

BUSINESS UPDATE

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HMRC's new charter makes taxpayer promises

HM Revenue & Customs (HMRC) has continued in its attempts to improve its relationship with taxpayers by issuing a new taxpayers' charter. It is called 'Your Charter' and was launched on 11 November 2009.

The Charter was included in the Finance Act 2009 and sets out taxpayers' rights and how they should expect to be treated by HMRC. It also outlines what HMRC expects in return.

The new Charter says that, as a taxpayer, you can expect HMRC to respect you and treat you as honest. HMRC also pledges to help you to get things right, treat you even-handedly, protect your information and respect your privacy. There are more direct commitments to 'tackling people who deliberately break the rules and challenge those who bend the rules' and to keeping the cost of dealing with HMRC as low as possible. In return, HMRC expects taxpayers to be honest, respect HMRC staff and take care to get things right. The Charter is published alongside the 'HMRC Vision' (launched on 3 November 2009) which is a statement of HMRC's aspirations.

The Vision is closely linked to the Charter and is relatively brief. In some respects, it is similar to the vision (or 'mission') statements of many other large organisations (stating a commitment to professionalism and integrity, continuous improvement and success), but it also stresses HMRC's aspirations to understand and meet taxpayer needs. The Vision itself is as follows:

'We will close the tax gap, our customers will feel that the tax system is simple for them and even-handed, and we will be seen as a highly professional and efficient organisation.'

You can read both the Charter and the Vision in full on HMRC's website: www.hmrc.gov.uk/charter/index.htm.

If you feel that HMRC is not acting towards you as a taxpayer in accordance with the Charter, the first step is to contact us.



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In this issue: The impact of Pre-Budget Report tax changes • Tax penalties: what all directors must know • Pensions and tax relief • New points basis for employing foreigners • Compulsory online filing • New opportunity to reclaim VAT on shares

This newsletter is for general information only and is not intended to be advice to any specific person. You are recommended to seek competent professional advice before taking or refraining from taking any action on the basis of the contents of this publication. The newsletter represents our understanding of law and HM Revenue & Customs practice as at January 2010.

The impact of Pre-Budget Report tax changes



December's Pre-Budget Report was a careful balancing act between assuring the markets that the Government was behaving responsibly and not upsetting too many voters in the run-up to the general election. The Chancellor, Alistair Darling, also felt he needed to avoid hampering the fragile economic recovery.

How well he succeeded remains to be seen. The main tax increases and spending cuts are yet to come; this was just the start.

The headlines focused on the 50% payroll tax imposed on banks that pay bonuses of more than £25,000; the extra tax charge will not fall directly on the bank employees themselves. The Chancellor has also frozen all the main tax rates and allowances for 2010/11. However, the rate freeze is welcome news for small businesses; the planned 1% increase in the small company's corporation tax rate from 21% to 22% is now delayed until 2011.

People with high incomes will be hit by the new 50% income tax 'super rate' on incomes over £150,000 already announced for 2010/11. From 6 April 2011, higher rate tax relief for pension contributions is to be restricted for those with 'relevant income' over £150,000 and the Government has now set out the way in which this will work.

In the meantime, the special anti-forestalling rules that prevent people from getting higher rate tax relief on large additional contributions to their pensions before the change have been extended to those with incomes of £130,000 or over.

National insurance contributions are due to rise sharply in 2011/12. Employers, employees and self-employed people will each pay an extra 1%. The good news is that the primary threshold and lower profits limits will be raised to compensate lower income earners. Some other key measures announced by the Chancellor were:

- **Research and development (R&D):** From 9 December 2009 it has no longer been a requirement for SMEs to own the intellectual property derived from their R&D expenditure. This will enable more companies to claim the relief.
- **Business rates:** Businesses that have empty buildings with a rateable value below £18,000 will be exempt from business tax until 2011.
- **Basic state pension:** The basic state pension will rise by 2.5% in April to £97.65 a week for a single person and £156.15 a week for married couples and civil partners.
- **Inheritance tax:** The nil rate band was frozen at £325,000, even though an increase to £350,000 had been announced.

Did you know that since 6 April 2009, HMRC has operated daily subsistence scale rates for reimbursing expenditure incurred by employees working away from home? The rates vary from £5 to £15, depending on the length and time of absence. HMRC has now confirmed that a daily rate of up to £15 to reimburse expenditure may be paid to employees from abroad on UK assignments of no more than two years. If you have such foreign employees, and pay them a fixed expense allowance within this limit, there will be no income tax or national insurance contribution consequences. The scale rate covers daily subsistence only, and not overnight accommodation.



Pensions and tax relief

People with high incomes will cease to benefit from higher rate tax relief on pension contributions after 5 April 2011, and 40% relief will be restricted in the tax years 2009/10 and 2010/11.

