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SUMMER NEWS

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Pot and kettle

Cabinet ministers often lump together tax evasion and tax avoidance in the same sentence – both mean that the Exchequer misses out on tax that "ought" to be paid. They ignore the fact that evasion is a crime involving dishonesty, while avoidance is a matter of following the rules – very carefully, and sometimes artificially – to make sure that the tax bill is no bigger than it needs to be.

Now it seems that half the MPs, including senior ministers, have been following the rules – not always very carefully, but sometimes artificially – to make sure that their expenses claims are as high as possible. Will there be any reduction in denunciation of tax avoiders? Or is Parliament an embarrassment-free zone?

There is a very serious point: reading about the dubious practices of our lawmakers may tempt people to stretch the rules themselves. If MPs are just going to spend it on themselves, why should I pay all that tax? But HM Revenue & Customs have new powers to investigate and penalise people who pay too little tax, and "I was only doing what my MP did" will not be a defence. Don't sink to their level.

Meanwhile, we know that big tax increases are on the way, and some of them have already arrived. This newsletter explains some of the new rules that you may need to be aware of. If you want to know how to follow them carefully and minimise your tax legally, we are here to help. ●

Good times, bad times

Remember how it was before the recession? Businesses making profits, paying tax? Ah, those were the days. If you are making losses now, you can claim the loss against the profits you made in the past and get some of that tax back. Normally you can only go back one year, which is no good if your business has gone from profit through break-even to loss – you didn't pay tax for the break-even year so you can't get any back.

The Chancellor has extended the carry-back rule to three years for losses made in accounting periods which end in the two years from 24 November 2008 to 23 November 2010, but only for a loss of £50,000 in each period. If your losses are more than that, you have to apply the normal rules to the excess – one year carry-back, or carry-forward and hope to set them against profits in the future.

You can also defer the payment of last year's tax as it falls due if you expect to make a loss in the current period that you will then carry back - you won't have to wait until after the period has finished when you can prove that you're making a loss.

If you are making losses, reducing your tax bills is hardly a silver lining – but we can at least help you to get the best result. ●

Funny question

The personal tax return and the employer's end of year return P35 have for the last two years asked whether payments have been made by a "service company". This is a worrying question, because HMR&C don't like personal service companies gaining a tax benefit by disguising employment – charging fees and paying dividends to get around PAYE and NIC. The so-called "IR35" rules charge PAYE anyway if the relationship between the worker and the client would be an employment if the personal company wasn't there.

The trouble is that the question about service companies doesn't relate directly to IR35. You have to answer "yes" if you work through a company which makes most of its money by selling your services and you are a shareholder. You then separately say whether you have operated the IR35 rules – which you don't have to do if you would not be treated as an employee anyway.

It's not clear what HMR&C are doing with this information. Maybe they are working on "IR35 Mark II", or they want to identify people who perhaps ought to apply the rules but don't. If you work through a company that fits their description, we can help you make sure you are applying the tax rules correctly – and prove it to the taxman if he raises any questions. ●

Discipline

There have been statutory rules for dismissal and disciplinary procedures since 1 October 2004. Employers ran the risk of being held to have unfairly dismissed someone – who then qualified for compensation – if they strayed an inch outside the law. The problems this caused have been recognised and a more flexible system was reintroduced on 6 April 2009.

The new ACAS Code of Practice on discipline and grievance is more flexible, but it will still be important to be able to show that an employee is treated fairly. The guidelines suggest that disciplinary issues need to be addressed in six stages: fact-finding, informing the employee of the problem (including the possible consequences), holding a meeting, offering the employee the right to be accompanied, reaching a decision, and offering a right of appeal.All employers should consider whether they need to make changes to their standard procedures in the light of these changes. ●

A place in the sun

We are all Europeans now. One of the fundamental rules of the European Union is that governments cannot treat their own businesses more favourably than businesses from other member states – you can't be mean to foreigners just because they are foreign. It's surprising how often our Government forgets this.

We've had business-friendly rules for "furnished holiday letting" (FHL) for many years. Now someone has pointed out that only UK properties qualified – zut alors! Verboten! So the Chancellor has announced that the generous rules will be extended to properties elsewhere in Europe, and backdated to April 2003 if you have the records – but then the whole scheme will be withdrawn on 6 April 2010. We are allowed to be mean to foreigners as long as we are mean to ourselves as well.

