

2010

# SUMMER NEWS



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# HEYWARDS

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## Taxman and Axeman

Who wants a job which is probably impossible to do well, and which will make you very unpopular? George Osborne, for one. The Coalition Government has been telling us from its first day that the country's finances are in such a mess that drastic measures are needed – and the new Chancellor's first Budget has been described as the harshest since the Second World War.

Some of the changes are straightforward, if painful. We have all recently dealt with an increase in the rate of VAT – after a temporary decrease – so we know what that involves. The rise in CGT was so widely predicted that the actual figure seems surprisingly low.

What is much harder to judge at this time is the effect of the promised public spending cutbacks. These are supposed to amount to four times as much as the tax increases, so we know that civil service departments are going to feel the pinch. If that results in HM Revenue & Customs taking longer to process tax returns and deal with enquiries, the taxpaying public will suffer a double whammy.

Even with the excitement of a General Election and Emergency Budget, there are still other things going on that highlight opportunities and pitfalls for your tax and finances. This newsletter explains some of those recent developments, as well as the main points from the Budget.

Whatever is ahead, we will be keeping a close eye on the changes and how they affect you. ●

## Furnished lets reprieved?

In the 2009 Budget, Mr Darling announced that the tax advantages of Furnished Holiday Letting were to be extended from UK properties to any qualifying rentals in the whole of the European Economic Area, but were then to be cancelled for everyone from 6 April 2010. FHLs are treated as a trade rather than as an investment, which has a number of benefits, particularly for the relief of losses and the taxing of gains. The government had realised that European law didn't allow us to restrict the benefit to UK properties – and they decided that we could not afford to allow the advantages to people's gites, villas and ski chalets.

Even so, European properties can enjoy FHL treatment going back into past years, as long as the conditions were satisfied at the time – if you

didn't know you had to make the property available for 140 days a year and actually let it for 70, you may not have bothered, but if you can show that this is what happened, you may be due a repayment of past income or capital gains tax.

The June Budget confirmed that the new government wants to keep the favourable treatment, and will change the law so that it's clear that we are good Europeans. However, it is likely that the conditions will be tightened up for all properties going forward – it may become necessary to make the property available for longer, or actually let it for more days.

If you own something that does or might qualify as FHL, we will be happy to advise you on the tax treatment – at least until they change it again! ●



## Flat rate flattened

Since it was introduced in 2002, the Flat Rate Scheme has become popular with small businesses. Traders with annual sales of up to £150,000 can use the FRS – they simplify their accounting by not claiming input tax, and they are allowed to keep some of the output tax they charge to customers in order to compensate them.

A recent case highlighted a rule that has been around since the start of the FRS, but which hasn't received much attention up to now. If a trade is "associated with another business", it's not allowed to join the FRS. It's clear why – a business might be split into two in order to get around the £150,000 limit, or a FRS business could charge 17.5% to an associate – keeping some of it, while the associate claimed all of it back as input tax.

Those are the risks to HMRC, but the rule is absolute – it doesn't make any difference whether the trader is exploiting the system or not. In the case, two couples owned a company, and each couple set up a separate company to supply management services to the central business. One couple registered their management company under the FRS. When HMRC realised what was going on, they argued that it was "closely bound by financial, economic and organisational links" to the central business, and it should therefore never have been admitted to the FRS. The directors had probably answered the question incorrectly on the application form because they didn't know what it meant.

If you use the FRS, it's important to make sure that you don't fall foul of this rule. If you are involved in running more than one business, we can advise you on whether there is a problem or not, and what to do about it if there is. ●



## VAT's up – again!

It was no great surprise that Mr Osborne announced an increase in the standard rate of VAT in his Budget – it's a good way to put a lot of money in the Government's coffers at a single stroke, even if it is painful for the public. At least the hike has been deferred until after Christmas – and after New Year as well. The last VAT increase was supposed to take effect at midnight on New Year's Eve, and special rules had to be brought in at the last minute for businesses which would be quite busy just then. The new Chancellor has shown a rare sense of practicality in putting the rate up to 20% with effect from 4 January, the first working day in the month. Maybe there will be time to shake off the morning-after feeling before getting down to changing the prices.

At least the list of items that aren't charged to VAT – including food, children's clothes, books and newspapers – hasn't changed, and the reduced rate which applies to domestic gas and electricity stays at 5%. So there won't be any VAT-related price rise on them.

