client briefing

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Bird Simpson

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Real Time Information is on its way

Most employers will have to move over to the new system of reporting PAYE by April 2013 – and all employers will be on the new system by October next year. But very many employers are unaware of this deadline and have not started to make preparations.

The new HMRC system is called Real Time Information (RTI), and the low level of employer engagement is causing concern about its implementation.

Under RTI, employers and pension providers will have to tell HMRC about PAYE payments every time they make them, and when they make them. Payroll software will collect the information and send it to HMRC online, generally in the form of a 'full payment submission' (FPS), through the Government Gateway or Electronic Data Interchange. Employers will therefore no longer have to complete the P35 end of year return. RTI just affects reporting and the PAYE payments themselves will not change.

The reason for the tight deadline is that RTI is necessary for the introduction of the Universal Credit, which will replace current payments to job seekers and low-income earners.

RTI will therefore provide HMRC with up-to-date information about claimants' employment income so that the Department for Work and Pensions can calculate benefit payments without claimants having to supply information. RTI is also intended to simplify the operation of PAYE and make it more accurate, reducing the need for recalculations after the end of the year.

As well as providing HMRC with information about payments, the first time employers make an FPS, they will have to detail each employee's normal hours worked. Employers who do not pay any employees in a particular tax month, or only want to recover statutory payments and certain other sums, will have to send an employer payment summary (EPS). RTI will be enforced by new late filing and late payment penalties, and regulations to introduce these will be published later this year.

Most employers will have to move to RTI in April 2013, but all employers will be switched over by October 2013. Ten employers took part in HMRC's April 2012 pilot scheme, including HMRC itself, and around 1,600 more joined in the following three months. In July, HMRC said the pilot was going well and was on track for all small employers and most large employers and payroll bureaux to join RTI in April 2013.

Employers running their own payroll will have to update their software to allow RTI reporting. The Business Application Software Developers Association has said that the industry is trying to meet the timetable, but HMRC had not clarified all the specifications as at July 2012. The smallest employers – those with nine or fewer employees – can use HMRC's free Basic PAYE Tools software, which will support RTI.

Although employers will no longer have to make end of year PAYE returns, they will still have to give employees a form P60 and report expenses and benefits in kind on form P11D as at present.

Finally, RTI will enable HMRC to issue PAYE penalty notices for late monthly payments as soon as employers incur a penalty. This may be good news for employers. At present, HMRC issues notices only after the end of the year when several months' of penalties have accumulated and it is therefore too late for employers to correct any errors.

Caught in the IR35 tax net?

HMRC has published guidance setting out various business entity tests aimed at helping taxpayers decide if they are at risk of being subject to IR35. The tests build up a picture of how a business works based on a points-scoring system:

- Do you have business premises that are separate from your home and from your client's premises? *Yes = 10 points*
- Do you need professional indemnity insurance? *Yes = 2 points*
- Has your business had the opportunity in the previous 24 months to increase business income by working more efficiently? *Yes = 10 points*
- Does your business engage workers who bring in at least 25% of your annual turnover? *Yes = 35 points*
- Has your business spent over £1,200 on advertising during the previous year? *Yes = 2 points*

- Has your current client employed you as an employee subject to PAYE during the 12 months ending on the previous 31 March with no significant changes to the working arrangements? *Yes = deduct 15 points*
- Does your business have both a regularly updated business plan and a separate business bank account? *Yes to both = 1 point*
- Does your business have to bear the cost of having to put right any mistakes? *Yes = 4 points*
- Has your business been unable to recover payment for work done during the previous 24 months amounting to more than 10% of your annual turnover? *Yes = 10 points*
- Do you invoice for work carried out before being paid and also negotiate payment terms? *Yes = 2 points*
- Do you have the right to send a substitute in your place? *Yes = 2 points*
- Have you actually hired anyone in the previous 24 months to work in your place? *Yes = 20 points*

A score of less than 10 indicates high risk, while medium risk is 10 to 20 and there is a real chance that HMRC will check whether IR35 applies. A score above 20 is considered low risk, and if this is your score you should gather supporting evidence for each test in your favour. There are indications that HMRC will increase the number of IR35 compliance checks, and it has already started sending out letters to contractors.

Tax credit changes set to shock

Many couples, especially those on higher incomes, no longer qualify for tax credits from 6 April 2012.

Although some tax credit elements have increased, the income thresholds have not been increased in line with inflation and this means that even lower-income couples do not gain in real terms.

Rate increase

The child element has been increased in line with the consumer prices index, but the main working tax credit rates and relief for childcare are unchanged, with the exception of the disabled worker tax credit rates.

Income thresholds

The £40,000 family element second income threshold has been removed, and the family element is now withdrawn along with other elements. For 2011/12, a couple earning £39,000 with one child, not paying childcare, would have received the full family element of £545. This year they are not entitled to anything. The other income thresholds are unchanged, more than cancelling out the benefit of the child element increase.

Disregard for income fall

A fall in income of less than £2,500 is now ignored. For example, if income last year was £22,000 and forecast income for 2012/13 is £20,000, entitlement is still based on £22,000. The reduction will not be taken into account until 2013/14. Also, the first £2,500 of any larger fall is disregarded. Although a fall under £2,500 has no immediate impact, it should still be reported promptly to HMRC to avoid an underpayment at the start of 2013/14.

Backdating

It was possible to backdate a claim by up to three months, but the time limit is now just one month. This limit applies when making an initial claim, or notifying HMRC of a change of circumstances that increases an award – such as the birth of a child or paying extra childcare costs. Even though a couple's income may initially be too high to qualify for tax credits, it might be wise to make a protective claim, for example, in case of an unexpected redundancy.


