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Inheritance Tax treatment of Trusts after 21 March 2006

The 2006 Budget and Finance Bill include proposals to radically change the inheritance tax treatment of certain types of Trusts. The existing legislation surrounding Trusts and the 2006 Finance Bill clauses are complex and further complicated by the fact that some of the new provisions are drafted in English legal terms that do not have a clear meaning in Scotland. The changes which will apply after 21 March 2006 are outlined below.

If you have set up a Trust for a child or grandchild or are contemplating this then the type of Trust will generally be one of the following:

- Discretionary Trust – gifts into such a Trust are immediately

chargeable to inheritance tax at the 20% lifetime rate to the extent that the assets transferred exceed your £285,000 nil rate band. After that, such Trusts are liable to periodic charges to inheritance tax and, in particular, a charge at a maximum effective rate of 6% every 10 years.

- Accumulation and Maintenance Settlements – these are a form of Discretionary Trust where, pre-budget, the beneficiary must become absolutely entitled to at least the income by age 25, although the capital can be retained within the Trust for longer. Prior to the budget, gifts into such a Trust were potentially exempt transfers and the 10 year charge did not apply.

“ ... landlords must register with each local authority in whose area they let property ... ”

- Interest in Possession Trusts – these are often referred to as Liferent Trusts. Gifts into the Trust were potentially exempt transfers. On the death of the liferentor, the value of the Trust assets were added to the other assets of the deceased and inheritance tax computed on the whole with the tax being paid pro-rata by the executors and trustees from the respective assets.

The proposals do not alter the regime for Discretionary Trusts at all.

Existing Accumulation and Maintenance Settlements will continue under the existing regime until 6 April 2008. If by 6 April 2008 the Trust has been

altered such that beneficiaries become entitled to capital outright on or before age 18 then the Trust will continue with the existing treatment applying. Otherwise, there may be a 10 yearly charge and also an inheritance tax charge when assets leave the Trust. Whether such a charge will arise in practice will be dependent upon the value of the Trust assets and the availability of a nil rate band.

Accumulation and Maintenance Settlements and Liferent Trusts created after 21 March 2006 will be treated in the same way as Discretionary Trusts in that:

- Gifts into the Trust will not be potentially exempt transfers.

- There will be 10 yearly inheritance tax charges.
- When assets leave the Trust there will be an inheritance tax charge.
- The termination of a liferent will not have an inheritance tax effect.
- Where the Interest in Possession terminates on death the Trust assets are not added to the estate of the deceased and there will, therefore, not be an inheritance tax charge.

As stated at the beginning, this is a fairly involved area and you should contact us if it seems likely that you will be affected by the proposals.

Letting property in Scotland

Landlords who rent residential property in Scotland were perhaps surprised to learn that the Anti Social Behaviour Order (Scotland) Act 2004 had a direct effect on them. This piece of legislation gives local authorities in Scotland additional powers to regulate rented housing.

One very practical effect is that as from 30 April 2006 landlords must register with each local authority in whose area they let property.

The stated aim of landlord registration is to ensure that all private landlords and agents in Scotland are “fit and proper” to be letting residential property. The owner of every let property

must register, and must declare any one who acts for them in relation to their letting.

It is worth noting that members of the public (and other public departments and agencies) will be able to view each local authority’s register on-line, for example by entering the address of one of your properties they will be able to see your name and contact address or the contact address of your agent. Apparently local authorities can also provide the home or office address of any registered person or company, but only at the authority’s discretion.

The forms for registration are quite detailed. There is a

section about the landlord and a separate section about the properties being let. The final section includes a declaration that the landlord complies with all legal requirements relating to the letting of houses involved. There is a fee for each registration application. The current rate is £55 for the applicant and £11 for each house or property registered. There are discounts for registered charities which own property. Finally, there is a discount available for those who apply on-line and this can be done at www.landlordregistration.scotland.gov.uk.

“ ... it is necessary for the pension contribution to be “wholly and exclusively” for the purposes of the trade ... ”

Tax relief for company pension contributions

Up until A Day (6 April 2006) pension contributions by companies were generally allowable where they fell within certain criteria, often based on calculations by actuaries. From 6 April 2006 however, it is necessary for the pension contribution to be “wholly and exclusively” for the purposes of the trade and relief will not be available where there is a non-trade purpose. One situation where a company pension contribution may not meet the wholly and exclusively test is where it is paid in respect of a director who is a controlling shareholder or a close friend or relative.

