



**DAVID PATTINSON**  
**CHARTERED ACCOUNTANTS**  
Tel: 01636 706543 E-mail: david@davidpattinson.co.uk



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## NEWSLETTER

### State Pension and Tax

Many people do not realise that the state pension is taxable, although it is always paid gross, with no tax deducted. What the state pension effectively does, in most cases, is reduce the amount of personal tax allowance which is available to set against other income, such as private and company pensions. In administering the PAYE system, what HMRC does is to issue a tax code for the private/company pension which deducts the state pension from the personal allowance, leaving just a small code number. Although tax is deducted only on the private/company pension, it is actually the total due on that and the state pension.

The recent high rate of inflation meant that the state pension rose by about 10% in April 2023, but the personal allowance was frozen. Some people could now be liable to tax even if the state pension is their only income, but whether HMRC would bother collecting such small amounts of tax is uncertain. Precisely to avoid that situation, there used to be a higher tax allowance for people over 65, but it was abolished some years ago, after some significant increases in the personal allowance made it largely irrelevant.

There are no plans to increase the personal allowance until April 2028, but the state pension will be raised every year because of the "triple lock" which increases it by the rate of inflation, wage rises, or 2%, whichever is higher. That will bring more and more pensioners into tax and people with private/company pensions will see significant increases in their tax deductions. In some cases it may not be possible for the pension company to deduct the right amount of tax, because the PAYE rules say that the tax cannot be more than 50% of the gross amount.

I wonder whether Jeremy Hunt foresaw any of these problems when he decided to freeze the personal allowance for several years.

### SEISS Grants

During the Covid-19 pandemic, the government paid out up to 5 grants over 2 tax years to self-employed people who declared that their businesses had been adversely affected by lockdown. Surprisingly, I have not seen a single instance of HMRC querying someone's entitlement to claim, even where the tax return showed no drop in income.

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### Over-Zealous Enforcement

One thing which really annoys me is being contacted by government agencies or other organisations asking me to confirm that I am not breaking their rules. I used to receive letters from TV licensing, based solely on the fact that my office is an address without a TV licence. I always ignored them and they seemed to give up after a few years. Now I have started receiving phone calls from PPL PRS, the organisation which licenses copyright music, asking whether I play music in the office. Likewise I have refused to answer.

That is not how law enforcement should work. In a free society, people should be able to go about their daily lives without being required to give assurances that no laws or other rules are being broken. PPL PRS should not interfere in people's affairs unless they have evidence of a breach of copyright law.

That amounts to asking people to prove their innocence and an analogous situation sometimes arises in tax enquiries, particularly where the taxpayer is self-employed. HMRC will request all business records (which the taxpayer is legally required to retain and hand over) but may also ask for private bank statements (which they have no right to see unless they contain transactions relevant to entries on the tax return). Many unrepresented taxpayers do not realise that they could challenge such a request, so meekly hand over their private bank statements.

That allows HMRC to carry out what is no more than a "fishing expedition" looking for undeclared income. Sometimes perfectly innocent items, such as gifts from family, can end up being taxed just because the taxpayer cannot prove what they are. Some people (even in tax tribunals occasionally) express the view that the private statements might as well be handed over if there is nothing to hide, but they are failing to see that it would be an infringement of civil liberties and the right to privacy.

## Taxation of Property

It may seem like stating the obvious, but the taxation of income from property must follow its legal ownership. Surprisingly, I have seen cases where income from a property owned by one spouse has been declared as income of the other, just because it gives a lower tax bill. Quite simply, that is tax fraud.

In the case of married couples, there is a specific rule that income on jointly-owned property has to be shared equally, unless there is a Declaration of Trust (which cannot be backdated) stating that the property is held in unequal shares. Other joint owners, however, can allocate the income among themselves in any way they please, even giving it all to one of them.

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### Self-Assessment Powers

The principle of self assessment is that the taxpayer (or accountant) submits a tax return and, unless there are obvious errors or omissions, HMRC then issues a tax bill based on those figures. HMRC has 12 months (the enquiry window) to raise queries, otherwise the figures become final, unless deliberate fraud can be proven.

The Taxes Acts set out a statutory procedure for making enquiries into a tax return, including issuing a formal notice at the start. That will be accompanied by a list of documents to be produced. If the taxpayer fails to respond or challenges the relevance of any request, then HMRC can issue a formal request and the taxpayer can appeal to an independent Tax Tribunal to make a decision.

Sometimes, however, HMRC does not want to follow the law. Last year, I submitted the first accounts and tax return of a new client, who was entitled to a tax refund. Instead of paying the tax refund immediately, as is usual, HMRC sent a letter requesting additional information, on the pretext that they needed to carry out identity checks because of an increase in the number of fraudulent tax refund claims. The documents requested covered these areas:

1. Identification, which was reasonable.
2. Information already held by HMRC, such as PAYE earnings.
3. Items which should be requested only in a formal enquiry, such as bank statements and receipts for expenses.

Furthermore, the letter threatened to permanently withhold the repayment and remove my client from self assessment. When I telephoned HMRC to challenge the requests under 2 and 3, I was told that “thousands of people have already answered these letters” as if that provided some justification. When I wrote and asked for the legal authority, HMRC simply quoted their general powers to manage the tax system, as if they could ever override a specific provision elsewhere in law.

I provided only the identification documents and complained about the other requests. HMRC quickly backed down and paid the refund, but without admitting that they had done anything wrong. Additionally, they reimbursed my fees for the time I had wasted trying to reach them by telephone.

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### VAT Penalties

There have always been penalties for late submission of VAT returns and late payment of VAT but, until recently, they were always based on the amount due on the VAT return, so could be quite small. That all changed in January 2023 with the introduction of fixed penalties. It takes more than one default to incur the first fixed penalty of £200, but subsequent late submissions will immediately lead to another £200 penalty.

To bring VAT into line with other taxes, interest will also be added to late VAT payments and repayments.

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### Sales Suppression

I read recently that HMRC is sending letters to retail businesses stating that they have information that the till system may have been misused to reduce tax payable. I do not know what is meant by that, but it reminds me of a story from the early days of video rental shops (remember them?).

A software company produced a specialised program for video rental shops, to record customer details, rentals and income. It sold well because it deliberately under-recorded sales and therefore VAT payable. Everybody was happy until an alert VAT inspector realised what was happening at one shop, leading to the software supplier being prosecuted and every one of its customers being investigated.

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### Pass it on

**Please** feel free to copy or pass on this newsletter to friends and business acquaintances. Anyone who would like to be added to the mailing list should e-mail me at the address below.