July 2022 newsletter

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Are you on top of Making Tax Digital's latest developments?

The widening scope of Making Tax Digital (MTD) is highlighting several issues, including the limited availability of the MTD for income tax pilot scheme, and low awareness of the recent expansion of MTD for VAT to all VAT registered businesses.

Pilot scheme

Although the functionality of the MTD for income tax pilot scheme is constantly evolving, HMRC is still restricting sign-up to small numbers, citing the need for detailed, individual guidance for users.

From July, taxpayers can join the pilot if they have the following types of income:

- self-employment, even if there is more than one business;
- UK property;
- employment income; or
- UK savings and dividend income.

Functionality to be added over coming months will mean that pilot scheme users will be able to claim relief in respect of personal pension contributions and the marriage allowance, and it will also be possible to report capital gains, pay voluntary class 2 NICs and make student loan repayments.

The scope of the pilot scheme is still quite restricted, with taxpayers only able to sign up through their software provider.

MTD for VAT

MTD for VAT was extended to all VAT registered businesses from 1 April. Previously, it only applied to those above the £85,000 VAT registration threshold.

Some new entrants will currently be in the process of preparing their first MTD compliant VAT return – although research indicates considerable misunderstanding as to how MTD for VAT differs from the previous electronic VAT return filing requirement. Some 30% of responders thought they had already signed up to MTD, when in fact they had not.

There will be something of a delay for those businesses who submit VAT returns annually. For example, with an annual accounting period running to 31 March 2023, the first MTD return will not need to be submitted until 31 May 2023.

As MTD progresses, stay up to date with HMRC guidance here.

Please get in touch if you require assistance with your MTD transition.

Tax implications of no fault divorce

No fault divorce became a reality in April. Although it brought no associated changes to the tax rules, divorcing couples should now be in a better position to focus on financial issues – particularly important if not using a lawyer or solicitor.

Capital gains tax

For most couples, the main tax issue will be the capital gains tax (CGT) consequences of transferring assets as part of the divorce settlement.

The basic rule is that transfers only escape CGT (on a ‘no gain, no loss’ basis) if made by the end of the tax year in which the couple are no longer living together – the year of separation.

After the end of the year of separation, but before the divorce is finalised, any transfers of assets will be treated as made at market value, so CGT can be payable – but with no proceeds to fund the tax liability.

Couples dissolving a civil partnership can now also do so on the same no fault basis.

Private residence relief will generally mean there are no – or few – CGT implications if transferring the family home, but someone with a portfolio of property and investments could face a large, unnecessary, CGT bill without careful planning.

Timing

With a no fault divorce, the applicant is required to wait 20 weeks from the start of the divorce proceedings until a Conditional Order (previously the Decree Nisi) is made. This is the time for reaching a financial agreement on how assets are to be divided. There is then a further wait of six weeks until the Final Order (previously the Decree Absolute) can be made.

This is a minimum of six months. Add on possible paperwork processing delays, and a separation in the second half of the tax year means a straightforward transfer of assets will not be possible until the next tax year, making CGT an issue.

HMRC has provided an updated help-sheet on the CGT implications of divorce, dissolution and separation here. During such a stressful process, it’s more important than ever to ensure you have the right expert guidance, so let us know if we can help.

Defining ‘period of ownership’ on residence disposals

The disposal of a private residence is exempt from capital gains tax (CGT) if used as a main residence throughout the period of ownership. A recent case heard in the First-Tier Tribunal has come up with a very favourable interpretation of what this means.

The facts

In the case heard by the Tribunal:

- A married couple purchased a plot of land.
- Over the next two and a half years the land was redeveloped, with the original house demolished and a new house built.
- The couple then moved in before selling the new house a year later.
- The sale resulted in a gain of over £500,000 for each spouse.
- The couple claimed private residence relief for the total amount gained, but HMRC argued that full exemption was not available as the house had not been lived in for the entire period from when the land was originally purchased.

The decision

The question for the First-Tier Tribunal to decide was whether the period of ownership covered just the new house (one year) or whether it went back to when the land was bought (some two and half years earlier).