There probably aren't many people who have a foreign holiday cottage which qualifies as FHL – if you didn't think you could benefit, you probably wouldn't have ticked all the boxes. If you think you might, we can look into whether you should make a claim for repayment of past tax.

If you have any FHL property, in the UK or elsewhere, it will be important to plan for the withdrawal of the relief. Capital gains tax is reduced to only 10% on most sales of FHL property, so there could be an immediate jump to the normal 18% rate on 6 April 2010. That might cause a scramble to sell and a collapse in the market. There may be a transitional period in which sales can still be made at the old tax rate.

If you have any furnished holiday lettings, it will be important to think about the changes in tax treatment. We will be happy to discuss them with you. ●

Foreign Service

Anyone who supplies goods to customers in the rest of the EU is used to filing "European Sales Lists" (ESLs) – quarterly reports which set out the amount of the supplies and the VAT numbers of all the recipients. From 1 January 2010, these ESLs will have to be filed every month if you make more than £70,000 of EU sales of goods in a quarter, and the time limit for filing comes down from 42 days to 14 days (paper) or 21 days (e-filing).

People who supply services to EU customers also come into the system for the first time. They will have to file ESLs as well, but only on a quarterly basis.

These are big changes and those affected will have to plan carefully and in good time to make sure they can cope. If you want to discuss the rules, we can advise you. ●

Dividend rules ok?

Small companies often pay their shareholder/directors a regular amount each month which represents a dividend out of profits rather than a salary. The advantage is that dividends aren't subject to PAYE and NIC. You settle up any higher rate tax under self-assessment at the end of the tax year.

The problem is that you can only pay dividends if there are profits in the company to do so. You also need cash to pay a dividend, but in a downturn it's possible to run out of profits before you run out of cash – not least because the corporation tax the company owes is not payable until 9 months after the end of the period. So you could continue paying what you paid last year, then find out that it was too much.

Sorting that out can be painful. The extra payment might be regarded as a loan, and you'll have to pay it back to the company – you may also pay income tax on the benefit of having a cheap loan. If you want to keep it, you'll have to recharacterise it as salary, and then the PAYE and NIC will all be wrong. It's much better to see the problem coming and try to avoid it. That requires some budgeting – not necessarily in detail, but at least to assess whether the profit and loss account can support the current level of dividends.

If you want help deciding what profits you can take out of your company and how best you can do it, we will be happy to advise you. ●

No more stealth

Mr Brown attracted criticism for introducing "stealth taxes". At least Alistair Darling was open about it: the top rate of income tax will go up from 40% to 50% on 6 April 2010 for people earning over £150,000 a year. There are still hangovers from the Brown approach, though: the rules are more complicated than they surely need to be, with personal allowances to be taken away from those earning £100,000 a year, different rates for dividends and for other income, and the impact of NIC on earnings but not on anything else. So it will be possible next year to have a marginal tax rate of 61% if your income is just over £100,000, and it is likely to be 51% if you earn more than £150,000.

This was one of the Chancellor's more popular Budget moves – popular, that is, with people who earn less than £100,000. If you are affected by the increases, or if you hope to earn more in the future, there are things you can legitimately do to reduce the impact. For example, you might want to earn a bit more this year, paying 40%, and a little less next year. Although you would pay the tax a year early, you would pay much less. We can suggest a number of ways to move taxable income from one year to another. ●

Nice motor

Employees pay tax on their company cars according to the car's CO_2 rating and its list price. The percentages run from 10% to 35%, and at the moment the list price is capped at £80,000. So the absolute maximum taxable figure is £28,000.

In 2011/12 they will lower the CO_2 thresholds again, which will nudge the percentage up one notch for most people. They will also remove the £80,000 cap, which will have a significant effect on those people who drive a company car which cost more than that – if the list price is £200,000 the taxable figure will jump to £70,000.

Keep that in mind if you drive an expensive company car. ●

Compliance checks

Since 6 April 2009 the taxman has had new powers to carry out checks on taxpayers' records. This is part of the long running marriage of Customs & Excise with the Inland Revenue: traditionally, Customs officers – who dealt with VAT but were also responsible for the prevention of smuggling – had far greater powers to visit and inspect businesses than their income tax and corporation tax counterparts. The new rules appear to give more power to the taxmen rather than reducing the authority of the VATmen.

