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Money Matters

UK200Group News Update

One of the main concerns of all UK200Group member firms continues to be to improve clients' access to working capital. There is no evidence of real change by the banks. The Enterprise Finance Guarantee scheme, which replaces the Loan Guarantee Scheme, has been taken up by the major banks and we hope to see wider use of it made in the coming weeks.

In uncertain times many businesses look for strategic help and advice. This is where the strong working relationship between UK200Group members and their clients is proving of added value. A pioneering move by the Group is the formation of the SME valuation index for clients looking for investment, merger, acquisition or sale. Until now there has been no benchmark index for valuing SMEs. Providing an average price-earnings multiple is now possible, based on actual deals completed by UK200Group members. For further information on the SME index published in November 2009 please contact us or visit www.uk200group/SMEindex

SPRING 2010

Do all good things come to an end?

The tax treatment of Furnished Holiday Lettings (FHL) has been advantageous for tax for many years but the rules are set to end on 5 April 2010 for individuals and on 31 March 2010 for companies.

One key area of change will be the tax treatment of any capital gains arising on the disposal of a FHL business.

The availability of Entrepreneurs' Relief (ER)

When an individual disposes of a qualifying FHL business the gains have been eligible for ER provided certain conditions are met. The relief reduces gains of up to £1 million per individual per lifetime so that only 5/9th of the gain is chargeable to tax. It does not apply to gains made by companies.

The bad news

A FHL business will be treated as ceasing on 5 April 2010 (31 March 2010 for companies) and will then be treated as a normal property investment business. This means that generally from 6 April 2010 a FHL business will no longer qualify for ER.

And the good

However, the relief should still be available on the sale of any assets comprised in the business provided:

- the asset was used in a FHL business in the 12 months to 5 April 2010 and
- the disposal (for example by sale) occurs before 6 April 2013.

Example

In September 2009 Brenda sold a FHL business which consisted of two North Devon holiday cottages for a combined gain of £97,200. She has not previously used any of her ER entitlement so the gain is reduced by 4/9th to £54,000.

If instead the properties had been retained and not sold until October 2011, the subsequent gain would still be eligible for ER as the disposal is before 6 April 2013. This is the case even where the cottages continue to be let after 5 April 2010 as furnished rental accommodation.

There are similar provisions to allow ER where a company which ran a FHL business is liquidated and a capital distribution is made to qualifying shareholders within three years.

There are other changes arising as a result of FHL businesses ceasing to qualify as a trade. These include:

- restricted availability of capital allowances
- changes to loss reliefs available and
- the non availability of other CGT reliefs.

Please do contact us if you are likely to be affected by these matters.



Changes to the State Pension

Over the last few years a number of changes to the basic State Pension have been announced. Fundamentally, for those who reach pension age on or after 6 April 2010, major differences to the current system will be encountered.

Link to earnings

The basic State Pension will, generally in the future, increase in line with earnings rather than prices. This means it should rise more quickly each year than it does now. This change is due to happen from 2012 at the earliest and by the end of the next parliament at the latest. The change will apply to existing recipients as well as those who reach pensionable age in the future.

The increasing age of entitlement

Currently the State Pension age is 65 for men and 60 for women. For women born on or after 6 April 1950 it will gradually be increased from 60 to 65 between 2010 and 2020. Therefore by 2020 the State Pension age will be 65 for both men and women but this is to be further increased for both men and women to 68 in stages between 2024 and 2046.

The entitlement to the basic State Pension on reaching State Pension age depends on whether the individual has paid or has been credited with

sufficient National Insurance Contributions (NIC) throughout their working life. If there is a shortfall in an individual's contribution record it can be rectified by paying Class 3 voluntary contributions.

The reducing qualifying years

The number of qualifying years in order to qualify for a full basic State Pension is set to reduce. Currently a man generally needs 44 qualifying years and a woman generally needs 39 qualifying years. Where a person reaches State Pension age on or after 6 April 2010, both men and women will generally need only 30 qualifying years for a full basic State Pension. For those with less than 30 qualifying years there will be an entitlement to a least some basic State Pension.

