

# Money Matters

AUTUMN 2008

## UK200GROUP news update

How long will the bad news last? There is a lack of confidence which is so necessary for the retail and housing markets and there is no certainty that it will come back in the immediate future.

The residential and commercial property market is expected, traditionally, to be quieter in July and August. However the ballooning price of oil, the rise in material costs hitting manufacturers, food price increases reported and the reluctance of financial institutions to lend, hint that this slow down will be more than a statistical glitch.

Member firms of UK200Group have been working especially hard to help clients during recent difficult weeks. The newly formed UK200Group Property and Construction Group, combining as it does the experience and knowledge of both accountants and lawyers, has an opportunity to make a difference at a difficult time for the industry. This forum for the exchange of experience, knowledge and expertise amongst the multi disciplinary members promises well for the advice and support that can be offered by UK200Group members to their clients.

The continuing exchange of knowledge and experience between individual firm members of the Group helps not only those firms but is an unseen yet important source of support to all our clients.

## It's going to penalties!

The Euro 2008 football championship saw some important games decided on penalties. There is always a huge element of tension and usually it comes down to strength of nerve. The rules are set and both the goalkeeper and the player taking the penalty operate under those rules. How different it would be if the player taking the penalty could decide to change the rules, taking the penalty from two yards away rather than twelve or if the goalkeeper had to stand in one corner of the goal.

Well something like that is happening in the world of tax penalties! It is right that those taxpayers who set out to evade their tax liabilities should be required to pay back the tax with interest and should also suffer a financial penalty. For many years the matter of the level of penalties has been one for negotiation between the taxpayer and HMRC. Account has been taken of the disclosure made by the taxpayer, their co-operation in the investigation and the size and gravity of their

offences. That will all change from April 2009 when a new penalty regime introduced in the Finance Act 2007 comes into effect for the main taxes under HMRC's control.



Under that regime if an error is made on a tax return which leads to tax being lost, or an exaggerated claim for losses or other relief is made, the maximum penalty will be set by law depending on the type of

behaviour that has led to the error being made. No penalty will arise if it can be shown that the error was due to a simple mistake by the taxpayer. The three levels of unacceptable behaviour that will give rise to a penalty are defined as:

- Careless action
- Deliberate action
- Deliberate action with concealment.

Whilst no one will condone deliberate action to evade taxes, the likely definition of careless action will include not doing something that a reasonable person would be expected to do. The borderline between what may be considered an honest mistake and carelessness is going to be hard to establish.

The maximum penalty for each offence can be mitigated by the level of disclosure which has been made by the taxpayer. This includes the degree of co-operation they have shown. Significantly the greater reduction will be where the disclosure is what is termed 'unprompted' which basically means a totally voluntary and spontaneous admission by the taxpayer when HMRC had no indication that anything was wrong. Any other disclosure is regarded as 'prompted'.

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# A Pregnant Pause...

Following changes being made to the Sex Discrimination Act and, later this year, to the Maternity and Parental Leave Regulations, the law on contractual terms of employment during Additional Maternity Leave is due to change for women whose babies are due on or after 5 October 2008.

## Rights during maternity leave

In order to understand the changes it is necessary that you have an understanding of some of the terms used and current employment rights.

Broadly speaking a woman is entitled to take up to 52 weeks maternity leave regardless of

how long she has worked for her employer. This leave is currently broken down into two 26 week periods. The first of which is Ordinary Maternity Leave (OML) followed by 26 weeks Additional Maternity Leave (AML). Her employment rights may differ during these two periods.

## Statutory Maternity Pay entitlement

The first priority is to establish what she must be paid. A woman with sufficient earnings who worked for her current employer before she became pregnant, is entitled to be paid Statutory Maternity Pay (SMP) for up to 39 weeks. For most women, except for those on very low salaries, the first six weeks of her leave is paid at 90% of her average earnings and then the other 33 weeks generally at £117.18.

