a joint account. Nevertheless the Judge held that the ownership was equal, and the ex-partner was entitled to a half share of the house. Ms Chapman also claimed the return of some very expensive gifts, but the Judge also ordered against her.

COMMENT

The first case serves as a warning as to what can happen when property ownership is not sorted out by the time the owners die. In this case Bryan was solely responsible for the property for some 40 years, Christine did not contribute to it at all during that time and she still was found to have retained a 50% interest in the house. Had the ownership of the property been determined during the divorce proceedings the position might have been totally different.

The second case is another example of how important it is to fully consider the legal ownership of property. Once a property is legally owned by two people, it will be difficult (and no doubt costly) to argue that the actual ownership was on a different basis.

HMRC SALARY SACRIFICE GUIDANCE UPDATED

HMRC has updated its salary sacrifice guidance for advisers and employers.

The guidance also reminds us of the State benefits that may be affected by salary sacrifice which reduces National Insurance contributions below the threshold by reference to which certain State benefits are accrued, for example:

- State pension
- Statutory payments, such as statutory sick pay
- Earnings-related benefits, such as maternity allowance

Consideration should be given as to whether the definition of pensionable salary is based on the pre or post sacrificed amount as this will have an impact on the contributions being paid to a pension scheme.

It can be worth reviewing the wording of salary sacrifice arrangements to check that they are operating as expected and can cope with changes, such as a change in the level of sacrifice, without requiring an amendment to the member's employment contract.

EIS CGT RELIEF AND INCOME TAX RELIEF

In *R Ames v HMRC (2018) UK UT190* the Upper Tribunal found that CGT relief was not available on the disposal of EIS shares where no income tax relief had been claimed on their acquisition but granted judicial review of HMRC's decision not to allow a late claim for EIS income tax relief.

The circumstances of this case are somewhat unusual. While most investors in Enterprise Investment Schemes (EISs) do so primarily to obtain income tax relief on the investment into the scheme, in this case Mr Ames invested £50,000 in an EIS scheme in 2005, but he did not claim EIS income tax relief because his income was minimal so he had no income tax liability to reduce.

In June 2011 Mr Ames sold his shares for £333,200. He did not include any gain in his self-assessment because he understood that the gain was exempt from capital gains tax (CGT) under the EIS rules because he had held them for more than 3 years.

Following an enquiry, HMRC determined that Mr Ames was only entitled to the exemption from CGT if he had claimed EIS income tax relief on the acquisition of the shares even though he had no taxable income in the year in which the shares were issued. As he had not done so, he was liable for CGT on the gain. Accordingly, HMRC issued an assessment for a tax liability of over £72,000. Mr Ames appealed but the First-tier Tribunal (FTT) found against him.

Mr Ames also wanted to make a late claim for EIS income tax relief but, given that any claim for EIS income tax relief needs to be made not later than the 5th anniversary of the 31st January following the year of assessment, the crucial date for him was 31 January 2011. In fact Mr Ames made his claim in October 2012.

Generally speaking, HMRC has discretion to allow a late claim if a taxpayer has a reasonable excuse for failing to make the claim before the statutory deadline. In this case, however, HMRC did not accept that Mr Ames had a reasonable excuse and so refused to accept the late claim.

Mr Ames then took his case to the Upper Tribunal. The Upper Tribunal (UT) upheld the FTT decision that CGT relief on disposal of EIS shares will not apply unless there had been an income tax relief claim when the investment was first made. However, the UT heard that the decision-making process by HMRC as a result of which it declined to allow a late claim for income tax relief was flawed. HMRC did not properly apply the guidance on when and how it should exercise its discretion. The Guidance Note, SACM10040, specifically states that there may be exceptional cases which are not covered by specific guidance relating to particular claims or elections where it may still be unreasonable for HMRC to refuse a late claim or election.

In Mr Ames' case the exceptional circumstances included the fact that he had almost no income in the relevant tax year and therefore claiming relief would result in no income tax relief being in fact obtained. It would be a pure formality in order to preserve his entitlement in principle in the future to CGT exemption.

The UT accepted that it was perfectly reasonable and understandable for Mr Ames to believe that, given his very small income, he did not have to make a claim for relief. There is in fact no guidance dealing specifically with such unusual circumstances.

The UT accepted that the legislation has created an anomaly for investors with taxable income of less than the personal allowance. In such circumstances the argument presented by HMRC that misunderstanding of legislation or guidance does not justify that a late claim was considered to be too inflexible and too much of a mechanical approach. For this reason, the Upper Tribunal quashed HMRC's decision from 2015 and remitted it back to HMRC for reconsideration.

