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BUSINESS UPDATE

SUMMER 2005

Promise of reduction in red tape for small businesses

As many of you will be aware, the Inland Revenue and Customs and Excise are merging to form HM Revenue and Customs (HMRC). The new department is keen to look at ways of reducing the administrative burden on small businesses. In the relatively short-term measures proposed include:

- abolishing payments of tax credits via employers
- reducing the tax return for 500,000 small businesses from 16 to four pages and
- looking at new ways of paying and managing VAT online.

A small start you may feel but to help take the process forward, a consultation document has been issued and a summary can be found at www.inlandrevenue.gov.uk/consult_new/small-business-summary.pdf

Do let us know if you have strong views on any of the issues raised.

There is no doubt that the process of reform will take time, probably a very long time, but those of you running small businesses who do battle daily with bureaucracy and red tape will welcome any moves in this direction.

Tax avoidance: where are we now?

The Inland Revenue has always taken a dim view of tax avoidance using what it sees as 'artificial schemes'. Blocking successive schemes became something of a cat and mouse game. Once the Inland Revenue latched on to a particular scheme they could seek to block it either by taking a case through the courts or by introducing amending legislation to render it ineffective. Typically tax planners then sought either to find a loophole in the amending legislation or to move onto 'mark II' of the scheme.

Consequently new rules were introduced in 2004 requiring tax scheme promoters to provide details of their schemes to the Inland Revenue. The scheme is then registered and a reference number allocated. Taxpayers using such schemes are required to include the number on their tax returns.

In the government's words 'these rules provide early warning of avoidance schemes (and) enable the governmentto respond to tax avoidance'. The result to date has been an apparently much quicker response in introducing specific anti-avoidance measures.

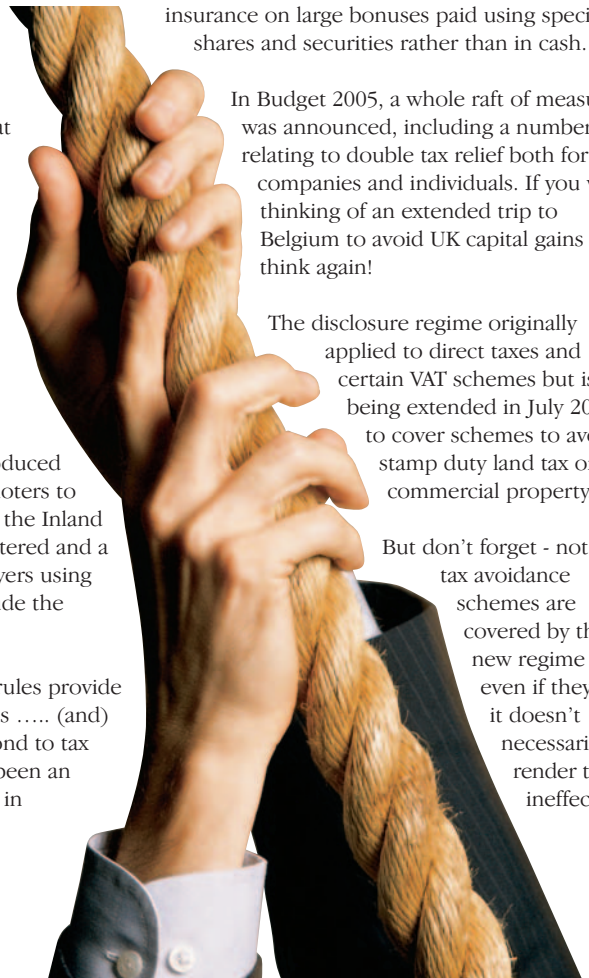
In December 2004 a measure was announced essentially designed to stop avoidance of tax and national

insurance on large bonuses paid using specific shares and securities rather than in cash.

In Budget 2005, a whole raft of measures was announced, including a number relating to double tax relief both for companies and individuals. If you were thinking of an extended trip to Belgium to avoid UK capital gains tax, think again!

The disclosure regime originally applied to direct taxes and certain VAT schemes but is being extended in July 2005 to cover schemes to avoid stamp duty land tax on commercial property.

But don't forget - not all tax avoidance schemes are covered by the new regime and even if they are it doesn't necessarily render them ineffective!



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Service charge optional



The tax and national insurance (NI) treatment of tips, gratuities and service charges in the catering and related industries is notoriously complex. The Inland Revenue is well aware that tax and NI is not always properly accounted for and has started to look into this matter. We summarise briefly the correct tax and NI treatment below.

Where the customer pays a tip direct to the employee the responsibility for dealing with that tip rests with the employee. They should declare the amounts received to the Inland Revenue and usually the tax will be collected through the employee's PAYE code. The employer has no PAYE responsibility and there is no NI due.

