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Money Matters

Government defers income shifting rules

As you are no doubt aware some tax planning revolves around ensuring that all family members' are able to utilise their personal allowances and lower rates of tax.

It has been common practice to introduce an otherwise non-working spouse as a partner or shareholder, to enable part of the profit of the business to be allocated to that spouse. These measures can result in tax and national insurance savings.

The government had said that they would legislate to prevent 'income shifting' in April 2008 and then deferred their plans until April 2009. However in the Pre-Budget Report, the Chancellor made the following announcement:

'The government firmly believes it is unfair to allow a minority of individuals to benefit financially from shifting part of their income to someone else who is subject to a lower rate of tax, known as income shifting. The government has consulted on this issue but, given the current economic challenges, the government is deferring action and will not bring forward legislation at Finance Bill 2009. The government will instead keep this issue under review.'

We will keep you informed of developments.

SPRING 2009

Use it or lose it

Referees in Rugby Union are often heard telling players that they must use it or lose it – meaning that if they don't take advantage of the possession that they have, the opposition will be given it. There is an important tax relief for owners of businesses where the same message can be given.

If you run a business, whether it is unincorporated or you hold shares in a company (the 'business'), the value of that business may represent a significant part of your total wealth. The tax rules recognise this and provide a very important relief, known as 'Business Property Relief' (BPR) which applies for inheritance tax (IHT) purposes. At its best this relief provides 100% relief from IHT when passing on the business. This should mean that there is little risk of the business having to be sold to meet IHT liabilities on the death of the owner.

Such a generous relief has many conditions and it is important to ensure that your business meets the conditions for relief. Unlike the new Entrepreneurs' Relief for capital gains tax there is no requirement to hold a minimum shareholding in an unquoted company or be actively involved in the business. However generally, the business must have been owned for at least two years before a transfer. You must also ensure that there is no binding contract to sell the business in place at any time – for example an agreement between partners that on the death of one of them, the remaining partners must buy out that share of the business.

Most importantly of all you must ensure that the business does not consist wholly or mainly of making investments or dealing in land, buildings or shares. Wholly or mainly is generally judged as more than 50%. If the business simply has a trade and does nothing else, this will not be a problem. The issue can arise where the business starts to hold investments such as property. HMRC will look at a number of factors such as the level of rental profit compared to trading profit. These various factors are then judged together to form a view of whether the business qualifies for BPR.

This may be very relevant in the current climate for property development businesses. Where the business normally develops and sells on property there is no problem for BPR. However in the current climate there may be a need to hold on to completed developments and rent them out until the market improves and a sale can be effected. A recent case before the Special Commissioners has indicated that it is important how such rented properties are viewed by directors and how they are shown in the accounts of the business. Retaining them as trading stock and not as longer term investments may be critical to winning an argument on the status of the business.

Making sure that the conditions are in place is critical if you are going to pass on your business. Do remember that if you sell the business, then whilst you will have a significant cash sum to enjoy, you also have a potential major IHT problem because there is no entitlement to BPR on cash. There are ways in which the business can be passed on in lifetime to secure BPR and make IHT planning much more effective and we can talk to you about these planning ideas.

UK200Group quality assured professionals

Healthy warning

New legislation in the form of the Health and Safety Offences Act 2008 came into force in January 2009. It increases the penalties and provides the courts with greater sentencing powers for those who flout health and safety legislation.

Why?

It had been generally considered that the level of fines for some health and safety offences was too low. These changes will ensure that sentences can now be more easily set at a level to deter businesses that do not take their health and safety management responsibilities seriously and further encourage employers and others to comply with the law.

The Act raises the maximum penalties that can be imposed for breaching health and safety regulations. The range of offences for which an individual can be imprisoned has also been broadened.

The effect of the Act is to:

- raise the maximum fine which may be imposed in the lower courts to £20,000 instead of £5,000 for most health and safety offences;
- make imprisonment an option for more health and safety offences in both the lower and higher courts; and
- make certain offences, which currently can only be tried in the lower courts, able to be tried in either the lower or higher courts.

For further information on health and safety matters: www.dwp.gov.uk

New rules on tax relief for business expenditure on cars

As you may be aware, the government is introducing new rules for capital allowances on business cars. The new rules apply to expenditure incurred on or after 6 April 2009 (1 April 2009 for companies). The 100% immediate write off for expenditure on cars with CO_2 emissions of 110 grams per kilometre (g/km) or less remains but the old 'expensive car' rules are abolished.

