NEWSLETTER • SPRING 2003

BRONSENS

CHARTERED ACCOUNTANTS
REGISTERED AUDITORS

National Insurance

From 6 April 2003 an extra 1% national insurance contribution (NIC) will be imposed on all earnings above the first £4,615 a year with no upper limit. For directors and employees the extra 1% will be added to both employee's and employer's NIC. Company owners who draw profits as remuneration will in effect suffer a 2% increase.

The NIC liability on employment earnings arises when earnings are paid, so paying bonuses before 6 April 2003 should avoid the increase. Directors who are shareholders could take a dividend instead of a bonus and avoid NIC altogether, but care is needed. The share ownership structure might not allow dividends to be paid in the same proportions as bonuses. In a few cases dividends are more costly than bonuses, despite the NIC, if the company's and individual's tax liabilities are added together. And dividends are not pensionable earnings, which could restrict a company's contributions to a director's pension scheme. In addition, the payment of dividends may not be effective if the company is caught by the 'personal service company' provisions.

Self-employed individuals and partnerships with an accounting date before 6 April might be able to bring forward profits into 2002/03. However this will also advance income tax payments, which might negate the saving.

The NIC increases will boost the savings that can be achieved by incorporating a business and then drawing profits mainly by dividends. Incorporating before 6 April 2003 will mean that none of your self-employment earnings will be taxed in 2003/04, so avoiding the increased NIC.

Please contact us now if you are in business and have not yet considered incorporating, or if you wish to discuss other ways of reducing your NIC liability.

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Gaining from Investment Losses

A poor year on the stock markets has left many investors with losses on shares and unit trusts sales. While recovering your money in full might take some time, you can at least turn these losses into tax savings now or in the future.

If you have an overall loss on disposals this tax year, you might be able to sell other assets at a profit. You will have no tax to pay on the profit if, after you deduct the losses, the result is not more than the £7,700 capital gains tax exemption. However, it might be better to delay realising any gains until 2003/04. Where losses are brought forward, you need only set off enough losses to bring net gains down to the annual exemption. In contrast, losses of the same year have to be set against gains in full, which could waste up to £7,700 of losses. In

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Taxation

Budget Preview

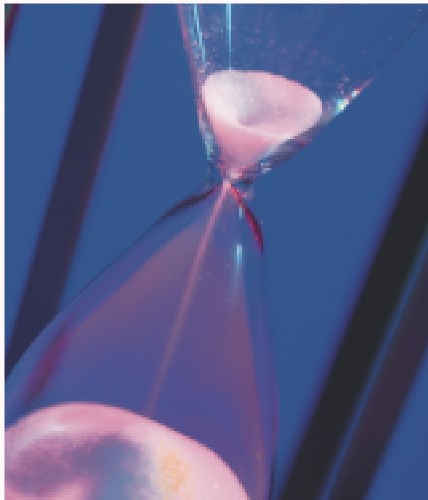
Companies can now get corporation tax relief when they provide shares for employee share schemes in a wider range of circumstances than before, following an announcement in the Pre-Budget Report in November. Companies will benefit from tax relief where employees are subject to income tax on the award of the shares, and also where shares are provided for any of the share schemes or enterprise management incentive share options approved by the Inland Revenue. The change, which applies to accounting periods starting after 31 December 2002, will make it easier for companies to set up share schemes without having to establish complex trust arrangements to secure corporation tax relief.

On the other hand, employers who have established employee benefit trusts (EBTs) as a means of providing tax-free benefits to employees might not welcome the move to defer corporation tax relief on contributions to EBTs until the EBT makes a payment that is liable to income tax.

For individuals there was little respite from next April's additional tax burden, resulting primarily from national insurance rises. The best news, perhaps, was the preservation of existing pension tax reliefs. The promise of a new regime for offshore funds in 2004 should help investors in due course.

Like many of his predecessors, the Chancellor has shied away from reforming the complex residence and domicile rules that determine individuals' liability to UK tax. He had promised to report in November, but there will now be only a background paper and its publication date has not been announced.

Year-end tax planning



Another tax year is drawing to an end, making this an ideal time to look at how you can save tax. The timing of a transaction – before or after the end of a tax year – can sometimes make a big difference to the amount of tax you have to pay.

• If you are selling a business, you could pay up to £12,500 less tax if you sell before 6 April. Retirement relief currently exempts gains of up to £50,000 and half of the next £150,000 on the sale of an unincorporated business, a partnership share, assets used in a business or shares in a trading company. However the relief will no longer be available after this tax year. In order to qualify you have to be 50 or over, or retiring on health grounds, and you have to satisfy several other conditions.

• For non-business asset sales, careful timing can also save capital gains tax (CGT), depending on several factors, such as whether you have used your annual CGT exemption this year. If you are planning any major sale, please ask us for advice beforehand.

• This is also a good time to review your company car arrangements. From 6 April the income tax charge on fuel provided for private travel in company cars will be based on the car's CO_2 emissions, in much the same way as the charge on the car itself. If the car has high emission levels, the benefit of free fuel might no longer be worth having. Even for the current tax year, reimbursing your employer for the private fuel provided could turn out to be cheaper than paying tax on the set scale.

