NEWS UPDATE - 10 JUNE 2021

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IHT business relief for holiday lets

There are various tax advantages to a rental property being treated as a furnished holiday letting, but inheritance tax (IHT) business relief is generally not one of them. Even though the law supports HMRC's view, property owners regularly appeal against their refusal to give relief.

The tax advantages

The most immediate benefit is full tax relief for finance costs. For normal rentals, relief is restricted to the basic rate, so a higher-rate taxpayer with a £250,000 mortgage at an interest rate of 2.5% will receive extra tax relief of £1,250 annually.

When it comes to disposing of a property, business asset disposal relief and holdover relief will be available.

Business relief

Some £225,000 in IHT was at stake in the recent appeal by the executors appointed by Sheriff Graham Loudon Cox against business relief being denied. Although the late taxpayer worked hard to ensure guests enjoyed their stay in his three furnished holiday flats, the First Tier Tribunal dismissed the appeal, finding that there was nothing exceptional about the business to elevate it beyond being one of mainly investment.

And that is the essential problem. The level of additional services provided must be sufficient that the activity is considered as non-nvestment. This needs to be more than just:

- cleaning;
- providing heating and hot water;
- a welcome pack; and
- being on call to deal with queries and emergencies.

These are considered as simply incidental or ancillary activities. The extra services which would have helped the appeal, such as dog-sitting, childminding, transport, breakfast and supper, were not provided to guests with sufficient regularity. Owners of holiday lets could consider making use of the CGT reliefs by gifting furnished holiday property to the intended beneficiaries during their lifetime. The property then drops out of charge to IHT after seven years.

Details about the reliefs available for furnished holiday lettings, and the qualifying conditions, can be found from the link below:

https://www.gov.uk/government/publications/furnished-holiday-lettings-hs253-self-assessment-helpsheet

Umbrella companies - sorting the good from the bad

Contractors have turned to umbrella companies as a hassle-free way of providing their services to clients following the recent changes to the off payroll working rules. They receive no tax savings, but pass on some administration and pay less than a standalone limited company would charge. However, not all umbrella companies are equal.

The main advantage to using an umbrella company is that the off payroll working rules will not apply. All of your earnings become subject to PAYE in the hands of the umbrella company. HMRC has published a useful guide explaining how and what you will be paid when working through an umbrella company (www.gov.uk/guidance/working-through-an-umbrella-company).

Employment

You, as the contractor, will be an employee of the umbrella company, and the umbrella company will therefore pay you for the work carried out for clients, whether contracted directly, or via an employment agency. Gross pay is calculated after various costs, such as:

- the umbrella company's administration costs;
- employer NICs;
- workplace pension contributions; and
- holiday pay.

As an employee, you are entitled to 5.6 weeks of paid holiday pay a year, and the umbrella company must pay you for this if you leave with holiday entitlement accrued.

However, holiday pay must normally be taken in the year it is accrued and cannot be carried forward. This is one area where an unscrupulous umbrella company can cost you, with some simply pocketing pay for unclaimed holidays.

Tax avoidance

Most umbrella companies are compliant with tax rules, but some use tax avoidance schemes. Be wary of an umbrella company that:

- Claims they can help you keep more of your earnings than others; or
- Asks you to sign an annuity, loan or other agreement involving a non-taxable element of pay, especially if this involves a different organisation to the umbrella company.

Moreover, avoidance schemes may come with a high, non-refundable, fee.

HMRC has published guidance to identifying schemes that wrongly claim to increase take-home pay here - https://www.gov.uk/guidance/tax-avoidance-schemes-aimed-at-contractors-and-agency-workers

Unhappy families - challenging inheritance issues

The outcome of a recent High Court case is a warning for anyone challenging a will. As inheritances become more valuable, the number of disputes about wills have increased.