Entitlement to SMP is dependant on still being on leave from work, so apart from any occasional days at work to 'keep in touch' with her employer, once she returns to work any unused entitlement to SMP is lost.

Employers are entitled to claim the majority of SMP costs back from HMRC via the PAYE system (either 92% or 104.5% of SMP costs depending on the employer's circumstances). Where an employer has contractually agreed to pay more than the statutory entitlement, for example paying half pay throughout the leave period, then only the SMP element would be recoverable.

## What are the current rules on holiday rights?

Currently a woman on OML accrues her holiday entitlement for the duration of her OML. Once the 26 week OML period is over she continues to accrue the statutory minimum entitlement which is currently 24 days including bank holidays.

## Example

Michelle's baby is due on 1 August 2008. Her contractual holiday entitlement is 30 days plus 8 statutory bank holidays being 38 days in total. If she takes her full entitlement of OML and AML then she will be entitled to paid holiday of:

During her OML	$26/52 \times 38 = 19$ days
During her AML	$26/52 \times 24 = 12$ days
Total entitlement	31 days

## Increased holiday rights

For babies due on or after 5 October 2008 a woman will be entitled to accrue her full contractual holiday entitlement throughout her AML as well as the period of her OML.

## Example

Helen's baby is due on 1 November 2008. Her contractual holiday entitlement is also 30 days plus 8 statutory bank holidays. If she takes her full leave entitlement of OML and AML then she will be entitled to paid holiday of 38 days for the leave period.

These days can either be paid for or taken on return to work (as paid leave) so Helen could take a year off and then extend that absence from work for a further 7 weeks and 3 days (assuming she works a normal 5 day week). The holiday period would need to be paid at her normal salary rate. Although SMP costs are mainly funded by HMRC, payment for holidays will need to be paid for by the employer.

The increased holiday rights is one example of the contractual benefits which are now extended. Other benefits such as medical insurance cover must also continue through into the AML period.

If you would like any help with this complex area please do get in touch.



# It's going to penalties! continued...

The table below shows the maximum level of penalty for each type of behaviour and the lowest

level of penalty that the HMRC officer will be able to levy in settling a case depending on the type of disclosure.

Type of behaviour	Max penalty	Min penalty unprompted	Min penalty prompted
Careless action	30%	0%	15%
Deliberate	70%	20%	35%
Deliberate with concealment	100%	30%	50%

In each case the penalty percentage is based on 'potential lost revenue' which represents not just actual tax underpaid as at

present but also amounts in relation to losses which may have been reduced as a result of the enquiry.

These levels of penalties represent a significant increase on the present levels typically negotiated with HMRC officers. They will now be in a much stronger position because the law states there is a minimum level below which they cannot go.

The Finance Act 2008 extends this penalty process to every tax and duty under the control of HMRC and will apply to them from April 2010.

The message is clear – accuracy in producing any kind of tax return is paramount. Failure to do so puts HMRC almost in front of an open goal – they can miss of course, but don't bank on it!



## All the best things come in small green packages...

In a year when motoring costs have spiralled and are set to increase, the news that there are changes to the tax treatment of business cars should attract attention.

In recent years the government has introduced certain tax incentives to encourage investment in new plant and machinery including cars which are more environmentally friendly or energy saving. It was reasonable to expect that further developments in this policy would occur.

### The green benefit

So, on Budget day the announcement that up front tax relief of 100% would continue for businesses of all sizes on new 'green' car purchases, was not unexpected. The arrangement which has been around for the last 6 years was due to end on 31 March 2008. It now has a new lease of life to 2013.

One key change has been made however in relation to what qualifies as a 'green' car.

From 1 April 2008 the new car will have to emit no more than 110 grams of CO<sub>2</sub> emissions per kilometre (gm/km). Previously it was 120gm/km. The CO<sub>2</sub> emissions of a car are readily available as it is a required piece of information on the vehicle registration document, so has to be supplied by the car manufacturers by law.

