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newsletter

WINTER 2010

Is there a doctor in the house?

You may remember recent HMRC attempts to 'encourage' certain individuals to review their tax affairs. The New Disclosure Opportunity (NDO) related to offshore bank accounts and the Tax Health Plan (THP) related to doctors, dentists and other health professionals. Both schemes have now closed.

Both of these schemes provided a chance for those affected to approach HMRC about undeclared tax liabilities and settle them on favourable terms with a reduced penalty.

HMRC have now released details of the outcome of both schemes:

- the NDO raised around £82m from approximately 5,500 disclosures; and
- the THP raised around £9m from approximately 1,500 disclosures, with one case alone raising £1.2m!

Whilst details of future campaigns have yet to be agreed with ministers, HMRC are making it clear that they hold information that has still not been disclosed, particularly in relation to doctors and dentists.

HMRC also pointed out that disclosures have identified others who should have come forward but who have not done so, such as other partners in the same medical practice.

HMRC have stated that they will start investigations into these cases in the autumn, so anyone who has anything to tell HMRC would be wise to do so sooner rather than later. Please do get in touch if you would like to discuss these matters in more detail.

Restrictions revealed

The uncertain situation over the tax relief on pension contributions finally appears to be over. The Coalition Government considered that legislation passed by the previous Government was too complex. That legislation involved charging high earners with an additional income tax charge in respect of their total pension contributions from 6 April 2011.

However, the Government had also made it clear that some form of restriction/ charge relating to the tax relief on pension contributions would proceed as the measures were budgeted to be worth up to £3.6 billion per annum once established. A consultation period followed and now the Financial Secretary to the Treasury, Mark Hoban MP, has announced that the annual allowance for pension saving will be reduced from £255,000 to £50,000 from 6 April 2011. He said:

'We have abandoned the previous Government's complex proposals and developed a solution that will help to tackle the deficit but not hit those on low and moderate incomes. The Coalition Government believes that our system is fair, will preserve incentives to save and - compared to the last Government's approach - will help UK businesses to attract and retain talent.'

This means that those who are most able to make significant pension savings will still be the primary target group. Where the annual allowance is exceeded a tax charge may apply (but see later). This is generally likely to be 40 or 50% of any excess pension savings. Both personal and employer provided pension savings will be taken into consideration in determining whether an excess arises.

Measures will be introduced to allow individuals to exceed the annual allowance with no tax charge accruing where there is unused capacity from the previous three years. For this purpose the annual allowance for years before 2011/12 will be deemed to be £50,000. To be able to benefit from this facility it will also be necessary for the individual to have been a member of a registered pension scheme at some time during those earlier years.

The Government plans other changes such as a proposal to reduce the lifetime allowance. This is set to reduce from the current £1.8 million to £1.5 million from April 2012. All of this may necessitate some careful planning for those seeking to make substantial pension provision now or in the future. So please contact us for further guidance as to how this may impact on your individual circumstances.

Reducing tax emissions!

Employees and directors who have the private use of an employer owned (often referred to as a company car) have to pay income tax on the value of the benefit. Their employer also has to pay Class 1A national insurance on the value of the benefit. It is therefore critical in replacing such cars that both employer and employee are fully aware of the tax implications before such decisions are made.

This article summarises the changes for this current tax year 2010/11 as well as those which will impact in the next two tax years 2011/12 and 2012/13.

The starting point

The valuation of a car benefit is usually worked out by applying a % to the list price of the car. The list price is the manufacturer's published price for the vehicle, including any accessories and VAT and currently is capped at £80,000. The % is worked out by reference to the CO_2 emissions of the car and its fuel type but for most cars falls in the range 15% to 35%. There are some exceptions, the key one currently being a 10% only benefit for low emission cars up to 120 grammes per kilometre (g/km) CO_2 emissions.

Current changes - 2010/11

A car with CO_2 emissions of 135 g/km was valued at 15% of list price for example in 2009/10 – this has increased to 16% from 6 April 2010. In other words, there is an increase of 1% on the benefit for all cars with CO_2 emissions of up to 235g/km compared to last year. All cars with higher CO_2 emissions were already taxed at the maximum 35% of list price.

