2008 SUMMER NEWS

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After U Gordon?

When she was Prime Minister, Lady Thatcher was famously "not for turning". Now Gordon Brown has been forced to accept an astonishing U-turn, upsetting the headline-grabbing changes to income tax rates he made in his last Budget in 2007. Alistair Darling had to announce an increase in personal allowances to compensate those low earners who lost out as a result of the abolition of the 10% tax rate on 6 April 2008. The Chancellor had to tell Parliament, but it was Mr Brown who admitted he had made a mistake in failing to realise the impact of his changes on the very people his party have traditionally stood up for.

No-one can remember such a thing happening before. The personal allowance is usually an uncontroversial part of the Budget, and for it to be changed after the Revenue have sent everyone their notices of coding – after tax rate cards have been printed and despatched – is unprecedented. Although there will be a lot of extra paperwork to deal with it, it seems to be quite a simple move: the first £6,035 of income will be tax-free instead of £5,435, and higher rates of tax will start after another £34,800, instead of £36,000 on top of the £5,435. It won't affect those entitled to the higher age-related allowances, because those had been put up to allow for the rate changes anyway.

As Lady Thatcher would no doubt have argued, though, it's an unhappy precedent to set. Once you give in on something like that, where will it end? The foreign domiciled taxpayers who are now liable for a £30,000 flat rate tax on their foreign income may be looking at this with interest – if they have not already left.

Whichever way Messers Brown and Darling twist and turn, we will keep you informed. ●

Gift horse

Tax cuts are supposed to be good news, but charities always complain about a fall in the basic rate of tax. That's because they reclaim the basic rate that is deemed to have been paid by people who give cash to charity – last year, that was 22/78 of a gift, or 28.2%. When the cut to 20% was announced, charities expected to see their income fall – only 20/80, or 25% of the cash, would be reclaimable from the Revenue.

In the Budget, the Chancellor announced that charities would still get the same 22/78 for the next three years, up to 5 April 2011. This doesn't change the treatment of the donor – if you are a higher rate taxpayer, you will be due another 20% relief through self-assessment or PAYE to make a total of 40%. Confusing? If you want to clarify the consequences of giving to charity, or if you are involved in claiming Gift Aid relief on behalf of one, we will be happy to advise you. ●

Penalty shoot-out

A few years ago, HM Inland Revenue and HM Customs & Excise were separate organisations. They both wanted your money, but they had very different ways and means of relieving you of it. Since the merger of the departments in 2005, they have been looking at the differences between them and trying to iron some of them out. One of the areas where they are bringing in new rules – to be the same for income tax, corporation tax and VAT, but different from either regime before – is penalties for declaring too little or too late.

Of course, you hope never to have to worry about this, but everyone makes mistakes occasionally. A careless mistake can cost up to 30% in a penalty on top – but if you notice it first and put it right without being prompted, this is likely to be waived. You just have to pay the tax and some interest because it's late. The law now tells us what a "careless" mistake is – although some Inspectors of Taxes would say that any mistake is careless, because if you were taking proper care you would get the answer right. It's nice to see the law recognising that it is possible to do your best and make a truly innocent error.

A deliberate mistake that you don't try to conceal – some might call that a foolish mistake – gets a 70% penalty, but repenting and telling them about it might cut it to 20%. And a deliberate, concealed understatement of your tax could cost up to 100%.

These new penalties apply to chargeable periods which started on or after 1 April 2008, where you have to file a return on or after 1 April 2009. The 2008/09 tax year for individuals, 31 March 2009 accounting periods for companies, and the 31 March 2009 quarter's VAT return will all be covered. For mistakes in earlier periods, the old rules still apply.

The rule changes don't affect the penalties and surcharges for paying tax late or filing returns late. They will probably be reviewed at some point, because there are big differences between VAT default surcharges and the income tax and corporation tax rules – it's likely that the two systems will be brought into line eventually.