• One tactic could be to make pensions contributions, which benefit from tax relief. Another possibility would be to influence the timing of your income, perhaps by the payment of bonuses or dividends from your own company. You should also not forget to make use of this year's £3,000 annual exemption from inheritance tax, and also last year's exemption, if you did not make gifts totalling £3,000 in 2001/02.

• There could be many other tax planning opportunities, depending on your circumstances. For example, you might be able to maximise your entitlement to age allowances if you are 65 years old or more, or to children's tax credit if you have children under 16.

Child tax credit

Nine out of ten families will be eligible for the new child tax credit (CTC), which replaces the current tax allowance for children from April 2003. The benefit will be paid directly to the main carer where the family has a joint income of up to £58,000, (or £66,000 if there is a child who is less than one year old). You have to claim this benefit from the Inland Revenue, although claims cannot be backdated more than three months.

Families with an income of at least £50,000 are only eligible for the family element of the CTC (up to £545 a year), which doubles during the first year after a baby's birth. The payment is reduced by £1 for every £15 of income over £50,000.

If your family income is less than £50,000, you could receive additional benefits, including the childcare element of the working tax credit – up to £7,280 – and the child element of the CTC – £1,445 for each child. These benefits start to be withdrawn gradually where the family income is more than £5,060, but some families could receive payments at relatively high levels of income, depending on their circumstances.

For example, a couple with two children and annual income of £35,000 could benefit from total CTC of £3,280 a year if they pay £200 or more a week for eligible childcare. Even with an income of over £40,000, the CTC award could still exceed the basic CTC of £545. Benefits could also be paid higher up the income scale where a family is eligible for some special benefits, for example for the disability of an adult or a child.

Eligible childcare can extend to the cost of employing a nanny in your own home, but only if the nanny is a registered childminder who has undertaken a childminding and first-aid course, undergone a police check and applied for Ofsted approval.

One way to calculate your entitlement is to complete a questionnaire available on the Inland Revenue website at www.taxcredits.inlandrevenue.gov.uk. Alternatively, we can do the calculation for you.

Pension rules will be simplified

Just before Christmas, the government published a Green Paper with several supporting documents on its future pension strategy. At the heart of the proposals are some very radical reforms of the complex tax rules that apply to pensions. These include:

- The Inland Revenue currently operates eight different pension tax regimes for pensions. The proposals would scrap all of these and replace them with just one universal set of rules.

- The present labyrinth of contribution and benefit limits would be replaced by two primary rules: the *maximum contribution* into a pension by an employer and an employee in any one year would be £200,000, but employee contributions would be limited to 100% of their salary (or £3,600 if that is more). The *maximum total pension benefits or fund* available to provide retirement benefits without tax penalty would normally be £1.4m. Both the contribution and fund figures would be index-linked to prices. However, the size and shape of existing benefits worth over £1.4m would be protected.

- The new regime would apply to new and existing pension scheme members and pension policyholders from a future date, probably 6 April 2004. Thus there would be a clean break from all the current legislative complexities.

- The concept of a normal retirement age would disappear. However, the minimum age for drawing benefits would rise from today's 50 to 55 probably by 2010. The upper age limit at which pension benefits must be taken would remain at 75.

- The rules which prevent a member of an occupational scheme drawing a pension while remaining in employment would be scrapped. Gradual retirement would therefore become a more viable option.

- All pension arrangements would allow a maximum of 25% of their value to be taken as a tax-free lump sum unless a higher tax-free cash sum has been protected. If you are a member of an occupational pension scheme or contribute to AVCs, the proposal could mean more cash at retirement than the current rules allow.

- The structure of income in retirement would change. The proposals include the replacement of pension fund withdrawal (income drawdown) rules with a more flexible system that could apply to all pension arrangements. New types of annuity would also be permitted, including one that gives you some capital protection on early death before 75.

These proposals – and it is important to remember they are only proposals at present – could have a significant effect on your retirement financial planning. Some current strategies simply would not work, but new opportunities would emerge.

Tax-free business sales

Companies can now sell trading subsidiaries without incurring corporation tax on the capital gain, but must first meet several conditions. In particular, the company selling the shares (the investing company) must have held a 'substantial' shareholding in the investee company (the company whose shares are being sold) throughout a continuous period of at least 12 months in the two years before the disposal. 'Substantial' means broadly 10% or more of the ordinary shares. The exemption is not available where a company hives down a part of its business into a new subsidiary shortly before a sale. If you are thinking of selling part of a business at a profit, you might want to transfer it into a separate subsidiary well in advance of the sale.

The other important conditions concern the companies' activities. The company being sold must be a trading company or holding company of a trading group or subgroup immediately after the sale and during at least 12 months in the two years before it. Similarly, the company which is buying must be a trading company or member of a trading group before and immediately after the sale.

