

ABOUT

Spring 2007

business

Tax Simplification Promise from HMRC

Small businesses will have a slightly easier time dealing with their tax affairs, HM Revenue & Customs (HMRC) has promised, but it will take up to five years to achieve the necessary changes.

Reforms on the agenda include a single point of contact with HMRC, a range of flexible tax payment options, less time spent on dealing with HMRC inspections and audits, and better guidance and support.

One of the most significant changes, according to HMRC, will be the introduction of a 'single customer record'. This will bring together all the information that

HMRC holds on your business, whether for VAT, pay as you earn or taxation of business profits. You will then only need to give HMRC new information once. The benefits apparently include HMRC resolving queries more quickly.

Although the proposals are helpful, it is no surprise that taxpayers will not be the only ones to benefit. Bringing together all the information on a business will make it readily available in any HMRC enquiry. Flexible payment options will enable HMRC to chase unpaid tax more quickly.

What will not change is the complexity of the legislation that

businesses have to contend with. For instance, better administration will not make it any easier for employers to work out the correct tax

and national insurance treatment of many employee expenses and benefits.

Some of the simplifications made so far do no more than withdraw burdensome compliance requirements imposed by recent legislation. For example, HMRC first made



all companies complete a complicated form whenever they issued shares to directors and employees, then two years later decided it was a waste of time for most new companies.

Tax will never be easy but we can help you.

New Focus on Inheritance Tax Avoidance

According to recent research, ten million homeowners own assets worth more than the inheritance tax threshold.

Continuing rises in property prices have ensured that more than four out of ten estates will be liable to pay IHT. Although the government has brought in measures to prevent avoidance of IHT, there are still plenty of straightforward steps you can take to reduce the impact of this increasingly significant tax.

Lifetime gifts to individuals remain free of IHT provided the donor survives seven years. If you are in a relationship, consider the advantages of getting married or entering into

a civil partnership. It will mean that property can pass to your partner tax-free. And where tax cannot be avoided, you could enter into an insurance contract or savings scheme to provide the means to pay it.

Above all, if you own any property, make sure you have a will and that you review it regularly so that you can make use of all available IHT exemptions and reliefs, and also ensure that assets pass to your heirs in line with your wishes.

You might think that you could save IHT by moving your money outside the country or by buying a property overseas. In fact, the chances are that it will not help. If you are UK domiciled you are

liable to IHT on all your assets regardless of where they are situated in the world. HM Revenue & Customs recently stepped up scrutiny of inheritance tax returns showing overseas property in the belief that some estates and trusts may not have fully declared it.

If you move abroad permanently, you may eventually be able to lose your UK domicile, leaving only your UK assets liable to IHT – but it is not easy to achieve. A recent Special Commissioners' decision emphasised the importance of establishing an intention to live permanently in a specific overseas country and the need to break all significant links with the UK.

Question Mark Over Pensions Tax Relief

A little noticed change that took effect on 6 April 2006 – pensions tax simplification A-Day – was a new rule about tax relief for employers' contributions to registered pension schemes.

Previously, employer contributions to occupational schemes (but not personal pensions) were statutorily entitled to tax relief. But now, pension payments have to meet the same criterion as all other business expenses: they have to be wholly and exclusively for the purpose of the trade. Spreading of the deduction into future years may still be required for exceptionally large contributions.

So far, so straightforward, except that the practical application of

the 'wholly and exclusively' test for pension contributions remains uncertain. Employer pension contributions are more efficient than employee payments because of the national insurance savings, but they would rapidly lose their attraction if there is any doubt that the employer will get full tax relief.

Normally, questions only arise in relation to controlling directors and husbands or wives, or other people who are connected with them.

However, HM Revenue & Customs (HMRC) does seem to look more closely at large pension payments. HMRC has said it will allow tax relief for an employer's contribution for a controlling director or connected person if the payment



is 'in line with a contribution that would have been made for an unconnected employee in a similar situation'. This may be very difficult to judge in the case of a controlling director where nobody else does a similar job.

It seems that individual tax inspectors are interpreting the new rule inconsistently and HMRC's pension specialists have not yet produced definitive guidance. Until then, there can be no guarantee of tax relief and HMRC will not express any opinion in advance of paying the contribution. Ask us for guidance if you are in any doubt.

Non-Residents May Face Crackdown

If you enter and leave the country often, you can no longer assume that your days of arrival and departure will be left out in tests for deciding whether you are a resident in the UK.

A decision by the Special Commissioners in late 2006 contradicts HM Revenue & Customs' (HMRC) current guidance to taxpayers and leaves many people in an uncertain position.