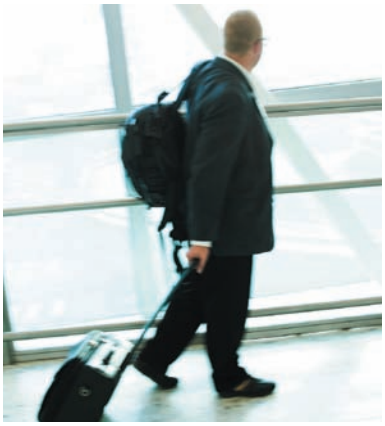
We hope you never have to discuss penalties with HM Revenue & Customs – but if you are aware of making a mistake of whatever kind, putting it right as early as possible will greatly reduce the penalty. We can advise you on how to go about setting the record straight. ●

Last one out…

The tax breaks given in the past to foreign domiciled people living in the UK stir up strong emotions. Some say that they are absurd, and anyone living here should pay their proper share. Others point out that wealthy foreigners are usually also highly mobile individuals: if you give them a good deal they will at least contribute something, but if you drive them away you get nothing at all.

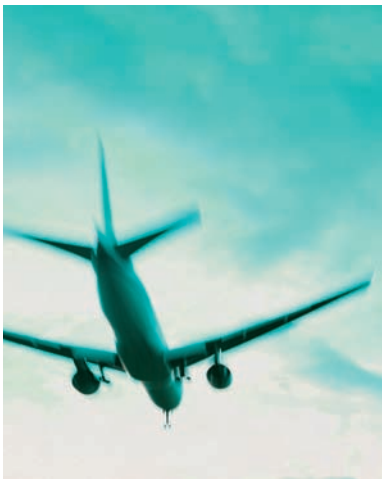
The Government has come down on the "fair share" side by imposing a flat rate £30,000 a year charge on foreign domiciled people who don't want to pay tax in the UK on their overseas earnings and capital gains. It's easy to work out that you have to have at least £75,000 of foreign income to make that worthwhile – remember that you are already taxed in the UK on anything you earn here, so this doesn't significantly affect the tax take on the salaries of expatriate workers living here.

There have been dire warnings of an exodus, and some businesses are reported



to be relocating elsewhere because the tax climate in the UK is becoming too unfriendly. It must be nice to have the choice. If you have in the past used the "remittance basis" for taxation of overseas income and gains, we will be happy to advise you on the new rules – if you are still here. ●

Going, going, gone



If someone wants to become a tax exile, but still has some connection with the UK, they need to be sure that the Revenue can't still tax them. If you've taken everything you own and left, there isn't much doubt that you are no longer resident here – but what if you are a pilot who makes regular visits to the UK during your work and you keep a house here close to Gatwick Airport? Not surprisingly, HM Revenue & Customs argued in a recent case that the pilot remained chargeable to UK tax. Rather more surprisingly, the Appeal Commissioner said that the house was irrelevant and the pattern of the man's life, looked at in the round, suggested he was no longer UK resident.

If you are thinking about moving abroad, it's worth thinking about how your tax here will be affected. We can explain the rules and the Revenue's likely view of your plans. ●

Ups and downs

On 6 April, the 22% rate of tax was cut to 20%, and the 10% rate was abolished for most taxpayers. The first thing many people will have noticed is an increase in pension contributions which are paid "net of basic rate tax" – in recent years, the individual has put £78 of a £100 premium into the policy, and the Revenue have contributed the other £22. Now the Revenue's contribution has fallen to £20 so the saver has to find £80. That looks like bad news, but you are supposed to celebrate paying 2% less on a great deal of income, so you will not mind having to put a little of that saving into your pension fund.

The second thing to come through would be the difference in the April PAYE deductions. The 10% band applied last year to the first £2,230 of income – that now suffers twice as much tax. It's fairly easy to work out that you need to enjoy the 2% cut on five times as much – £11,150 taxed at the basic rate – before you are compensated for paying 10% more on £2,230. So the 20% rate only produced a net benefit for anyone earning £13,380 more than their personal allowance. It's possible that the April payslips were a significant reason for Labour's misery in the elections on 1 May.

Apart from PAYE and pension contributions, most of the other effects of the rate changes won't come through until the 2008/09 tax returns are submitted in a year's time and the tax charges for the year are worked out. By that time, the Chancellor may have finished changing the figures! ●

Back taxes, taxes back

In 1996 Customs tried to introduce a rule to restrict claims to recover overpaid VAT to the last three years' worth. That's been held to be a reasonable rule going forward, but they tried to apply it to existing claims at the time: before they announced the "cap", you could reclaim VAT overpaid all the way back to the introduction of the tax – the next day, you had instantly lost the right to most of that.

At the end of a large number of arguments that have been running ever since, the House of Lords and the European Court have both held that this was unlawful behaviour by the Government.