From 6 April 2010, the current system of Home Responsibilities Protection (which protects entitlement to the basic State Pension for those caring for a child or someone who is sick or disabled by reducing the number of qualifying years needed) will be replaced by a system of weekly National Insurance credits.

It is not unknown for errors to occur due to difficulties linking NIC with pension records. You can check your current pension entitlement by asking for a pension forecast. Visit www.pensionservice.gov.uk for further information.

Refurb rules rule OK?

In 2008 a new category of relief was created for 'integral features' under the capital allowances regime. The rules apply for expenditure incurred on or after 6 April 2008 (1 April 2008 for companies) on the provision or replacement of an integral feature of a building or structure. Items that come within the definition of integral features are specifically defined as plant. They fall into a 'special rate' pool which only attracts a 10% annual allowance to the extent that all or part of the £50,000 Annual Investment Allowance (AIA) is not available.

So what is an integral feature?

An integral feature means:

- electrical systems (including lighting systems)
- cold water systems
- space or water heating systems, powered systems of ventilation, air cooling or air purification, and any floor or ceiling comprised in such systems
- lifts, escalators and moving walkways and
- external solar shading.

Prior to the introduction of the integral features category some of these items would have received no capital allowances at all, for example, lighting systems. However, other costs such as air conditioning would have qualified for at least a 25% allowance but now only qualify for 10%.

Replacements

One thing to watch out for is the special rule for 'replacements' which applies to certain repairs on integral features. Normally the repair or refurbishment of an asset (but not improvements) would qualify for 100% tax relief as a revenue deduction. Expenditure would only generally be

classed as a replacement and therefore capital if the whole asset was replaced. However, where the expenditure incurred on an integral feature is more than 50% of the cost of replacing the whole integral feature then this is treated as capital.

The 50% trigger

When undertaking repairs of an integral feature, this replacement rule will be triggered where the actual expenditure, referred to as the 'initial expenditure' exceeds 50% of the anticipated cost of replacing the whole asset, at that particular time.

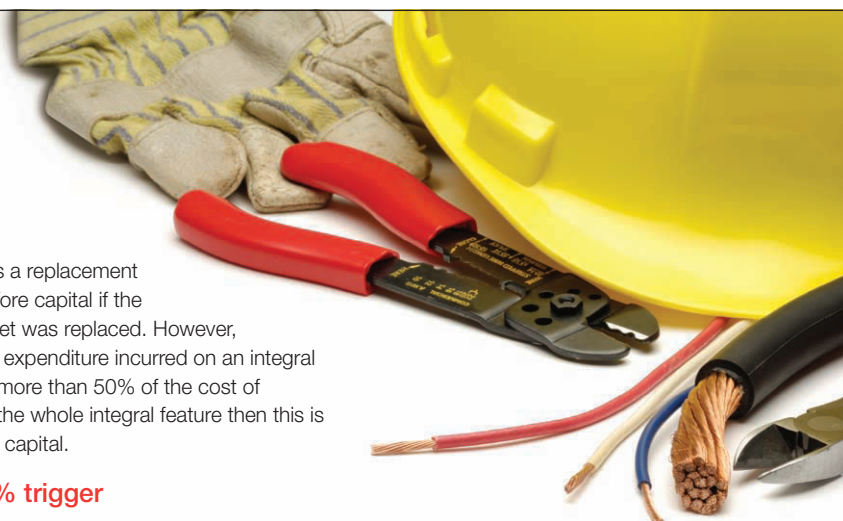
Where additional expenditure is incurred on the same asset within 12 months of the initial expenditure and the combined amount now exceeds 50% of that replacement cost (at the time of the initial expenditure), the combined amount will be treated as capital under the rule.

Putting it into practice

HMRC initially promise a light touch in operating the replacement rules but, read further, and their attitude really boils down to 'prove it or lose it'.