The rate of annual writing down allowance (WDA) for expenditure on other cars will be determined by the car's CO_2 emissions. The new rules provide that expenditure on cars with CO_2 emissions:

- not exceeding 160g/km will be pooled in the 20% pool: and
- over 160g/km will be pooled in the 10% pool.

The big issue here is that, because the cars are pooled, there will be no immediate relief on sale for any balance of expenditure unrelieved at that point (a balancing allowance) – the remaining balance will instead continue to be written off at 10% or 20%.

Cars with private use

Expenditure incurred on a car which is provided or used partly for non-business purposes will continue to be allocated to a single asset pool. These rules generally apply to cars used by proprietors of self employed businesses. The WDA of this single asset pool will be determined by the CO_2 emissions of the car as above and the allowances will continue to be adjusted so that only the proportion of the allowances relating to business use is allowed. As the car is in a pool of its own, a balancing allowance may be due on disposal.

Cars acquired before 1 or 6 April 2009

Expenditure on cars costing less than £12,000, incurred before either the 1 or 6 April 2009, will continue to be pooled in the main 20% pool, regardless of the car's CO_2 emissions.

Expenditure on cars costing more than £12,000 and incurred before either the 1 or 6 April 2009 will continue to be allocated to a single asset pool and subject to a 20% WDA. This treatment will continue for a transitional period of five years or longer depending on the accounting period of the business. For these cars the WDA will continue to be capped at £3,000 per annum for each period. If the car is disposed of before the end of the transitional period, a balancing allowance may be available. However, any balance of unrelieved expenditure in the relevant pool after the transitional period will be added to the main 20% pool.

Example

A company bought a car for £35,000 in its accounting period ending 31 December 2008. This expensive car went into a single asset pool on acquisition.

As it is pre-April 2009 expenditure, allowances will be calculated under the old rules for the transitional period.

The transitional period will end on 31 December 2014 (the last day of the first accounting period to end after 1 April 2014). At 31 December 2014 any unrelieved expenditure will be transferred into the main 20% pool.

Expenditure on cars purchased prior to April 2009 and allocated to single asset pools, so that adjustments for non-business use can be made, will continue in single asset pools. These pools will continue to attract a WDA of 20% even after the transitional period has ended until the car is disposed of.

Leasing

Currently, a business faces a reduction in the amount of rental payments allowable as a tax deduction on the hiring of most cars if the retail price of the vehicle, when new, exceeds £12,000.

Where a lease commences on or after the 6 April 2009 (1 April 2009 for companies), the reduction in the amount of car lease rental payments will be applied only to expenditure on cars with CO_2 emissions over 160g/km. The new rules will disallow a flat rate of 15% of the amount of the deduction that would otherwise be allowed.

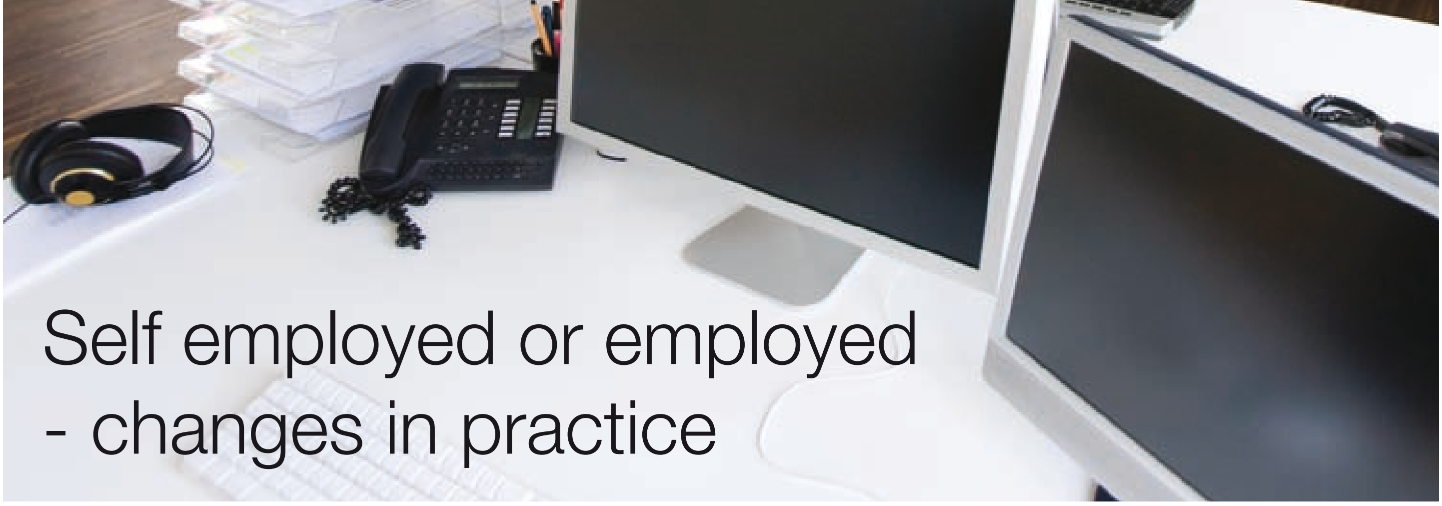
So what to do next?

