



Howard Watson Smith Chartered Accountants

First Floor, St Giles' House, 15/21 Victoria Road, Bletchley, Milton Keynes MK2 2NG
Tel: 01908 376424 Fax: 01908 648730 Website: www.hwsmk.co.uk Email: info@hwsmk.co.uk

Registered to carry on audit work and regulated for a range of investment business activities by the Institute of Chartered Accountants in England and Wales

BUSINESS UPDATE

AUTUMN 2005

Does your business have illegal software?

According to the Federation Against Software Theft (FAST) more than 90% of businesses have some form of illegal software on their IT systems but many aren't even aware of the problem.

In many cases illegal software use is undoubtedly accidental. It is easy for businesses, particularly smaller ones without a dedicated IT department, to lose track of their software and licences. However ignorance is not a valid excuse in the eyes of the law.

According to research from the Business Software Alliance, UK businesses have paid £1.8 million in fines resulting from the use of illegal software over the past five years. Indeed FAST is so concerned at the level of software 'theft' that it has launched a tracking system to trace illegal software down to individual computers.



The season for excuses



Do you suffer from late payment of invoices by your customers? The DTI estimates that at least 10,000 businesses fail each year as a result. British businesses now wait an average of 61 days for payment. The most popular excuses for non-payment include 'the cheque's in the post', 'computer downtime' and 'lost invoices'.

For your part, don't accept late payment as inevitable. Make sure you agree terms of payment in advance, invoice promptly, collect on time and don't be embarrassed to discuss money!

A crop of recent excuses came from the Revenue. They announced delays in processing employers' end of year returns. Their excuse: additional testing of their new computer system. As far as the tax credits system is concerned the excuses have run out and there has finally been an

admission that the system 'appears unable to provide an immediate, responsive and appropriate service, particularly when things go wrong'. At the end of April this year, there were 125,000 disputed tax credit cases awaiting a decision and an admission that nearly half of the 5.7 million awards made in 2003/04 had to be adjusted. What an unhappy state of affairs.

You can rest assured that we won't bring you excuses; just sound advice and solutions to your problems. We hope you enjoy our offering of news items. Make sure you don't miss our update on the important Arctic Systems case - essential reading for those of you running your business through a husband and wife company. If all of this makes you think about moving on then see our article on relocation to ensure that whatever else happens, any move is tax efficient.

In this issue

- Introducing the new Pension Regulator
- Arctic Systems - the chill wind continues
- Changes in the service sector
- Domain names
- Calling all farmers
- Location, location, relocation
- The cost of forgetfulness
- Approving of nanny