Court cases rose by almost 50% to 188 in 2019 compared to the previous year according to the latest Ministry of Justice figures. Many more are settled or abandoned along the way. The cases which do reach the High Court tend to be those involving the 'right' mix of large sums and elevated emotions. An example that appeared in April 2021 is *Miles v Shearer.*

Tony Shearer died in October 2017, leaving nearly all of an estate worth about £2.2 million to his second wife, Pamela. His two daughters, Juliet and Lauretta, born in the early 1980s to his first wife, received nothing. This prompted them to make a claim under the Inheritance (Provision for Family and Dependants) Act 1975.

Lauretta wanted a payment from her father's estate to cover:

- The cost of a home, so that she could move out of her mother's property;
- Fees for training as a dog behaviourist, to enable her to support herself; and
- The expenses of caring for her autistic daughter.

Juliet sought funds to:

- Reduce her mortgage by about £245,000, so that it would become affordable for her on a repayment basis: and
- Buy out her ex-husband's share of a flat in which she was living – about another £100,000.

In 2008, shortly after his divorce, Tony gave £177,000 to Juliet and £185,000 to Lauretta. At the time he made clear there would be no further financial support to his daughters. This was an important factor in the case as it reinforced the decisions Tony made in the creation of his will.

The judge rejected the claims of both daughters, stating that neither had established a need for maintenance to be funded from their father's estate. Two lessons can be drawn from the case:

- Make your intentions clear in advance to try to reduce potential disappointment and the likelihood of legal action when a will is finally read.
- Tony's will achieved what he wanted to happen. Had he left matters to English intestacy laws, Pamela would have received only £125,000 and personal chattels outright, with Juliet and Lauretta immediately jointly receiving half the residue (less about £285,000 of inheritance tax).

The future of capital gains tax takes shape

A recently released report on capital gains tax (CGT) by the Office of Tax Simplification (OTS) has made several recommendations on the future of a tax, about which it says many people have limited awareness or understanding. The 30-day reporting and payment deadline for residential property disposals comes in for particular criticism.

Although around half a million people need to report disposals each tax year, the majority will only be affected on a one-off basis. Reporting may be via self-assessment, 30-day reporting or the real time CGT service, so the OTS has suggested integration into a single customer account.

Residential property

The OTS considers 30 days to be a challenging requirement and has therefore recommended the reporting deadline is increased to 60 days. An alternative proposal suggests estate agents and conveyancers could be more involved.

However, HMRC may well resist extending the deadline given that over £1.3 million was raised in late filing penalties for the last six months of 2020.

Private residence relief nominations

The OTS found a lack of awareness of the nomination procedure for second homes, and recommends:

- A review of the practical operation of nominations;
- Raising the level of awareness of how the rules operate; and
- Using a new, single customer account for nominations.

Some 1.5 to 2 million homeowners are estimated to benefit from private residence relief annually, although a common misunderstanding is to assume all private homes are exempt.