The main consideration if a business is acquiring a car in the near future will be whether to incur the expenditure before or after 1 or 6 April 2009.

For expenditure after these dates, the critical factors will be two-fold:

- whether to buy or lease
- the emissions of the vehicle.

The changes are not straightforward. Please do get in touch if you would like to discuss these matters further.



Self employed or employed - changes in practice

In the case of Demibourne, the company was required to pay all the PAYE tax due to the reclassification of an individual as an employee. HMRC practice over many years had been, provided that the individual had paid income tax on a self employed basis, to treat this as tax due on earnings and to allow the employer a credit against the overall outstanding liability.

In Demibourne, HMRC sought a full settlement of the tax, with no set-off for the tax already paid by the individual on a self employed basis. The Commissioner upheld this approach – the employer could not claim a set-off for any tax paid by the individual.

New regulations have been introduced from April 2008 to help address this issue. Broadly, the new power allows HMRC to make a direction to transfer part of the employer's tax liability to the newly-classed employee in given circumstances.

The rules will apply if the amount of the payment which should have been taxed as employment income has been included in a self assessment made by the individual or, although a self assessment has not yet been made for the year in question, tax has been paid in relation to the income in question, either as a payment on account or as a subcontractor deduction.

Where certain 'trigger' events occur HMRC will consider the transfer of the tax liability. Such trigger events include situations where HMRC formally assess the employer for all the tax concerned and also where the employer agrees that the individual in question should be 'on the books'. The new rules are capable of applying to previous tax years where certain conditions are met.

Once any transfer has taken place, the employer will be relieved of the tax liability transferred but will remain liable for any tax in excess of the amount covered by the transfer. The individual will have a very limited right of appeal.

In practice, this means the employee's self assessment for the year(s) in question can remain undisturbed. The tax already assessed or paid via self assessment will equal the amount of tax transferred.

However, the employer will remain potentially liable to penalties on the full amount of tax which should have been deducted, or accounted for, under PAYE. The extent to which penalties are charged will depend on the degree of culpability of the employer. Interest will also be charged on any balance of tax remaining payable by the employer after a transfer has been made.

Whilst these rules are better than before, some important issues still remain:

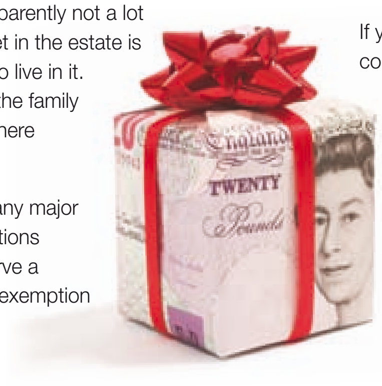
- HMRC are still vigorously pursuing the employed/self employed issue; and
- HMRC may attempt to go back several years to address any such problem.

It is important to ensure that any workers paid on a self employed basis are exactly that – self employed. Now may be an opportune time to review the working arrangements of such individuals to ensure a clean bill of health. If this is an area where you need to know more, please do contact us.

Get the giving habit

Even in the current recessionary times house prices are significantly higher than they were a decade ago – the Halifax Index for the average value of a property in November 2008 was £163,000 compared to £73,000 in 1998. For many couples this means that they have a significant inheritance tax (IHT) problem. If the value of the joint estate of a married couple is over £624,000 then IHT will be payable.

Some people would consider this to be someone else's problem. Others recognise that it is a problem but there is apparently not a lot they can do about it because the major asset in the estate is the family home and they need to continue to live in it. Whilst some planning may be possible with the family home it is often complex and expensive. Is there anything else that can be done?



The answer is yes and it should not involve any major decisions. There are some important exemptions available for IHT and three in particular deserve a second look. Every individual has an annual exemption for IHT of £3,000. This can be used in the tax year and can be carried forward for just one tax year where it can only be used after that year's exemption. It can cover gifts of cash or assets to any individual. It may not sound a lot but in tax terms it is worth £1,200 a year. Make sure that it is used for say ten years and each individual will have saved IHT of £12,000.