This will create uncertainty and H M Revenue & Customs may enquire whether company contributions meet the test and

look for evidence such as:

- If there are comparable third party employees with similar salaries and benefits, are the company pension contributions also similar?
- If the pension contribution for the controlling shareholder or his wife is greater than the contribution made for the third party employee, is there a business reason for this? If not there may be a non-trade purpose with no corporation tax relief being given for at least part of the payment.
- Are there special circumstances? There may be a pension fund deficit which is being made up by the company?
- Is the salary level commensurate with the work

undertaken by the director or spouse for the company? If the salary is excessive then it is likely that the pension contribution will be for a non-business purpose.

- Is a low salary being paid combined with a large pension contribution. Again, the rationale for this will have to be established and whether this strategy has been adopted for tax or NIC planning purposes. Many companies have adopted a strategy of remunerating director/shareholders by way of a modest salary and pension contribution, combined with a dividend.

Speak to us if you may be affected and we can consider your strategy in light of available HMRC guidance.

Employed or self employed

In the case of *Demibourne Ltd v HM Revenue & Customs* (HMRC) it was held that Mr Bone, who carried out electrical, plumbing and general maintenance work for the Frensham Pond Hotel on a self employed basis over a period of 9 years, ought to have been treated as an employee. He had submitted invoices regularly for £255 per week and had some other customers which generated a modest amount of other income.

HMRC sought from the hotel PAYE and employer’s NIC for a five year period. Mr Bone had however paid tax and national

insurance as a self employed person but was outwith the time limit to claim this back.

It was recognised that there would therefore be double taxation and it was recommended that the payments already made by Mr Bone should be offset against the amount being sought from the company. It was recognised however that this was a matter for the parties to agree and was outwith the jurisdiction of the hearing.

This case is a warning to consider carefully the status of individuals who work regularly

for one party on a self employed basis. If you are in any doubt about such status, please contact us for advice.

Company vans

At present, an individual who has a van available for private use, which has been provided by his employer, is subject to income tax on a benefit in kind of £500 per annum.

From 6 April 2007, the taxable benefit increases to £3,000 and, if fuel for private purposes is also provided then there will be a further taxable benefit of £500.

“... The Regulations apply to all charities registered with the Office of the Scottish Charity Regulator ...”

New accounting regulations issued for charities

The Charities Accounts (Scotland) Regulations 2006 have now been published and are available to download from www.opsi.gov.uk/legislation/scotland/ssi2006/20060218.htm.

The Regulations apply to all charities registered with the Office of the Scottish Charity Regulator (OSCR) for financial years beginning on or after 1 April 2006, including charities established under the law of a country or territory other than Scotland. Accounts must be submitted to OSCR not later

than nine months after the end of a charity's financial year. Charities which are also companies must also continue to file their accounts with Companies House within ten months of their financial year – end and also need to continue to comply with the Companies Act 1985 accounts and audit requirements. Please contact us for further information. Alternatively the OSCR website www.oscr.org.uk contains up to date information on developments in the sector, including information about the duties of charity trustees.

New Tax return filing dates proposed

You may have noticed in the national press recently that Lord Carter of Coles in a review set up by the Government recommended that consideration should be given to reducing the filing periods for income tax self assessment and company tax returns. This is apparently to bring them closer to those imposed in other countries. The specific recommendation for the

self employed and self assessment tax payers is that the filing period for paper returns should be reduced to six months making a new deadline of 30 September. Additionally the period during which HM Revenue & Customs can raise queries into tax returns would be linked to the date the return is submitted so this would also come forward.

HMRC and Internet auction sites

We have heard on the grapevine that HMRC has been taking an interest in and in some cases following up people whom they think are making frequent or regular sales on Internet auction sites.

Although not always clear cut and easy to apply, there are a number of long established principles or “badges of trade” which help decide whether someone's activities amount to an adventure in the nature of trade.

One important test is to consider the seller's intentions when he bought an article which he subsequently sells. If, for example, an article is purchased for private use and later this is sold, it would be difficult to argue that this is trading or in any way a business transaction. If, however, something is purchased in anticipation of a later sale at a higher price this is likely to be successfully challenged as a business transaction and tax may well be payable. Frequency and size of transactions also help to decide whether a trade or business is being conducted.

**MANSON
& PARTNERS**
CHARTERED ACCOUNTANTS

51 Rae Street
Dumfries, DG1 1JD
Telephone: 01387 269726
Facsimile: 01387 259039

partners **Frank N Manson CA David McMillan CA
Brian Johnstone BSc CA MSPi Craig J Kerr BCom CA**

associates **Alison E Anderson BA CA Allison J Thomson CTA Val Vince CTA**

consultant **Anne M Spence BAcc CA Dip PFS**