Various websites provide lists of eligible cars including comcar.co.uk. The list of qualifying models is currently short and often only basic versions of small cars will qualify, as higher specifications such as automatic transmission increases the emissions. Many come with a low price tag, some for as low as £7,000, a further potential attraction. Qualifying cars include Citroen C1, Toyota Prius, Peugeot 107 and even a 1.6 diesel version of the Mini Clubman if you want to splash out!

### Employees benefit

Where qualifying low emission cars are provided for employees, another change from 6 April 2008 means there is a significant reduction in the employment benefit, so both the business and the employee benefit.

The employee in fact will have only a £700 benefit charge to income tax on a petrol fuelled car with a £7,000 list price as the benefit is only 10%. If they had a qualifying car in the previous tax year this would have been charged at 15% and a benefit charge of £1,050 would have applied. Moreover this reduction of the benefit to 10% applies to cars right up to 120gm/km and not the new lower 110 gm/km threshold.

The only negative is that if the low emission car is a diesel then there is an extra 3% charge as in previous years.

A further advantage for the business is that as the employment benefit is lower, it reduces the Class 1A employer only National Insurance cost of providing the car.

## Selling part of your share portfolio?

The start of the tax year saw some fundamental changes to the system of capital gains tax (CGT) for individuals. The changes which made the headlines were:

- taper relief being abolished
- the availability of indexation or inflation allowance being removed, and
- the introduction of a flat rate of capital gains tax of 18%.

However one area which did not receive so much attention was the simplification of rules for the disposal of company shares.

### Simplification of the share identification rules

From 6 April 2008, all shares of the same class in the same company will be treated as forming a single asset, regardless of when they were originally acquired.

There are some exceptions to these rules however, as 'same day' transactions will continue to be matched and the anti-avoidance rules will remain, such as the requirement to match together a disposal with any share acquisition in the next 30 days, where the purchase is of the same class of shares.

Also the cost of any shares acquired prior to 31 March 1982 will be rebased to the shares value on 31 March 1982.

### Example

On 15 August 2008 Jeff sold 2000 shares in a plc for £20,000. He had acquired shares in the plc as follows:

1000 in January 1980      cost £500

This cost would be increased to the value at March 1982 of £1000

1500 in March 2001      cost £3000

1500 in July 2005      cost £4000

The total cost of the holding of 4000 shares is £8000 (£1000+£3000+£4000).

Due to significant stock market changes he decided to purchase a further 500 shares on 30 August 2008 in the same company for £2000.

### Step 1

In order to calculate the gain you have to ascertain which shares the disposal will be matched with.

The disposal of 2000 shares will be matched firstly with the later transaction of 500 shares as it is within the following 30 days and then with 1500/4000 of the single asset pool calculated on an average cost basis being £3000 (1500/4000 x £8000).

### Step 2

The gain is calculated as sale proceeds (after deducting incidental costs) less the costs calculated above. So his CGT computation will be:

	£
Proceeds 500 shares $500/2000 \times £20,000 =$	5,000
Less cost of the shares purchased in August 2008	<u>(2,000)</u>
Gain	3,000
Proceeds of the remaining 1500 shares	15,000
Cost on average cost basis	<u>(3,000)</u>
Gain	<u>12,000</u>
Total gain (3,000 + 12,000)	<u>15,000</u>

### CGT annual exemption

It shouldn't be forgotten that every tax year each individual is allowed to make gains up to the annual exemption without paying any CGT. This year's annual exemption is £9,600. This exemption should not be wasted.

So to return to Jeff's sale of shares, the gain above would be reduced by the annual exemption of £9,600 to £5,400 and this would be taxed at 18% resulting in a tax charge of £972.

Careful planning of capital asset disposals is essential to minimise tax liabilities. We would be happy to discuss the options with you.

# The real value of stock

On occasion trading stock is not sold in the normal course of business but is instead used for another purpose.

Examples of this include:

- goods taken for own use by a sole trader
- retention of stock on cessation of trade
- a transfer to fixed assets.