VAT

Invoicing Rules

All VAT invoices will have to show the unit price of each item from 1 January 2004. Although the date is nearly a year away, you might need to alter computerised invoicing systems to produce this information. You should also bear this in mind next time you order invoicing stationery.

VAT invoices already have to include a great deal of information, including:

- An identifying number,
- Time of supply (tax point), and
- Date of issue.

All sums of money must be in sterling. It is worth checking that your invoices comply with all the requirements. Please contact us if you are not sure whether your invoices pass muster.

Mail order goods – VAT position

It is important to be clear about the VAT treatment of postage charges. A dispute over VAT on postage costs went to the House of Lords before it was resolved. The business in question supplied goods by mail order using Parcelforce, which is exempt from VAT. It showed the delivery charge separately in sales invoices and charged the customer VAT on the goods but not on the postage. Customs said the business should have accounted for VAT on the whole amount paid by the customer, and the House of Lords agreed.

There are now two main possibilities:

- If there is no separate charge for delivery, the VAT is effectively the same as on the goods themselves. This is also the case for sales of 'delivered goods', ie where the contracted sale is not completed until the goods are delivered to the customer and the supplier is responsible for their safe delivery. Most mail order sales are treated in this way.

- If delivery is arranged by the business as an optional extra, there is a separate supply of delivery services. This supply is standard-rated, whatever the VAT liability on the goods.

Commercial Law

Is your website legal?

If you do business through e-mails, mobile phones or a website, you need to comply with the Electronic Commerce Regulations, which came into force in August 2002. Businesses that ignore the rules could be forced to take down their website and could face a claim for damages.

All business websites, even those that do not sell goods or services online, must show the name of the business, a geographic address, contact details including an e-mail address, any supervisory authority under which the business operates and the business's VAT registration number. Companies must also show their registration number and place of registration.

Sites that sell goods to the public must give further information before a customer places an order, including details of the steps required to conclude the contract and how the customer can find and correct input errors. Websites must also display the terms of business, where the user is asked to indicate acceptance.

There are several other legal requirements that apply to distance selling generally. For example, customers must be informed of their right to cancel an order within seven days. Websites that collect information about users, such as their names and addresses, must also comply with the Data Protection Act 1998.

Charities

Major changes for charities

Charities will be allowed to trade directly instead of through a trading subsidiary, under government proposals to reform charity law. At present, charities can only trade in limited circumstances. The simplification should reduce costs, but could expose charities to greater risk.

Another change is to remove the need for a charity's accounts to be audited if its turnover is less than £1 million. The current threshold is £250,000. Charities that rely on grant income might, however, find that funders will still want to see audited accounts, and charity trustees might prefer an audit as a safeguard. Charities in England and Wales with annual income of less than £10,000 will no longer have to be registered with the Charity Commission, and the definition of charitable purposes will be updated. The proposals have been subject to consultation and could change before they become law.

Property

Revenue help from letting agents

More and more property letting agents are receiving notices from the Inland Revenue asking them to provide details of the landlords for whom they collect rents. The move is a result of the Inland Revenue's suspicion that some of those who have entered the buy-to-let market over the last few years have not been paying tax on their rental income.

The notices ask for landlords' names and addresses and the amount of income the agent has collected. Letting agents who fail to provide the information face a fine.

Anyone who receives rental income from property in the UK is liable to tax, but allowable deductions, such as loan interest and repairs, can reduce the amount on which tax is charged. If you have not received a tax return, you must notify the Inland Revenue by 6 October following any tax year in which you received rental income. Penalties for failing to do so can be severe, but are reduced for taxpayers who volunteer information, even if it is late, rather than wait until the Inland Revenue contacts them.

Gaining from investment losses

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addition, delaying gains until after 5 April 2003 will mean that any tax payable is not due until 31 January 2005.

If you would rather keep an investment that is doing well but you want to realise the gain, your spouse could buy it back, although this does involve some costs. You cannot buy back shares that you yourself have sold within the past 30 days, as this would prevent the intended taxable profit from arising.

Losses are deducted from gains before taper relief. So if you deduct a loss from a gain that qualifies for little or no taper relief, you will save more tax than if you deduct the loss from a gain that attracts high taper relief. For example, for a higher rate taxpayer, deducting £10,000 of losses from £10,000 of gains with no taper relief saves tax of £4,000. If the same losses are deducted from gains that qualify for the maximum 75% taper relief on business assets, the tax saving is reduced to £1,000. Careful timing of gains between tax years can maximise the tax benefit of losses brought forward.

Husbands and wives cannot use one another's losses against their own gains, but you can achieve a similar result by transferring assets, 'tax free', to a spouse who has losses, if the sale of those assets is likely to produce a gain that exceeds the annual exemption.

There should be as much time as possible between the transfer of the assets and the sale, otherwise the Inland Revenue could ignore its effects. Documentary evidence of the transfer is also desirable.

This newsletter has been written for the general interest of our clients. It is therefore essential to take advice on specific issues. We believe the facts are correct as of January 2003 but there may be certain errors and omissions for which we cannot be held responsible.