In addition to the annual exemption, you can make small gifts of up to £250 each to any number of other individuals in each tax year.

If you have some surplus income which is adding to the IHT problem then you could consider making regular payments say to children or grandchildren. If the gifts come out of income and do not impair your own standard of living they will be exempt under the so-called 'normal expenditure out of income' rules. The key is to establish a pattern of giving that can be considered as 'normal' and to do this as soon as possible. The sooner you start, the bigger the potential tax savings will be.

Please contact us if you require further advice to assist you with your estate planning.

Make your losses go further

Where a company makes a trading loss there are a number of ways in which the loss can be relieved against profits. Very broadly the rules allow an offset against:

- other profits in the same accounting period
- total profits in the preceding 12 month period
- trading income from the same trade in subsequent accounting periods.

The carry back provisions will be extended for companies for up to three years if a trading loss is made in an accounting period ending between 24 November 2008 and 23 November 2009. There will be no limit on the loss which can be carried back for one year, but the relief which can be carried back beyond that will be restricted to £50,000. If the loss making accounting period is less than 12 months the £50,000 cap will be reduced proportionately.

Example

Company A makes a trading loss of £130,000 for the year to 31 December 2008. Its total profits for earlier years were:

y/e 31 December 2007	£70,000
y/e 31 December 2006	£40,000
y/e 31 December 2005	£40,000

Losses of £70,000 can be carried back to the 2007 period without any limit. Under the new provisions the company would be able to take £40,000 of the loss back to the 2006 period and just £10,000 back to the 2005 period. This will leave £10,000 of the loss available for carry forward to future periods.

When can a company make a claim for loss relief?

The earliest time is after the end of the accounting period in which the loss is made and the claim is made by submitting a corporation tax return for the period.

When can a company get a tax repayment?

For existing loss provisions (eg the one year carry back), repayments will be made once the corporation tax return has been processed by HMRC. For the new loss relief provision, HMRC will accept a loss claim but will not repay the tax until after Budget Day 2009.

What about unincorporated businesses?

There are similar rules for unincorporated businesses but the loss must be made in an accounting period ending in the 2008/09 tax year. So a loss made in the 12 month period ending on 31 March 2009 will qualify but not a loss in a period ending 30 April 2009.

Please talk to us

If you are currently making losses, please talk to us about these provisions so that we may maximise your entitlement to loss relief and also help to obtain an early tax repayment. This is particularly relevant if you are an unincorporated business as we may need to consider changing your accounting date so that your current losses fall into the current tax year.

Termination payments

In these troubled economic times, more and more employees are losing their jobs. Even HMRC appear to be affected!

Payments connected with employees leaving their jobs may be tax free, or they may be taxable depending on the type of payment. It is an area that HMRC regularly check on and care needs to be taken. We provide below a table laying out the main situations. However, the table comes with a health warning - tax is never as simple as it seems.

Type of payment	Tax position
A contractual payment instead of a notice period being given (known as a PILON) or gardening leave, even if the employer has an option to pay.	Generally taxable as salary.
Payments on leaving where there is an expectation or that are customary.	Good evidence of expectation has to be established from documents and interviews before these can be taxed.
Where there is no entitlement or expectation to a PILON and the employer unilaterally dismisses the employee with less notice than the employee is entitled to.	As the employer has breached the contract a PILON in such circumstances represents damages for breach of contract and the first £30,000 may be tax free.
Instead of acting unilaterally, the employer and employee may reach an agreement to terminate without proper notice. A payment of a PILON is then made.	Where this is done **before** termination is in prospect, it is simply a variation in the terms of employment and any subsequent payment may be contractual and hence taxable. If it is done only as part of the process of termination, the payment may not be from the employment but from the agreed terms for its destruction and is dealt with as a damages payment ie the first £30,000 may be tax free. If the agreement settles an existing contractual provision, the payment may be taxable.
A statutory redundancy payment is exempt from liability to tax unless it exceeds £30,000.	In practice there is unlikely to be tax payable because most statutory payments are covered by the £30,000 exemption. However, all payments in respect of a termination must be added together in applying that exemption.
Statement of Practice 1/1994 explains that a lump sum payment for redundancy under a non-statutory scheme is exempt up to £30,000.	HMRC are prepared to comment on the tax position of such payments before they are made.

For more information on this area, please do get in touch.