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Chartered Accountants

# Initial Payment of Inheritance Tax

Inheritance tax is once again in the political spotlight with the recent announcement by shadow chancellor George Osborne that the Conservatives, if elected, would raise the inheritance tax threshold to £1m. Whether this becomes a reality remains to be seen, but in the meantime HMRC have announced changes to the processes for making the initial payment of inheritance tax where payment is made by cheque. The new processes apply from 5 November 2007.

The new processes have been introduced as a result of HMRC moving advance IHT payments from Nottingham to Accounts Office, Shipley. This move has necessitated the need for bank-approved payslip. The new processes will also improve security as regards registering IHT processes before an account is delivered.

## IHT 200 and New IHT Reference

Where someone dies and it is expected that inheritance tax will be due, it is necessary to deliver a full account on the form 'IHT 200' to HMRC.

From 5 November 2007, an IHT reference number must be obtained before submitting IHT 200. The IHT reference number should be written in the top right-hand corner of the IHT 200. The new IHT reference is not needed if the IHT 200 is to be delivered before 5 November 2007.

HMRC recommend that the IHT reference is applied for as soon as possible, but in any event, at least three weeks before the expected delivery date of the IHT 200. It is necessary to apply for the form in writing, either online via the HMRC website or by post using form D21.

The online option will be available on the HMRC website from 22 October. The IHT reference can be requested by using the `do it online' link on the far side of the IHT home page (www.hmrc.gov.uk/cto/iht.htm). If the online option is used, an email acknowledgment will be sent confirming that HMRC have received the IHT reference request.

If the postal route is taken, form D21 is required. This can either be downloaded from the HMRC website or ordered by telephone from the forms orderline (0845 30 20 900; option1).

An IHT reference will then be allocated to the estate and HMRC will send details of the reference, together with a payslip and a pre-addressed envelope, by post. HMRC have stated that they will aim to respond to requests for an IHT reference within 5 days where the request is made on-line, and within 15 days where the request is made by post.

The new IHT reference is not required if there is no inheritance tax to pay, but the form IHT 200 is required. In this situation, the completed IHT 200 should be sent to HMRC in the normal way.

## Due Date for Payment of Inheritance Tax

Inheritance tax is due six months after the end of the month in which the person died. This means that if someone dies on 2 October 2007, any inheritance tax in respect of their estate is due on 30th April 2008. If the tax is not paid by that date, interest is charged on the unpaid tax.

However, it is not necessary to pay all the tax that is due in order to apply for a grant, although a minimum amount of tax must be paid. This is the tax that is due on assets included in section F of the IHT 200. This is inheritance tax on assets where the option to pay in instalments in not available and includes items such as cash, bank and building society accounts, premium bonds, quoted shares, dividends and interest, personal assets and household goods.

The inheritance tax due on items included within section G of the IHT 200 can be paid in instalments. The instalment payment option applies predominantly to land and buildings, business interests and assets, and certain shareholdings. The tax in respect of such assets may either be paid in a lump sum before the six month due date in order to avoid interest, or in ten instalments. Where payment is made by instalment, normally interest is payable on the tax that remains unpaid at the time each instalment falls due. However, where tax is paid by instalments in respect of some businesses, certain quoted shares or land that qualifies for agricultural relief, some interest relief may be available such that interest is only charged as each instalment becomes due.

It is important to note that if any of the assets on which tax is being paid by instalments is sold, HMRC should be notified. The instalment payment option comes to an end if the associated asset is sold and any remaining tax is due immediately.

## Payment Methods

Inheritance tax can be paid in various ways:

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- Cheque
- Electronic transfer
- Bank giro credit
- National Savings Investment owned by the deceased.

Each payment method is examined further below.

## Cheque

The processes governing the initial payment of inheritance tax by cheque are changing from 5 November 2007. From that date, a bank approved payslip carrying an IHT reference must be sent with the cheque. As noted above, the payslip is sent out together with the IHT reference and a pre-addressed envelope once the IHT reference has been requested either online or by post.

When making the payment by cheque, the payslip should be completed and put with the cheque (and nothing else) in the pre-addressed envelope sent out by the HMRC with the reference and payslip. The cheque should not be folded, nor should the cheque and payslip be stapled together.

Cheques should be made payable to `Her Majesty's Revenue & Customs'

The payment and the IHT 200 should not be sent together. The cheque and payment need to be sent to the HMRC cashiers at Nottingham, whereas the IHT and supporting papers should be sent to either Nottingham or Edinburgh, depending on where the application for probate or confirmation is to be made.

## Electronic Transfer

Payment of inheritance tax can also be made by electronic transfer using CHAPS or BACS payments. When making payments in this way, details should be given of the full name of the deceased, transferor or settlement, where appropriate, the date of death or settlement and the capital taxes reference number, if known.