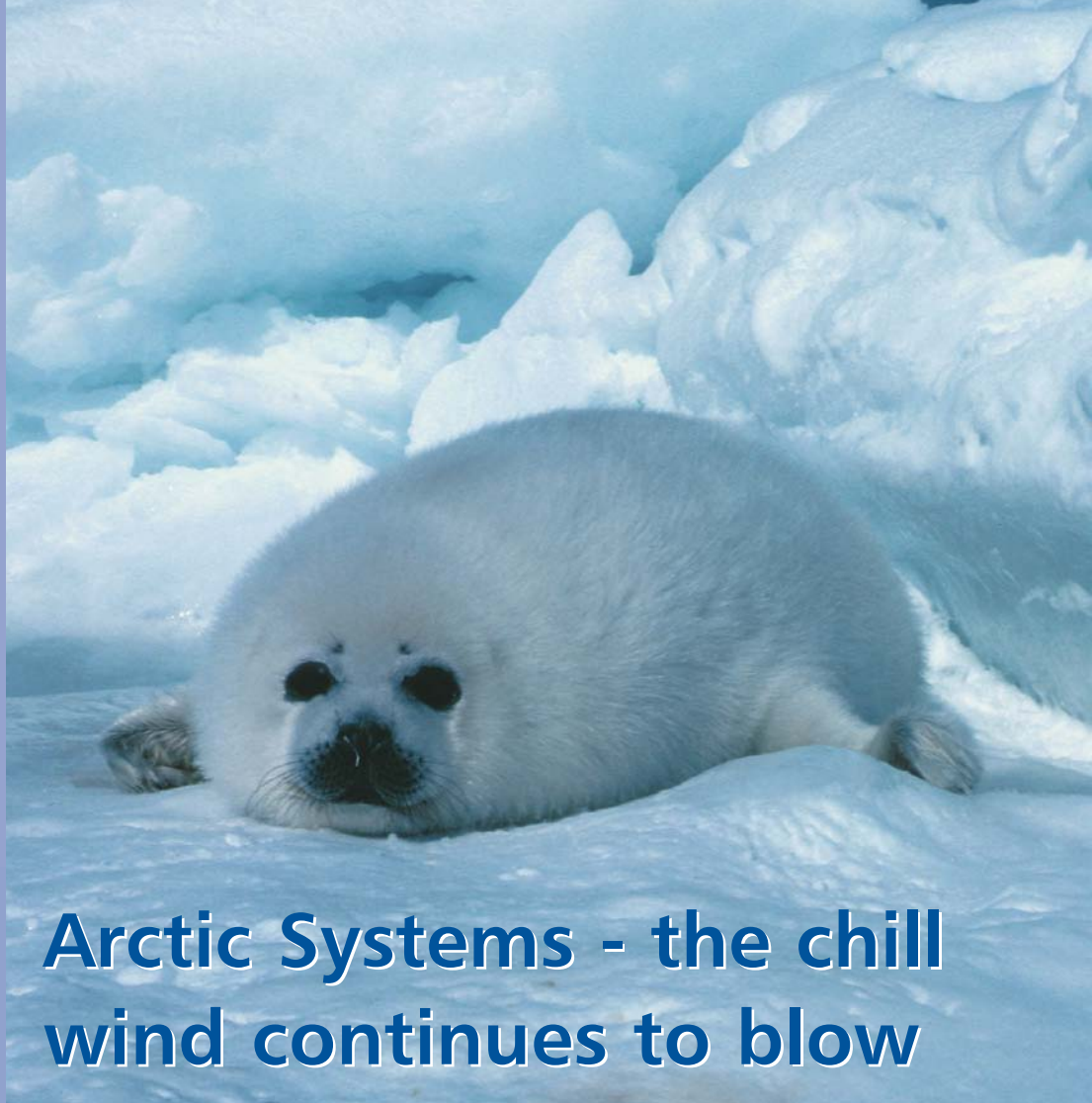
Introducing the new Pensions Regulator

Earlier this year the government introduced a new regulator to the pensions sector. Dealing with work-based pension schemes and known as the Pensions Regulator, this new body has replaced Opra - the Occupational Pensions Regulatory Authority.

The new regulator deals with any pension scheme made available by an employer, which includes occupational, personal and stakeholder schemes. Its main objective is to tackle risks to scheme members' benefits. In this respect it will be a more proactive organisation than Opra, concentrating its resources on schemes where there is greatest risk to the security of members' pensions.

The Pensions Regulator (TPR) has already started to gather detailed information about schemes and how they are being run through new scheme returns. The information provided will help support the risk assessment that will now be carried out on all schemes. This assessment will consider how likely it is that an event could occur that would affect the security of the scheme and will also consider the impact of the event should it occur. Any schemes assessed as high risk will then be closely monitored by TPR.

The introduction of TPR stems from a wider review of the pensions sector, which includes a new Pensions Act and a Pension Protection Fund. Further information about TPR can be obtained from www.thepensionsregulator.gov.uk



Arctic Systems - the chill wind continues to blow

Many people in the UK run their business through a husband and wife company. There is no doubt that the tax system in this country, for a variety of reasons, encourages:

- businesses to be run through a company rather than as a sole trader or partnership
- income to be split between husband and wife to take advantage of the independent taxation rules
- profits to be taken out of a company as a dividend rather than salary or bonus.

It is against this background that the Arctic Systems case is set.

Briefly - the facts

Mr and Mrs Jones owned and ran an IT company. They were the founder shareholders. He was a director and she was the company secretary (but not a director). There were no other employees. Mr Jones was responsible for earning all the income of the company whilst Mrs Jones dealt with the administration and worked on average about four or five hours each week on company business.

Mr Jones drew a very modest salary and the balance of the profit was paid out to the couple as dividends - each taking 50%.

The arguments

The Revenue argued that the corporate structure whereby Mr Jones was responsible for earning all the income of the company, drawing only a very small salary and allowing substantial

dividends to be paid, (half of which went to his wife), was an 'arrangement'.