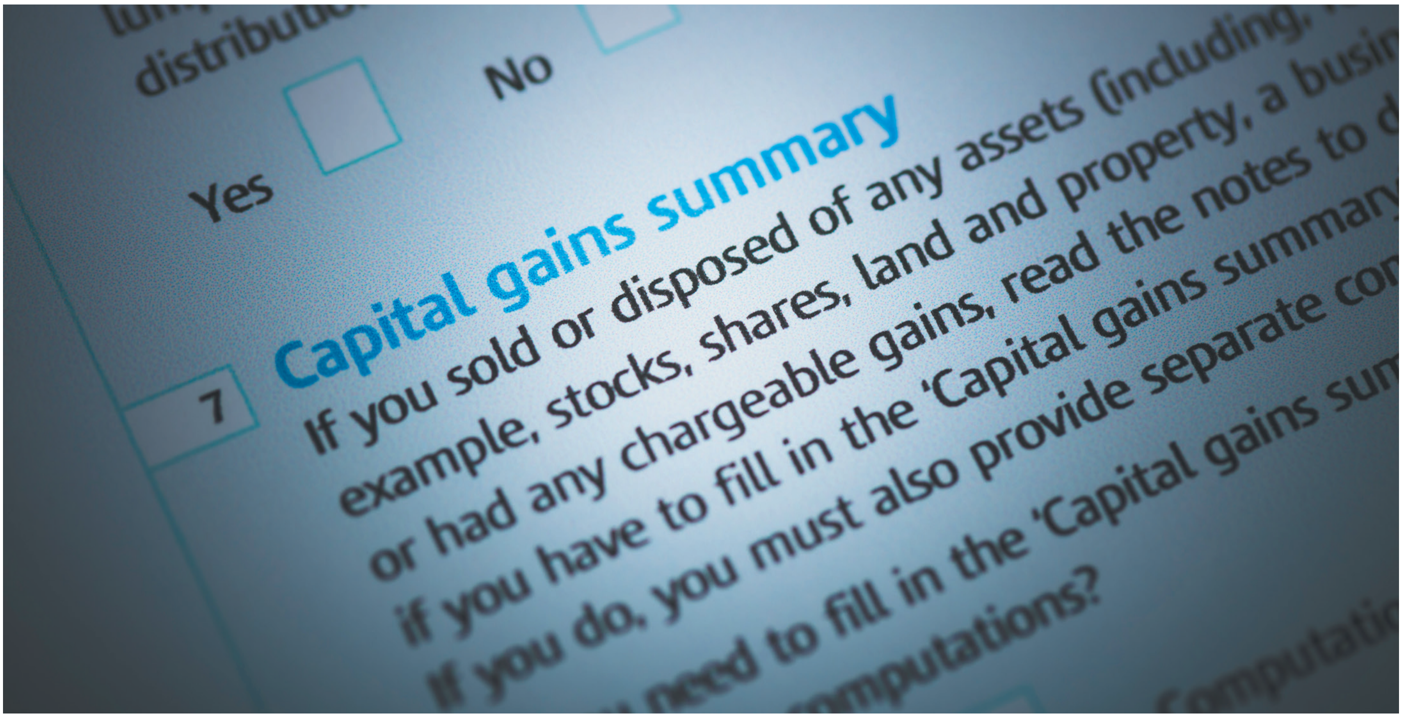
Divorce and separation

Divorced and separated couples do not incur any CGT on transfers between themselves for the tax year of separation, but very few are able to come to an agreement and transfer assets during this timeframe unless separation occurs near the start of the year.

The OTS therefore suggests relief be extended until the later of:

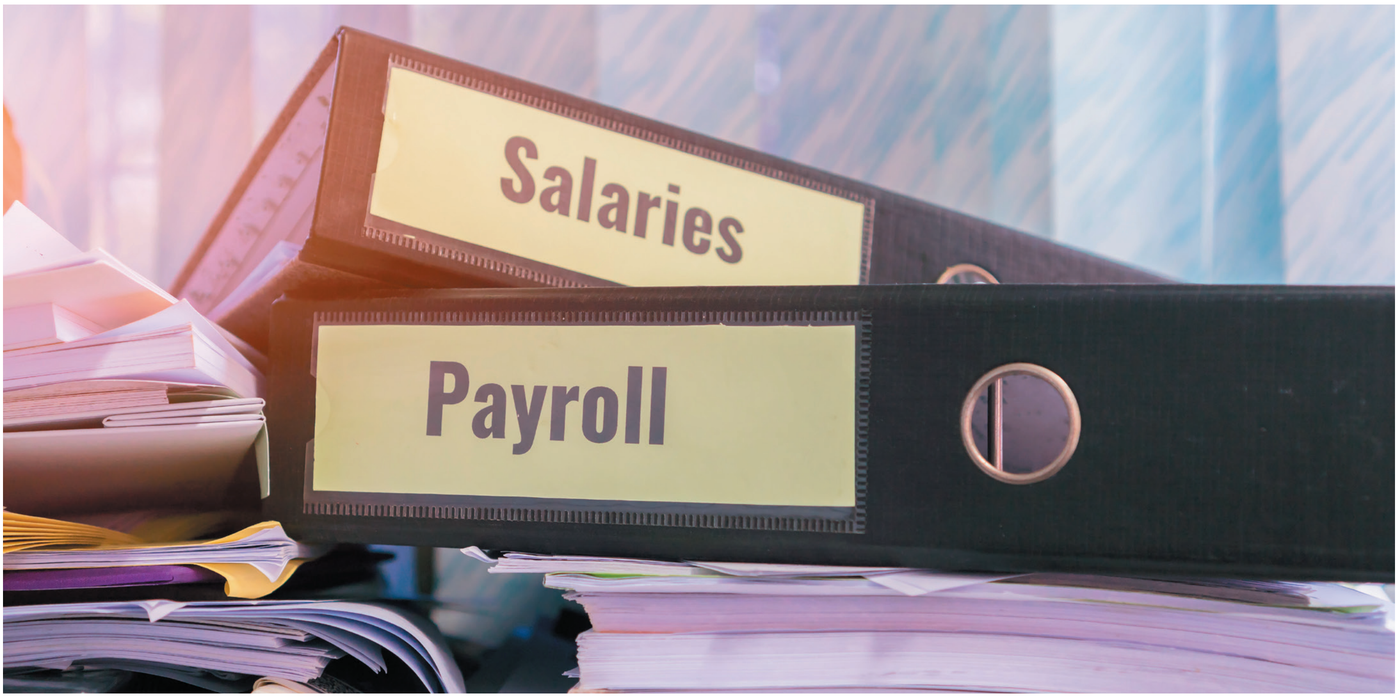
- At least two years after separation, and
- Any reasonable time set for the transfer of assets in accordance with a financial agreement.

Whether the government takes on board any of these suggestions may be unveiled in the anticipated autumn Budget.



Focus on national insurance contributions

New government proposals target the promoters of national insurance contribution (NIC) avoidance schemes, while plans are in place to introduce a zero rate of employer contributions in Freeports. Both measures are included in the National Insurance Contributions Bill 2021.



Crackdown on avoidance

NIC avoidance is already within the scope of the Disclosure of Tax Avoidance Schemes (DOTAS) regime, but these measures will strengthen HMRC's ability to clamp down on the market for NIC avoidance. HMRC will be able to act quickly and decisively where promoters fail to provide information on their NIC avoidance schemes.

One area which has received considerable publicity is the use of mini-umbrella companies, where a temporary workforce is split into hundreds of small, limited companies. Each company benefits from the £4,000 employment allowance, avoiding the annual employer NICs on this amount.

HMRC is on the lookout for particular actions. The new measures target promoters that:

- Respond by restructuring their business when challenged by HMRC;
- Engage in protracted circular correspondence; or
- imply deny they are a promoter even with clear evidence.

Freeport employees

From 6 April 2022, employers with business premises in a Freeport tax site will be able to benefit from a zero rate of employer NICs (visit www.britishports.org.uk/Freeports to find out more about Freeports). Eligible employees will be those who spend at least 60% of their working time at the site. However, only new hires will qualify, and then only on annual earnings up to £25,000. Relief will apply for 36 months per employee. At current rates, a Freeport employer will save a potential £6,690 in NICs per employee over 36 months.

Relief is available until at least 5 April 2026, although it might run for a further five years. Regardless of whether relief is extended, new hires employed by 5 April 2026 will qualify for 36 months of relief.

Should you wish to discuss this News Update in further detail please contact BGM at: communications@bgm.co.uk

Disclaimer: This information provides an overview of the issues considered and is for general information only. It is not intended to provide advice and should not be relied upon in any specific transaction.