They have the right to visit the place where a business is carried on and ask to see the records. However, if that is your home, you don't have to let them in. They are supposed to tell you in advance, unless they can show a senior officer a pressing need to make an unannounced visit – and if you don't want them in your house, you can offer to meet them somewhere else, for example at their offices or at your advisers' premises.

HMR&C can also issue demands for information. If what they want is part of the records that you are required by law to keep to back up your tax or VAT returns, you can't refuse to provide it, unless you can give a reasonable excuse ("the dog has eaten the books"). Even then you have to say what you will do to recreate the information.

New powers for the taxmen are worrying, and in spite of reassurances many people wonder whether even they will know what their new powers are. They can also ask you to give them things that they have no power to demand – if you agree, you may dig yourself into a hole. You may think you should co-operate because you have nothing to hide, but your attempts to be helpful may make a tax officer suspicious about things that are entirely innocent.

We don't want to be alarmist, but at the very least, any enquiry or request for information from HMR&C must be taken very seriously. We recommend that you take advice before answering, and consider having an adviser present if you receive a visit. You may need someone on your side. ●

Penalties

From April 2009 HMR&C have a new set of penalties for people who make errors in returns. There is a new language to get used to: 30% for "careless" mistakes, 70% for "deliberate but not concealed" errors, and 100% for "deliberate and concealed" errors – what used to be called dishonest conduct. The penalties for direct taxes – income tax, corporation tax and CGT – used to be 100% for negligence or dishonesty, which would then be mitigated to a smaller figure for the seriousness of the offence and other factors, so the end result may be similar. The penalty for careless VAT errors has potentially doubled – the old rate was only 15%.

The good news is that an error that isn't careless doesn't get penalised at all. If the tax return is wrong, the average taxman may say that's got to be careless – but you might have followed a court decision that was later overruled on appeal, or you took a reasonable line on the basis of professional advice and later decided to revise it.

If you make any sort of error, there is the opportunity to mitigate the penalties by disclosing the mistake to HMR&C so it can be corrected. A full, unprompted disclosure should remove the 30% penalty completely. Failing to deal with something that you know about may move a careless error into one of the higher categories.

Some people are worried that HMR&C will use these new penalties to extract more money than before from long-suffering taxpayers. Until we have some experience of how they operate the new system, we won't know. In the meantime, it's important to take care – and to take steps to correct any errors that you find. If you want advice on how to steer clear of penalties, or if you are worried that HMR&C might levy one on you, we are here to help. ●

This year, next year

The VAT rate is currently 15%. We know that it will go back to 17.5% next January. If you can't recover VAT on your expenses, can you get charged at the current rate for things you will only need next year? Yes, to some extent – but there will be rules to stop some of the more blatant devices such as issuing a tax invoice and then not collecting the money for more than six months.

If you want to take advantage of the lower rate before it goes, it's worth checking that you won't be caught by these rules – we can tell you what's caught. ●

Making allowances

One of the Budget measures intended to boost business was the temporary introduction of first year allowances on plant and machinery at 40%. They keep changing the rules, but the current rate of tax depreciation is 20% a year on most assets, so you get two years' worth of relief at once on anything you buy in the year starting 1 April 2009 (companies) or 6 April 2009 (income tax traders).

Except… you already get 100% relief on the first £50,000 of plant and machinery bought in a year. So this change only helps you if you spend more than that. If you are planning large expenditure on plant, it's worth thinking carefully about the timing to make sure you get the best relief. We can work out the numbers for you. ●

Just the ticket

If you took an advance payment before 1 December 2008 and delivered the goods afterwards, you would have charged 17.5% VAT but you were allowed to refund 2.5% to the customer and adjust your VAT account. What if you sold a ticket before December for an event that happened afterwards? Football clubs and season tickets – concert promoters and events – a lot of people thought they could make refunds to reflect the drop in VAT.

Not so, according to HM Revenue & Customs. Strangely, they think that the sale of the ticket is the whole of the deal – it doesn't matter when the event takes place. So if you sold a ticket in November and charged 17.5% VAT, that was correct and can't be changed.

