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Money Matters

WINTER 2007

UK200 Group news

We approach the New Year with a credit squeeze, a deeply disappointing Pre-Budget Statement and access to funds rarely more difficult. Both government and banks continue to pay lip service to small businesses as the nation's lifeblood but fail to realise that building and growing a business not only requires real ability and hard work but also access to funds. One of the most hurtful measures of the Chancellor's statement was the abolition of taper relief which will have a major impact on owners of small businesses planning to sell for pension provision.

The cost burden overall has been discouraging, as The Times recently put it 'what of the clever young person who opens a bakery in a deprived area or the couple who have worked for 16 hours a day over four decades and just seen their tax burden almost doubled? They have taken risks that an MP or parliamentary adviser or closeted bureaucrat will never have to tackle.'

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Are you a winner or a loser in the new CGT regime?

The big surprise in the Pre-Budget Report was the new 18% rate of capital gains tax (CGT) which will apply to gains made by individuals and trustees from 6 April 2008.

Currently gains are treated as the top slice of income which often means a 40% tax rate. However if 'business assets' are sold the capital gain may be discounted by 75% due to taper relief. That works out at just 10% tax for a higher rate taxpayer or 5% for a basic rate taxpayer.

Taper relief will not be given for disposals on or after 6 April 2008. If 'non-business assets' are sold the maximum discount is 40% which works out at an effective rate of 24% for higher rate taxpayers or 12% for basic rate taxpayers. So there are winners and losers in the new regime.

Note that the annual exemption (currently £9,200) will continue to apply to remove the first slice of gains from CGT.

Do your assets currently qualify for full taper relief?

Where an asset comes within the definition of a business asset, it qualifies for a maximum taper relief of 75% after just two complete years of ownership. The three most common types of asset which qualify are:

- assets which are used in a trade, for example a property
- any shareholding in an unquoted trading company (provided that the company satisfies the CGT definition of a trading company)
- any shareholding in a quoted company of which the shareholder is an employee or director.

The definitions of a business asset are complicated so please talk to us if you require confirmation regarding the status of your assets.

Can you do anything to crystallise your entitlement to business asset taper relief?

Clearly if you are considering selling business assets, it may be better to do so now. A much more difficult question is whether it is possible to sell the asset to obtain the taper relief but retain ownership in a different form. The main example of when this may be practical would be if a property

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held personally is used by a company in which you are the main shareholder. The sale of the property to the company will crystallise the taper relief (and in respect of that gain a tax bill) but the company will acquire the property with a base cost equal to the current market value of the asset. There are however many other issues to consider, so you will need to talk to us.

You have an investment property. Will you win or lose?

Some investment properties qualify as business assets and so you are a likely loser unless the asset is sold before April 2008. Examples are assets used by a trade (as explained above) and 'holiday lets'. But owners of second homes and buy to let properties are likely to be winners. The 24% effective tax rate which is derived from the maximum non business taper relief is only given for property bought before 17 March 1998. Your taper relief may therefore be less, giving an even higher effective tax rate.

However, owners of investment properties originally acquired well before 1998 also need to consider the effect of the loss of indexation allowance from 6 April 2008. Indexation allowance only applies if assets were acquired prior to 6 April 1998. The effect is to uplift the cost of the asset to reflect general inflation from the date of acquisition to April 1998. An asset purchased in September 1988 for example would qualify for a 50% uplift to cost if sold before April 2008. So if you have an investment property with a relatively high base cost, indexation allowance may reduce your effective rate to below the 18% rate. This is another scenario about which you may need to talk to us.

Planning for the new capital allowance regime

Significant changes are planned for the tax relief available on the purchase of plant and machinery for businesses from April 2008.

The changes were announced in the Budget in March 2007 but with very little detail. In recent months details have been announced which put some flesh on the bones of the proposals. If you are planning to incur capital expenditure on plant in the next few months we are now in a position to consider the tax effect of accelerating or deferring expenditure.

For small and medium sized businesses, the main effect of the changes is the withdrawal of First Year Allowances (FYAs) - currently 50% for small businesses and 40% for medium sized businesses - and the introduction of an Annual Investment Allowance (AIA). The allowance will give immediate tax relief for the cost of equipment within an annual limit of £50,000. All items that currently qualify as plant or machinery, including fixtures in buildings and vans, will be eligible for the AIA if purchased on or after 1 April 2008 for companies, and from 6 April 2008 for unincorporated businesses.

Other factors to take into account in capital expenditure plans are:

- writing down allowances (WDAs) for plant and machinery in the 'pool' of unrelieved tax expenditure are being reduced from 25% to 20%
- the purchase of certain fixtures integral to a building, which may currently qualify for the same rate of allowances as other plant, will go into a new '10% pool' which will have a WDA rate of 10%.

Expenditure in excess of the AIA will get relief in the year of expenditure at the 20% or 10% rate.

So should you acquire plant and machinery before or after April 2008?