People's rights can't be taken away arbitrarily without giving them a last chance to claim. HMRC have now accepted defeat and are allowing that last chance – although for many people it is a little late. If you still have the paperwork and the energy, you can claim up to 31 March 2009 for output VAT overpaid up to 4 December 1996 or input tax underclaimed up to 30 April 1997.

It's all a long time ago, but if you think this might affect you – for example, if you made a claim in the past and the cap was applied to it – we will be happy to advise you. ●

Sick note

Suppose you send your child to private school for an exorbitant fee. What could be more frustrating than the child being off sick? All that money for nothing. Many schools offer an "insurance" scheme – for a small amount added to the fee, you will get a refund if the child is absent for an extended period, usually a week or more. Once the child has been ill for three days, the insured parent might reckon they need a couple of days more to get over it properly.

HMRC decided that the extra charge for the refund scheme was subject to VAT, even if the school fees themselves were exempt – the scheme wasn't "education", so it didn't qualify for any VAT relief.

The High Court judge disagreed. In reality, there wasn't a separate scheme at all. There were two deals on offer for slightly different prices: education with no refunds, and education with the possibility of a refund. Either way, the supply was only education, and it was exempt.

It's worth remembering that HMRC don't always get this sort of technical decision right. If they give you a ruling that you don't like, it's worth going over it carefully – we'll be happy to help. ●

Hire higher

If you use temporary staff, you are probably used to paying VAT only on the agency's charge for supplying them – not on the wages of the staff themselves. You might pay £200, of which £150 goes to the worker, and the VAT is only charged on the £50 that the agency keeps.

The trouble is that this is only a concessionary treatment which Customs have allowed in order to be fair to different types of employment business. In the 1990s, a case showed that agencies which used self-employed workers could just charge VAT on their commission, and the concession was introduced so that employment businesses which employed their staff could do the same.

Now HMRC say that there is no longer a need for the concession, and we aren't allowed to have it under European law. Department of Trade regulations means that all temporary workers have to be supplied in the same way, so one type of arrangement wouldn't have a VAT advantage over another – so they are giving everyone the VAT disadvantage. From 1 April 2009, VAT will have to be charged on the gross amount paid by users of temporary staff – in the example above, £200 rather than £50.

This is clearly a big change and if you use or supply temporary staff, you need to be thinking in advance what it will mean to you. At least we have been given a year to prepare for it. ●

Nowhere to hide

Doing business through a limited company is supposed to protect you financially when things go wrong. The company goes bust but you don't. That's the theory, but it has limitations. Lenders and landlords often take personal guarantees from the directors or shareholders; and the law doesn't look kindly on people who risk other people's money from the safety of their company.

In a recent case, a director signed a contract committing his company to pay for goods when he knew the company was insolvent. One judge said he could be sued for damages on the grounds of deceit, but the Court of Appeal ruled that he was personally liable on the contracts. He knew what he was doing and he knew that it was wrong, and he could not walk away.

It's a reminder that directors need to think realistically about their company's ability to pay, and to make sure they have up-to-date and reliable information to help them make good decisions. ●

Cats and dogs

If a charity sells goods that have been donated for sale, it enjoys "zero-rating" for VAT – it can recover VAT on its costs but it doesn't have to charge VAT on its sales. A recent tax case featured a charity which took in stray cats and dogs from the public and the local authority dog catcher and, if the proper owner couldn't be traced, sold them.

HMRC said the animals couldn't be "donated" to the charity because someone finding a stray cat or dog didn't own it. You can't give away what you don't own. An ordinary pet shop has to charge VAT on animals, and HMRC reckoned the charity would have to charge it as well.

The Appeal Tribunal looked back at some of the dustier laws of England – dating from 1722 – and decided that, in fact, you do own an animal that you find wandering about. Perhaps not if you find it in a farmer's field, or if it has a name-tag on it, but it's much more "yours" than for example a bicycle that you happen to find unlocked leaning on a lamp-post. So the animals were truly donated and the charity enjoyed the favourable VAT treatment. ●

I thee endow

Divorce is a costly business, particularly if a richer partner finds that their other half claims… well, their half. A prenuptial agreement is not very romantic – "I love you forever, but in case we break up…" – but it could make sure that the marriage is for love not money.

