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BUSINESS UPDATE

SUMMER 2004

UK200Group summer news

The UK200Group's one-day spring conference for the Growing Business Sector, appropriately titled 'Aiming for the Rich List?' was held at the Cafe Royal, London, in April. Amongst the guest speakers were successful entrepreneurs, bankers, investment managers, tax advisers, corporate lawyers and economists.

Having access to such an event with expert speakers covering a wide spectrum of key topics is one of the advantages of being a UK200Group member firm. The conference not only proved enlightening for partners and guests present, but will benefit clients with growth ambitions, interested in preparing a business for sale, mounting an MBO, or funding a purchase.

There was also good advice on pitfalls to watch for when selling part of a business, or partnership or company. Perhaps inevitably one speaker, a senior economist from HSBC Bank, raised the question: How long can the party last? And how severe will the hangover be in the light of Chancellor Brown's recent decision to loosen the Government's inflation target?

Sharing knowledge and experience brings benefits we can share with all of our clients.



The Family Home



Ever since the Labour Party came to power in 1997, rumours of a fundamental reform of inheritance tax (IHT) have abounded. Although this has not happened, the failure of the annual rises in the IHT nil rate band to keep pace with rising house values has meant that increasing numbers of individuals find themselves potentially within the IHT net as a result. In turn this has led to much IHT planning focussing on ways to remove the increasingly valuable family home from the estate whilst still enjoying some of the benefits of ownership by continuing to live there.

The IHT regime has a set of rules commonly known as the 'gift with reservation' rules that render a gift of property

ineffective for IHT if the previous owner continues to enjoy or occupy the property.

However, in recent years, various schemes have been developed to get around the rules - the most recent being the 'double trust' or 'home loan' scheme. The scheme enabled individuals to remove the family home from their estate for IHT whilst continuing to live there.

The government has now moved to do something about this. However rather than change the IHT rules they will instead (from April 2005) charge income tax on the value of the continuing benefit. In the case of a property, the charge will be based on deemed income equal to the market rent for

the property. Clearly quite a hefty charge and one designed to render the home loan scheme defunct. Although the charge is not introduced until next year it will not only catch arrangements entered into in the future but also those set up previously. Given that these may be difficult to unravel, there will be the choice to treat the property as remaining within the estate for IHT purposes rather than suffer the new charge. Something of a frying pan or fire decision!

Please talk to us if you have any questions arising from this article or wish to discuss estate planning more generally.

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Good news for employers

It has always been good advice to businesses unhappy with an employee's performance or conduct in their first year of service that they take action well before 12 months service has accrued, taking into account any notice period.

For example, if you must give an employee three months notice, any disciplinary action should be taken before nine months service has been accrued. Otherwise the employee could potentially claim unfair dismissal on the basis that at the end of their notice period they would have completed 12 months service.

A recent case (*Virgin Net Limited v Harper*) however has reversed this stance. In this case Sally Harper was employed at Virgin and was entitled to three months notice. She was however dismissed with no notice on 2 March 2001, 33 days short of accruing one year's continuous service which would have entitled her to bring a claim for unfair dismissal, in line with the Employment Rights Act 1996.

The Employment Tribunal upheld her complaint of wrongful dismissal and awarded her damages equal to three months notice. In addition she received £25,000 for 'loss of opportunity to claim unfair dismissal'.

The good news for employers is that Virgin has successfully appealed against the Tribunal's decision. It was held that Harper did not qualify for the right to claim unfair dismissal as she had not completed the qualifying 12 months period of service and therefore should not receive compensation for the loss of opportunity to claim it.

The case confirmed that the statutory minimum notice period of just one week could be added to the employment period to determine the date of termination, but not any longer contractual notice period.



Business rates

Business rates are the third largest item of expenditure for small businesses and, according to the government, place a disproportionate burden on SMEs as a percentage of turnover, profit and overheads.

Because business rates are such a burden on UK SMEs the All Party Parliamentary Small Business Group is conducting a research study. Thousands of SMEs are being surveyed and the findings will be published in a report later this year.

The group is looking at all aspects of business rates including valuations and appeals as well as possible reforms of the system. Over the next few years there will be significant changes to the rating system including the use of business rates to fund urban regeneration and the use of

rates relief for certain types of business. In 2005 there will be another revaluation with many small businesses seeing significant changes in their rateable value and their rates liability. Increases are likely to have a more significant effect on SMEs than large businesses.

You can find further information at: www.smallbusinessgroup.org.uk

National minimum wage

The government has confirmed that in future, changes to employment law will only happen twice a year on 6 April at the start of the tax year and on 1 October when the national minimum wage is reviewed. This is an attempt to make it easier for employers to keep tabs on the changes being made.

The government has confirmed that in October this year, the minimum wage rate for adults will rise from £4.50 to £4.85 and the rate for 18 to 21 year olds will rise from £3.80 to £4.10. In addition 16 and 17 year olds will be paid a legal minimum wage for the first time and the rate will be £3 per hour.

There is a helpline for anyone who thinks they are not being paid the minimum rate: 0845 6000 678. In Scotland the number is 0845 600 1768 and in Northern Ireland 0845 650 0207. There is also an interactive website (www.tiger.gov.uk) which provides guidance for both employers and employees.

Please contact us if you have any questions relating to the national minimum wage.