In addition two new changes have been introduced in 2010/11 as the government tries to encourage the development and purchase of lower emission vehicles. Firstly a new 0% charge applies for a car (or van) which 'cannot in any circumstances emit CO_2 when being driven' - essentially electric cars! This means that an employee with a qualifying car will pay no tax on the benefit. Likewise, the employer will have no Class 1A NIC to pay on the car.

Secondly a new 5% band has been introduced for cars with CO_2 emissions of 75g/km or less. Various car manufacturers are busy developing cars with such low CO_2 emissions which are available to pre-order.

And the future brings

There are two further mainstream changes from 6 April 2011 as follows:

- A further 1% increase in the benefit will again generally apply to cars with CO_2 emissions of up to 230g/km compared to 2010/11.
- The £80,000 list price cap is to be abolished meaning that more expensive cars will be taxed on the true list price value.

Finally, from 6 April 2012 cars will have to have CO_2 emissions of between 76g/km and 99g/km to be taxed at 10% of the list price (currently up to 120g/km). Cars with CO_2 emissions of 100g/km will then be taxed at 11%, with a 1% increase for every 5g/km increase in CO_2 emissions, subject to the maximum of 35%, attained when cars have emissions of 220g/km or more.

Clearly this menu of changes provides food for thought so that the decisions on car replacements do not result in tax indigestion! A business also needs to consider the tax relief aspects of the cost of the car purchase or lease against their profits, so please do contact us if you require further information on these areas.

Tax Credits

Key changes announced in the Emergency Budget 2010

A number of announcements were made in the Emergency Budget which will affect individuals entitled to tax credits.

Changes in income

Tax Credits for the current tax year are normally determined by the level of household income of the previous year. An individual only needs to immediately report a change of income during the year if it is more than £25,000 above the previous year's income. When the claim for the current year is finalised any income increase below this limit is ignored. This 'income disregard' limit is set to reduce in two stages:

- from 6 April 2011 the limit is to reduce to £10,000
- from 6 April 2013 the limit is to reduce to £5,000.

However, where income falls in a tax year, an individual may currently receive extra credits. From 6 April 2012 it is proposed to introduce a new income disregard of £2,500 for falls in income. This will mean that any reduction in income in a year of less than £2,500 will have no impact on an individual's tax credit award.

The current family element income threshold of £50,000 will reduce to £40,000 from 6 April 2011. Additionally the existing withdrawal rate of 39% will increase to 41% from 6 April 2011.

Working Tax Credits (WTC)

An individual who is aged 50 or over and who has returned to work after receiving a qualifying out of work benefit for at least six months currently qualifies for an additional 50+ element of WTC. This only applies for the first 12 months and from 6 April 2012 this element will no longer apply.

However, from 6 April 2011, people aged 60 and over will qualify for WTC if they work 16 hours a week rather than the current 30 hours required.

Child Tax Credit (CTC)

It is proposed to reverse the decision announced in the March 2010 Budget that an additional amount of CTC would be available for those families with children aged under three from 6 April 2012.

Further, an individual who has recently had a child is entitled to an additional baby element for the first 12 months after the child is born. That element will no longer be available from 6 April 2011.

Please contact us if you need further information about how these changes may affect you.

R&D disaster

R&D tax credits were introduced for small and medium-sized companies as far back as 2000. The relief can be hugely valuable – for every £100 spent on qualifying revenue expenditure extra tax relief can be claimed of £75.

However, as with anything in life, you don't get something for nothing. The tax rules can be complex. Firstly, the definition of qualifying R&D runs to many pages of government guidance. Even if this first hurdle is successfully jumped, there are then more pages of rules laying down exactly what sorts of costs do and do not qualify.

