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CHARTERED ACCOUNTANTS
REGISTERED AUDITORS

COMPANIES STILL AHEAD FOR TAX

You can still save tax and national insurance contributions by running a small business through a company rather than as a sole trader or a partnership – despite the Budget. Previously a company making a profit of £15,000 could incorporate and pay virtually no tax, compared to nearly £3,000 in tax and national insurance contributions payable as a self-employed individual. Now the same company would have to pay corporation tax of about £1,650.

Last year, the attraction of saving £3,000 a year persuaded many small self-employed traders to incorporate, but a saving of £1,300 is unlikely to be such a lure. Companies have higher administration costs and are less flexible.

Luckily, it could be fairly straightforward to abandon your company and to resume self-employment. However you should seek our advice so that we can help you avoid any unexpected tax liabilities.

At higher levels of profit incorporation still makes a lot of sense. A company with income of £35,000 paying a salary of £4,745 and the balance as dividends, will now pay £5,575 in tax – £734 more than last year. A self-employed individual making £35,000 would pay tax and NIC of £8,711.

The Budget also made it harder to save tax by paying dividends to a husband or wife who is not involved in the business. Last year the Inland Revenue started using complex anti-avoidance legislation under which dividends paid to a non-working spouse can be taxed as income of the other spouse. The Budget closed a means of diverting income to a spouse using jointly owned shares that bypassed the anti-avoidance legislation. The Inland Revenue can be expected to continue to attack payments to spouses that it considers have no commercial basis.

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MIXED TAX NEWS FOR BUSINESS



Small businesses can now claim tax relief in the year of purchase for 50% of the cost of plant and machinery, rather than 40%. This increased first year capital allowance is only available for a period of one year, which will end on 31 March 2005 for companies, and on 5 April 2005 for sole traders and partnerships. Medium-sized businesses remain entitled to the 40% first year allowance.

A business counts as small for capital allowance purposes if it meets at least two of the following conditions:

- Not more than 50 employees.
- Turnover not more than £5.6 million.
- Balance sheet assets not more than £2.8 million.

To count as medium-sized, the limits for enterprises are 250 employees, turnover £22.8 million and balance sheet assets £11.4 million. If a company is part of a group, the group itself must fall within the limits.

Transfer Pricing Rules

This year's Finance Bill also includes a welcome exemption from the transfer pricing rules for

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Taxation

RETROSPECTIVE PENALTIES ON TAX SCHEMES



The proposed annual income tax charge on 'pre-owned assets' is likely to stop much of the inheritance tax planning that involves the family home.

The tax, to be imposed from 6 April 2005, will affect you if you enjoy the use of assets that you formerly owned or provided the funds to buy. For example, you enjoy the benefit of a house if you live in it; you enjoy the benefit of a picture if it hangs on your wall.

The income tax charge is intended to apply to those arrangements that bypass the inheritance tax 'gifts with reservation' legislation. The charge will be imposed on transfers made at any time since 18 March 1986, the date when inheritance tax was introduced.

The income tax payable on the enjoyment of such pre-owned assets will be based on the market value rent for property, or on a percentage of capital value for other assets, such as works of art. For example, a house worth £400,000 with a market value rent of 5% a year, would give rise to an annual benefit of £20,000 on which a higher rate taxpayer would pay income tax of £8,000. Any rent the individual pays for the property will be deducted from the benefit, but of course the person who receives the rent will normally be taxed on it.

An example of the type of arrangement being attacked is the so-called 'double trust home loan scheme', in which an individual sells a house to a trust at full market value in exchange for a commercial debt, and then

gives the debt to a second trust. This may succeed for inheritance tax purposes because the individual does not enjoy any benefit from the subject of the gift, namely the debt. The arrangement became less attractive to set up after 1 December 2003 because the property sale became liable to stamp duty land tax.

Some types of arrangements may be reversible, but there may be some people who cannot legally undo their arrangement. They can escape the income tax charge by agreeing to the asset remaining part of their estate for inheritance tax purposes.

Sales of assets to an unconnected party for cash will not give rise to an income tax charge, nor will absolute gifts where the donor just enjoys an incidental benefit from the asset as a result of a change in circumstances. For example, an elderly parent might move back into the home that they gave to a son or daughter several years after making the gift. Benefits of less than £2,500 are also exempt, and there will be certain other exclusions.

There are still many ways of reducing inheritance tax that will be unaffected by the new income tax charge. Please let us know if you are concerned about the new rules or would like advice on inheritance tax planning generally.

NUMBER UP FOR TAX AVOIDANCE SCHEMES

Individuals or companies who use tax avoidance schemes will now have to disclose them to the Inland Revenue. The disclosure requirements should not affect the 'everyday tax planning advice' that accountants give their clients, according to the Inland Revenue.

