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Money Matters

WINTER 2009

UK200Group News Update

Every business welcomes the end of 2009 and looks forward to a happier, more prosperous new year.

As the economy climbs out of recession we will continue to work with clients to achieve new growth and profit targets by providing the right business solutions tailored to their specific needs. Strategic expert help is available to tackle short term problems, or longer term issues such as raising finance, restructuring, entering new markets, expansion or succession planning.

UK200Group membership gives us the confidence to know we can offer clients up to date information and support to aid recovery and new business development.

As our last newsletter of 2009 we would like to take this opportunity to wish you the compliments of the season.

A change in the Status Quo?

For many years, HMRC have been concerned that individuals are correctly classified as employed or self-employed. Usually, there are more taxes payable overall if the individual is classed as an employee. Also, employees generally obtain more statutory protections than the self-employed because of a variety of employment law legislation which includes for example, Statutory Sick and Maternity pay.

Clearly, for these and other commercial reasons, such as flexibility, many employers would rather the people that they pay work for them on a self-employed basis. The construction industry, whilst not alone, is a business sector which sees a great deal of work conducted by self-employed subcontractors.

The government has decided that the best way to address this issue, which they refer to as 'false self-employment in the construction industry', is to introduce legislation which deems workers within the construction industry to be taxed as employees unless one of three criteria is met.

HMRC comment: 'Where both the worker and the engager decide that self-employed status is the desired outcome, then it is very challenging for HMRC to build a full and accurate picture of the true terms of the engagement. As a result, demonstrating any mismatch between the contract and the reality can be difficult and time-consuming. Or, if there is no written contract in place, establishing the actual terms of the engagement can also be problematic.'

The criteria

The government believes that the following three criteria are reliable indicators, within the context of the construction industry, of a worker being in receipt of self-employment income:

- Provision of plant and equipment – that a person provides the plant and equipment required for the job they have been engaged to carry out. This will exclude the tools of the trade which it is normal and traditional in the industry for individuals to provide for themselves to do their job.
- Provision of all materials – that a person provides all materials required to complete a job.
- Provision of other workers – that a person provides other workers to carry out operations under the contract and is responsible for paying them.

A worker will have to meet one or more of these three criteria in order not to be deemed to be in receipt of employment income.

If the worker is deemed to be in receipt of employment income, PAYE will be due on the payment he receives. The person who makes the payment to the worker will have the obligation to apply the statutory criteria.

We will keep you informed of the progress of these proposals but in the meantime please contact us if you need further information on status issues.

UK200Group
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A new system for dealing with disputes with the taxman

It has always been a fundamental part of the UK tax system that there should be a way in which the taxpayer can dispute decisions made by the taxman. For nearly 200 years that has been via the Special Commissioners and General Commissioners.

The Special Commissioners were individuals with a tax legal background who generally heard the more complex cases either in London or one of the main cities in the UK. The General Commissioners on the other hand were laymen – much like the tax equivalent of magistrates. They sat in local areas known as 'divisions' of which there were several hundred around the country.

When VAT was introduced a parallel body – the VAT Tribunal – was set up to deal with disputes with Customs and Excise.

Appeals by taxpayers could be heard by either type of Commissioner and the losing party had the right to have the appeal heard on a question of law by the High Court and then higher courts if appropriate. From these decisions comes a large body of case law which helps to interpret the tax legislation.

On 1 April 2009 all of this changed with the introduction of a new tribunal system. The bodies of General and Special Commissioners and the VAT Tribunal have been abolished and replaced by what is known as the Tax Chamber in the First-tier Tribunal. This has an administrative base in Birmingham but appeals will be heard in a number of centres around the country.

The losing party in the First-tier Tribunal will be able to appeal to the Upper Tribunal which has a status equivalent to the High Court.

The right of the taxpayer to appeal a decision made by HMRC remains enshrined in the new system. Such appeals will be made to the Tribunal which will deal with more routine matters by simply looking at written evidence and producing a decision. Only more contentious matters will be dealt with by a formal hearing.