Not everyone can claim R&D tax credits and not all expenditure qualifies. The most important conditions are:

- only companies can claim R&D tax credits. The special R&D tax relief scheme is not available to an individual or partnership
- the company must be a small or medium-sized enterprise (SME) as defined by the European Commission for State Aid purposes
- the R&D does not have to be undertaken in the UK
- the company must be entitled to the ownership rights of any intellectual property arising from the R&D (not for expenditure incurred in accounting periods ending on or after 9 December 2009)
- the spending qualifying for relief must not be less than £10,000
- the spending must not be incurred in carrying out activities contracted to the company by another person
- the expenditure must not have been met by another person (if the R&D project is funded in whole or in part by state aid such as a government grant, none of the spending on that project can qualify for R&D tax credits)
- the payable R&D tax credit is limited to the amount of the company's total PAYE and NIC liabilities of the accounting period.

In a recent case, the director of an engineering company was also the director of an associated company. The director carried out research and development work for the engineering company on behalf of the associated company and his salary had been paid by the associated company. The associated company sent an invoice to the engineering company by way of recharge in respect of the work carried out

Unfortunately, recharges are not a qualifying cost and so the company lost out on its R&D claim. The other difficulty that this case illustrates is that it can be many years after a claim is submitted before HMRC raise an enquiry, so getting it right in the first place and providing enough to HMRC at the start to make an informed decision is vital.

Please do contact us for further information if you think that these reliefs may be relevant to your company.

The future of PAYE?

HMRC have issued a consultation document looking at major reforms of the PAYE system, using real time information. Whilst no decisions have yet been taken, it is an interesting insight into how HMRC view the future.

With real time Information, employers paying electronically would send HMRC details of an employee's pay, the deductions of tax, NIC and student loan repayments, and information about the employee's identity.

The information would be produced automatically by the payroll system at the point of making the payment and would be sent to HMRC via the electronic payments system as part of the payment instructions.

HMRC think that this could simplify the processes when people change jobs, avoiding the need to complete a P45/46, whilst still ensuring that individuals pay the right amount of tax.

This system also offers the possibility of simplifying the end of year process if the employer is providing information during the year which is continuously reconciled by HMRC. Access to real time data could also improve the benefits and tax credits system.

And beyond

Once HMRC are in a position to hold a real time tax account for each individual, further development of a centralised deductions system could follow. When HMRC have specific details for each individual regarding personal tax allowances and other reliefs that may be due, HMRC could then work out the correct deductions of tax, NIC and student loan repayments from an individual's pay. The resulting net payment would then be sent to the individual's bank account. The main thing to note is that employers would not be responsible for calculating tax, etc and so would not need to operate tax codes or a separate procedure for people starting and leaving work.

HMRC estimate that the potential savings to employers from the introduction of such a system could be up to £500m.

For the time being, though, the complexities of the PAYE system remain. If this is an area where you would like more help, please do get in touch.

Update on Furnished Holiday Lettings

The tax treatment of Furnished Holiday Lettings (FHL) has been advantageous for many years. Provided that certain conditions are met, FHL are treated as a deemed trade for certain purposes. This can be more preferable than the tax regime for normal let property in a number of specific areas, as the rules and reliefs for trades are often more generous.

Changes were made in 2009 to ensure that this preferential treatment was available to properties located anywhere in the European Economic Area (EEA) as well as in the UK to avoid discrimination issues.

Repeal of the FHL rules?

The extension was to be temporary as HMRC had already effectively decided to completely abolish the FHL rules for all properties, whether in the UK or EEA, with effect from 6 April 2010. However, these changes never made it through Parliament before the General Election.

The Coalition Government has since confirmed that there will be no changes to the rules for the current tax/financial year. Instead of abolition, new proposals have been put forward as follows:

- that the minimum period over which any property must be available for letting to the public will be increased from 140 days to 210 days in a year
- that the minimum period over which a qualifying property is actually let will be increased from 70 days to 105 days in a year
- that losses incurred will only be set against income from the same FHL business. This means that losses on letting an EEA property could only be set against profits from the EEA business.
- that certain changes to capital allowances would be required.

Clearly, this would mean that some businesses would cease to be FHL and lose several valuable tax reliefs. Even if a business meets the new tests and remains as a FHL, the compliance and record keeping burden will be increased.

The above changes which could apply from April 2011 are not final yet and we will keep you informed of any further developments. Please do get in touch if you would like to discuss how these proposals might affect your own position.

