October 2009

Focus

Welcome to the autumn (or fall) edition of Focus. Following the US tax disclosure initiative earlier in the year, we are about to experience the UK version – the New Disclosure Opportunity. We have a leading article on how HM Revenue & Customs (HMRC) plan to bring taxpayers into full compliance; armed hot off the press with various agreements reached with offshore jurisdictions to share information. We have set out the limited extensions that have been announced to Foreign Bank Account Report (FBAR) compliance – as a result of the Internal Revenue Service (IRS) not thinking through the full ramifications of the new obligations.

In the UK, we have seen the introduction of caps on tax relief for pensions for high earners. So we have covered this and some pointers on UK deferral/pension mechanisms and the foreign equivalents.

An update is the best we can offer on the question for US filers anxious to know the creditability of the £30,000 remittance basis charge, with some issues to consider as we speed towards the end of 2009 with uncertainty remaining.

There are some important VAT changes which phase in from next January to prepare for, which are discussed.

Now on to Frank Hirth news; in line with our ethos of growing and developing our staff through their professional qualifications we are pleased to announce that in the last quarter, four of our tax staff, Matthew Pannell, Tracy Ng, Fiona McManus and Glenn Snow have successfully completed their ATT and Rebecca Singleton has now completed her ACCA studies.

We have had five promotions into the management team here at Frank Hirth in July; Stacie Richardson, Alison Hibbs and Anthony Boyne as Managers in the Business Advisory Group, and Kristina Searle to Manager and Stephen McAndrew to Assistant Manager in the Personal Tax Group. We have also added to our teams with seven new experienced technical hires into the business and five new HR, accounts and administration assistants. At the beginning of September, we brought nine graduates into the business who joined our London office and, as a significant milestone our first group of four trainee graduates for our New York office – Fantastic!

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THE LAST CHANCE SALOON FOR UK TAX DISCLOSURE

On 28 July 2009, HMRC announced further details of the second (and expected to be final) opportunity for taxpayers to disclose and pay tax on their non-UK income, the New Disclosure Opportunity (NDO). UK taxpayers with unpaid taxes linked to offshore accounts have a final chance to settle them with a reduced penalty expected to yield a £1 billion windfall for the Treasury. The first version, which ran during autumn 2007, was widely acknowledged by HMRC as falling well below expectations, in terms of the returns to the Exchequer.

Following the recent UBS scandal in the US, the IRS is currently running their own Voluntary Disclosure Program for US taxpayers to regularise their tax affairs in connection with non-US accounts. This program has seen a significant take up and HMRC are clearly expecting a similar, if not more positive, response to the NDO.

The NDO is designed as the 'carrot' to taxpayers to provide details of any previously undeclared income, settle the tax, pay interest on the late payment and accept a lower penalty regime for their transgression. The 'stick' will come for those found to have transgressed following the completion of the program where the threat of more draconian penalties (starting at 30%) and potentially criminal prosecution will loom large.

Will HM Revenue & Customs ever know about me?

In the run up to the first disclosure window, HMRC obtained UK based customer details from the UK's five biggest banks with trading operations offshore. They have yet to really act on this information.

HMRC have made no secret of the fact that they are actively pursuing an ever wider range of financial institutions for details of their UK based customers, including details of their assets and income. They have tightened up the legislation to make this easier and have already obtained court orders compelling financial institutions to provide the information.

Recently, HMRC won a judgment before the Courts allowing them access to details of up to 500,000 non-UK accounts owned by UK residents. The UK also concluded a Tax Information Exchange Agreement with Liechtenstein, which will yield details of accounts held within that jurisdiction and is subject to a separate Disclosure Facility. This will go alongside information yielded from other 'offshore' jurisdictions, including Jersey, Guernsey, Switzerland and the Isle of Man closer to home, as well as the more far flung Caribbean hotspots of the Cayman Islands, Turks & Caicos Islands and the British Virgin Islands. There is a reasonable chance that any institutions with which individuals have accounts will be caught up in this exercise.

Outside this process there is likely to be months, if not years of time-consuming investigation which HMRC are keen to avoid. So we can expect the heat to be raised as has occurred in the US over the last couple of months to ensure greater success on this occasion.

What would I need to declare and what will I need to pay?

Individuals, companies and trustees will need to report details of all omissions within the prior 20 UK tax years (or, if less, as far back as the irregularity goes). For many clients, records will simply not go back that far and we will work with clients to put together a reasonable approximation of undisclosed income and/or capital gains for those years.