The individual concerned in the case had argued that he was not resident in the UK because he spent an average of fewer than 91 days a year here. But the Special Commissioners, who are the first line of appeal in tax disputes with HMRC, said that

ignoring all travel days gave a distorted picture of the time that this person spent in the UK and agreed with HMRC that nights in the UK should be counted instead. The upshot of this decision is that a person who has come here on a Monday and then leaves on Tuesday, the following day, is treated as spending one whole day in the UK instead of none.

The ruling is not binding on other cases but the case is likely to go to the High Court, and their eventual decision will be binding. It leaves many questions unanswered, in particular whether it applies to all people and all lengths of stay in the UK, or only to frequent travellers or short visits.

For the moment, the only way of being sure you are treated as not resident in the UK for tax purposes is to assume the worst case scenario. This means being in the UK fewer than 91 nights a year on average and fewer than 183 nights in any one tax year.



Freelancers' Tax Scheme Attacked

New rules to stop workers avoiding PAYE deductions by using managed service companies (MSCs) will be set out in the upcoming spring Budget. The December 2006 Pre-Budget Report announced that MSCs will be required to deduct tax and national insurance from all payments to their workers from 2007/08.

MSCs, or composite companies, allow individuals to provide services without being taxed as employees. Workers hold shares in the MSCs and avoid national insurance contributions (NICs) by receiving most of their earnings in the form of dividends. The existing IR35 legislation on personal service companies does cover MSCs, but is difficult to enforce against them. The government estimates that around 150 companies are in the business of providing and managing MSCs.

The new rules will target MSC schemes by reference to four criteria, one of which is that the worker does not exercise financial and management control of the company. Crucially, HM Revenue & Customs (HMRC) will not have to show that the worker is engaged on terms similar to employment. The legislation will also tackle the problem of enforcing payment – at present some MSCs, which have no assets, avoid tax by ceasing to trade as soon as they have established a tax debt. In such cases, HMRC will be able to make the MSC provider, or certain other third parties, pay.

The measures against MSCs are unlikely to be the end of the story of stopping NIC avoidance. The Pre-Budget Report also stated that the government remains concerned about self-employed people incorporating to save tax and national insurance, and is continuing to review the rules.

Help With Claiming R&D Tax Relief

The government has opened seven specialist units to help small and medium-sized enterprises (SMEs) claim the enhanced tax relief for research and development costs. The new offices now deal with most claims by SMEs and many claims by large companies.

The purpose of this move is to ensure greater consistency in granting relief and to promote greater take-up of the scheme. The units aim to help companies identify areas of their business that could benefit from R&D relief and to assist them with the application process. R&D tax credits were launched in 2000

but have attracted criticism for being complicated and inconsistently given. Many of the smallest companies remain unaware of the enhanced relief.

The scheme gives small and medium-sized companies tax relief on 150% of qualifying expenditure on R&D. You need only spend £10,000 on research and development in an accounting period in order to claim – and a wide range of projects can qualify.

Very broadly, projects qualify if they are intended to increase scientific or technical knowledge, or to create or improve a process, product or service

through scientific or technical advances. Expenditure has to be on staff costs or on consumables used directly in carrying out R&D. Small or medium-sized companies can, in certain circumstances, surrender the tax relief to claim payable tax credits in cash.

Capital expenditure does not qualify, although there is a separate 100% capital allowance for equipment used in R&D. Large companies can claim tax relief on



only 125% of qualifying expenditure and there are several other differences in the rules.

If you are carrying out R&D, or you are not sure whether you might qualify, do ask us about these tax credits.

Family Company Tax Case Awaits Lords' Decision

The case about taxing dividends that were paid by a husband and wife company is due to reach the House of Lords in June, although it may be several weeks later before their Lordships publish their decision.

The Lords will have to rule whether HM Revenue & Customs (HMRC) was correct to tax a working husband on the dividends that his company, Arctic

Systems Ltd, paid to his wife, who was a 50% shareholder but who played a much lesser role in the business than her husband.

Last year the Appeal Court decided in favour of the taxpayer, overturning the High Court's verdict. HMRC has said that it intends to delay settlement of all enquiries into similar cases until the Lords have ruled.

Where taxpayers go to the

Commissioners to get an enquiry closed in accordance with the Appeal Court's view of the law, HMRC will oppose the application claiming that the appeal to the Lords is reasonable grounds for not issuing a closure notice.

HMRC has also said that taxpayers are entitled to self assess or amend a self-assessment based on the Appeal Court decision. Of course, HMRC might then open an enquiry.