Both parties put forward detailed arguments to support their respective positions, but in the end the decision was simply that the natural reading of the legislation was the ‘period of ownership’ means the period of ownership of the house being sold – so the couple’s gains were fully exempt.

It is of course possible that HMRC might chose to appeal the decision.

There may be tax planning scope for anyone sitting on a plot of land representing a potential substantial gain if they can build a house on the land and live in it for a few years before a sale to claim private residence relief.

However the other important caveat to bear in mind is that First-Tier Tribunal decisions do not set a precedent. View HMRC’s guidance on private residence relief here.

Planes, trains and automobiles – managing employees' transport challenges

With strikes and cancellations affecting trains, the underground and flights, employers need to decide how they are going to treat employees who cannot get into work or are stuck overseas.

Commuting

Although inconvenient, there is generally plenty of notice when it comes to train, tube and tram strikes, and therefore the chance to make contingency plans. With hybrid and homeworking now commonplace for many offices, this will be the simple and obvious answer to discuss with employees on affected days.

Employees who are required to attend work in person may face a longer and/or more expensive journeys than normal – especially if an alternative mode of transport is required. So employers should consider offering help with some financial assistance. Some absences may be avoided by rearranging work patterns or promoting car-pooling for instance.

Stuck overseas

The treatment of employees who cannot return to work after a holiday because they are stuck overseas due to a cancelled flight is somewhat more problematic.

- If an employee can resume work as usual while abroad then they should obviously be paid as normal. It is unrealistic, however, to expect most employees – especially if not in a senior position – to have travelled with their work laptops.

- Assuming sufficient annual leave is available, extending a holiday may be an answer where an employee is unable to work remotely. Or the employee may be happy to take unpaid leave.

- Although there is no requirement to otherwise pay an employee who is stranded overseas, the employer might consider treating it the same as an emergency situation and remunerating on a similar basis to other emergencies, especially if the employee is taking all reasonable steps to return home.

Employees may not be able to leave the UK for their holiday in the first place and so need to rearrange their dates. Employers do not have to agree to this, especially given short notice, but a flexible approach is advisable where possible.

The Government's guide to holiday entitlement for employers and employees can be found here.

60% income tax reappears

The high marginal tax rates created by phasing out the personal allowance are back in the news.

'A million to pay 60% income tax within years,' ran a recent headline in *The Sunday Telegraph*. The next day *The Times* picked up on the same story with the article 'Inflation may leave million more workers paying 60% tax'.

Whether either article counts as 'news' is debatable. The 60% income tax rate (or 61.5% on earnings in Scotland) has been around, in one form or another, since 2010/11. It is not, as *The Times* suggested, the result of 'a glitch in the personal allowance regime' but was the product of a carefully crafted piece of legislation. At the time, the aim was to raise extra revenue while keeping the threshold for the newly introduced 50% additional rate tax at £150,000.

How the 60% tax rate happens

In 2022/23, Yasmin expects to have an income of £100,000 and is therefore entitled to a personal allowance of £12,570. If she receives an unexpected bonus of £10,000, her total income will be £110,000 and her personal allowance will be reduced by half of the amount by which her total income exceeds £100,000 – i.e. £5,000. As a result, she will not only pay tax of £4,000 on her bonus (at 40% outside Scotland), but she will also have to pay £2,000 of tax on the £5,000 of her income no longer covered by the personal allowance. The result is:

$$\frac{\text{Total extra tax}}{\text{Total extra income}} = \frac{£4{,}000 + £2{,}000}{£10{,}000} \times 100\% = 60\%$$

If Yasmin received a bonus of over £25,140, she would lose all her personal allowance.

The newspaper articles indirectly highlighted that:

- The £100,000 threshold at which the personal allowance is tapered has been unchanged since 2010; and
- The personal allowance has almost doubled since 2010, resulting in a £25,140 band of income in which the 60% rate can bite.

Both factors mean that more taxpayers are being caught as incomes rise over time.

The one piece of good news is that if you are hit by 60% income tax you may also be able to claim 60% tax relief on pension contributions or gift aid.