The answer, of course, is that it depends. But, generally speaking, it will be more attractive to take advantage of the full tax write off given by the AIA rather than the percentage given by FYAs. However, it is important to take into account the maximum AIA given in the first accounting period wholly or partly within the new regime. So if for example a company has a 31 March year end, spending plans need to be considered up to 31 March 2009. See the example opposite.

Fixtures

A situation in which it is worth considering accelerating expenditure is if significant expenditure is planned on 'fixtures integral to a building'. We don't know exactly which assets will be classified as integral fixtures but they are likely to include central heating, general lighting and air conditioning. Expenditure before April 2008 may qualify for FYAs and the balance of the expenditure will fall into the 'pool' (giving allowances at 25%/20% pa). Expenditure after March 2008 may qualify for the AIA but will otherwise only qualify for 10% WDAs.

What if your accounting period does not end on 31 March or 5 April?

This adds some complications! Where an accounting period does not start on 1 or 6 April the first AIA limit will be proportionally reduced. If a company's accounting period runs from 1 January 2008 to 31 December 2008 it will get nine months worth of the AIA (£37,500) for expenditure between 1 April 2008 and the end of the year.

The rate of WDAs will also be subject to a special computation which will give a rate of between 25% and 20%.

You may need some assistance from us in these circumstances to decide whether you should purchase your new equipment before or after April 2008, so please talk to us before you buy.

Example

A company has a 31 March year end and is a small business. There is planned expenditure on plant of £80,000 up to 31 March 2009. If all of this is incurred after 1 April 2008, the allowances will be:

	Accounting period to:		
	31.03.08	31.03.09	31.03.10
FYA/AIA	£Nil	£50,000	£Nil
WDA (20% on £30,000)		£6,000	
WDA (20% on £30,000 – £6,000)			£4,800
Total allowances in each year	£Nil	£56,000	£4,800

If expenditure of £30,000 out of the £80,000 total is accelerated to fall in the year to 31 March 2008, the allowances will be:

	Accounting period to:		
	31.03.08	31.03.09	31.03.10
FYA/AIA	£15,000	£50,000	£Nil
WDA (20% on £15,000)*		£3,000	
WDA (20% on £15,000 – £3,000)			£2,400
Total allowances in each year	£15,000	£53,000	£2,400

*The balance of the expenditure which doesn't qualify for FYAs is given relief for WDAs in the following accounting period.

In summary a key objective should be to maximise the £50,000 AIA as much as possible. Bear in mind though that deferring expenditure until after 31 March or 5 April may delay any tax relief on the expenditure by a full year for your business.

No more AGMs

Amongst the many changes introduced by the Companies Act 2006 is the good news that private companies will no longer need to hold an annual general meeting (AGM) and will find it far easier to conduct almost all of their business by written resolution.

For many years, company law required every company, including private companies, to hold an AGM with not more than 15 months between meetings. This was amended in 1989 to allow private companies to make an election "by elective resolution" to dispense with the AGM. Many private companies, but not all, took advantage of this. Holding a formal members' meeting always helped to facilitate the passing of necessary resolutions including, for example, the payment of a dividend and the reappointment of the auditor where the company has an audit.

From 1 October 2007 there is no longer any requirement in the law for private companies to have an AGM. However, if there is an existing provision in the Articles of the company requiring an AGM this will need to be removed by special resolution before you can dispense with the AGM. A company may of course still choose to have a shareholders' meeting and meetings can be called by directors or by members representing 10% of voting shares.

The new legislation envisages written resolutions being used to make nearly all shareholders' decisions. If the company wishes to remove a director or the auditor, then a meeting is still required by the legislation.

Written resolutions can be proposed either by the directors or by members representing 5% of votes or whatever is stated in the articles. Previously a written resolution required the unanimous approval of the shareholders. Under the new Act, and again from 1 October 2007, private companies will be able to pass written resolutions without needing the consent of all shareholders. The resolution can also be circulated to the shareholders electronically, for example by publication on a website. There are two types of written resolution in the Act; ordinary resolutions which require a simple majority of the eligible votes to approve them and special resolutions which require 75% actually voting in favour. Please be aware that the Articles of individual companies sometimes require a higher majority for each of these.

In the absence of an AGM, private company meetings are now on 14 days notice unless the Articles require something different and 90% of members rather than the previous 95% can agree to hold a meeting at short notice.

Other consequences of no longer having an AGM are:

- where the company has an audit the auditor is automatically re-appointed for the following year
- private companies will no longer need to lay accounts before the AGM; however, shareholders will still be entitled to receive the accounts as at present.

These new rules will enable you to make decisions more quickly and efficiently without the need for a meeting and will be of benefit for most private companies. Please contact us if you would like to discuss any specific matters in more detail.

CIS - are penalties on the way?

In April 2007, major changes were introduced to the Construction Industry Scheme (CIS). One of these changes was the requirement for contractors to send a monthly return to HMRC by the 19th of the following month. The failure to do this could, in principle, lead to penalties of £100 per 50 subcontractors (or part thereof) per month.

The monthly return requires contractors to:

- confirm that the employment status of subcontractors has been considered
- confirm that the new verification process has been correctly dealt with
- detail payments made to all subcontractors
- detail any deductions of tax made from those payments.