The NDO is no amnesty. It is a facility for taxpayers to regularise their position by paying the full tax due plus penalties on the following favourable terms:

- A standard penalty of 20% of tax due if you received a letter as part of the previous facility from HMRC; or
- A standard penalty of 10% of tax due if you did not receive a letter the first time around; or
- No penalty where the income disclosed is less than £1,000; or
- No penalty for pre-death liabilities of a deceased taxpayer.

How long do I have?

You will need to disclose your intention to notify under the NDO by 30 November 2009. You will then have until 31 January 2010 to make full disclosure on paper, which is extended to 12 March 2010 where the disclosure is made electronically.

If I make a disclosure, will I be prosecuted?

The guidance does not yet make it clear whether HMRC would prosecute if there is a clear case of evasion. However, the NDO has been rolled out on the basis that it can quickly resolve cases HMRC perceive as low risk. This will allow them to concentrate on more substantial cases where there is either greater risk or more tax at stake. Each case will depend on its particular facts, though by volunteering under the NDO, it is accepted that the risk of prosecution is less than HMRC tracing you after non-disclosure.

What could happen if I don't pay?

Savers who do not take advantage of the NDO, which the government says will be the last, are open to prosecution for violation of tax laws. They could face a penalty levy of at least 30% and as much as 100% on the understated income. With tax revenues being squeezed, HMRC have already announced their intentions to devote even greater resources to counter tax evasion and to 'name and shame' convicted tax evaders where the numbers involved justify it.

What is special about Liechtenstein?

Following the conclusion of the Tax Information Exchange Agreement on 11 August 2009, savers will be subject to a separate, though broadly similar regime, the Liechtenstein Disclosure Facility (LDF). As part of the Agreement, the financial institution in Liechtenstein will write to you separately and you will need to:

- Prove to the financial institution that you have no tax to pay in the UK, supported by the requisite level of proof;
- Prove to the financial institution that you are not a UK taxpayer; or
- Register under the Facility and send the financial institution a copy of the acknowledgment from HMRC.

However, if you hold accounts in Liechtenstein and do not receive such a letter, there may still be a requirement to make a full disclosure. Unlike the NDO, if you fall within the terms of the LDF, you will have a limitation period starting from April 1999 and HMRC confirmed that they will not instigate a criminal investigation for a tax related offence as long as a full and accurate disclosure is made and the source of the funds is not from criminal activity.

Article by: Graeme Privett

VAT – ALL CHANGE

Many of you will recall with great fondness the practical troubles when the VAT rate was reduced to 15%. What many of you may have forgotten is that the reduction was a temporary provision which means that the rate is due to revert to 17.5% from 1 January 2010.

Therefore, accounting systems will require updating and pricing considerations may be required where the additional 2.5% once again becomes an additional cost to the customer. There are of course, various anti-avoidance provisions to ensure the correct rate is used.

Place of Supply of Services

Under the directive to reduce fraud and simplify the legislation, the places of supply of services have been revised. The revisions will be phased in three stages on 1 January 2010, 1 January 2011 and 1 January 2013.

Most of the changes are cosmetic in that they standardise what were previously considered exceptions. However, in certain areas we now have differences in supplies made to business and non-business customers so care needs to be taken.

The place of supply rules determine in which state the supply is deemed to have taken place and thereby where VAT is payable. They also determine whether the VAT due on a supply should be dealt with by the supplier of the service or the customer (under the reverse change principles).

The current legislation provides a basic rule that the supply takes place where the supplier has established its business. This will remain unchanged for supplies to non-business customers but from 1 January 2010, for supplies to businesses the basic rule will change to where the customer is established.

There will continue to be exceptions to the basic rule;

Supplies of cultural, artistic, sporting, scientific, educational, entertainment and similar services, as well as valuation work and work on goods are currently taxed where the service is performed. For supplies to non-business customers this will remain unchanged but for supplies to business customers;

- From 1 January 2010 valuation and work on goods will be taxed where the customer is established;
- From 1 January 2011 the remainder of the above services will also be taxable where the customer is established. However, admission to events relating to these services will continue to be taxable where the event takes place.

Services supplied in relation to land are currently taxable where the land is situated and that will remain unchanged.

The supply of intermediary services is currently the same place as the service being arranged. From 1 January 2010 for business customers the general rule will apply but it will remain unchanged for non-business customers.

The place of supply of certain intangible services will continue to be the place where the customer belongs when provided to non-business customers.

EC Sales List (ESL)

There will be an additional requirement to submit an ESL for services provided to business customers established in the EU.

Provided such services do not exceed a value of £70,000 per quarter the business will be able, in general, to submit ESLs quarterly rather than monthly.

The time of supply of these services will be the earlier of when the service is completed or when payment is made.