The arrangement had the effect of giving income to his wife and so the 'settlements' legislation treated the dividends paid to Mrs Jones as belonging to Mr Jones for income tax purposes. As she was not a 40% taxpayer whilst he was, additional tax could be collected.

The decision so far

The technical arguments have been complex but both the Special Commissioners and more recently the High Court have decided in favour of the Revenue. The case is now on its way to the Court of Appeal but the position is far from clear leaving a whole host of questions unanswered.

We do not normally bring you 'half-finished' news but when a case hits the headlines in the way that this one has we felt it important to at least update you on the story so far.

What we still need to know....

- The final outcome of the case.
- Whether it would have made any difference if:
 - Mr Jones had drawn a 'commercial' salary
 - Mrs Jones was more involved in the running of the company.

The future

Rest assured we will be keeping a close eye on developments and the implications. In the meantime please get in touch if there are any issues you would like to discuss with us now.

Income recognition: changes in the service sector

Consider the following.....

Your business has negotiated a consultancy contract with a customer for an agreed fee of £20,000. The contract is halfway to completion at your 30 September 2005 year end. The total costs of providing the service are expected to be £12,000 (and this is mostly salaries) leaving £8,000 of profit.

In the past, the full £8,000 of profit would have been reflected in the accounts for the year to September 2006. The £6,000 (ie half) of costs incurred by September 2005 would have been carried forward as work in progress.

For accounting periods ending after 22 June 2005, income from incomplete contracts must be included in the accounts to the extent to which the contract has been completed (under the terms of UITF Abstract 40). Smaller businesses adopting the Financial Reporting Standard for

Smaller Entities (FRSSE) must do the same for accounting periods beginning on or after 1 January 2005.

Now..... instead of £8,000 profit being reflected in the 2006 accounts, effectively £4,000 will be included in the 2005 accounts and the other £4,000 in the 2006 accounts.

And...you guessed it, the tax treatment will follow suit and there is no provision to allow any spreading although the professional bodies continue to push for this.

Some thoughts if you are likely to be affected:

- given the choice, focus on completing existing contracts as your year end approaches and defer new work until after the start of your next financial year
- ensure you have efficient invoicing and cash collection procedures so that at least you have the funds to pay the tax.



Domain names

The Internet Corporation for Assigned Names and Numbers (ICANN) has recently approved the use of .eu as a suffix for European domain names. EURid (the European Registry of Internet Domain Names) will be responsible for registering new .eu domain names.

The system is not yet 'live' but it is anticipated that a 'pre-registration' period will be granted to government bodies towards the end of 2005 with others able to apply on a first come first served basis probably from early in 2006. A tentative timetable together with a number of questions and answers can be found on the EURid website: www.eurid.eu

Calling all farmers

The EU Common Agricultural Policy (CAP) reforms have led to ten major CAP payment schemes being replaced by one new single payment - the Single Farm Payment (SFP). One of the most notable changes is the introduction of 'decoupling' - ie payments to farmers are no longer linked to production. In effect this means that a farmer can cease to produce agricultural products altogether and still receive financial support.

There is a one-off opportunity in 2005 to receive payment entitlement (PE). Thereafter SFPs can only be received by acquiring entitlement from another farmer.

How is the SFP to be treated for tax purposes? There are variations in the precise detail of the scheme across the UK but the tax implications are broadly the same.



Is the SFP taxable?

Yes, whether or not it is linked to the production of saleable produce. Expenses are deductible if they are incurred 'wholly and exclusively' for trading purposes.

What about capital gains tax (CGT)?

Gains arising from transactions in PE are liable to CGT. If the PE is linked to a farming

trade it is likely to be treated as a business asset and therefore potentially eligible for taper relief at 75%. Gains may be deferred under the rollover relief provisions.

Will inheritance tax reliefs apply?

PE itself is not eligible for agricultural reliefs but so long as it relates to a farming trade, it will generally qualify for business property relief at 100%.

Will I have to pay VAT?

If PE is sold without land, VAT is due at 17.5% on the sale. Where PE is sold with land, the position is more complex and VAT may or may not be due.

This is only a very brief outline of a complex scheme. Please talk to us if you have any questions or require more detailed advice.