If you can't get back the VAT on your costs, it may be worth advancing expenditure to before the end of the year in order to save the 2.5% – but there are rules to stop people doing this "artificially".

After two VAT rate changes since December 2008, traders should be used to the problems of this exercise by now – but if you need to check again how to deal with it, or whether you might be caught by the rules on advancing expenditure, we will be happy to help. ●

## MPs to live in

A new law was passed by the outgoing government which included the provision that any member of the House of Commons or House of Lords is treated as resident, ordinarily resident and domiciled in the UK for the whole of any tax year in which they

## For the company

For many years, a company's shareholders were not allowed to sue anyone on behalf of the company – they had to leave it to the directors to take action. That was a problem if the directors were, for whatever reason, unwilling to act. Since 1 October 2007 the Companies Act 2006 has provided for shareholders to take action on behalf of their company if it involves an act or omission involving negligence, default, breach of duty or breach of trust by a director. The idea is that the shareholder sues, but the remedy is awarded to the company – once the company has been compensated, the shareholder should be happy, because the shares will be restored to their proper value.

Even after the law was changed, the courts have been slow to allow this sort of claim, because they have preferred the aggrieved shareholder to pursue other solutions. Now a case has been allowed to proceed. The company was owned and run by two individuals, one of whom owned a separate company which made supplies to the central business. The other shareholder believed that these supplies had been exaggerated, but he could not force the company to take action because he did not control the board.

The court has now granted permission for the shareholder to bring an action on behalf of the company. He had produced evidence to show that he was acting in good faith, while the other director had produced no evidence at all. The claim may or may not succeed when the full case is heard, but this is a reminder that there are new protections in the law for shareholders who haven't always been able to control what the board of their company is doing. ●

are a parliamentarian here. That means that they will be subject to the same tax rules as all the ordinary people whose affairs they govern – more or less.

Maybe, in the "new politics", they will try to apply the same expenses rules as well. ●

## Nurses or nursing?

A year ago, HMRC cancelled the long-standing "staff hire concession", which allowed an employment business to charge VAT only on its margins rather than on the full amount paid by a customer for the use of temporary staff. Now they have issued a clarification on the difference between a supply of staff and a supply of services – it seems that the distinction has become more important since the concession was abolished, and they have found people getting it wrong.

A supply of staff is almost always subject to VAT, although international supplies may be accounted for by the customer instead of the

UK business. A supply of services – which are carried out by the staff – could be exempt, for example under the heading of healthcare.

HMRC say the difference is based on control and supervision. If the person supplying staff is responsible for what they do, it's probably a supply of services – nursing, not nurses. If the staff work under the control of the customer, it's got to be taxable.

It seems that HMRC are looking into this area and picking up mistakes, so if you are involved in this sector, you need to check what you are doing. We will be happy to advise you. ●

## Your cheque is in the bank

It's important that you pay what you owe to HMRC by the due date. If you don't, they can charge you interest, and sometimes a surcharge or a penalty as well – not to mention annoying phone calls and the threat of the bailiff. But what does “paid by the due date” mean?

For years, they have regarded a cheque as “paid” when they physically received it, or when the taxpayer paid it into a bank for their account. In either case, they wouldn't receive the funds until a few days later, when the cheque cleared.

Recently, they have become so keen on getting taxpayers to pay by direct credit transfer that they are willing to extend payment deadlines to people who do this – PAYE is due by the 19th of the month, but if the funds arrive in their account by the 22nd, they are happy. VAT is due on the last day of a month, but they will accept a BACS or CHAPS payment that arrives on the 7th of the following. Be aware that they are precise about their generosity – the funds have to clear no later than that date, and they mean seven calendar days not business days.

From 1 April 2010, they have changed their policy on VAT cheques. They will now regard a cheque as “paid” when it clears, not when it



arrives. So if you need to post your VAT return in time to have a reasonable expectation that they will have the money by the due date, you can no longer mail it with a cheque the day before the end of the month – HMRC reckon that, to be on the safe side, you should give 3 days to the Post Office and 3 days to the banking system, so you should post the return and cheque 6 working days in advance.

They are really keen for everyone to pay directly – so they are making it harder to pay by cheque at the same time as making it easier to go online. If you want advice about due dates and how to pay, we will be happy to help. ●

## Mind the GAAP



Generally Accepted Accounting Principles are mainly important for companies, which have to prepare their accounts using the proper accounting rules. Since 1998, though, unincorporated businesses have been supposed to calculate their profits using GAAP, even if their accounts don't have to follow all the other format and disclosure requirements.