Article by: Steve Butler

UPDATE ON PENSIONS AND OTHER RETIREMENT PROVISIONS

For those who are now paying tax on the arising basis in the UK for the first time as a result of the new rules for non-domiciled individuals, the UK taxation treatment of certain investments and especially retirement planning vehicles such as personal or occupational pension arrangements, employee benefit trusts and Individual Retirement Accounts (IRAs) may prove to be a bit of a minefield.

Pension Arrangements

A UK income tax deduction can only be claimed by an individual on contributions made to an overseas pension scheme which has registered with HMRC. In addition, the individual must have been a member of the scheme prior to his arrival in the UK, have UK taxable earnings of at least the same amount of the contribution and have informed HMRC of his intention to claim income tax relief. The contributions must also have previously qualified for relief in the individual's home country. Whilst this may seem like a large number of conditions to be met, the vast majority of contributions to standard personal or occupational pension arrangements would qualify under these rules. In the case of overseas Small Self Administered Schemes (SSAS) or Self Invested Pension Plans (SIPPs) a more detailed review may be necessary to ensure any contributions will qualify for relief.

In addition, many double tax treaties, including the arrangement between the UK and the US, extend tax relief in one country to essentially equivalent schemes established in the other country. This would cover contributions to US domestic plans such as 401K arrangements and others which are broadly equivalent to UK schemes and should allow US nationals to continue to contribute to such arrangements with certainty of treatment.

Income tax relief is currently available in the UK for domestic purposes, in connection with contributions, up to the lower of the individual's earned income or the annual allowance of £245,000 for 2009/10. This annual allowance does however also include any employer contributions so care needs to be exercised when trying to ensure that contributions are kept within this limit to avoid the significant tax charge which results from excess contributions.

However, new provisions aimed at high earners were introduced by the Chancellor in the recent budget in April. Under these provisions, the amount of contributions on which an individual can gain full tax relief at the higher rate is limited to £20,000, (an amount known as the special annual allowance) with effect from 6 April 2009. Contributions above this level will be subject to a 20% income tax charge which will be collected via the annual self assessment tax return. Pension contributions will therefore need to be considered more cautiously going forward as a way to reduce an individual's income tax liability.

There is some light amongst the gloom, however, as there are transitional provisions allowing full relief for contributions made at least quarterly under an arrangement entered into before these new rules were announced on 22 April 2009. A pattern of regular contributions prior to 22 April 2008 but less than quarterly will increase the £20,000 limit to £30,000.

When it comes time to draw on the pension fund, it is less clear as to whether under the provisions of the UK/US double taxation agreement a lump sum payment, which would be tax free in the UK, would receive the same treatment in the US. It is recommended that specific advice is sought before any such payment is received.

Employee Benefit Trusts (EBTs)

These are popular arrangements whereby equity in a company is placed on trust for the benefit of the employees and their families. It is often possible for an employee to borrow against the value of the shares within the trust which have been allocated for them, in advance of any amounts being distributed.

HMRC are increasingly reviewing such arrangements and where the employee has been resident in the UK for 17 of the last 20 tax years and is therefore subject to UK Inheritance Tax on a worldwide basis or where the company is resident in the UK, contributions to the employee benefit trust will need to be carefully structured to ensure they do not give rise to an immediate inheritance tax liability at 20%.

Amounts received from an employee benefit trust will still be considered to be taxable earnings in the UK even if received when the individual no longer holds the employment. Where interest free loans are received this will be considered a taxable benefit with the taxable amount calculated with reference to HMRC's approved rate of interest.

It must also be kept in mind that for US citizens and long term permanent residents, the tax deferral is not effective and such arrangements may therefore be unsuitable.

Roth and Traditional IRA

When it comes to making contributions, Individual Retirement Accounts (IRAs) are treated like traditional pension arrangements. This means that UK tax relief will be available in respect of contributions to both Roth and Traditional IRAs in line with the rules outlined above.

In terms of receiving distributions, in the case of a Roth IRA, the double taxation agreement between the US and the UK provides for a distribution to be exempt from tax in the UK to the extent that it would be exempt in the US. This means that withdrawals from this IRA (which are considered in the US to be from taxed income) should be exempt from UK tax. With a Traditional IRA, the UK treatment follows the US treatment and therefore sums are taxed on withdrawal.

In conclusion, retirement planning, and particularly pension contributions to either a standard personal or occupation pension arrangement or an IRA, remains tax efficient. However, with the new pension rules introduced from 6 April 2006 well established, and the further changes which took effect from 6 April 2009, it is vital to keep track of the level of contributions being made by you and your employer, to ensure that tax charges are not triggered unexpectedly. It is also important to ensure that the type of vehicle being used is the most appropriate to your worldwide tax obligations and any long term retirement strategy.