However, in many situations the employer will collect the tips, particularly where tips are added to the credit card bill or where the employer makes a service charge. If the employer distributes these to their staff, the employer has an obligation to operate PAYE on making payments of the tips to the employees. In addition NI (both employers' and employees') is due. The plus about this route is that the tips can count towards the employer's requirement to pay the National Minimum Wage.

If the employer leaves the tax position to the employee to sort out, it is prudent that this is reflected in the contract of employment, so that it is clear that the responsibility rests with the employee and not the employer.

A tronc is a special arrangement used to pool and distribute tips. It is usually operated by a troncmaster who is responsible for operating a PAYE system independently of the employer's scheme. NI will not be due so long as there is no contractual entitlement to a share of the tips and the employer does not determine, directly or indirectly, their allocation.

The Inland Revenue has published a revised guide on the subject - booklet E24(2005). Please talk to us if you have any questions on anything we have raised in this article.



Company hijack - are you at risk?

You may have been surprised to read about cases of company hijack recently. Also known as the '287' scam, hijacking involves fraudsters forging certain documents that are filed at Companies House, form 287 being the main one. This form changes a company's registered address but the scam also includes forging forms that change the addresses of company directors.

Once they have decided upon a target company, hijackers manually submit a new form 287, changing the company's registered address to one that they control. Companies House only completes basic checks and then automatically processes the form and makes the requested changes. The hijackers are then in a position to use the company to order goods and services, trading off its creditworthiness. Goods delivered to the bogus address are then sold on but the supplier never receives payment.

This can obviously lead to severe problems for the real company and its directors to sort out. The first that the directors may hear of the problem is when suppliers try and enforce payment for goods ordered in the company's name!

Companies House is aware of the risk of hijacking in this way but does not have the power or resource to investigate the contents and accuracy of forms sent in for filing. Millions of documents are submitted each year!

Instead, Companies House has introduced a new service, PROOF (PROtected Online Filing), which in conjunction with its 'Monitor' service should help to combat this type of fraud. These services help directors monitor changes to certain statutory documents that must be filed.

The **PROOF** service requires companies to sign up to file specific statutory forms in electronic format only. Paper submissions will then be refused. The **Monitor** service literally monitors which documents are filed at Companies House - once a new document is filed, those registered are automatically informed that a new form has been filed. This provides an early warning that a change has taken place.

Please get in touch or visit www.companieshouse.gov.uk if you would like to find out more about the availability of these services.

Stamp duty land tax: good news and bad news

The Budget back in March was light on pre-election sweeteners but the stamp duty land tax (SDLT) threshold on residential properties was doubled from £60,000 to £120,000. The Council of Mortgage Lenders estimates that this will reduce the proportion of first time buyers liable to SDLT from 83% to 48%, still much higher than the 22% who paid back in 1997.

Above £120,000, SDLT is still applied to the full purchase price at rates of 1%, 3% and 4% a regime which many consider to be unfair. The purchaser of a £250,000 property will continue to incur a charge of £2,500 whilst the buyer paying £260,000 faces a charge of £7,800.

The SDLT threshold for commercial properties remains at £150,000. However the exemption for commercial properties in designated 'disadvantaged areas' has been withdrawn with effect from 17 March 2005, rather earlier than expected.

eBay

eBay, the online auction website, has been hugely successful. At any one time it has well over 100 million registered users (10 million in the UK). It has been used increasingly by businesses with stock to shift or out of date equipment to unload. However until earlier this year, only individuals were allowed to register with the inevitable result that many businesses registered and traded as individuals.

UK businesses can now officially join eBay and can also sign up for a PayPal account allowing them to send and receive credit and debit card payments online. Don't forget that anything sold on eBay should be reflected in the business books in the normal way.

Private sellers registering on eBay can sell unwanted items online. Are there tax considerations? it all depends.

Sales of high value items such as paintings and antiques may incur capital



gains tax but generally only if the amount generated exceeds £6,000.

There are so called 'power sellers' who buy goods specifically to sell them online and in some cases give up their day jobs to concentrate on this. These individuals are trading and should be paying tax on their profits.

Not surprisingly the Inland Revenue is keen to catch up with these people and ensure they are complying with the law and paying any tax that is due. eBay has met with the Inland Revenue to discuss the way forward. There are no specific measures yet in place to tackle the problem but it is likely that this will change. **Watch this space!**

The construction industry

Over the years, the Construction Industry Scheme (CIS) has been subject to a number of changes and reviews. Despite this, the Inland Revenue still has two main areas of concern. The first is fraud, particularly paying 'off the books', and the second is the job status of the people working within the industry. Major changes will be implemented in April 2006 to try and address the first point. The second point is a continuing area of risk.

The status of workers ie whether they are employed or self-employed, is not a new subject but the Inland Revenue is targeting it again. Last year they sent out thousands of letters to contractors in the industry warning that they were not happy with the position of workers within those businesses and inviting them to review the terms on which subcontractors are engaged. In view of the Inland Revenue's increased 'interest' in the industry, it is probably advisable to carry out a status review even in the absence of a letter.

