2020 vision

HMRC's ambitious programme 'making tax digital for individuals' (MTDfI) creates both challenges and opportunities.

By April 2016, every individual taxpayer will have access to a personal digital tax account. Initially, this will be pre-populated with information HMRC already holds via RTI (employment income and occupational pension information) and state pension details. Other taxable state benefits will presumably be added over time. Interest reported by banks and building societies will be included in tax codes. HMRC will consult this spring to establish what further information could be captured, in order to reach its goal of reducing the number of tax returns from the current 10.2 million to nil by 2020.

This is an ambitious goal, but pre-population is not a new idea: several overseas tax administrations have been doing it for years. Denmark, for example, began pre-populating returns as long ago as 1988. Iceland, Norway, Sweden and Finland, as well as Estonia, Chile and Spain, have also moved to a system where personal tax returns are partly or largely pre-populated. Several lessons can be drawn from their experience.

First, there must be a unique, high integrity taxpayer identifier to ensure that information from payers of income is associated with the right individual and that when passed to the revenue authority, it is allocated to that person's account. Clean, accurate data must be at the heart of the system.

Second, information must be passed to the revenue authority speedily. In both Denmark and Sweden, information is provided within a few weeks of the financial year end. The use of sanctions for the late submission of payment data varies across the Nordic countries. Some impose penalties, whereas others believe that the reputational risk of failure to supply information is sufficient to encourage compliance.

The common experience is that adequate resources must be made available to encourage and support those supplying data, to enable the rapid and accurate processing of information and to engage taxpayers. A key principle is that information is being used to help taxpayers make a correct declaration, rather than to challenge them. HMRC will need to decide whether deemed acceptance of figures or positive affirmation of correctness will constitute a valid 'declaration' and also consider what constitutes reasonable care.

One final lesson may perhaps have already contributed to the thinking behind some recent UK policy developments: the less there is to be declared, the more effective the system is. Was this perhaps a contributory factor in the decision to create the £5,000 nil rate band for dividends and the £1,000 (or £500) savings income exemption? Either way, these measures will help to significantly reduce the number of people in the system at a stroke. Other policy changes might be possible to both simplify the system and to remove even more people from it for little or no loss of tax revenue.

To remove all taxpayers from the annual chore, however, HMRC will have to look at capturing information from stockbrokers and others paying dividends and interest (including private companies), as well as capital gains and – ultimately – foreign sources. Pre-populating personal tax accounts for more complex taxpayers will be challenging.

Hopefully, HMRC will already be looking at the Nordic experience to inform the design of MTDfI and supplement the research it recently commissioned on pre-population from Exeter University's Tax Administration Research Centre.

HMRC is arguably beginning this exercise with a more complex tax system and administration infrastructure than some of the Nordic countries. Its vision of no tax returns by 2020 is radical, but pre-populating return data has been successfully implemented elsewhere and the potential opportunities for simplification are tantalising. ■

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Accelerated payment notices

Is it time for Parliament to step in to counter unintended consequences of APNs?

Last month, following an address by Lord Reid, a question arose from the floor in response to his comments on the intention of Parliament as it applied to tax legislation. The questioner asked about the position of a client who ten years ago had made an investment in (for example) a film. Ten years later, the law has changed and he is required to make a substantial payment of tax. The payment is not of any assessed or determined liability; it is merely an amount demanded by HMRC just in case some tax might arise when the matter is finally adjudicated. However, the amount is large and he is made bankrupt. Five years later, when the substantive matter is adjudicated, he is found to be entitled to the relief. However, it is too late. He is bankrupt, his business has been lost, all his employees have been put out of work and there has been a seriously adverse effect on his family. He has broken no laws, he has paid the right amount of tax, but he has still been ruined.

The questioner asked whether these entirely foreseeable consequences could really have been the intention of Parliament. Lord Reid (no doubt wisely) declined to express a view.

HMRC is naturally keen to dissuade people from entering into avoidance arrangements which take advantage of reliefs or allowance that were not intended by Parliament. However, in this example, the courts will have shown that the relief sought by the taxpayer was intended by Parliament, so why did the taxpayer have to be ruined?

It must be acknowledged that accelerated payment notices (APNs) are the law – and that is the end of it, although possibly the unfairness in some cases will be so grotesque that the courts will find a way to intervene.

However, it must also be acknowledged that there is a clear mischief which APNs are intended to address. I would suggest, though, that the retrospective nature of APNs overcooks this particular goose.

There could be little criticism if APNs were prospective and not retrospective. If the APNs operated from the date of their announcement, anybody becoming involved in an arrangement for the saving of tax which fell within the parameters of an APN would know exactly what they were in for and could not complain of burnt fingers. The APN would simply be part of the legal framework to which they must have regard when conducting their affairs.

That is quite different from saying that you did something perfectly lawful ten years ago but HMRC has now taken exception to it; and, whether it is right or wrong, it will make you bankrupt. This is much too close to the regimes which operate in some countries where those in government will penalise (or bankrupt, or worse) citizens with whom they disagree, without anything so tediously inconvenient as a legal process.