The monthly return can be sent either manually or electronically and relates to each tax month (ie running from the 6th of one month to the 5th of the next). Even if no subcontractors have been paid during a month, contractors still have to make a nil return unless the contractor does not expect to engage subcontractors for a period of at least six months. Nil returns can be made by telephone.

Problems to watch out for when completing paper returns include ensuring that:

- the forms used are the pre-populated return sent out by HMRC each month or the blank returns included with the contractor pack. Photocopied returns will not be accepted because the returns are scanned electronically which can only be done properly with the original returns
- the return is sent for the right month - do not, for example, send in the return due for August on a form pre-printed for July
- entries are legible
- the declarations on the back page have been completed and the return has been signed
- the return is submitted on time.

To help contractors in the transition to the new system, HMRC stated that they would operate a 'light touch' on penalties for the first six months of the new regime but, of course, that honeymoon period is now over.

HMRC have now announced that they will start imposing penalties in respect of any returns outstanding since April unless these were submitted by 19 October 2007. It is clear that HMRC are gearing up to start imposing penalties, so if you have any concerns about the monthly returns or any other aspect of the CIS regime, please do get in touch.

Flexible working - the benefits

In April 2003 the government gave all parents with a child under the age of 6 (or under the age of 18 if disabled) the right to request flexible working arrangements from their employer. This was further extended to the carers of adults in April 2007. Studies indicate however that many employers offer more than the statutory requirements when it comes to flexible working patterns.

Flexible working is an agreement allowing both the employee and employer to adjust working arrangements regarding both when and where the employee works. It has become increasingly necessary for employers to offer these arrangements, for a number of reasons. These include the changing labour market, with an increased female labour force and an ageing population meaning that many more employees commonly have caring duties. Other factors include the fast pace of technological developments, which allows for the ease of home working, together with rising expectations of the provision of a 24-hour service.

Flexible working patterns can take a variety of forms with part time or term time only contracts, flexi time, job share and home working often being used when it fits in with the needs of both the employee and the organisation. It is essential that there is a clear policy outlining the parameters of flexible working and these are clearly understood by all parties.

Once implemented flexible working patterns can then provide benefits such as:

- **Improved employee retention**
  Employers attract employees who would not normally work for them and are able to retain those employees, thereby reducing recruitment and selection costs and building a loyal workforce. Employees have a better work life balance and generally show an increased commitment and performance.
- **Reduced stress levels**
  Employees find it easier to cope with family situations and therefore commit more fully to the workplace whilst there.
- **Reduced absence**
  Surveys on absenteeism carried out by Kronos Systems indicate that as many as 25% of salaried employees are prepared to admit that they would call in to work sick, in order to enjoy a day off. With flexible working practices, employees are less likely to have unauthorised sick leave if they can work reduced hours on some days and make up the time on others.

Flexible working patterns are seen as a fundamental part of good people management in many companies thus having a positive impact on business reputation.

Do you need to change your Will?

New rules announced in the Pre-Budget Report now allow any inheritance tax (IHT) nil-rate band unused, on the first death of a spouse or civil partner, to be used when the surviving spouse or civil partner dies. For many couples this has effectively doubled the nil-rate band from £300,000 to £600,000 in the current tax year.

The move will potentially simplify IHT planning for many couples.

How did the old rules work?

Each person has an IHT nil-rate band. For married couples or civil partnerships to have used this effectively, the spouse or civil partner who died first would need to have bequeathed assets to beneficiaries other than the surviving spouse or civil partner, as transfers of property between spouses or civil partners are generally exempt from IHT. If the first spouse or civil partner wanted the surviving spouse or civil partner to potentially benefit from all the assets, a nil-rate band discretionary trust could have been set up on the first death which would ensure that the nil-rate band was used.

How do the new rules work?

The transfer of the unused nil-rate band from a deceased spouse or civil partner, irrelevant of the date of death, may be made to the estate of their surviving spouse or civil partner who dies on or after 9 October 2007.

The amount of the nil-rate band available for transfer will be based on the proportion of the nil-rate band which was unused when the first spouse or civil partner died.

For example, on the first death none of the original nil-rate band was used because the whole of the estate was left to the surviving spouse or civil partner. If the nil-rate band is £350,000 when the surviving spouse or civil partner dies, it would be increased by 100% to £700,000.

But if the deceased spouse or civil partner had made significant gifts to their children, or created a nil-rate band discretionary trust, there may not be any nil-rate band remaining.

What if your Will provides for a nil-rate band discretionary trust?

If both spouses or civil partners are still alive, the trust will not have been created. It will therefore be appropriate to consider amending the Will. If the only reason for the trust was to use each spouse's or civil partner's nil-rate band, there may be little point in creating such a trust. However, there can still be advantages in creating a trust:

- a person may want to direct who the ultimate beneficiaries of the assets will be rather than leaving that decision to the surviving spouse or civil partner
- assets put into the trust on the first death may grow at a faster rate than the increase in the nil-rate band. That growth is not included in the surviving spouse's or civil partner's estate.

Please contact us if you would like more advice specific to your circumstances.