Should a given subcontractor be treated as employed or self-employed? The position is not always clear-cut and a number of factors are used to paint a picture. The factors must be applied individually to each situation. The main ones which will usually need to be considered are:

- whether the worker could provide a substitute or will always have to undertake the work themselves

- who controls when, where and how the work was done, the worker or the payer
- who provides the equipment used
- whether there is an ongoing obligation to offer and perform the work by the payer and worker respectively
- what the basis of payment is and whether the worker has any financial risk
- what the intention of the parties is.

The Inland Revenue is trying to establish whether the workers truly are in business on their own account. If, having considered all of the above tests, they are not happy, they may reclassify the worker as an employee and seek to rectify the position for earlier years, with additional tax, interest and possibly penalties being due.

A further issue relates to those who are paid gross, rather than net, within the construction industry. In order to be paid gross, a subcontractor must obtain a gross payment certificate and renew this on a regular basis. However, the Inland Revenue is starting to deny renewal where the subcontractor has regularly paid over their own employees' PAYE deduction late. Non-renewal may cause severe financial hardship and it is vital that PAYE is paid over on time.

If you have any concerns about either of these issues, please contact us.



Being civil

Last November the Civil Partnership Act (CPA) became law. Its effect is to give legal recognition to same-sex couples. The Act comes into effect later this year on 5 December 2005 and will allow same-sex couples to make a formal legal commitment by entering into a civil partnership. From the same date the Inland Revenue will treat registered civil partners as married couples for tax purposes.

The main tax implications will be as follows:

Inheritance tax

Transfers between civil partners both during lifetime and on death will generally be exempt.

Capital gains tax (CGT)

Main residence exemption will only be available for one property per couple.

Transfers between partners will be on a 'no gain no loss' basis and thus not attract an immediate CGT charge.

Settlements

Anti-avoidance legislation that currently applies to spouses will be extended to civil partners. Broadly the legislation prevents the effective transfer of income in certain circumstances from a higher rate taxpaying spouse to one liable at a lower rate.

Jointly owned property

Married couples often own property jointly. Any income arising from such property is generally taxed on the couple 50/50 unless they elect for the income to be split in the proportion in which the asset is owned. Civil partners will be treated in exactly the same way.

Generally the changes are good news but please talk to us before registering your partnership so that we can run through all of the implications with you.

As a final point, note that the provisions do not extend to unmarried heterosexual couples. They still need to marry if they are to be treated as married couples for tax purposes.

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Protecting the family home

In his March Budget, the Chancellor made great play of increases in the inheritance tax (IHT) threshold above the normal inflation linked rises. The limit is now £275,000, up from £263,000 last year and will rise to £285,000 in 2006 and £300,000 in 2007. This is small comfort to the many families who find themselves within the IHT net, primarily because of the value of their homes. If the IHT threshold had been increased in line with house values since 1997 it would now stand at over £500,000.

As a consequence much IHT planning in recent years has focused on ways of removing the family home from the estate for IHT purposes whilst continuing to live there. In simple terms an outright gift of the home to, say, your children whilst you continue to live in the house is ineffective for IHT purposes. The property will still be treated as part of your IHT estate by virtue of the 'gift with reservation' rules.

Complex schemes were therefore developed to allow continued occupation of the property whilst removing it from the IHT estate. A variety of schemes were used, the most common being the 'home loan' or 'double trust' scheme. The government has now acted to outlaw such schemes and, since 6 April 2005, the pre-owned assets tax charge has been in place. This imposes an income tax charge based on a notional market rent for the property. Assuming a rental yield of 5%, the annual income tax charge for a higher rate taxpayer on a £1 million property would be £20,000. However the upside is that the property is **not** treated as part of the IHT estate and so the IHT saving (after taking into account the £275,000 nil rate band) would be £290,000.

The new charge has been criticised on several counts. It involves valuation of the property to establish the income tax charge - at best a

costly and subjective matter. It is also seen by some as retrospective in that it can apply to arrangements put in place at any time since March 1986.

Two critical questions arise.

Is there any planning that still works?

There is no easy answer. Space does not permit us to set out the available options in full in this newsletter but the following could still be considered:

- Discretionary will trust
- Deed of Variation
- Equity release schemes
- Sharing arrangements - whereby the parent and (adult) child share the property.

The new charge will only apply to those who have entered into certain schemes or arrangements. But what can be done to avoid the new charge?

The options are limited but the following could be considered:

- 1 Dismantle the scheme, although this may be complex and costly and in some cases impossible.
- 2 Elect to treat the property as part of the IHT estate. This will achieve the same tax result as 1 - ie no income tax charge but loss of all IHT 'savings'.
- 3 Move house or pay a full market rent for use of the property.

Inevitably given the complex nature of these schemes avoiding the new charge is not easy.

IHT planning is a very personal matter and the most appropriate solution will differ from family to family. We would welcome the opportunity to talk to you about IHT planning. Please give us a call.