One of the most controversial changes to GAAP in that time has been the treatment of partly-completed contracts. Accounting

standards require some of the income to be brought in if it has been “earned”. Some people argue that a job often isn't worth anything at all until it's been finished, but others say that accounting should match the revenue earned with the period in which the work was done. That means – broadly – that half the income should be recognised if half the work has been done by the balance sheet date.

That second approach has recently been supported by the Tax Tribunal. A building contractor had only recognised income when customers issued a completion certificate and he was sure that he would be paid. HMRC said that this was far too prudent, and as a result his income was underdeclared for several years. The Tribunal agreed: accounting standards required the income to be brought in as the work progressed, not only on completion.

This is a reminder that GAAP apply to sole traders as well as companies. If you want to discuss the accounting treatment of significant transactions in your business, we will be happy to advise you. ●

## Birthday present

The Budget included an important announcement about taking your pension benefits. Up to now, anyone with a pension fund has to start drawing an income no later than their 75th birthday. After that, the fund cannot be passed on to the pensioner's dependants without a heavy tax charge. Next year, the Chancellor proposes to relax these rules considerably;

and, in the meantime, the age limit has been raised to 77. That means that anyone who hasn't yet cashed in their policies will not be forced to do so before the rules have been changed.

If you are getting close to taking your pension benefits, it's worth making sure you have considered all the options. We'll be happy to advise you. ●

## Darling's last gasp

The outgoing Labour government rushed out its last Finance Act on 8 April. Most of the announcements in the March Budget were included, including the new 50% income tax rate for those with incomes over £150,000 and restriction of personal allowances over £100,000. Looking for good news, you can now have a company car with no tax charge at all – as long as it is wholly electric and cannot produce carbon dioxide at all.

The trend in recent years has been for each Budget to include announcements covering several years. It will be interesting to see whether some of those included in this Act are cancelled, for example the proposed 6 April 2011 increase in Stamp Duty Land Tax to 5% for properties costing more than £1m. On the other hand, a SDLT holiday was introduced for first-time buyers of houses costing up to £250,000 for two years starting on 25 March 2010.

The IHT nil rate band was frozen at £325,000 “until 2014/15”. Although reducing the impact of IHT is a key Conservative policy, it seems likely to be shelved for the time being, so more estates will fall into the tax net over the next few years.

It is surprising to note that, in the hurry to finish the Parliament and get to the hustings, the government still found time to notice that the 2011 European Champions League final will take place in the UK – at Wembley. The Finance Act exempts from UK tax whatever visiting foreign players and officials will be paid for taking part in that match. Surely this misses an open goal: even a 10% tax charge would have cancelled most of the country's deficit... ●

## Good company

In recent years, the rate of corporation tax for small company profits has been creeping up – from 19% to 21%, with another rise to 22% promised for next year. The intention was to reduce the tax advantages of companies over unincorporated businesses.

Now George Osborne has announced that the rate will be cut back to 20% in April 2011 instead of going up. The main rate of corporation tax will also be lowered by 1% a year for four years, so this seems to be a set policy to favour companies again.

That's good news, and it may make it worth considering incorporation if you are currently in business as a sole trader or partnership. It's a big step, and shouldn't be taken on tax alone – we can advise you on all the implications. ●

## U-turn on pensions?

Alistair Darling wanted to cut the tax relief on large pension contributions by high earners. Rules were brought in to withdraw higher rate relief for those earning over £150,000 – once income reached £180,000, contributions would only be entitled to the basic rate relief that a much lower earner would enjoy. This was supposed to come in from 6 April 2011, but to stop people bringing forward their contributions to get around the rules, there is an “anti-forestalling charge” which may apply to anyone paying a contribution over £20,000 in the current year if they have income over £130,000.

In the June Budget, the Chancellor announced that he is reconsidering this measure. That doesn't mean high earners will go back to getting full relief, because Mr Osborne needs to raise just as much money from this as Mr Darling intended to. He might instead allow full relief, but only on smaller contributions – 50% of £40,000 instead of 20% of £255,000.

In the meantime, the rules on big contributions in 2010/11 have been kept – someone who earns over £130,000 and pays over £20,000 into their fund needs to take advice on the tax consequences. If that affects you, we will be happy to help. ●

## Transport catches

If you do business abroad, you should be well aware of the VAT changes that came in on 1 January 2010 – the “VAT package”, which changed the VAT treatment of some supplies of international services and brought in new reporting requirements for UK businesses selling goods or services to EU business customers.

