

HEYWARDS NEWSLETTER

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In recent weeks, thousands of self-employed people and small business proprietor have received a letter from the Inland Revenue saying that:

'This letter is to remind you that your Tax Return is a legal document and that your signature is a declaration that the information in the Return is, to the best of your knowledge and belief, correct and complete.

'From a risk review of 2003 Returns, we have identified an aspect of the Self-Employment pages of your Return which may need particular attention. We want to help you get this aspect right first time for 2004

Most people have read this letter as an accusation that there was something wrong with their Return for the year to 5 April 2003 – and many assumed that it was the opening shot in a full-scale Inland Revenue enquiry. The letters are still being sent out and so are worrying more and more people.

In fact, the Inland Revenue's computers have been programmed to identify certain situations, such as a trader whose Return does not include an add-back for private motoring. If the red light flashes, a letter is generated automatically, even though there may be a good reason why there is no add-back – for example, that the only business vehicle is a concrete mixer lorry.

Other known 'triggers' are wages paid to a family member, substantial claims for travelling and subsistence, or for advertising, promotion and entertainment, and professional costs in excess of an average accountancy fee. A full list of 'triggers' has not of course been published, but it probably also includes an analysis of ratios, such as sales to purchases. Falling profits, or profits which fluctuate from year to year, have always struck the Revenue as suspicious, even though in the real world business proprietors rarely enjoy the steadily if gently rising income typical of a salaried career.

The letters are known, in Inland Revenue jargon, as 'enabling letters' because they 'enable taxpayers to put things right'. That of course assumes there is something wrong in the first place, which will not necessarily – or even usually – be the case. The letters are being sent to a broad spectrum of self-employed people and business proprietors, on the basis of 'Let's shake the tree and see what falls out' – the Revenue are simply assuming that a minority, however small, will have a guilty conscience about something and come forward with their hands up.

Meanwhile, the innocent majority have been put to a great deal of unnecessary worry and trouble.

TWO MORE GRUMBLES

We also have two other quarrels with the Inland Revenue. The first is that they have issued a large number of £100 penalty notices for Tax Returns which were in fact filed by the statutory deadline of 31 January 2004. The Revenue has conceded that some penalty notices were issued incorrectly, but has refused to confirm the number, estimated by leading accountancy firms at between 250,000 and 500,000 – at the top end of that range, penalties of £50 million are at stake.

The Revenue has refused to go back and check all the penalty notices issued, on the grounds it 'would require a huge amount of time and effort'. Any individual who believes he or she has been wrongly charged must appeal against the penalty. Obviously, we shall be taking the necessary action where a client has been wrongly charged, but this is something you may wish to draw to the attention of friends or family members.

Secondly, the Inland Revenue has issued 'guidance' stating that, when a new company is formed, the founders are allocated their shares because they are directors, so that the whole arrangement constitutes a 'share scheme' for which a special Return must be filed. Frankly this is nonsense – the founders can appoint themselves directors because they are the controlling shareholders, not vice versa – but if you have formed a company, please let us know, because it is quicker to file the form than argue about it.

INHERITANCE TAX PLANNING

Rising property prices have led to many houses being worth more than £263,000 and so potentially liable to inheritance tax on the death of their owners. To avoid this potential liability, many people have been recommended, often by their family solicitor, to enter into complex arrangements designed to allow them to continue living in the house while making an immediate, tax-free gift to their children.

The new Finance Act destroys the viability of most such arrangements by imposing an income tax charge on the annual value of the right to occupy the property retained by the original owner (or owners, in the usual case of a married couple). The problem is that the new income tax charge is imposed on existing as well as new arrangements, so many people will have a liability that could not have been foreseen when the arrangements were made.

The new charge does not come into force until April 2005 and those affected will have the option of avoiding the income tax charge by opting back into inheritance tax. In some circumstances other options may be available, such as unscrambling the omelette altogether.

People who have entered into these arrangements will have to consider what action they should take, but as the opt-back does not have to be made until the filing date for 2005/06 Tax Returns (31 January 2007), there is no need to rush the decision. Over the coming months, further official guidance and expert commentary on the operation of the new legislation will become available.

More generally, it makes all tax planning far more difficult, as we have been put on notice that future anti-avoidance legislation may do more than simply block tax mitigation schemes – it may well impose new liabilities in an unpredictable and almost capricious way.

NATIONAL MINIMUM WAGE

From Friday, 1 October 2004 the National Minimum Wage will rise from £4.50 to £4.85 an hour and the Development Rate (payable to 18- to 21-year-olds and to some new employees undergoing formal training) from £3.80 to £4.10.

For the first time, there will also be a minimum wage of £3 an hour for 16- and 17-year-olds. However, this will not apply to children who are still of compulsory school age (which includes most 16-year-olds, until the end of the Summer term), or to apprentices, who are not entitled to the minimum wage until they have completed their first year's apprenticeship and are aged 19 or more.