The Government has produced a consultation paper setting out the proposed rules that will apply in the longer term as well as tightening up on the so-called anti-forestalling rules that apply now.

After 5 April 2011, the big dividing point for income will be £130,000 – and that's income from all sources. If your pre-tax income is less than this amount, the new rules will not apply to you even if your employer makes a very substantial contribution to your pension scheme.

If your income is £130,000 or more, then you will potentially come into the rules, because the value of your employer's contributions to your pension scheme will be included in the definition of income. If your income including employer pension contributions is £150,000 or more, then HMRC will taper the amount of 40% or 50% higher rate tax relief that you receive.

If your income is £180,000 or above, then you will only receive 20% basic rate tax relief on all of your pension contributions. The reduction in the tax relief will be made by a special charge on you personally.

The current anti-forestalling rules for 2009/10 and 2010/11 have been amended so that a £130,000 threshold has also applied from 9 December 2009. The rules

apply if the limit is exceeded in the year of the contribution or in either of the two preceding years.

It is possible to make limited pension contributions regardless of your income that qualify for full higher rate tax relief. The amount that can be invested in this way is at least £20,000 but could be more depending on your circumstances. It will make sense to contribute as much as possible while you are still able to get full tax relief. Pension contributions that qualify for just 20% basic rate tax relief will be significantly less attractive.

For some people the challenge will be to keep their income below the £130,000 (or £150,000) threshold without affecting their standard of living too much.

Did you know that hiring a contractor may soon prove to have unexpected consequences? If the UK implements the EC Agency Workers Directive (AWD) in the way currently planned, contractors using personal service ('umbrella') companies and who are reclassified by HMRC as deemed employees under the so-called 'IR35 rules' could qualify for the same employment rights as a permanent employee. Although IR35 has no tax consequences for the hirer (only for the contractor and the contractor's service company), the AWD could require the hirer to grant the contractor holiday pay and other employment benefits available to the hirer's actual employees.



Tax penalties: what all directors must know

Tax officials expect you to take 'reasonable care' in completing tax returns and other documents. This requirement is central to the new penalty rules HMRC introduced with effect from 1 April 2009.

If you make a mistake, but you were found to have taken reasonable care, you will not be penalised. However, if you made a mistake and were found to be careless, then a penalty may apply.

So what does 'reasonable care' really mean? HMRC has released some guidance in its Compliance Handbook Manual. In principle, reasonable care will vary depending on the capabilities and circumstances of the individual, and in particular on the type of business or transaction being dealt with.

In general, HMRC will expect lower standards from an unrepresented taxpayer than a taxpayer who is advised by a professional. Taxpayers are expected to take extra care where they are undertaking complicated or unusual transactions.

HMRC does not just expect taxpayers to take reasonable care in completing the official returns; the duty also extends to the records that a taxpayer must keep in order to report income and gains

correctly, and to the systems that a business needs to ensure that it correctly deals with tax in relation to its transactions.

A director has a statutory duty under the Companies Act 2006 to protect the interests of the company and its creditors. This includes being familiar with the various taxes that apply to the company and ensuring that the company has adequate systems in place to maintain accurate books and declare its tax liability. Directors are also required to make sure that the company has adequate systems so that it can meet its obligations for VAT, PAYE and any other relevant taxes.

Some directors are likely to have a better understanding of tax than others and HMRC accepts this. For example, finance directors would be expected to know about filing deadlines and how the tax penalty regime operates in practice.

Directors may also delegate responsibilities to employees. If so, the employees must be properly trained and equipped and HMRC will still hold the director responsible for the employee's mistakes. If a director does not understand the tax treatment of a particular transaction, HMRC would expect them to ask for advice from a competent person or HMRC.

New points basis for employing foreigners

If you are employing anyone from outside the European Economic Area (EEA), they must hold a British passport or a visa in order to work in the UK. UK work visas are granted under a points-based system consisting of five different tiers. However, only four are currently available because Tier 3 (low-skilled workers required to cover a temporary labour shortage) is suspended indefinitely.

A foreign worker is entitled to apply for a work visa under a specific tier depending on their skills or their sponsoring employer's type of business.

Each tier has different entry checks, entitlements and requirements and is organised into categories. For example, Tier 2 consists of four categories: general (ie sponsored workers in skilled roles), inter-company transfers, ministers of religion, and elite professional sports people.

In April 2009 the qualifications and salary required for general applications under Tier 1 were raised to a master's degree and a minimum salary requirement of £20,000.

The Home Office's Border Agency provides useful information for employers who want to recruit workers from outside the EEA or retain foreign workers they already employ (www.ukba.homeoffice.gov.uk/employers/points/). The information includes how to go about obtaining a sponsor licence, which you will need if you want to sponsor foreign workers. It is not specific to any individual employee.