HMRC have been monitoring the new rules in practice, and have moved quickly to deal with one unexpected catch. Now, transport services bought by a UK business are subject to the VAT “reverse charge”, even if the goods and the courier are outside the EU. This wouldn't usually be a problem because a business which moves goods around can generally recover all its VAT, but the Haiti earthquake highlighted an issue for charities – if they paid someone to move aid supplies, they would suffer a VAT charge which they couldn't get back. That wasn't intended, so HMRC have confirmed that supplies of transport services which happen wholly outside the EU won't be charged to VAT.

There are probably other wrinkles with the new rules which will need ironing out. If you want to discuss them, we will be happy to help. ●

## Tax ping-pong

If you haven't finished your tax return by the due date, you can avoid penalties by at least paying the tax – maybe making a generous estimate to be on the safe side. A man took this approach to his 2006/07 return, paying an estimate on 30 January 2008. In August 2008 he asked for a repayment, which HMRC surprisingly agreed to – given that they still hadn't received the return – and then he had to pay the money back again when he finally put the papers in during December 2008.

HMRC levied a surcharge on the basis that he hadn't filed his return by 28 February and he hadn't paid the tax until December. The Tax Tribunal ruled that surcharge depends on the position on 28 February – and on that date, he had paid the tax. The later refund didn't affect the situation. So the surcharge was cancelled.

We wouldn't recommend this course of action – much better to have the return done and dusted at an early stage so you can tell what you owe. But if all else fails, making sure HMRC have enough cash is a good second best! ●



## Rebalancing act?

The Chancellor announced that there will be a “holiday” from paying a year's employer's National Insurance Contributions for up to 10 new employees taken on by new businesses which start up from Budget day onwards. The details are complicated and not yet finalised, but the idea is to encourage new private sector employment in parts of the country which are currently heavily dependent on public sector jobs “to rebalance the economy”. Reading between the lines, with 25% cuts promised for many civil service departments, many of those public sector jobs are about to disappear.

£5,000 per employee for a year sounds attractive, but the maximum benefit will only be enjoyed on staff with salaries of about £40,000 – if you take on relatively low-paid workers, the saving is much less. It remains to be seen whether this is a real boost for new jobs, or one of those wonderful political ideas that doesn't work in practice.

If you want to discuss the possibilities, we will be keeping an eye out for the final rules when they are published. ●

## No gains without pain

Everyone expected tax on gains to go up in the Budget – the only question was how much. The rise is probably at the lower end of expectations – higher rate taxpayers will pay at 28%, but that's still much less than their marginal income tax rate of 40% or 50%, and the annual tax-free amount remains £10,100. The amount of gains that an “entrepreneur” can make within a 10% tax rate have also gone up to £5m.

On the other hand, no-one has ever had to deal with a change in the CGT rate during the tax year before – disposals from 23 June onwards are subject to the new rules, and anything sold up to Budget day will still be charged at a flat 18%. If there are some of each, the computation promises to rival a Su Doku puzzle...

There's still a big incentive to earn your returns in the form of gains rather than income. The Chancellor hasn't committed himself to keeping the rate at 28% forever – it's going to be looked at again year by year. But it seems he wanted to split the difference between the old generous treatment and going straight to income tax rates.

If you want to know what the changes mean for your portfolio, we're here to help. ●

## Taxman in cyberspace

Everyone knows that death and tax are unavoidable. Well, maybe not everyone – a recent case involved a company selling hotel accommodation over the internet that didn't account for any VAT. Maybe they thought that the internet should be tax-free, or HMRC wouldn't know where to find them.

When the taxman came calling for £7m in unpaid VAT, the company argued that it was just arranging contracts between the holidaymakers and the hotels. If there was any VAT, it was due in the countries where the hotels were – not in the UK. The Tax Tribunal didn't agree: even though the website said that the company was only acting as an agent, the reality of its

agreements with both sides was that it was buying and selling the accommodation and was fully responsible for it. The assessment was confirmed.

It's easy to forget about VAT and tax when you are planning your business idea, but it can make the difference between success and failure – and, if you don't get it right from the start, it's quite likely to turn a success into a collapse. There's one sound principle to follow: if you are going to keep all the money and give none to the taxman, you need a very good reason why that's correct. If you want to discuss the tax treatment of your business, we will be happy to advise you. ●