New rules for pieceworkers

There are also important changes to the National Minimum Wage rules for pieceworkers. For NMW purposes, an employee is only a 'pieceworker' if the employer does not set the working hours. So someone who is contracted to work at his employer's factory from 8am to 5pm every day is not a pieceworker for NMW purposes, even if he is paid on a piecework basis – instead, he must simply be paid at least the NMW for each hour he works. In practice, the NMW 'piecework' rules mainly apply to people working in their own homes – including not only traditional 'outworkers' such as seamstresses but also (for example) telephone sales staff paid on a commission-only basis.

At present, piecework rates for outworkers must be set so that an averagely proficient employee can earn at least 80 per cent of the NMW. For example, if an average seamstress can make four garments an hour, the rate must be at least 90p for each garment, to allow her to earn £3.60 (80% of £4.50) an hour. From 1 October 2004 the rate must be set to allow an average worker to earn the whole NMW – so in the same example, the rate per garment would have to be set at £1.21¼ ($4 \times £1.21\frac{1}{4} = £4.85$) – an increase of nearly 35%. Furthermore, from April 2005 the rate will have to be increased again, to allow the average outworker to earn 120% of the NMW (making the rate per garment £1.45½).

The importance of employment status

Some firms assume their outworkers are not covered by the NMW rules because they are self-employed subcontractors. However, the NMW is payable to all 'workers', defined to include both employees and self-employed people who are not carrying on a genuinely independent business. Employment Tribunals have reached conflicting decisions on the status of outworkers, but the likelihood is that the overwhelming majority are 'workers' entitled to the NMW. Certainly, what is important is the real relationship between the parties, not the terms of any written agreement.

Employment status also has implications for PAYE and National Insurance. Here, the determining factor in drawing the line between employment and self-employment is likely to be the degree of control exercised by the firm, for example in tightly specifying the work to be done, or providing a sales script and list of 'prospects'. Again, the wording of any contract the worker may have signed will not be conclusive.

Getting employment status wrong is likely to be expensive for the firm, as it can create a backdated obligation to make pay up to NMW levels and to account for PAYE and National Insurance liabilities. The true status of workers treated as independent contractors may be challenged by the Inland Revenue and, increasingly, by Trade Unions, which have recently been prioritising NMW claims by outworkers.

COMPANY VANS

In the Budget last March, the Chancellor of the Exchequer announced that the benefit-in-kind charge for the private use of a company van is to be reformed.

At present, the benefit-in-kind is valued at £500 a year, or £350 if the van is at least four years old. From April 2007, the value will be taken as £3,000 a year, plus an extra £500 if the employer provides free fuel for private journeys.

However, the initial announcement also indicated that, from April 2005, there will be no benefit-in-kind charge at all if the employee is required to take his van home and the van is only used for home-to-work journeys. The good news is that it has since become clear that there will be no benefit-in-kind charge if the van is used only for home-to-work journeys, whether or not the employer actually requires the employee to take the van home, and that 'insignificant' private use will also be ignored. An example given is 'regularly making a slight detour on the way to work to drop a child at school'.

TAX CREDITS

For clients submitting their own Tax Credit claims, this is a reminder that, if you have not yet sent in your renewal claim for 2004/05, you should now do so as soon as possible. This is important because, if the Tax Credit Office do not receive your claim by 30 September 2004, they will suspend payment of both Working and Child Tax Credit. (This does not apply to people claiming only the Family Element of Child Tax Credit – equivalent to the old tax allowance – who do not have to submit a new claim every year.)

Many people will have updated their Tax Credit claims by telephoning the Helpline with details of their income for 2003/04. Indeed, we recommended this, because it would stop any overpayment or underpayment building up. However, even if you telephoned the Helpline, your Tax Credit payments will be suspended if you do not submit the paper renewal claim by the end of September.

A final point to watch is that, even where an accountant has been expressly authorised to deal with Tax Credit claims on a client's behalf, the Tax Credit Office still sends letters and forms direct to the client and does not send copies to the accountant. It follows that we only know what clients tell us, so if you receive any communication about your Tax Credit claim, which you want us to deal with, you must send it to us.

Pension Credit

Pension Credit – the income supplement for people aged 60 or more – was introduced in October 2003. We would like to remind clients that claims made by the end of September 2004 will be backdated to the launch of the scheme, but later claims will be backdated for one year only. Anyone who thinks he or she may be entitled should telephone the Pension Credit Application Line on 0800 99 1234.

This newsletter deals with a number of topics which, it is hoped, will be of general interest to clients. However, in the space available it is impossible to mention all the points which may be relevant in individual cases, so please contact us for personal advice on your own affairs.