Extracting profits wisely

If a business is run as a company, funds may be extracted from the company in a variety of ways. The most important methods of income extraction are as follows:

- remuneration (including benefits in kind)
- pension contributions
- dividends
- loans from the company
- interest on loans to the company
- rent on personally owned property used in the company's trade.

In addition, some extractions can be structured as a capital gain. These include:

- selling assets to the company for value
- purchase of own shares
- liquidation of the company.

Certain of these gains may qualify for Entrepreneurs' Relief (ER) which means a 10% rate of capital gains tax and is therefore highly attractive. However, such capital extraction methods are only usually available at the beginning or end of an individual's involvement with the company and HMRC have some nasty rules for the unwary, so advance planning is crucial.

For an individual who has ongoing involvement in the company, the main income extraction options are reviewed below.

Dividends v Bonus

Dividends continue to be more tax efficient than bonuses in most circumstances, due to the fact that the corporation tax deduction does not outweigh the added national insurance (NIC) costs of providing cash remuneration. This is particularly attractive for companies that pay the small rate of corporation tax currently at 21%.

It is therefore essential that, if dividend extraction is required, attention is paid to company law procedures and that it is lawful. For dividends to be lawful they must meet two conditions:

- the company must have sufficient profits to finance the dividend and
- the dividend paid to shareholders must be paid according to the terms laid down in the Articles for that type of shareholding.

Benefits

Certain benefits are tax and NIC free and should not be overlooked. In addition, tax relief on their provision is usually available to the company.

Examples currently include:

- cars and vans which don't emit CO_2 emissions
- childcare vouchers
- the provision of a car parking space at or near the employee's normal place of work
- the provision of bicycles and associated safety equipment for mainly home-to-work travel
- a mobile phone
- employer pension contributions.

Loans

Making a loan for a temporary period to a director/shareholder does have a number of taxation implications but can be used effectively. For the company, where loans are outstanding more than nine months after the accounting period end, the company will have to pay a 25% tax charge. However, this will eventually be refunded when the loan is repaid or written off. For the individual, they will be assessed on a benefit for the use of the funds at the official HMRC interest rate, currently 4% of the loan balance annually. The employer will be charged with Class 1A NIC on this element.

However, compared to awarding a bonus or declaring a dividend there may be a tax saving, especially for those in the 50% tax band.

Loans to the company

Loans to the company may provide another route for extracting profits from the company through interest receipts rather than dividend receipts. The company will usually receive a corporation tax deduction for the interest accrued.

However if the interest rate is more than a 'reasonable commercial return' the excess is treated as a dividend and so the excess is not tax deductible.

The company is normally obliged to deduct 20% tax at source on interest paid to individuals and account for it to HMRC (just like on interest paid by the banks).

Pension contributions

Pension contributions are tax efficient for both employers and employees/directors. From the individual's perspective employer contributions are generally tax and NIC free. However those with incomes of £130,000 or more in 2010/11 or in either of the previous two tax years should take advice before making contributions due to targeted anti-forestalling rules. Recent announcements for 2011/12 may also impact substantially on the tax efficiency of significant employer pension contributions for all levels of earners in future tax years so again advice is recommended before action is taken.

From the employer's perspective tax relief is normally available with no employer NIC cost, provided the overall remuneration package is justifiable.

Pension contributions must be paid in the period for a corporation tax deduction to be obtained for the same period.

Using family members

Employing family members or running the company in tandem with them can be a very useful way of both spreading the tax burden within the family and obtaining a business tax deduction. Consideration should always be given to whether the overall package is reasonable and commercial for the value of the work undertaken.

Charging rent on personally owned assets used by the company

Where a property is held outside the company, the proprietor can extract funds from the company by charging up to a commercial rent. The rent paid by the company is deductible against its profits and is taxable in the proprietor's hands. The tax effect is therefore similar to paying remuneration except that no PAYE or NIC is payable.

In many cases the proprietor will have borrowed to purchase the property. The rental income received will ensure immediate tax relief for the resulting interest paid, which can be deducted against it along with other rental expenses.

However, the capital gains relief ER may be affected by the payment of rent.

As you can see, there are many options available to owner managers but each has different consequences. If you would like to discuss your personal options in more detail, please do get in touch.

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