At the moment the Home Office's published commitment is to decide 95% of sponsorship licence applications within four weeks. To obtain a licence, you will need to provide supporting documentation and comply with certain requirements. For example, Tier 2 skilled jobs must now be advertised through Jobcentre Plus for a total of at least four weeks.

Employers can face a civil penalty of up to £10,000 for every foreign worker they employ illegally, and so it pays to check the Home Office and Border Agency's guidance on preventing illegal working. Support is available to help you avoid this pitfall: Business Link (www.businesslink.gov.uk) will help you check an individual's eligibility.



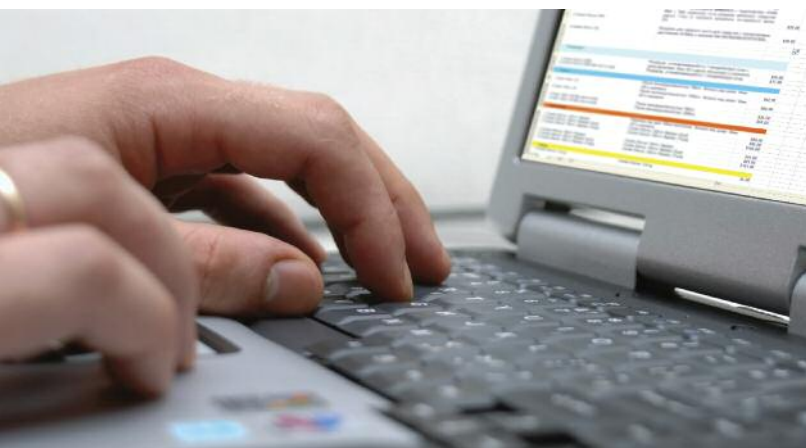
It is also worth ensuring that, in preventing illegal working, your actions are not perceived as contravening human rights and racial discrimination laws. Again, there is official guidance available if you are unsure.

Company car benefit scales

Company car benefit scales are changing from April, with the main CO₂ threshold falling by 5g/km to 130g/km for 2010/11. For 2011/12 there will be another 5g/km cut and the £80,000 list price cap will be abolished. Unless your car is low emission (120g/km or below), the effect of these changes will usually be to increase the taxable value of your car by 1% of its original list price every year. For example, if your company car had a list price of £25,000, the amount on which you will pay income tax will typically rise by £250 in each of the next two tax years.

Compulsory online filing

Are your company's or association's accounting systems ready for compulsory online filing of virtually all corporation tax returns from 6 April 2011? From the same date, accounts will also have to be filed at Companies House in a special format and payments will have to be made electronically.



The date may seem quite a long way off, but the catch is that accounts and computations will have to be filed in a specified format, called Inline XBRL (iXBRL). iXBRL is a computing language allowing real-time access to financial information by embedding 'tags' in items in the accounts and tax computations.

Software obtainable from HMRC, or commercially, will automatically embed these tags. There will also be commercial iXBRL-enabled conversion software available for those companies using Excel or Word-based packages for producing financial statements. Those companies planning to use or devise their own software will need to make sure they can tag 4,000+ items in financial statements and computations.

Until April 2011 HMRC will accept less than full tagging, but over 1,000 items will still need to be tagged initially in both cases.

New opportunity to reclaim VAT on shares

UK companies that have incurred irrecoverable input VAT on sales of shares may now be in a position to reclaim this VAT following a recent decision of the European Court of Justice (ECJ).

The ECJ made it clear that companies and other taxable persons have the right to deduct input tax paid on services supplied for the purpose of a disposal of shares if there is 'a direct and immediate link between the services and the overall economic activities of the taxable person'. In other words, if a share sale forms part of the company's general business activities, there is a possibility of recovering some or all of the input VAT on the related services, especially where the share sale forms part of business reorganisation. The name of the relevant case was *Skatteverket v AB SKF*.

It is up to national courts to determine whether the link required by the ECJ exists in any particular situation. The ECJ also drew attention to the fact that if a subsidiary has been sold as a going concern, it would be wrong to deny input VAT recovery where the special rules for transferring a going concern would allow

relief in similar circumstances. In other words a sale effected by the sale of shares is treated the same as if the sale of assets.

HMRC practice in share disposal transactions is almost always to disallow any input VAT incurred on the associated costs because it relates to an exempt supply – the sale of the shares – unless the purchaser belongs outside the European Union. The ECJ's judgment puts this practice into question in the case of the sale of wholly owned and actively managed subsidiaries, where there is a direct and immediate link between the services incurred and the taxable person's economic activities.

To discuss whether and how your company may be able to reclaim input VAT incurred in connection with a sale of shares of a wholly owned and actively managed subsidiary, please get in touch.