We know that Parliament is sovereign and can enact any laws it chooses. There can be no question of its right to do so, nor of our absolute duty to adhere to those laws. However, sometimes the laws that Parliament chooses to enact can have wide ranging and unintended consequences. There would be no shame in Parliament acknowledging that APNs go rather further than it really intended and that some revision would be appropriate. ■

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Tax advisers should not be agents of the state

Tax advisers are going to be required by law to inform their clients about the dangers of not declaring offshore income using wording specified by HMRC. No harm in that, you might think, but where does it end?

Clients engage tax advisers for different reasons. Some, fewer than you might imagine, want to find out how to pay as little tax as possible; others want advice on what to do in specific circumstances, such as a divorce or company sale. The vast majority, though, simply want somebody who can guide them through the complexities of the system and keep them out of trouble with HMRC.

They all have one thing in common. They pay an adviser to act on their behalf. They don't expect that their adviser will be acting on behalf of HMRC. Yet advisers are now going to be required by law to inform their clients, by individual letter or email, about the dangers of not declaring offshore income or gains using wording specified by HMRC. I can well imagine that some clients will be indignant that their adviser has spent time and money passing on what will be seen as HMRC propaganda.

Now I am not saying that the role of the adviser is to be antagonistic to HMRC. Far from it. In most cases, it will be in the client's interest for the adviser to work cooperatively with HMRC to resolve problems.

Similarly, I have no issue with warning clients about the importance of ensuring that all income and gains are reported. Indeed, I would be derelict in my duty if I did not do so.

There is, though, a world of difference between that and me being forced to pass on messages from HMRC. If HMRC wants particular messages to be conveyed to taxpayers, then it should do so directly.

You may think I am making a fuss about this. After all, what is wrong with reinforcing the message about the need to declare offshore income? But where does it stop? Agents are not creatures of the state; nor are they neutral intermediaries between the client and HMRC. The role of the agent is to act in the best interest of his or her client. He who pays the piper calls the tune. ■

Andrew Hubbard, RSM (Weekly Tax Brief)

Reader feedback

Take care with the valuation of trade-related properties.

Ian Maston makes some interesting points in his article 'Impact of incorporation on business property relief' (see 'Ask an expert', *Tax Journal*, 5 February 2016). 50% relief on the premises and 100% on the rest of the business, for example free goodwill, is one thing. However, the position could actually become worse.

A restaurant is known by real estate valuers as a 'trade-related property' (TRP). The argument runs that a TRP specifically adapted for use as a restaurant could not be used for any other trading activity; and that therefore it is appropriate to value the bricks and mortar by reference to the notional profitability of the business conducted within it, as seen through the eyes of a 'reasonably efficient operator', generally not the actual operator. Whereas ordinarily a profitable trading business might be expected to have valuable free goodwill, this would of course attract the business property relief (BPR) to which Ian refers, at 100%. However, if the profits of the restaurant are captured in the value of the premises, they cannot surely be used a second time in order to determine the value of any free goodwill in the business. Unsurprisingly, on that basis, in many recent business incorporation cases the specialist valuation department of HMRC – Shares and Assets Valuations (SAV) – has succeeded in maximising the real estate value, marginalising that of free goodwill, and consequently minimising the tax advantages that were supposedly available on incorporation.

Those tax advantages are of course now largely gone, but SAV has said that it will remain consistent in its approach and will therefore continue to value goodwill in TRPs as it has done historically. That will presumably apply for IHT as well. On that basis, the bulk, if not the entirety, of the value in a restaurant business, and other TRPs, will continue to lie in the real estate.

One of Ian's key points is that the amount of BPR hangs on how the premises are owned – relief could be 100%, but it might only be 50%. If the premises were transferred into the company, relief applies at 100% after two years, although there would be an SDLT cost on its transfer, on the very high values that follow from the TRP valuation methodology. If, however, the premises remain outside the company, only 50% relief will be available on them, and, by reason of its exclusion from the business value, negligible relief at 100% on free goodwill, a further unfortunate dimension to the scenario that Ian identifies.

For example, A Ltd, a widget manufacturer, achieves profits of circa £200,000 per annum, trading from premises valued at £500,000 including various tangible assets. Capitalised on a multiple of five, A Ltd would be valued at £1,000,000. Following the convention that goodwill is what remains after all other assets have been deducted, it is therefore valued at £1,000,000 – £500,000 = £500,000. If A Ltd owns the premises, etc., business property relief is available on the entire value including goodwill, at 100%. If it was owned by the controlling shareholder, only 50% of its value would attract BPR (£250,000) and the same amount might attract IHT at 40% (£100,000). If not owned by the controlling shareholder, IHT might be £200,000.

B Ltd is a restaurant, also making profits – EBITDA – of £200,000. If, for the sake of argument it was also capitalised by five, its value would also be £1,000,000. However, as it is a TRP, the £1,000,000 represents in effect the value of the restaurant premises, and there is no separate free goodwill. If the restaurant is owned by B Ltd, relief at 100% would seem to apply. However, if owned by the controlling shareholder, the reduced 50% rate would mean that this time £500,000 would be liable to IHT, with a potential tax liability of £200,000. If not owned by the controlling shareholder, IHT might be £400,000.

Plan with care! ■

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