They announced in January that they wouldn't argue with anyone who had refunded the difference up to the date of their announcement, because they accepted that the rule was not clear. Since 21 January everyone is supposed to know it. There must be a lot of money at stake and it seems bizarre – but there is no sign yet of anyone arguing it in court.

We're going to have to deal with another change of rate on 1 January 2010 – we can help you understand the rules and possibilities when that happens. ●

Pensions hit

The tax reliefs for pension contributions have been very generous for many years. Gordon Brown was blamed for many of the troubles of the pension industry in the last ten years because he took away the repayment of tax credits on dividend income, but payments into funds have continued to enjoy tax relief at the individual's marginal rate, and the fund pays no tax on income or gains while the money is there. That's a small comfort if you are looking at your fund valuations at the moment – the state of the stock market has put a much bigger hole in everyone's pension pot than the Chancellor.

Now Mr Darling is going to restrict top rate pension relief for high earners. Most people pay tax at 20%, so the tax relief on their contributions is worth 20% – they put in £80 and the Government tops it up to £100. A higher rate taxpayer gets an additional £20 back, so £100 in the fund costs you £60. From 2011/12, the higher rate relief is being withdrawn for people earning over £150,000 a year. It will be phased out as income increases, but we are told that someone earning £180,000 a year will only get the 20% relief that a basic rate taxpayer enjoys.

To stop people advancing their contributions to beat the change, anyone earning £150,000 a year who pays extra pension contributions – more than their usual regular payments and more than £20,000 a year – after 22 April 2009 will suffer a clawback of tax relief. This is a complicated area and anyone who earns that much and who wants to pay pension contributions should tread carefully. We will be happy to explain your options to you. ●

Mind the halfpennies

If you sell something for 96p, what's the VAT? At the current rate of $3/23$, it's 13p – 12.52p rounds up. If you sell the same thing for 95p, the VAT is only 12p – 12.39p rounds down. That means your customer pays a penny less, but you keep the same amount – 83p either way.

This may not seem like a big issue, but the European Court of Justice has had to rule on two disputes about rounding calculations and VAT in the last year. Wetherspoons, the pub chain, thought that they should be allowed to round everything down – after all, 13p is too much tax if it ought to be 12.52p, and the state shouldn't be allowed to extort even a halfpenny too much.

The judges thought that member states should be allowed to set their own rules on this, as long as the rules were reasonable – and requiring traders to round halfpennies up wasn't unreasonable. So no change for Wetherspoons: but it's a reminder that anyone who sells a lot of small items to the public should think about the prices they charge. A penny off is small change to the customer, but it might be a penny off the VAT instead of a penny off the trader's income. ●

Pay my friend

A recent court case highlighted an important tax rule. A man sold his company, and the buyer agreed to pay him some money and also pay more to the company itself for it to put into his pension fund. He reported a gain including only the cash he had received directly, then tried to make a correction to his tax return which would lead to a repayment. HMR&C refused, so he appealed to the court.

The judge said that they were right to refuse – he should be paying more tax, not less, because the money paid to the company was just as much sale proceeds as the money he received himself. If you can direct someone to pay money to someone else, then you have to be treated as entitled to that money.

This taxpayer was lucky – it was too late now to raise an assessment to collect the extra tax. So he lost his repayment, but was still better off than he should have been… apart, no doubt, from a lot of lawyers' bills. He may be wishing he had kept quiet. ●

Redundancy

In a recession, the "R"-word is a worry for both employees and employers. If the conditions for redundancy are met, there are grounds for a fair dismissal under employment law. Calling something redundancy when the conditions aren't met will lead to a claim for compensation, because the dismissal is likely to be unfair.

There are four situations which can justify treating employees as redundant: closure of the whole business; closure of a workplace where the employee works; a diminishing need for someone to carry out the duties of that employee; and a diminishing need for those tasks in that location.

Even if one of these applies, you still need to follow correct procedure and to act reasonably. Employers are required to consult the workforce, select employees for redundancy fairly, and consider whether the workers can be redeployed elsewhere. Failure to do these things can turn a fair redundancy into unfair dismissal.

If you have to make people redundant, make sure you follow the rules. ●

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