The cost of forgetfulness

A recent survey for the Prudential found that nearly half of those surveyed didn't know exactly how much they were paying each month by direct debit and standing order or to whom they were making payments. Furthermore almost 20% continue to pay old direct debits and standing orders averaging £53 per month. Worse still, many of those continue to pay for at least six months! The cost nationally is over £400 million a month.

The message is simple - review your direct debits and standing orders and put an immediate stop to those that are out of date or irrelevant.

Approving of nanny

Since 6 April 2005, there has been a tax and national insurance exemption of up to £50 per week for employees in receipt of childcare vouchers or other employer-supported childcare.

However the exemption only applies if the childcare is registered or approved.

In the case of a nanny working in the child's home, approval requires:

- evidence of a childcare qualification or induction course attendance
- the nanny to hold a valid paediatric first aid certificate
- an enhanced Criminal Records Bureau check including a Protection of Children's Act list check.

Nestor Primicare Services Ltd has been appointed as the approvals body. The approval lasts for 12 months and costs £96 per year. For further details see www.childcareapprovalscheme.co.uk

Disclaimer - for information of users

This newsletter is published for the information of clients. It provides only an overview of the regulations in force at the date of publication, and no action should be taken without consulting the detailed legislation or seeking professional advice. Therefore no responsibility for loss occasioned by any person acting or refraining from action as a result of the material contained in this newsletter can be accepted by the authors or the firm.



Location, location, relocation

Recent research indicates that the cost of moving house now averages out at over £5,000. Not surprisingly this can act as a deterrent to moving but what if you have no choice? Perhaps you are starting a new job or your employer wants you to work in Plymouth when you previously worked in Manchester.

In such circumstances an employer can pay an employee up to £8,000 in relocation expenses free of income tax and national insurance (NI) but only if certain conditions are satisfied. Otherwise reimbursed relocation costs will be taxable and liable to NI and need to be reported on the employee's P11D.

Broadly the following categories of expense are covered by the exemption:

- disposal or intended disposal of old residence
- acquisition or intended acquisition of new residence
- transporting belongings
- travelling and subsistence
- domestic goods for the new residence
- bridging loans.

Sounds simple! But as with all tax rules there are complications. We address some of these in this article so that if you are an employer reimbursing relocation expenses or an employee in receipt of them you are in with a fighting chance of benefiting from the exemption.

An employee will only be entitled to tax relief if the **main residence** has changed as a result of the job change. This doesn't mean that the old residence needs to be sold BUT the new residence must be within reasonable daily travelling distance of the new place of work and the old residence must not. Needless to say 'reasonable travelling distance' is not defined and the only help the Revenue can offer is that 'you should apply common sense and take account of local conditions'. Thanks!

An example may help.

Tim is offered a relocation by his employer from Manchester to Cambridge. He buys a house in Lincoln and commutes two hours each day each way from Lincoln to Cambridge. His reimbursed relocation expenses will be taxable since Lincoln is

not, in the Revenue's view, 'within reasonable travelling distance' of Cambridge.

What if Tim buys a flat in Cambridge but retains his house in Manchester? He only uses the Cambridge flat as somewhere to live during the week returning to Manchester at weekends and sometimes during the week. Once again there has not been a qualifying relocation and any expenses paid are taxable and liable to NI.

The situation can be even more complicated if Tim has a family and they split their time between Manchester and Cambridge.....talk to us if you are faced with a similar situation.....before rather than after the event.

Sometimes a relocation involves a relocation company. What is the tax treatment of the **management fees** they charge? It depends.

Again we use an example.

Angela is reimbursed qualifying (ie exempt) relocation expenses of £7,000. In addition a relocation company charges a fee of £1,000. This takes the total up to £8,000 and so is exempt. If the company had charged, say, £1,200 then £1,000 would have been exempt being within the £8,000 limit and the balance of £200 taxable.

The management fee will need to be pro-rated where only some of the expenses are exempt.

The £8,000 exemption can be used to cover the **provision of a car** for the purposes of relocating.

Andy has been relocated and will be moving house in a few months time. In the meantime his employer gives him a 'spare' company car to commute from his old home to his new place of work. The taxable benefit arising can be covered by the £8,000 exemption so long as the car is not available to Andy for any other private use apart from the travel relating to his relocation. If there is any other private use, the benefit will be taxable in full applying the normal car benefit rules.

As you can see the rules have the potential to be something of a minefield. It is worth making sure you get it right. Please talk to us if you have any questions.