

June 2008

Sunday Supplement

Reclaim your Spanish tax ... or should you?

Some Sunday newspapers have been getting excited about a change in the Spanish tax system, which could allow Britons who have sold Spanish property in the last few years to claim a tax rebate. The *Sunday Telegraph*, for example, suggested that those affected should initiate legal action to claim the repayment. However, we caution that such action could leave UK taxpayers with a hefty legal bill and no tax repayment!

The discriminatory 35% tax rate

The issue relates to Spanish Capital Gains Tax levied against non-Spanish nationals. Until recently, they had to pay 35% tax on their gains, compared to just 15% for their Spanish counterparts.

The EU challenged this system on account of it being discriminatory and, as a result, the 15% tax rate applied to everyone from the beginning of 2007. However, those who had previously paid the 35% discriminatory rate have not been offered automatic refunds. Legal firms in Spain have been offering to act for those wishing to take legal action to get their 20% difference back.

Most firms are offering a 'no win, no fee' arrangement, by which they charge 35% of any tax that is successfully reclaimed. The *Sunday Telegraph* has urged those affected to begin a claim as soon as possible, suggesting that an average of £8,300 could be repaid to successful claimants.

Should you claim?

We are concerned that such reporting does not take into account the interaction between the Spanish and UK tax systems when a UK resident has sold property in Spain.

More particularly, a reduction of tax in Spain may well lead to an increase in the UK liability.

If you are UK resident and sold property in Spain before 2007, you are likely to have suffered UK tax between 24% and 40%. However, you are allowed to deduct the tax paid in Spain against your UK liability, up to a maximum of the UK liability. For example, if you have an effective rate of 40% in the UK and 35% in Spain, you only pay 5% in the UK on account of the amount you paid in Spain.

The tax paid in Spain therefore has a direct impact on the tax paid in the UK. If the tax paid in Spain reduces, the UK liability can often increase by the same amount. This applies even if a sale occurred some time ago because UK taxpayers must inform HM Revenue & Customs (HMRC) if they ever receive a rebate in foreign tax. A successful claimant in Spain would therefore need to tell HMRC that their tax liability had reduced.

Let's look again at the taxpayer with a UK rate of 40% on the sale of his Spanish property. With a 35% Spanish rate, he is only paying 5% in the UK. However, if the Spanish rate is reduced to 15%, the UK tax payable increases by the same margin to 25%. He must therefore pay all the Spanish tax repayment to the UK authorities and is potentially left with the legal fees from the Spanish lawyer. Someone with a UK tax rate of 24% would be in a better position, as he would only need to repay 6% to the UK authorities. But when the Spanish legal fees are added to this, he would not be making as much money as he might otherwise think.

What is your UK tax rate?

It is quite possible that some taxpayers will benefit from taking legal action in Spain to reclaim their 20%, but careful

consideration must be taken over how this would affect the UK liability. It may well be more beneficial to let sleeping dogs lie!

Taxman targets landlords!

Another month, another HMRC crackdown! The press has recently picked up on the fact that HMRC has been quietly gathering information on individuals who let out properties to tenants but who have not necessarily been declaring their income.

It is thought that thousands of landlords will be targeted, with an initial wave of 5,000 letters being post in April. It is possible you may have already received a letter.

If you have not been declaring all your property income, you should not fear the worst straight away! Allowable expenses to set against rents for tax purposes are generous and you may find your tax bill is lower than you think. However, you do need to declare all your income to HMRC and we suggest professional advice is taken as soon as possible if you feel you may be affected.

It is our belief that if you have undeclared offshore income and did not participate in the amnesty, HMRC is likely to be knocking on your door at some point in the future.

All is not lost, however! HMRC will still accept any 'voluntary disclosure' after the deadline. Such disclosures should also carry minimum penalties, which are rarely much higher than 10%.

Speed is crucial to ensure you speak to HMRC before it speaks to you. We would therefore recommend that anyone concerned about their offshore income seeks urgent professional advice.



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HMRC bureaucracy threatens new inheritance tax relief

It was with much publicity that the Chancellor announced in his Pre-Budget Report late last year that married couples and civil partners would be allowed to share each other's nil-rate bands for Inheritance Tax (IHT) purposes. The nil-rate band is the value of the estate that is not subject to IHT.

The new measure

The government was quick to highlight that this would allow couples to keep more of their combined estate out of the taxman's reach, while at the same time blunting opposition pressure to increase the nil-rate band for all individuals.

The new measure works as follows. On the death of the first partner, the proportion of their unused nil-rate band is calculated. Then, on the death of the second partner, that same proportion is added to the second partner's nil-rate band, using current rates. For example, if the first partner died leaving 50% of his nil-rate band unused and the second partner dies in the current 2008/09 tax year, the amount available to the second partner is the current limit of £312,000, plus an additional 50%, totalling £468,000.

The paperwork chase

One key feature of the measure was that it could apply to all couples where the second partner died on or after 9 October 2007, regardless of the date of the first death. However, as many newspapers are now highlighting, HMRC's demands for paperwork relating to the first death is making it very difficult for some widows and widowers to take advantage of the new measure.

Many are reporting that HMRC is insisting that a long list of documents is produced to prove that the late spouse has not used all of his nil-rate band, before allowing a transfer to the surviving spouse. Such documents include the grant of probate, the will and any deed of variation.

The problem arises because it has been practice for most solicitors to store documents for just six years, and grants of probate for 12 years, before destroying the documents. This is making it very difficult for elderly taxpayers to gather the documentation needed to prove how much nil-rate band was actually used by their deceased spouse.

The attitude of HMRC to this problem has, so far, been very unsympathetic. The current stance is to insist that documents are produced in order to substantiate claims. It believes that it is possible to obtain copies of some of these documents, such as wills, from public record bodies such as the Court Service and General Register Office, and expect the surviving spouse to locate such documents. However, this would certainly prove very difficult to do for elderly people without professional help.

Going forward

Accountants have emphasised to HMRC the need to be more lenient in its treatment of elderly people whose spouses died many years ago and where there are few records available. We wait to see whether HMRC's attitude will soften in the coming months. However, should you have any worries regarding the new arrangement, professional advice should be sought. It would clearly be unfortunate for an estate to be burdened with a large inheritance tax bill just because the paperwork was not in order.

10p tax row

The Chancellor's recent announcement that he would raise the personal allowance for the current 2008/09 tax year by £600 means that all basic-rate taxpayers will now pay £120 less tax than they would otherwise have done.

His claims that higher-rate taxpayers would be unaffected by the changes (due to the level at which they start paying 40% tax reducing by £600 from £41,435 to £40,835) has come under closer scrutiny by the press.

The *Telegraph* recently claimed the reduction was actually £1,200 (from £36,000 to £34,800 of taxable income) and that up to 150,000 taxpayers would have higher tax bills because they would now be paying 40% tax.

On this occasion, we think the press have got confused. The *Telegraph's* use of taxable income does not take into account the fact that the personal allowance has increased for everyone.

However, this still means that those with annual incomes between £40,835 and £41,435 will have an increased tax liability of up to £120, although regrettably, it is unlikely this will cause the Chancellor further sleepless nights.

For further advice please contact Tim Norkett by telephone on 020 7842 7151, or by email tim.norkett@horwath.co.uk