The new rules will focus on what the Revenue regards as high risk areas, especially certain kinds of financial products and schemes that aim to pay directors and employees outside the PAYE system or in a way that avoids or artificially reduces tax. The Revenue has said that the rules are "designed to catch large avoidance schemes".

Under the new rules set out in this year's Finance Bill, UK firms that market tax avoidance schemes will have to register them with the Revenue, which will then give each scheme a reference number. Individuals and businesses that use a registered scheme will

be required to state the scheme number on their tax returns. If a taxpayer buys a scheme from an overseas promoter, the onus will fall on the taxpayer to disclose details of the scheme to the Revenue. Taxpayers will also have to provide the Revenue with information about any schemes that they devise themselves within five days of implementation. Failure to do so could result in a fine of up to £5,000.

Promoters will not be required to tell the Revenue the names of taxpayers using their schemes. Registration of a scheme will be no indication as to whether or not the Revenue believes it will succeed in producing a tax advantage.

The government will also continue to change the law, often with instant effect, to plug loopholes as they emerge. Many tax avoidance schemes exploit loopholes in complex legislation that was designed to clamp down on earlier avoidance attempts. Other schemes

use tax reliefs for wider purposes than those the government intended.

The new rules to combat VAT avoidance schemes will work in a different way. Promoters will not be required to register schemes, although they may do so if they wish. Instead Customs and Excise (C&E) will compile and publish its own list of designated schemes. A business using a listed scheme will have to disclose its use to C&E within 30 days of the due date for making the first VAT return affected. However businesses with annual turnover (total taxable and exempt supplies) below £600,000 are exempt from this rule.

Businesses with turnover of £10 million or more will also have to disclose any non-listed VAT schemes that have as a main purpose obtaining a tax advantage, where they include certain designated types of transaction or other features associated with tax avoidance.

Employment

EMPLOYER FINED FOR NOT PROVIDING PENSION SCHEME

The first fine on an employer for failing to give its employees access to a stakeholder pension scheme has been imposed by the Occupational Pensions Regulatory Authority (Opra). The company, which has around 300 employees, was fined £10,000. Opra said this reflected the number of employees involved and the length of time the company took to comply.

Opra became involved after an employee complained that the company had denied him access to a pension scheme. Since October 2001, employers with more than four employees have had to designate a stakeholder scheme for their staff to join, or provide alternative pension arrangements. Employers must start the process of designating a scheme as soon as they take on a fifth employee, even if the employment is



only temporary. There is a set process to go through, including consultation with employees, formal designation of a scheme, and setting up a payroll deduction facility for employees who wish to join. Employers should keep a record of all decisions made. Employees are not forced to join the scheme, and the employer does not have to contribute on the employee's behalf.

Opra has the power to fine employers up to £50,000 but emphasises that a fine is a last resort. In the first instance, the regulator wants to help employers to comply with the law. Opra maintains a regularly updated register of schemes that meet the stakeholder requirements, and this currently lists over 40 providers. The register includes information on any restrictions a scheme imposes on employers. For example some schemes only accept designation through a financial adviser. A number of providers have closed their schemes to very small employers, but an Opra spokesperson said that there are currently still at least a dozen schemes on the register that accept employers irrespective of size.

Any employer having difficulty in designating a scheme should let Opra know.

MINIMUM WAGE – RATES RISE



The national minimum wage will be extended to 16–17 year-old workers from 1 October 2004, although apprentices will be exempt. The hourly rate has been set at £3.00. From the same date the adult rate rises to £4.85 (from £4.50) and the rate for workers aged 18–21 will be £4.10, up from £3.80. The increases amount to nearly 8% – much greater than the rise in average earnings. The government also intends to change the way in which the national minimum wage applies to piece workers.

From 1 October 2004, employers will have to pay piece workers the minimum wage for every hour they work or they will have to set a fair piece rate under which an average worker will earn at least the minimum wage for the work done. Then from April 2005, the piecework rate will have to be based on 120% of the minimum wage. For example, if a person working at average speed produces 10 items an hour, the fair piecework rate from October 2004 will be 48.5p (£4.85/10) per item, rising to 58.2p next April.

NEW CHECKS ON ILLEGAL WORKERS – MORE RED TAPE FOR EMPLOYERS

Changes have been made to the way in which employers have to check that the people they employ are legally permitted to work in the UK. The new rules are intended to make it harder for people to work illegally while simplifying the procedure for employers.

From 1 May 2004, employers have been advised to carry out three steps before any new employee starts work.