Not all companies owned by married couples or civil partnerships operate in a similar way to Arctic Systems Ltd. Whichever side the Lords take, the decision is likely to leave questions about its application in other circumstances. You can be sure that if you run your business through a family company, we will advise you on how best to arrange your affairs once the Lords' decision has become clear.



Company Law Easier to Understand

The largest Act that Parliament has ever passed aims to simplify company law and generally reduce the regulatory burden once all its provisions have come into effect. The Companies Act 2006 should also make

company law easier to understand.

Directors will have a legal duty to act in the way they consider would be most likely to promote the success of the company in the interests of the shareholders, but they must also have regard

to the environment and the interests of employees, consumers and suppliers.

Medium and large companies will have to publish a directors' report containing a business review. The report should be forward-looking and cover risks and opportunities. Quoted companies will need to include information on environmental matters, employees and social and community issues. They will also have the option of not publishing the operating and financial review that was previously required.

In a welcome move, all directors and shareholders will have the option of filing a service address

rather than their private address on the public record. Private companies will be able to choose whether or not to have an annual general meeting and a company secretary. New model articles will contain simpler internal rules and give companies unlimited objects.

One of the first measures – introduced on 20 January 2007 – allows companies officially to communicate with shareholders electronically.

The government has said that the rest of the provisions will be introduced during the remainder of 2007 and 2008, with the whole Act implemented by October 2008.



Setting the Agenda for Selling Your Business

You have built up your own business, navigated what may have been a long and rocky road, and you now own an established and profitable concern. The time has come to think about its long-term future.

You might have heirs who want to carry it on after you retire or managers who might want to buy it out. But if not, an eventual sale may be the best way of realising your investment of time and money.

This will mean grooming your business to make it as attractive as possible to potential buyers. Ideally you should review all aspects of your business at least two years before putting it on the market. The following are

some of the areas you should start thinking about:

- Make sure your finances are sound. So you need good credit control and regular billing.
- You might be able to cut costs by renegotiating agreements or selling underused equipment.
- Develop a pattern of growth, if you can. Buyers like stable profits with some growth from year to year. You might be able to control the timing of income and expenditure to achieve attractive results.
- Be realistic about your sales forecasts.
- Make sure you have a strong management team. You will

not achieve a good price for a business that depends too heavily on your own skills.

- Polish your business plan and make sure that it sets out a realistic strategy for further growth.
- Ensure that your business is legally sound. For example, it should comply with legislation on employment, health and safety and waste management.
- Make sure the business has legal title to its assets, especially any intellectual property.
- Check that all your agreements and contracts with suppliers, customers and others, and all leases are on a firm footing.
- Make sure that you have reliable and legal IT systems that work efficiently and provide you with the right management information.



Are you aiming to sell the business assets or shares in a company? If you expect to sell shares, make sure the capital gain will attract business taper relief. Shares in companies that hold non-business assets, such as excessive cash or other investments, might not qualify for this valuable relief.

Also the timing of the sale could make a significant difference to your tax.

We can work with you to prepare your company for sale, and when you are ready to go ahead we can help with deciding a price and negotiating the terms.

Getting the Most Value from Spreadsheets

Spreadsheets are an integral part of the information and decision-making framework for companies. Accounts departments of all sizes rely heavily on them. The Microsoft Office tool is used by a range of organisations to perform vital bookkeeping and management accounting functions.

Research indicates that over half of financial management reporting is performed with spreadsheets. Despite this, a disparity exists between the importance of spreadsheets to business processes and the way that businesses protect and develop their spreadsheets.

Spreadsheets offer the flexibility

and ease of use of a desktop application, combined with the power to perform complex data analysis. But spreadsheets are open to user error and manipulation. You need to manage and control the use of spreadsheets to ensure the information produced is accurate, secure and properly maintained.

The key issues that you need to focus on in controlling the use of spreadsheets are:

- Preventing unauthorised access.
- Managing and monitoring spreadsheet changes.
- Retaining and archiving key spreadsheets.
- Developing robust spreadsheet models.

You need to check on the spreadsheets which have a direct impact on the statutory accounts or management information. You should pay special attention to spreadsheets that use complex calculations, make many connections to multiple

worksheets, or employ macro or other code.

Once you have identified the key spreadsheets, you need to put controls in place to make sure they are as rigorously managed as other areas of the business.

Risk	Control
Unauthorised access	Save to restricted area and ensure regular back up.
Unauthorised or erroneous modification	Once reporting period finished convert to read only and securely archive for later retrieval.
Errors in formulas leading to errors in output	1. Test formula before use. 2. Re-test on regular basis. 3. Lock formula to prevent inadvertent changes.
Lack of knowledge about how to use spreadsheets	Document elements such as input cells, formula cells, output cells and data sources and calculation methodology.