## Bank Giro Credit

Inheritance tax can also be paid via bank giro credit. If this option is chosen, a pre-printed giro slip is required. This should be obtained from HMRC and can be requested by telephone (0115 974 2463).

## National Savings

It is also possible to pay some, or all of the tax and interest that is due prior to application for a grant by using National Savings owned by the deceased. However, where this route is taken, it can take up to four weeks for the payment to be processed.

## Transferring Assets to the Crown

Perhaps not an option for the average person, but all or part of an inheritance tax bill and associated interest can be settled by transferring national heritage property to the Crown. The rules are complicated and property cannot be accepted in lieu of payment of inheritance tax before a grant of representation can be taken out. Further details of meeting inheritance tax liabilities in the way can be obtained direct from HMRC.

# Tax Tips

Moving To New Premises? Make Sure You Tell HMRC Beforehand!
When we move premises, we remember to tell the telephone, gas and electricity about it. However, forgetting to tell HMRC could lead to a lot of unnecessary hassle.

Legally, a business is required to tell HMRC of a change of address within 30 days, so what can happen if it forgets or chooses not to do this? Here's what happened to one particular business we know of, which we'll call 'Lord Lucan Ltd' for the sake of anonymity.

Lord Lucan Ltd registered itself for VAT, and was quickly visited by a VAT Officer to check some of the registration details. After two months, it moved premises, and HMRC came out to see the business again, only to find it wasn't there. Not surprisingly, the VAT Officer quickly decided that he may be dealing with a bogus business; such is the high incidence of 'missing traders' in relation to 'carousel fraud'. He promptly deregistered the business on 'revenue protection' grounds.

It was more than a month before Lord Lucan Ltd found out what had happened, and even then it was only through one of its customers, who had contacted the business after checking its VAT number. Alas, Lord Lucan Ltd is still trying to sort the matter out and get its registration reinstated. It later transpired that the VAT Officer had compounded things with a mistake of his own. Lord Lucan Ltd had actually faxed the VAT Officer details of their new address a month before the move, and later confirmed it in writing too. However, he had taken no action.

**Tip.** If you change address, write to the VAT Registration Unit. Ring up after a couple of weeks to check they received your letter and are acting on it, or else you could find yourself in the same position as Lord Lucan Ltd!

**Worried you've been given a dodgy VAT number?**
It's possible to make several checks on whether a VAT registration number shown on an invoice is valid. The validity of the number is important because the purchaser cannot recover VAT incorrectly charged by an unregistered trader, unless HMRC allow them to do so by concession.

The first thing you can do is an online check at the **EC VIES website**. It can be found via the following link:
http://ec.europa.eu/taxation_customs/vies/vieshome.do?selectedLanguage=EN

However, this check will only tell you if it's a real number, not who owns it.

If you want to check ownership details too, you should contact HMRC's **National Advice Service** (0845 010 9000). The number, name and address details you have can be given to HMRC, who will then confirm whether the details they have match with yours. If different, they will not be able to divulge the details they have, but by that point, you will already know you have a problem!

If you don't want to contact HMRC, or don't have immediate access to the Internet in a given situation, you can do a manual check using the **'modulus 97 check'**, which works as follows:

- The first seven digits of the VAT registration number are listed vertically.
- Each digit is multiplied by a number, starting with 8 and decreasing to 2.
- The sum of the multiplications is calculated.
- 97 is then subtracted from the sum as many times as necessary to get to a negative number.
- The negative number is the same as the last 2 digits of the VAT registration number if valid.

**Example calculation**
VAT registration number **339 0727 47**

3 * 8 = 24
3 * 7 = 21
9 * 6 = 54
0 * 5 = 0
7 * 4 = 28
2 * 3 = 6
7 * 2 = 14
Total = 147

147 - 97 = 50 - 97 = - 47

As the negative number (- 47) is the same as the last two digits of the VAT number, the number is valid.

**Have you had a tax investigation?**
Did it result in no additions to your profits or additions on a technical basis to the year of investigation only, so there was no "fraudulent or negligent conduct"? If so, you can treat the professional fees incurred as an expense of your business - either for the year they were incurred if your business is continuing, or for the last year of trading if the business has ceased - see HMRC's Tax Bulletin No. 37 for details.

**Are all Professional Fees Allowable Expenses?**
If you are selling your business, some of the professional fees you pay will be allowable expense and some will not. Check carefully with your advisers to make sure that they allocate the fees they charge you correctly

**Do you run a high-tech business?**
Make sure you are claiming any "Research and Development Tax Credit Units" to which you are entitled. HMRC issued a Press Release on 1 November to celebrate payments of £150 million to such companies last year. Let's try to give them even more to be proud of next year.

## Final Thoughts

It is important that the correct processes are followed to ensure that payments are allocated to the account promptly, and that interest in not incurred unnecessarily.