- You should ask the employee for documentary evidence of their entitlement to work in the UK. There are two lists of documents and employees must either produce any one document from List 1 – eg passport or some other document giving the holder the right to stay in the UK – or a combination of two documents from List 2. Forms showing an individual's national insurance number are on List 2, so they are not an adequate check by themselves.
- You should carry out certain checks to

satisfy yourself that the potential recruit is the rightful holder of the documents they have presented, and that the documents allow the individual to carry out the type of work being offered.

- You must retain a copy of all relevant parts of the documents seen.

The steps are not compulsory but only employers who carry out the full procedure will have a statutory defence against criminal conviction if it turns out that the employee is working illegally.

Employers are warned that they risk an accusation of racial discrimination if they only apply the new checks to those applicants they think might not be British. The safest policy is to treat all potential employees in the same way.

All European Union nationals have the right to work in the UK, including those from the eight east European countries that joined the



EU on 1 May 2004. Workers from these EU accession countries must register with the Home Office as soon as they start working for an employer. The employer must retain a copy of the worker's application form until the issue of a registration certificate. It is a criminal offence to employ an unregistered national from one of these eight countries. These rules do not apply to workers from the other two new EU countries – Malta and Cyprus.

Employment

NEW TAX-FREE CHILDCARE

From 6 April 2005 employers will be able to provide employees with up to £50 a week of tax-free childcare benefits following the extension of the existing tax relief.

Employees will qualify for the new exemption where their employer provides vouchers to pay an approved child carer or contracts directly for the service.

The main conditions for the exemption are that it is registered childcare or approved home-childcare, and that any arrangements the employer makes are available to all employees. At present childcare benefits provided by an employer are only exempt if the nursery is on the employer's premises or it is at least partly managed and financed by the employer – conditions that are very restrictive.

The national insurance rules will be brought into line with the tax rules. At present, all childcare benefits for employees are free of employer's and employee's NIC. From 6 April 2005, the NIC exemptions will be limited to £50 a week. However there will still be no employee's NIC on any of the cost where the employer contracts directly with the provider of the childcare.



Of course, the full cost of childcare is normally more than £50 a week, but the new exemption will help employers provide more family-friendly working conditions and make it a bit easier for employees to return to work after parental leave.

MIXED TAX NEWS FOR BUSINESS

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most transactions by small and medium-sized businesses. Transfer pricing broadly imposes market prices or values on cross-border transactions between connected parties.

The rules can be difficult to operate and the exemption is a welcome simplification. One condition for exemption is that the related business is in a territory with which the UK has a double taxation treaty containing a suitable non-discrimination article.

For purposes of the exemption, a business counts as small or medium-sized if it has not more than 250 employees and either turnover of less than €50 million (currently about £33.3m) or balance sheet assets of less than €43 million (currently about £30m).

The news is not so good for large businesses, which will now have to apply transfer pricing adjustments to transactions within the UK under an extension to the present rules. However, the connected UK business will be able to make a corresponding adjustment in the calculation of its taxable income.

The changes apply to the calculation of profits arising after 31 March 2004. Businesses will have to introduce systems to comply with transfer pricing requirements and keep evidence to show that they have calculated profit on affected transactions on an arm's length basis. Please get in touch if you need help with this.

Management Expenses

Another helpful change is the extension of tax relief for the costs of managing investments to all companies with investment business. Previously companies whose main activity was trading could not claim relief, because they did not qualify as investment companies. The UK residence requirement is also being removed, so that UK permanent establishments of non-resident companies can also obtain the relief.



Taxation

MORE TAX AHEAD FOR COMPANY VANS

New rules will greatly increase the tax payable where an employee uses a company van for private journeys. Although the changes will not take place until 6 April 2007, employers and van drivers should start planning ahead.

Currently, if a van is available for private use, the employee is taxed on a charge of £500 – or £350 if the van is at least four years old at the end of the tax year. There is no additional charge if fuel is provided. The private use of motor cars is much more heavily taxed, and this has led to some employees opting to drive one of the smarter types of van instead of a company car.

From 6 April 2007 the taxable benefit for unrestricted private use of a van will increase to £3,000, and there will be no discount for older vans. If the employer pays for fuel for private use, an additional charge of £500 will apply.

Some employees will benefit from the changes made. From 6 April 2005 employees will no longer be taxed if they have to take their van home overnight but are not allowed any other private use.

Unless an employee does a lot of private mileage, unrestricted private use of a van will generally no longer be worthwhile after 5 April 2007. However, it should be possible to avoid the van charge by prohibiting the private use of the vehicle other than for journeys between home and work. Such a restriction would not be enough to escape tax on a company car.

Employees who use their vehicle for private travel and have chosen a van instead of a car for tax reasons, might want to reconsider what type of vehicle they drive when the tax advantage of a van becomes much less.