Issues of costs and formality could put people off deciding to appeal, allowing HMRC to win an argument by default. To avoid this happening HMRC have been required by law to introduce a new review system to come into play when an appeal is made.

When an officer of HMRC has made a formal decision, the taxpayer will have the right to appeal against that decision as before but, in addition, the taxpayer will be able to ask for a review of the decision. This will be carried out by another HMRC officer who is not connected to the officer who made the original decision. That officer will generally have 45 days in which to carry out the review and can either agree the original decision or decide to change it in some way. If they uphold the original decision then the taxpayer has a further 30 days to advise the Tribunal that they wish the appeal to be considered.

HMRC have gone to great pains to try to make the system as impartial as possible. They are creating separate review teams who will sit outside the normal taxpayer contact and will not be part of the line management system in the tax office. They have been given detailed guidance on how to carry out the review and that guidance is available for all to see on the HMRC website. It certainly envisages that the taxpayer should have the right to present further evidence and meet the review officer to discuss the case.

Inevitably the new system will take time to bed down and it will be closely scrutinised both by HMRC and by professional bodies to ensure that it is really working and that taxpayers' rights are protected.

New Year new rate

The reintroduction of the standard rate of VAT at 17.5% will welcome in the New Year. For sales of standard rated goods or services that take place on or after 1 January 2010, a business should charge VAT at the new rate of 17.5% rather than 15%.

If you are a non-business consumer maybe now is the time to purchase those larger items and save 2.5%. For business customers that cannot fully recover their VAT cost, there may also be some scope to save VAT before the increase although advice is needed to ensure anti-avoidance rules are not triggered.

For all businesses charging VAT at the standard rate on their supplies care will be needed (as on the previous change of rate on 1 December 2008) to ensure that the correct rate is charged depending on the effective date of supply. This will vary, depending on the type of supply of goods/services, when it is invoiced and when payment is received. Please contact us if you need further guidance on these areas for your business.

Widening the scope of APR

Agricultural Property Relief (APR) is a key inheritance tax (IHT) relief that can reduce the value of agricultural property in an individual's estate for IHT purposes to nil. However, there are detailed conditions on ownership and use to be satisfied in order to obtain the relief.

Until now the relief has only been available where an individual owned agricultural property in the United Kingdom, the Channel Islands and the Isle of Man. The Finance Act 2009 however, extends the relief to qualifying land anywhere in the European Economic Area (EEA). This comprises all the EU countries plus Norway, Iceland and Liechtenstein.

Going forward this means that an individual owning agricultural land in, for example, France could now qualify for APR on the value of that land in their estate or pick up the relief if they were to transfer the land into a trust in their lifetime and possibly avoid or mitigate their IHT liability accordingly.

The relief has, however, been introduced retrospectively because the UK government has been forced to remove discrimination in favour of UK land. This means that there may now be an opportunity to make a claim for a repayment of tax.

If IHT was paid on property in the EEA after 23 April 2003 and the land would have met the conditions to qualify for APR then the tax paid can be recovered by making a claim to HMRC. Normally a tax repayment has to be made within six years which would now be impossible for tax paid early in 2003. HMRC are required to allow claims to be made by 21 April 2010 where they would otherwise be out of time.

It is not just IHT which might be repayable. Where a gift of land qualifying for APR is made, that gift can be deferred for capital gains tax (CGT) purposes. If for example an individual had gifted farmland in Eire to their children say in 2005, the parent may have paid CGT on the gain made by reference to the market value of the land at the date of the gift. A claim could now be made to defer the gain until the children dispose of the land and that would give the parent a repayment of CGT now.

Please contact us to review your family's IHT and CGT position if you consider this may affect you.

HMRC pursue unlawful dividends

Over recent years, HMRC have become increasingly interested in the company law elements of dividends. This is mainly due to the fact that running a business through a company and taking the profit as dividends can create substantial savings. Introducing family members as shareholders can effectively double up on these savings.