Further details on the procedures governing the delivery of an inheritance tax account and the payment of the tax are available on the inheritance tax pages of the HMRC website (www.hmrc.gov.uk/cto/iht.htm).

# "Income Shifting" - HM Revenue and Customs' Brave New World

A consultation document and draft legislation was published in the first week of December, as HMRC's response to the taxpayer's victory in the summer in the Arctic Systems tax case.

In that case, the House of Lords had to decide if it was legitimate for a husband and wife to share the dividends from their family company equally, despite the fact that the income of the business was "earned" by the husband, an IT consultant.

The Lords came down on the side of the taxpayers, saying among other things that the way the legislation operated was "workable and fair", and pointing out the potential problems that would arise if HMRC's line of reasoning was followed. HMRC had contended that, by not taking a salary from the company at a market rate, the husband was enabling the company to pay larger dividends on its shares, and thus he was "shifting" income to his wife (who only paid tax at the basic rate). They wanted to tax him on this "shifted" income. The Lords made the point that a "market rate" of salary was a very subjective matter and could lead to endless arguments between HMRC and taxpayers.

At the time of the Lords' judgement, there were some spiteful comments from the Treasury saying that they would legislate to stop "income shifting", and now we have the result.

The draft legislation is scheduled for inclusion in the 2008 Finance Bill and will take effect from 6 April 2008. What it says is that:

- If you are able to "influence" how a company or a partnership distributes its profits, AND
- You use your influence in such a way that income passes to anyone to whom it would not have passed if you were dealing with them "at arms length" , AND
- As a result, less tax is paid, THEN
- You're nicked!

You must declare the "shifted" income on your tax return, and the person to whom it was "shifted" must not declare it on theirs.

If this law is passed, chaos will ensue. Just think of the problems:

- One way to "shift" income, as set out in the consultation document, is to pay yourself less than a "market rate" of salary, as described in the Arctic Systems case above. But what is a "market rate"? My practice is based in Cornwall and Devon where average earnings are significantly lower than in other parts of the country, so will a "market rate" there be lower than in London? What about some of my clients who have their company's registered office in Cornwall, but mostly work in London - which rate do they have to pay themselves?

- What about confidentiality? Say I deal with a company but other accountants deal with some of the directors. In order to know if less tax has been paid as a result of the company's policy on salaries and dividends (one of the conditions for the law to bite), I need to know what the directors' other income for the year is, and if they use a different firm of accountants, that is none of my business - and if I ask the question, by implication I am disclosing the income of the directors I do deal with (because if they were not paying tax at 40% the "shifting" would not matter).

- What does "influence" mean? It is a new word in tax law and as such will need to be defined by court decisions before we get any certainty. I can think of one client, a company, where the parents no longer own any shares personally but their children (the shareholders) do exactly what Mum and Dad tell them. Do Mum and Dad "influence" the company's policy?

This is another example of "guess what I'm thinking" legislation (the most recent before this was the law on CGT losses which I dealt with in November's Tax Insider). It will give Tax Inspectors (or "Officers" as they now seem to be calling themselves) the opportunity to intimidate taxpayers into changing their policy on distributing profits from the family company, with the alternative of a long and expensive dispute about the meaning of the legislation.

The other possibility is that nothing will happen. At a time when HMRC is haemorrhaging staff, cannot operate basic security precautions to protect taxpayers' personal data, and is unable to administer the system as it exists - it recently took three months and a formal complaint to get them to make a simple change to my own PAYE code - they are hardly going to thank their masters for giving them yet more complex and ambiguous legislation to enforce.

## Q&A

**Q.1** I am employed by a company and work at home, putting aside a room for the purpose and meeting with clients at home. At the moment the company pay a proportion of the utility bills and other bills. If I were to charge a rent instead, how much could I charge before being liable for tax.

**A.1** You would be chargeable to tax on any rent you charged the company and you might also find your CGT main residence exemption restricted when you come to sell the house. HMRC take a strict line on the recharge of utilities, so make sure you are only charging the company for the extra costs you incur by working at home.

**Q.2** My mother bought a flat in my name in 1995 for £155k. We lived there until 2005 when I got married and moved out. She still lives there and would like me transfer half the property to her. There is a small mortgage of £85k and the property is now worth about £500k. She is a 64 year old pensioner. Will she have to pay stamp duty on the transfer and will I have to pay CGT? No money will change hands.

**A.2** If you gift the property to her, she will be deemed to take over half the mortgage, but as the value of that is below the SDLT threshold, there will be no SDLT to pay. There will also be no CGT because the property was your main residence until 2005 and the last three years of your ownership will always be exempt in such a case.