Article by: Gillian Everall

UK REMITTANCE TAX BASIS AND CREDITABLE £30K UPDATE

The clock continues to tick towards the filing of UK tax returns for the year to 5 April 2009; the first year following the introduction of the new rules impacting on non-domiciled individuals, working in the UK. For individuals resident in the UK for less than seven of the previous nine UK tax years, the cost of claiming the remittance basis (explained in the October 2008 edition of Focus) is the loss of the income tax personal allowance at £6,035 and capital gains tax annual exemption of £9,600 respectively for the last year. For longer term residents you will be reflecting on an arising basis against remittance basis; with the question of the additional charge of a £30,000 levy where the remittance basis is preferred. For those who are American, the open question from the day that this was first raised is whether the £30,000 will qualify as a creditable foreign tax for the US Individual tax return filings.

There has been both hope and expectation that this issue was to have been part of the five year review discussions of the US/UK treaty this summer. Regrettably this is not the case and the latest report of discussions between the US Treasury and the Internal Revenue Service (IRS) is that this is not on the table to be considered with any particular urgency in the foreseeable future!

Forgive us for thinking otherwise; the taxpayers and practitioners seem to be the 'meat in the sandwich' here. We have the UK introduction of new law without thinking through the ramifications of this imposition and the US intransigence to clarification on the matter and, the fact is that we all need this soon.

In the interim as far as those determining that paying the £30,000 is the right answer, the advice for US filers is to strongly consider making the payment only in 2010 (before the deadline of 31 January as well as considering on account payments for 2009/10). There doesn't seem to be any chance of clarity in 2009 now and pushing the payment into the 2010 tax year keeps options open. The question of making UK tax payments and this levy may require a careful split of payments pre and post the 2009 calendar year end. This is something that you need to look at more closely than ever with your adviser this year.

Article by: Mark Walters

FOREIGN BANK ACCOUNT REPORTS – LIMITED EXTENSIONS

On 7 August 2009, the IRS issued Notice 2009-62 which allows an extension for the filing of Foreign Bank Account Reports (FBAR) for certain categories of filer to 30 June 2010 and covers FBARs due for 2008 and earlier years and applies to all eligible filers.

The categories of filer included in the extension are US persons with:

- Signatory authority over, but no financial interest in a foreign account, and
- Either signature authority over, or a financial interest in a foreign financial account in which assets are held in a foreign commingled fund (such as private equity and hedge funds).

This extension is not available to all holders of foreign financial accounts as those with bank and brokerage accounts are still subject to the 30 June 2009 deadline, which in some cases has now been further extended to 15 October 2009 from 23 September 2009 as discussed in our last edition of Focus.

The current instructions to the FBAR also provide that a foreign financial account that must be reported includes any bank, securities, securities derivatives, or other financial instruments account. The FBAR instructions further provide that those accounts "generally also encompass any accounts in which the assets are held in a commingled fund and the account owner holds an equity interest in the fund (including mutual funds)".

The IRS has also indicated in the Notice that it is seeking comments on a number of issues recently raised concerning the revised instructions. It is expected that additional guidance may be issued in the future concerning the FBAR filing requirements pertaining to persons with signature authority over, or a financial interest in, foreign financial accounts, including foreign commingled funds.

The granting of the additional extension and the seeking of comments seem to be in response to the numerous questions raised with the IRS after the surprise inclusion of the requirement to include foreign private equity and hedge fund interests on the FBAR reports. There was an outcry about this as they don't seem to be "accounts".

Article by: Suzanne Willis

US ESTATE & GIFT TAX UPDATE

Current uncertainty about whether the scheduled repeal of estate tax (for a one year period) will come into effect as scheduled this 1 January 2010 may be resolved over the coming weeks as Congress battles over conflicting proposals, with Republicans advocating that the repeal should be made permanent while President Obama proposes that estate tax should be retained but with the present rate of 45% and the present (since January 2009) lifetime exclusion of $3.5 million.

The good news is that there appears to be no support for rolling back rates and exclusions to the levels that applied before the current temporary changes were enacted in 2001. We will report any new legislation in an upcoming Focus.

Article by: Jeffrey Gould

TRANSATLANTIC FRANK HIRTH TEAMS UP WITH BA

We have teamed up with British Airways to promote our unique expertise in US/UK tax matters to the transatlantic traveller. Readers may be interested to know that, as from 29 September this year, British Airways is offering a high-speed, business class only shuttle service between London City Airport and New York's John F. Kennedy Airport. The 32 seater Airbus A318 jet (pictured) will be making the journey twice daily 6 days a week.

This newsletter has been written for the general interest of our clients. It is therefore essential to take advice on specific issues.
We believe that the facts are correct as at October 2009 but there may be certain errors and omissions for which we cannot be responsible.