Example

Jane would like to replace the electrics on the ground floor of her shop and gets a quote for £150,000 to rewire the whole building. She then gets another quote to replace the wiring and sockets on the ground floor of £70,000. The replacement cost represents less than 50% of the total replacement cost and so the special integral features rule will not apply, meaning that a 100% revenue tax deduction is expected.



Whilst there is some comfort in this example in that the whole building is generally classed as one asset rather than one floor, a number of other issues arise. Firstly, Jane is obliged to get a quote for work she has no intention of undertaking to prove that what she actually incurs is less than 50% of total replacement cost. Secondly, what happens if the job overruns and the cost increases to £78,000?

Example continued

As the actual cost incurred has exceeded the 50% rule, the expenditure is treated as a capital addition, some of which may attract 100% AIA depending on availability and the balance will be subject to a 10% annual allowance.

It appears that the rules apply separately for each integral, so a separate quote would be needed for wiring, cold water systems, heating, etc.

Clearly, pre planning is essential for any big refurbishment project, so if you have plans afoot, please get in touch with us before you start.



The route to tax free travel

The starting point for the vast majority of payments to employees is that they are taxable. The employee can then claim back the same amount if the cost they incurred was wholly, exclusively and necessarily incurred in doing their job. If employers wish to avoid the aggravation of reporting these business expense payments they can apply for a dispensation. This would also save their employees the hassle of having to submit a tax relief claim to HMRC. One common expense payment area which can be covered by a dispensation is business travel. However to ensure that the payments are eligible for dispensation treatment, ie tax free, requirements need to be met.

Employees are able to get tax relief on the full cost incurred in travelling in the performance of their duties, or to get to or from a temporary workplace. Tax relief is allowed for travel expenses if:

- the employee is obliged to incur and pay them as holder of the employment and
- the expenses are necessarily incurred on travelling in the performance of the duties of the employment.

Ordinary commuting

There is no tax relief for payments towards the cost of ordinary commuting, so they are fully taxable. Ordinary commuting is defined as travel between the employee's home (or any other place the employee does not have to attend for work purposes), and a place which is a 'permanent workplace' in relation to the employment.

Ordinary commuting also applies where travel between two places is substantially the same as home to a 'permanent work place'.

Example

John's ordinary commuting journey to his office in Birmingham city centre is 15 miles, however during the month of March, he travelled directly to a client premises which is located 300 metres from his office base. Such a journey would be classed as ordinary commuting as it is virtually the same journey.

Permanent Workplace

A 'permanent workplace' includes places where:

- there is a period of continuous work lasting more than 24 months; or
- the period of attendance comprises all or almost all of the period the employee is likely to hold the employment; or
- in either case, where it is reasonable to assume that either of these conditions will be met.

A 'period of continuous work' means a period over which, looking at the whole period and considering all the duties of the employment, the duties of that employment fall to be performed to a significant extent at that place.

Private travel

Once again, there is no tax relief for payments towards the cost of private travel, so they are fully taxable. Private travel is defined as travel:

- between the employee's home and anywhere he or she does not have to be for work purposes or
- between any two places neither of which is a workplace in relation to the employment.

There are also special rules for:

- employees travelling between employments where the employing companies are members of the same group
- employees who attend a depot or base and
- area based employees.

As can be seen, although the rules have been around for many years, they have never been straightforward. In fact, HMRC explain them in a convenient 86-page booklet - '490 Employee Travel'!

So, if you have any concerns about these rules or are interested in applying for a dispensation, please do get in touch.

When is published HMRC guidance not guidance?

Answer when it is published in booklet IR20. This booklet, first published in 1973, sets out the Inland Revenue's guidance on the complex issue of residence in the UK. It now seems that, since 2004, HMRC as they are now, have not been following their own guidance and seem to think that anyone else who has been may be wrong.

To prevent any further misunderstanding, HMRC have produced new guidance (which has no validity in law) which reflects a very different approach to the issue of determining residence. The old, simple approach was that if an individual spent at least 183 days in the UK in any tax year they would be treated as resident here and if they had left but spent less than 90 days a year on average in the UK (measured over a rolling four year period) then they could be treated as non resident. It is this latter point that has come under scrutiny.