I do, however, question the wisdom of transferring part ownership to your mother. The value of the property will be part of her estate for Inheritance Tax and £250K (half of the value of the flat) means she only needs other assets of £50K to use up her "nil rate band" and be taxable at 40% when she dies. Depending on the detailed facts, it is also possible that her share of the mortgage would not be allowed as a deduction from the value of her estate.
If you insist on going ahead, remember you will need to get the consent of the mortgage provider to the transfer.

**Q.3** I have moved to New Zealand approx 8 months ago and have been renting my property out for 20 months in the UK. I have decided to sell it so I can buy a place in New Zealand where I have married a native and intend to live. Could you tell me if I have to pay any capital gains tax? I purchased for £67.000 and intend to sell for £215.000 after 5 years of ownership.

**A.3** If the property was your main residence from when you purchased it until 20 months ago, it will be exempt from UK CGT provided you sell it within 36 months of moving out.

Even if it was not your main residence, if you are now resident in New Zealand you will not be liable to UK CGT on a sale of the property provided you remain not resident in the UK for five complete tax years. Did you leave the UK before or after 5 April 2007? If it was an investment property and you left the UK after 5 April 2007, wait until after 5 April 2008 before you sell. You should, however, check what the tax situation in New Zealand would be - that's outside my field, I'm afraid.

# Is your journey really necessary? - Employees' travel and subsistence

In last December's Tax Insider, we looked at travel and subsistence expenses for the self-employed, and this article completes the picture by dealing with the same topic where employees (including company directors) are concerned.

The rules are much more complicated than those for the self-employed, and in order to understand them we need to learn a new language:

**"Ordinary Commuting"** - this means travelling to your **"Permanent Workplace"** whether from home or from anywhere else that is not connected with your job, and you cannot claim the cost as an expense.

**"Permanent Workplace"** - this is a place you attend "regularly" to work, and not a **"Temporary Workplace"** you attend for a **"temporary purpose"**, or for a period of **"limited duration"**.

**"Limited Duration"** - means less than two years.

**"Temporary Purpose"** - means you do not spend 40% or more of your working time there - so if you are sent to work somewhere different for two days a week out of your five day week, then unless you are there for less than two years, that will become another **"Permanent Workplace"**

If you have to travel to a **"temporary workplace"**, you can claim the cost of the journey, whether you started from home, or from your "permanent workplace", or indeed from anywhere else.

Confused? Shame on you - these are the "simple" and "fair" rules for whether travelling expenses are allowable as an expense of your work.

In any case, we haven't even started on the complicated bits yet:

**"Fixed Term Appointments"** If your job has a fixed term, or is expected to have a fixed term, then the place you work will be your **"Permanent Workplace"** even if the fixed term appointment is for less than two years.

**"Substantially Ordinary Commuting"**. You cannot turn an **"ordinary commuting"** journey into travel to a **"temporary workplace"** just by finding a work related task to do on the way. For example, I live near Tavistock in Devon, and my **"Permanent Workplace"** is in Truro, 60 miles away in Cornwall. We have a number of clients who live near the road I use for the journey, but just because I call in to see one of them on my way to work or my way home doesn't mean I can claim the cost of the journey. HMRC say they will normally accept that a 10 mile detour from the usual route (so 20 miles in total) means that this "substantial" rule will not apply to deny relief for the journey.

## Subsistence

As a rule of thumb, if you are on a journey that qualifies as business travel (that is, it is not private travel or ordinary commuting), then the cost of subsistence (HMRC speak for meals, hotel bills, and so on) is also an allowable expense.

Some care is needed here - the expenses must be "necessary", so while the cost of a hotel room and food and drink are allowed, unnecessary expenses such as a newspaper, or having your laundry done. There is a round sum allowance that an employer can pay tax free (at the generous rate of £5 per night) to cover these "incidental" overnight expenses.

There are two myths about subsistence, which even tax inspectors have been known to perpetuate:

**Drink -** it does not matter (from a tax point of view!) whether the drinks you have are alcoholic or non-alcoholic.

**Cost -** the test is whether the subsistence is allowable according to the rules above. If it is, then the fact that it is more expensive than it need be is irrelevant - so a first class ticket is allowable if a second class one would have been, and just because you choose the most expensive items on the menu does not mean the expense is not allowable.

Once, while working for one of the "Big Four" firms, I was on the road for several days doing numerous presentations to clients about the latest Budget. At the end of the last day I was in a hotel a long way from home and feeling sorry for myself, and it just so happened the hotel was having a "Gourmet Dinner Night". I joined in enthusiastically, and a week later got a phone call from the firm's Expenses department, querying my claim for the hotel bill. I got on my high horse and started quoting them chapter and verse about an expense being allowable whether it was the cheapest option or not. It turned out that there had been a misunderstanding - the size of the bill for the Gourmet Dinner was such that they thought I must have had a guest (not allowable as an expense) at my table. Once I explained it was all my own work, there was no further problem!

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