Even with the proposed changes to the tax system from next year, including the 50% additional rate and a corporation tax (CT) rate of 22% for small companies, there are still savings to be made.

Consider Anthony, who makes annual profits of £300,000 and his year end is 31 March. A comparison of his position as a sole trader or if he incorporates at the start of the 2010/11 tax year (taking a salary equivalent to the nil rate NIC threshold and the balance as dividend and using figures for 2009/10 where appropriate) is as follows:

2010/11	**£**
Profits before salary if incorporated	300,000
Salary	5,715
Dividends if incorporated	229,542
Taxes payable:	

As sole trader	**£**	**As company**	**£**
Income tax	127,520	Income tax on salary	1,143
NI	5,739	NI on salary	Nil
		Tax on dividends	61,332
		CT @ 22%	64,743
Total	*133,259*	*Total*	*127,218*

Extra taxes payable if unincorporated	£6,041

However, if HMRC can show that the dividends were unlawful from a company law perspective at the time of payment, then they will argue that the money extracted was not a dividend but a loan.

For many owner managed companies, this would result in;

- a 25% corporation tax bill for the company on the amount treated as a loan - £229,542; and
- a benefit on the director shareholder, on the use of the monies, calculated currently at 4.75% for **each** tax year the loan is outstanding; and
- an employer NI charge on the taxable benefit for **each** tax year.

Overall this may result in more tax than a dividend, especially if the loan remained outstanding for some time.

Further in a recent case, the taxpayers entered into a particular corporate structure which, if it worked, mitigated the corporation tax bill greatly. HMRC said that this structure did not work. However, the companies involved did not have enough money to pay the corporation tax.

HMRC then looked back in time and saw that the owners had extracted a lot of the profit over the years as dividends. So HMRC attempted to use company law to make the owners repay the dividends on the basis that they had been paid unlawfully… which would then leave the companies involved with money to pay the corporation tax. Sneaky!

HMRC won the first two rounds of this case. Although they have lost the latest round, it just goes to show how important dotting the ‘i’s and crossing the ‘t’s can be and that for companies on an ongoing basis, they need to ensure there are enough reserves at the time of paying the dividend to cover it.

HMRC are clearly interested in this area, so if you have any concerns, please do not hesitate to get in touch.

Trusts and the 50% rate

There has been much discussion surrounding the introduction of the 50% rate of income tax from 6 April 2010 for individuals with taxable income in excess of £150,000. The additional rate on dividends will also be introduced at the same level of income at a rate of 42.5%.

What is possibly not realised by many is that the same rates will be applied to the income of many trusts from the same date but that there is no cushion of £150,000. All trust income will be taxed at 50% (42.5% for dividends). The current trust tax rates are 40% (32.5% for dividends).

The impact of this change will be felt by those trusts where the trustees decide each year whether or not they want to distribute the income of the trust and to whom they want to make distributions. These trusts are known as ‘discretionary trusts’. Such trusts will pay tax at 50% on all their income (42.5% for dividends).

When income is distributed to beneficiaries it forms part of their taxable income. However beneficiaries do receive a full 50% credit for the tax deducted by the trustees. So if a beneficiary was only a basic rate taxpayer in their own right they would be due a repayment of tax.

Example

The trustees of a discretionary settlement receive gross interest of £200. They will pay tax on that of £100. They decide to pay the balance of the income to a beneficiary who is a basic rate taxpayer. The beneficiary will be deemed to have received £200 of income on which £100 tax has been paid. The beneficiary is only liable to tax on the £200 at 20% which means they will be entitled to a tax refund of £60.

Where the trust decides not to distribute the income then the overall position will be that the trustees will suffer the 50% deduction and this will deplete the ongoing reserves of the trust.

Where the trustees are obliged by the terms of the trust to pay out the income each year to named beneficiaries (what is known as an interest in possession trust), the tax rate which trustees will pay is only the basic rate of 20% (10% on dividend income). The beneficiary will again obtain the benefit of the tax credits passed on by the trust but only at the 20% or 10% rates. For a basic rate taxpayer this will cover the liability but not create a refund.