The new guidance states that residence in the UK (which is not defined anywhere in law) will only be based simply on days in the UK in one set of circumstances – the 183 day rule. In any other situation, days in the UK will be just one of the factors to take into account alongside factors such as:

- the reasons why you left the UK
- the number and duration of visits made after leaving and
- the connections kept with the UK such as family, business, property and social links.

These factors were highlighted by cases heard in the courts up to 100 years ago when the world was a much less mobile place than it is now.

This new approach means that the decision to go non resident is going to require careful thought. The implications for the way of life of the individual and in some cases the personal costs of what may be needed may be considered too high.

The position of those who leave the UK to work full time abroad does not appear to have been affected by this new approach. Where the absence from the UK and the employment contract cover a complete UK tax year and the duties of the overseas employment are full time, then HMRC will still treat the individual as not resident and not ordinarily resident in the UK.

Great care is needed and advice should always be taken.



Nothing ventured is nothing gained

At the time it seemed like a good idea to invest £20,000 in the family company or the venture being undertaken by your lifelong friend but what happens when the venture is not successful and instead of looking at reaping the benefits you are now in a position of losing your capital?

Irrecoverable share capital

A loss on a disposal of shares is a capital loss but, of course, there may be no immediate relief if an individual currently has no chargeable gains to set it against. This is because a capital loss can normally only be relieved against current or future capital gains.

However, certain losses on shares can be relieved against income rather than capital. This alternative treatment may provide tax relief now and could also generate a more substantial tax saving, given that in 2009/10 there is a higher rate income tax of 40% compared to the 18% capital gains rate.

The conditions which must apply for the shares to qualify in such circumstances are:

- the individual must have subscribed for the shares when issued and
- the shares must be in an unquoted qualifying trading company.

Certain trades are excluded such as leasing, legal or accountancy services, property development, farming, and operating and managing nursing homes or hotels.

What about irrecoverable loans?

Where money is lent to a UK resident borrower wholly for use in a trade and that loan subsequently becomes irrecoverable, the lender can make a claim for a capital loss, subject to certain conditions. A key condition is that the loan was not to a spouse/civil partner.

A loan becomes irrecoverable when there is no prospect of recovering it. This would be the case if a company ceased to trade with the prospect of insufficient funds to repay its creditors on dissolution. If the borrower continues to trade, HMRC will want to see more robust evidence that there is no prospect of recovery in the future.

Once established, a capital loss may be set off against capital gains realised by the individual or carried forward until such time as gains are realised in the future.

And loan guarantees?

Similarly, in the scenario that a person has guaranteed a loan and the guarantee is then called upon, so that the individual has to make a payment, relief may also be available.

Again, the loan must have been of money and must have been used wholly for the purposes of the trade.

If you would like further advice on obtaining these reliefs please contact us to review your specific position.

Are you complying with the National Minimum Wage?

Automatic penalties will be levied on employers where HMRC compliance officers find arrears of the National Minimum Wage (NMW) that have arisen after 6 April 2009. Penalties can range from £100 to £5,000 and those employers who settle within 14 days of notification can receive a 50% discount of the penalty for prompt payment. The penalty must be paid in addition to any arrears owed to the workers. The most serious cases of non compliance can be tried in a Crown Court and subject to an unlimited fine.

HMRC officers will issue a combined notice of underpayment and penalty. This will be issued whenever HMRC discover that arrears are outstanding at the start of their enquiries.

The notice details the amounts due to workers and any penalty due on those arrears. The penalty will be half the total underpayments shown on the notice, for pay reference periods starting on or after 6 April 2009. HMRC can pursue arrears claims going back up to six years.

HMRC officers also have significant powers including the right to remove NMW records from an employer's premises for a reasonable period in order to copy them.

If you have any questions about the NMW, please feel free to contact us.