HMRC have always contended that an adjustment should be made to trading profits as if that stock had been disposed of at market value. So if jewellery for example retailed at £3,000 but cost the business £1,000 and the shop owner decided to use stock to provide gifts to family, then his profit will be increased by £2,000 as if he had sold the goods to a retail customer.

## Accounting versus tax treatment

The authority for this has always been based on old case law but in recent years a conflict has arisen because trading profits have been required by tax statute to be computed in accordance with generally accepted accounting practice (GAAP).

Under UK GAAP, where a person disposes of stock other than by way of trade such as for personal use, then the transaction would normally be accounted for at cost. For a property development company which transferred a property from stock for permanent use in the business as a fixed asset, using a cost basis for transfer under GAAP rather than market value could have a significant tax saving effect.

UK GAAP does not however apply where an adjustment is required by a specific tax law so the issue was whether the old case law was sufficiently robust to be globally applied.

The Finance Act 2008 now puts the market value principle onto a firm statutory basis and has applied since 12 March 2008. The new provisions have a broad application and include acquisitions into stock as well as transfers out of stock, when made other than in the course of trade. Please contact us if this area of transactions is relevant to you.

# When it goes wrong..?

They say we learn from our mistakes but in taxation matters errors can often lead to interest and penalties so a second chance is much appreciated.

For sometime a VAT registered trader has been able to correct VAT errors of previous returns in the period in which the error is discovered. This correction was allowed as long as the net errors were below £2,000. So if a trader had reclaimed input VAT of £1,750 on the purchase of a car which is generally not recoverable and this was discovered at a later date it could be easily rectified and the additional VAT paid over.

Net errors over £2,000 had to be separately notified to HMRC and usually attracted interest.

For return periods commencing on or after 1 July 2008 - the £2,000 limit is increased to the greater of:

- £10,000 or
- 1 per cent of turnover, subject to an upper limit of £50,000.

This revised limit should cater for the majority of trader situations.

# Will your business disposal qualify?

For gains on qualifying business disposals up to £1 million, the combination of the new Entrepreneurs' relief (ER) and the flat rate 18% has the same overall tax effect for the higher rate payer as the old taper relief with a 40% tax rate. But that is where the common ground ends.

There is a huge danger of thinking that the same type of business disposals which qualified for taper relief will qualify for ER. Let's take a look.

## Shares

Under taper relief generally all shareholders of unquoted trading companies would, on a disposal of shares, have benefited from taper relief. There was no minimum holding required. There was no requirement to be employed by the company. Under ER each individual who wants to obtain ER will have to:

- own a minimum of 5% of the ordinary shares and be able to exercise 5% of voting rights AND
- be an officer or employee.

Both conditions must be met for the 12 months leading to the disposal of the shares.

## Example

Mel has owned 3% of the shares in a family owned company for many years and works full time as an employee. Her husband Martin owns 10% of the company but is not involved as an officer or employee. Under taper relief, a disposal by either individual resulting in a gain would have qualified but under the ER rules neither gain qualifies. This is

because Mel owns less than 5% currently and Martin is not an officer or employee.

In this case, one solution would be for Martin to transfer some or all shares (using the special no gain rule between spouses) to Mel so that the whole 13% holding will qualify once she has fulfilled the 5% holding requirement for 12 months. There are other alternative solutions and if you consider your company and its shareholders to have similar issues please contact us now so that the structure can be altered in good time for future disposals.

## Unincorporated business

For a sole trader, under taper relief the sale of an individual asset used in the trade would have attracted taper relief. Under ER it will be essential that the business disposal consists of either the entire business or a clearly separate identifiable part.

## Example

Malcolm sells his business shop premises and continues to trade from rented premises at a nearby location. Under taper relief this disposal would have qualified. Under ER it will not as it is a business asset that has been sold, not the actual business. As in the first scenario, if you have any concerns about your disposal plans and the availability of reliefs and ER in particular please contact us for assistance.