Crossing the VAT channel

A package of measures is being introduced to 'simplify' and modernise the VAT system for cross-border trading and to counter fraud with effect from 1 January 2010 across the EU.

Who will be affected by the changes?

The changes will affect all businesses:

- supplying services to overseas businesses
- receiving services from overseas businesses
- supplying goods to other EU countries
- that want to reclaim VAT incurred in another EU country.

The measures include changes to:

- the basic place of supply of services rules
- the European Sales List (ESL) reporting requirements
- the refund procedure for VAT incurred in other EU Member States.

Place of supply of services rules

Changes will be made to the complex rules on the place of supply of services rules which determine the country where a supply of services is made and where any VAT due is payable. The rules also determine, if VAT is due on a supply, whether it should be accounted for by the supplier or their business customer.

The change is that, as far as possible for business to business supplies, VAT will be due in the country where the customer is based, as opposed to the current rule of where the supplier is based.

The basic rule for supplies to non-business customers will remain unchanged in that it will be where the supplier is based.

As now, there will be exceptions to these general rules but not necessarily the same exceptions, so it will be vital for any business involved in cross border services to review their position.

The changes will be phased in over the next few years commencing 1 January 2010.

EC Sales Lists for services

UK VAT registered businesses that supply services to EU VAT registered businesses, where the place of supply is the customer's country, will have to complete ESLs for each calendar quarter and submit these within 14 days for paper returns and 21 days for electronic returns.

This means businesses will need to start collecting their customers' VAT registration numbers now.

EC Sales Lists for goods

UK VAT registered businesses that supply goods to other VAT registered businesses in other EU countries already submit ESLs. However from 1 January 2010 new rules will:

- reduce the time available to submit ESLs from the current 42 days in line with the limits above
- require the monthly submission of ESLs where the value of the supplies of intra-Community goods (excluding VAT) exceeds £70,000 in the current quarter, or any of the previous four quarters. This threshold will be reduced to £35,000 (excluding VAT) with effect from 1 January 2012.

VAT refund procedures

A new electronic VAT refund procedure is being introduced across the EU from 1 January 2010 to replace the current paper based system.

From that date UK businesses which are entitled to a refund of VAT paid in another EU member state will submit refund claims electronically on a standard form to HMRC rather than direct to the Member State where the VAT was suffered.

For advice or a review on how these and other VAT changes may affect your business, please do contact us.

Groundbreaking deal between HMRC and Liechtenstein

In a surprising move, HMRC have brokered a deal with Liechtenstein to address the banking secrecy rules that have made the Principality such an attractive place for investors over the years.

You may be aware, that currently a New Disclosure Opportunity to allow people with unpaid taxes linked to offshore accounts and assets on a worldwide basis is currently in progress.

The deal with Liechtenstein is rather different. Under the agreement, Liechtenstein will introduce a five-year taxpayer assistance and compliance programme and HMRC will introduce a five-year special disclosure facility.

This means that financial intermediaries in Liechtenstein will have to identify persons which it knows or has reason to believe may be liable to tax in the UK. The intermediary will then be under a duty to notify the person.

Unless the person provides evidence to the financial intermediary that they are not liable to UK taxation or they are compliant with their UK tax obligations in relation to their Liechtenstein affairs within the five-year period, the intermediary will then be required to stop providing services to them.

HMRC will make available a special disclosure facility to each person who notifies HMRC under the taxpayer assistance and compliance programme. Effectively, this facility will limit the recovery of UK taxes to a defined 10-year period and provide an option for a simplified composite rate of tax in certain circumstances. Normally, HMRC would be able to consider tax, interest and penalties for up to 20 years.

David Hartnett, Deputy Chief Executive of HMRC, gave an estimate of the kind of money he believes may be liable to UK tax

"We think the amount is somewhere in the region of £2-3 billion. It could be more; it's unlikely to be less. And we expect to recoup around £1bn back into UK coffers over time."

It just goes to show it's an increasingly small world.