The question is, do they work? In a recent case, the wife argued in court that she had not known about the full extent of her husband's assets when she signed the agreement, so she should be allowed to ignore it. The judge saw no reason to do so: she had enough money to provide for herself, and it appeared that she had willingly signed it knowing what it was. She had agreed to walk away with what she had brought to the marriage, and that was that. The Court of Appeal agreed. ●

Mother's rights

Last year the Equality and Human Rights Commission took the Government to court over the details of sex discrimination legislation. The result is changes which increase the rights of employees on maternity leave, and extend an employer's responsibility to protect employees from harassment, even by third parties such as customers or clients. Some of the rules have been in force since 6 April, and the ones relating to pregnancy apply where the due date of the child is on or after 5 October.

It's worth reviewing your policy for equal treatment and protection of employees, and making sure that you are aware of the new requirements. ●

Countdown

For a long time, private companies have had 10 months from the accounting date to get their accounts to Companies House. Now this is being shortened to 9 months for periods starting on or after 6 April 2008. The new rules also include a nasty catch: 9 months after 30 June is 30 March, not 31 March. So the last minute is a little earlier than you might think. They've put the late filing penalties up, as well.

Of course, we will be ready to meet these deadlines for any accounts we prepare – but please expect us to ask for the information a little earlier! ●

Old-fashioned money

Banks don't have to pay VAT on the charges they make for handling money transfers. Credit card companies don't pay VAT on the commission they charge to retailers for making payments for customers' purchases. The charge levied by the Odeon Cinemas telephone booking line was held to be the same sort of thing, so the customer bought a VATable ticket and a VAT-exempt payment service.

Now a mobile phone company has tried to argue that another charge related to making payments was VAT-exempt. The problem was that they weren't doing the same thing as the booking service. They were charging people extra for paying by cheque, not for paying by credit card – they said that the old-fashioned way was inconvenient, so customers who used it would have to pay more.

The Appeals Tribunal agreed with HMRC that this was just an extra charge for the main telephone service, and it was all VATable. Handling a credit card payment is more complicated than handling a cheque – you have to collect information and transmit it to the bank in order to make the payment happen. Collecting a bundle of paper cheques and paying them into the bank isn't the same thing.

This confirms HMRC's view that, generally, extra charges for paying in a particular way are likely to be treated as part of the main supply. If you think you might be able to exempt a payment handling charge, we'll be happy to talk it over with you. ●

Extortion

What would you call a loan shark who charged you 15% interest for being a day late repaying a loan? "Taxman", perhaps. If you are regularly late paying the VAT due on your quarterly returns, you will become liable to default surcharge. This starts at 2%, but then it goes up with each late payment until it hits 15%. That's charged on the whole amount outstanding even if it's just a day late arriving – an annual percentage rate of 5,475%. You then keep paying that until you find a cheaper source of finance and manage to pay HMRC on time. Default surcharge can't be reduced for mitigating circumstances, although it can be cancelled altogether if you have a reasonable excuse.

There are more arguments about defaults and excuses for them than any other type of tax case. One rule which causes confusion is the extra 7 days that Customs give you to file your return and make your payment if you transfer the money electronically. The first problem is that they have to have the money cleared into their bank account by that 7th day – if that's a Saturday, you'll have to organise a BACS or CHAPS transfer to get the money to them by the Friday. The next working day, Monday, is too late.

Several cases recently showed what happens when Easter falls in early April, as it did in 2007. People realised at the last minute – or didn't – that the money would have to get to HMRC by Thursday, not by Friday, because Good Friday is a bank holiday. The Appeals Tribunal has been sympathetic to some, where there has been evidence that they tried to deal with the problem and failed. Just failing to notice is not generally an excuse.

If you are in the surcharge regime, or you have received any notification of surcharge liability from HMRC, it's very important to deal with it. Almost anything else is cheaper. We will be happy to advise you on how to get rid of surcharges. ●

Options open

The "option to tax" is one of the more complicated areas of VAT law. Anyone who owns property – particularly landlords and developers – needs to know how it affects them. If you supply land and buildings you may be exempt from VAT – no output tax to charge but no input tax to claim – but you could "opt to tax" your supplies in order to recover VAT on your costs. HM Revenue & Customs have rewritten the option rules with effect from 1 June 2008. The main idea is to make the law more understandable – it has been pieced together and patched up several times over the years, and it needed a makeover. However, there are several important changes which could make a difference to how property businesses use the option. If you are in the property business, we will be happy to explain the changes to you. If you are a business that uses property, so you only occasionally have transactions in land, it's particularly important to think about VAT when you do – again, we can help. ●

This newsletter is written for the benefit of our clients. Further advice should be obtained before any action is taken.