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Other changes

With some exceptions, a couple with children now needs to work a joint 24 hours a week to qualify for working tax credit. The minimum was previously 16 hours. The additional payment is no longer available for people aged 50 or over who return to work.

Most of these changes were announced in the first Coalition Budget in 2010. The only outstanding point is that the disregard for increases in income will fall from £10,000 to £5,000, and this will happen next year. If you are concerned that these changes will affect you, please contact us as soon as possible.

The rewards of philanthropy

Taxpayers can cut their tax bill even further by passing some of their wealth to charities or to the nation, as a result of two new provisions introduced by the Government.

The rate of inheritance tax (IHT) charged on an estate can now be reduced to 36% from the normal 40% where a person leaves at least 10% of their 'net estate' to a qualifying charity. The new rule applies to deaths after 5 April 2012. The net estate is the total assets after deducting IHT exemptions, reliefs and the nil-rate band of £325,000. The reduced rate of IHT will apply automatically if the 10% test is satisfied. However, personal representatives can elect for the reduced rate not to apply if the benefit is minimal.

It is important to take care where an estate consists of more than one 'component'. This is because the 10% rule applies separately to each one. The three possible components are:

- Assets owned jointly.
- Assets in trust.
- Assets owned outright or as tenants in common.

So one component of the estate could be subject to IHT at 36%, while another might be subject to the 40% rate.

The other new tax relief is for gifts of 'pre-eminent' objects to the nation. Land and buildings do not count as objects for this purpose. An object will be considered to be 'pre-eminent' if it is of particular historical, artistic, scientific or local significance or it is associated with a building in public ownership, which would include a National Trust property. Objects can be loaned or given to institutions such as charities, museums and galleries for safe keeping and to provide public access. In return donors will receive a reduction in their UK tax liabilities based on a percentage of the value of the object.

Experts will consider the offer and, if they determine that the object should be accepted, they will agree the value of the object with the donor. The donor will then receive a tax reduction based on the valuation if they decide to go ahead.

The tax reduction for individuals could be income tax and/or capital gains tax, and for companies it will be corporation tax at a fixed percentage of the object's agreed value, which will be 30% for individuals and 20% for companies. Individuals will be able to spread the tax reduction forward across a period of up to five years.

Avoiding tax avoidance confusion

Tax avoidance can be an emotive subject, as was apparent from media coverage of the revelation that some celebrities used schemes of varying degrees of artificiality to reduce their income tax.

Now, amid discussion of the morality of different ways of reducing tax liabilities, the Government has responded with a consultation on new proposals to tackle some aspects of tax avoidance.

One concern is that taxpayers can often not tell the difference between legitimate tax planning and contrived avoidance, according to David Gauke, the Treasury Minister responsible for tax. In fact it would be surprising if they could, because even the courts find it hard to rule in some cases.

Proposed changes

However, the Government is looking at ways to improve the information available to the public, with proposals to publish warnings and make people aware of tax advisers whose schemes have previously been successfully challenged.

Mr Gauke highlighted organisations he called 'cowboy tax advisers'. Some of their practices include: changing names frequently to avoid detection; setting up 'fighting funds' in their fees; and failing to comply with HMRC's disclosure rules.

The Disclosure of Tax Avoidance Schemes

Also under consultation is the strengthening of the Disclosure of Tax Avoidance Schemes (DOTAS) regime. The information provided is often not enough for HMRC to decide whether a scheme works or can be legally challenged, or whether new legislation might be needed to tackle it. The Government also wants greater publicity about those taxpayers who themselves use avoidance schemes.

The Government hopes that these measures will persuade taxpayers not to risk losing money by entering into an avoidance scheme that fails or of being 'named and shamed', and that this will also deter advisers.

The General Anti-Abuse Rule

In a separate move, the Government is consulting on the terms of a General Anti-Abuse Rule (GAAR). The word 'abuse' has replaced 'avoidance', an indication that the legislation should not hit legitimate tax planning. However, there is still uncertainty surrounding the criteria for deciding whether or not a scheme is abusive.

One part of the definition is that a transaction is not 'a reasonable course of action' although several other features need also to be present, such as a significantly reduced profit or greater tax deduction than justified by the economic amount.

If you have any questions about your tax planning, please contact us.

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Employment law update

A controversial proposal to allow compensated no-fault dismissals appears to have been shelved, because it received only limited support from business.

As an alternative, the Government has published details of a fast-track settlement scheme where employees can be asked to walk away by mutual agreement and, in return for their co-operation, receive a payout and possibly a reference – but they would forfeit their right to make any future claims against the employer.

Employee qualifying periods change

From 6 April 2012 the qualifying period for which employees must have been employed before they can claim unfair dismissal has increased from one to two years. However, this change only applies to employees taken on from 6 April this year. Despite the change, employers should be cautious when dismissing new employees because there is no qualifying period for an unfair dismissal claim based on, for example, discrimination or whistle blowing.

Compulsory retirement and age discrimination

The outcome of a recent age discrimination case heard by the Supreme Court was that, despite the abolition of the default retirement age, employers can still set the age at which employees retire – provided there is strong justification for doing so. The

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case concerned a partner in a law firm who was asked to leave at the firm's normal retirement age of 65, as per the partnership agreement. Although the case involved partners, the Court's decision applies to employees too.

The partnership successfully argued that a compulsory retirement age gave younger associates the opportunity to obtain partnership within a reasonable timeframe, and meant that it could plan recruitment and promotion knowing when vacancies would occur. It also limited the need to expel underperforming partners. The Court found that the justification has to be legitimate in the particular circumstances of the employment.

National minimum wage increase

Finally, advance warning that new rates of national minimum wage (NMW) will apply from 1 October. For workers over the age of 20, the NMW rate goes up to £6.19 an hour, and for apprentices it will rise to £2.65; the other pay rates are unchanged.

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