Employer's liability insurance



Research suggests that more than 200,000 small and medium-sized businesses (SMEs) in the UK are breaking the law by operating without ELI.

Employer's liability insurance (ELI) became a legal requirement for all UK businesses in 1972. It means that for a business to trade legally, it must have insurance cover for all employees. The legal minimum cover is £5 million and certificates must be displayed in the workplace. The cover ensures that if an employee is injured at work or becomes ill as a result of their work and decides to sue their employer, there is at least a minimum level of insurance to cover the claim.

However research has suggested that over 200,000 small and medium-sized businesses (SMEs) in the UK are breaking the law by operating without ELI. This is due at least in part to the steeply rising cost of ELI. A study by the Office of Fair Trading estimated that premiums rose by an average of 50% in 2002 and the rises are continuing albeit the rate of increase is slowing. The increases are due to a number of factors including the increasing number of claims made and the general increase in insurance costs following the terrorist attacks in America. Add to this the fact that the full financial consequences of long-term illnesses such as that caused by exposure to asbestos are only now being realised and you begin to understand why business insurance has never been so risky.

The British Insurance Broker's Association estimates that the increases have led hundreds of SMEs to shut down to date and that certain sectors have been particularly badly hit. Those hardest hit include the construction industry, painters and decorators, nurseries and childcare centres and haulage companies.

The government has undertaken an in depth review of ELI which recognises that 'the market hasn't failed but it hasn't been working well enough'. Amongst the measures under consideration is the possibility of waiving the requirement to obtain ELI for 300,000 of the smallest single owner-employer companies.

The situation will not improve overnight but the government review is the first stage in recognising the issues and looking at possible solutions.

Business tenancies

Changes to the Landlord and Tenant Act came into force at the beginning of June. The changes amend the part of the Act that deals with security of tenure where premises are leased to business tenants.

The main changes relate to:

- renewal and termination procedures
- time limits for applications to the courts for renewal of tenancies
- interim rent
- compensation for tenants where a tenancy is not renewed and
- contracting out and agreements to surrender tenancies.



How much corporation tax?

Your company made profits last year of £150,000 and the corporation tax bill at the small companies rate of 19% amounted to £28,500.

But if your company is part of a group of four companies the bill would have been almost £39,000. The impact of the group companies is to reduce, pro rata, the profit level at which the small companies rate ceases to apply.

More specifically, the pro rata exercise applies whenever there are 'associated companies'. The detailed rules are complex but the bottom line is that companies under 'common control' are associated.

Common control includes the scenario where you control one company and your spouse controls another. Think about

the impact on your trading company's tax bill if your spouse starts a small property investment company. Where other relatives are involved, say you control one company and your brother controls another, the rules are different. In this scenario the companies will only be associated if there is substantial commercial interdependence between them.

The situation can become even more complicated when shares are owned by family trusts as well as by individuals or where loans have been made between companies.

Falling foul of the rules can be very costly in terms of extra tax. Please talk to us if you are considering a new business venture. We can advise on the best structure.

Independent taxation: the rules change

The independent taxation of husband and wife was introduced over 14 years ago in 1990. Ever since that time, husbands and wives have had their own personal allowances, starting and basic rate tax bands for income tax purposes and planning has revolved around ensuring that these are fully used wherever possible.

Any income from property jointly owned by a married couple is treated for income tax purposes as belonging to them in equal shares unless an election is made for the income to be split according to the actual proportions of ownership and entitlement to income. In many cases, there is no incentive to elect because splitting the income equally for tax purposes is often the most desirable course of action.

However the government has recently decided that, in their view, the rules were open to abuse in the case of shares in family companies (specifically 'close' companies which are those owned by their directors or by five or fewer people). Consequently from 6 April 2004 married couples are taxed on dividends from jointly owned shares in 'close' companies according to their actual ownership of the shares. Therefore if the ownership is 95%:5% then that is how the income will be split subject to any interaction with the so called 'settlement' provisions.

The change is limited to close company shares and does not affect the treatment of other jointly owned property. For example rental income from an investment property can still be split 50:50 even where the ownership of the underlying capital is different.



Plant and machinery - what allowances?

The rules for determining what capital allowances may be available for expenditure on plant and machinery can appear confusing. Of course we are always here to help and answer any questions you may have but the summary below may prove helpful when you are contemplating an acquisition.

| Type of expenditure \ Size of business | Small | Medium | Large |
|---|--|---------|----------------------------------|
| Expenditure on computers, software and internet-enabled mobile phones | 100% first year allowance (FYA) expired 31.3.04 | N/A | N/A |
| General capital expenditure on plant and machinery (not : cars, long life assets or those used for leasing) | 50% FYA for 12 months from 6.4.04 (1.4.04 for companies) and 40% otherwise | 40% FYA | 25% writing down allowance (WDA) |
| Cars - CO ₂ emissions exceeding 120gm/km - CO ₂ emissions up to 120gm/km | 25% WDA restricted to annual maximum of £3,000 100% FYA | | |
| Other specified energy saving plant and machinery | 100% FYA | | |

The thresholds used to determine whether a business is small or medium-sized have been increased for financial years ending on or after 30 January 2004. The number of businesses eligible for FYAs has increased substantially as a result. **Please talk to us if you need any further information relating to this point.**

Certain specified energy saving plant and machinery continues to qualify for FYAs at 100% regardless of the size of business. Further details can be found at www.eca.gov.uk

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