Clearly, Mr Ames was not a typical EIS investor, namely someone with relatively high income on which relief against income tax is sought in the first place. But this is not the first case where the highly technical EIS rules have come under scrutiny.

The case illustrates how important it is for the investor to be familiar with all the rules relevant to EIS investments before committing themselves.

HMRC'S TOOL FOR CHECKING EMPLOYMENT STATUS – HOW WELL IS IT WORKING?

HMRC has published information about how its 'Check Employment Status for Tax' tool has performed against the results of recent IR 35 tax cases. What does this mean for the expected placing of the onus of IR35 decisions onto private sector businesses?

The placing of the onus of IR35 decisions onto private sector businesses could have a wide-reaching effect for clients. If this becomes law, where a business decides that IR35 applies to a worker, the business, agency or other third party who is responsible for paying the worker's intermediary will have to deduct tax and Class 1 National Insurance contributions and pay and report them to HMRC.

A key element of this reform will be HMRC's Check Employment Status for Tax (CEST) tool. Currently, HMRC advises public sector bodies to use its CEST tool to reach a conclusion on the IR35 status of the worker, and it says that it will stand by the tool's results provided, of course, that those results are based on accurate information having been entered in the first place.

The CEST digital service has been tested against live and settled tax cases and HMRC has now published its comments in relation to a list of 24 of these cases.

In the cases listed, HMRC says that the CEST outcome reflects its view of the employment status determined by the facts of the individual case. In two of the 24 cases, CEST returned a different decision from the First-tier Tribunal, which HMRC did not appeal.

In these two specific cases, HMRC points out that the judgment in Castle Construction (Chesterfield) Ltd acknowledged that the case was finely balanced and that in the case of Novasoft Ltd commentators expressed surprise at the result. HMRC says it would expect to contest similar cases in future, and that the CEST results reflect that position.

HMRC is clearly confident that the CEST tool will be fit for purpose and able to support the private sector in applying IR35 tests to determine the status of workers.

However, HMRC's published list doesn't reveal any detail of the output from its testing of the tool, nor any of the inputs made to arrive at those decisions. It only shows the end determination. So, it's not clear what detailed test data or evidence HMRC has to show CEST's accuracy.

According to figures provided in the May 2018 IR35 consultation, the CEST service has been used over 750,000 times in the public sector and it gave a clear answer as to whether a user is employed or self-employed in 85% of circumstances. The remainder (potentially more than 112,500 circumstances) would have had to rely on published guidance or HMRC's specialist employment status helpline. That's quite a large number of people for whom the tool didn't supply an answer at all, even before considering how many of the 85% answers were accurate.

HMRC's CEST tool has also been somewhat maligned by professional bodies.

In a letter to the Financial Secretary to the Treasury, the Institute of Chartered Accountants in England & Wales (ICAEW) stated that CEST:

'is not suitable for use in the private sector. HMRC has stated that CEST does not cover all scenarios, including the mutuality of obligations master and servant test, and that the tool was designed based on public sector contracts. Further, there are also no rights of appeal for individual Workers who disagree with the CEST status decision.'

Nevertheless, this latest plug from HMRC about the success of its CEST tool seems to suggest it has every intention of pressing ahead with IR35 reform in the private sector.

PROPOSED LAW CHANGE FOR MIXED-SEX COUPLES

Theresa May has announced that all couples in England and Wales will be able to choose to have a civil partnership rather than get married.

The proposed change comes after the Supreme Court, in June, ruled in favour of a mixed-sex couple, who wanted to be allowed to have a civil partnership. The couple said the "legacy of marriage... treated women as property for centuries" and was not an option for them and feel that this was a "major step" forward.

The couple campaigned for four years to get the law changed. This resulted in more than 130,000 people signing an online petition in support of civil partnerships for everyone.

Others have taken to social media to welcome the news and even taken the extra step of proposing a civil partnership to their partner.

COMMENT

Same-sex civil partnerships became law in 2004, and same-sex partners have been allowed to enter into marriage since 2014 so, by changing the law to enable mixed–sex couples to also be able to enter into a civil partnership, addresses the 'imbalance' that allowed same-sex couples to choose, but not mixed-sex couples. At present, though, there is no set date as to when the change will become law as the Government will first consult on the technical detail.

In addition, the Scottish Government is also carrying out a consultation on allowing mixed-sex couples to enter into civil partnerships. However, their consultation also sets out an alternative option for the closure of civil partnerships to new relationships from a specified date in the future.

INCOME WITHDRAWAL RATE FOR OCTOBER 2018

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 2018 is 1.75%.