2012 SUMMER NEWS

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U-turn if you want to

Every year, the Budget brings us a new bundle of tax measures. After years of tax experts protesting that it's often badly written and unworkable, the government promised to discuss new laws before imposing them on us. Surprises should be reserved for closing loopholes before everyone takes advantage. Consultation ought to work well for the government as well – if they can get people to agree that rules are fair, or at least as good as they can be, taxpayers are more likely to understand them and comply.

So it's hard to understand why the Chancellor announced the infamous 'pasty tax' in his Budget speech – changing the rules on which food can be sold VAT-free – in the way he did. He said the rules are a confusing mess, they create confusion and argument, and are unfair to fast food outlets which have to charge VAT on hot takeaways. All of that is true. He even announced that there would be a consultation on changing the rules – but it seemed an empty exercise, because the rules would change on 1 October 2012 anyway.

As this wasn't a loophole that he needed to close in a hurry, he could have consulted first and tested the response. He might even have persuaded people that a change would be fair. Because the tax increase was sprung as a surprise, and was seen as an attack on the less well-off in a Budget which promised a cut in the top rate of tax from 50% to 45%, Mr Osborne invited a campaign of protest which has led him to modify the measure and give up some of the revenue he had hoped to raise to reduce his deficit. So he has managed to make himself unpopular without raising any money.

We can only hope that the Chancellor will learn a lesson from this: next year, if he wants to introduce new rules that are likely to be controversial, he should ask for comments first. In the meantime, if you want some help with our increasingly complicated and unpredictable tax system, we'll be here to advise you. ●

A place to stay

Politicians may urge the unemployed to get on a bus and travel to find work, but if you take their advice, can you claim a tax deduction?

As a self-employed worker, when you travel from your business base to work for a customer, the travelling costs are tax deductible. But what if the distance is so great you can't return to your base (which may also be your home) every night? The practical solution is temporary rental of a flat near your workplace.

The tax inspector will allow you to deduct the cost of the flat from your profits if you can show you are an 'itinerant worker'. This is someone who travels from place to place to look for work. This could apply to agricultural workers, builders, IT contractors and even actors.

The itinerant worker typically has short periods of work in varying geographical locations. Think of Bob the builder working for six weeks in Newcastle, followed by six months in London, and two days in Luton. However, for all those jobs Bob keeps his business base and permanent home in Wolverhampton.

If you are an itinerant worker you need to show your business base doesn't move as you follow the work around the country. Any accommodation you take near a worksite must be temporary, and must not become your home. However, every situation is different so ask us to check if your accommodation costs will be tax deductible. ●

Charitable gifts

When you give to a charity you can declare that your donation is made under the Gift Aid scheme. This declaration can be made in writing, online or over the phone, and it can cover a series of gifts to the same charity. In all cases the declaration should include your name and address, the name of the charity, and a statement that you have paid or will pay sufficient UK tax to cover the 20% tax the charity will reclaim in respect of your gift from HMRC.

Say you make a £100 donation to a charity, which is covered by a Gift Aid declaration. Your gift is worth £125 in the charity's hands, including £25 of your tax bill the charity can claim back: 20/80 x £100 = £25. The charity will reclaim £25 from HMRC. Your declaration asserts that you have paid at least £25 in UK income tax or capital gains tax for the tax year in which you make the gift.

If you pay tax at 40% or 50%, the thresholds at which those higher rates are imposed are extended by the gross value of your gift, which gives you additional tax relief. The 40% threshold is currently £34,370, so if you make donations in this tax year under Gift Aid of £1,000, these are worth £1,250 to the charities. Your 40% threshold is extended to £35,620, saving you 20% tax on £1,250 = £250.

It's not possible to completely eliminate your UK tax liability by making donations under Gift Aid – the lowest you can go is 20% of your taxable income. If you want to know how giving to charity can reduce your tax bill, we can work out the numbers. ●

There is an alternative!

Arguing with HMRC can be a dispiriting business – it can take ages to get a response, and then it may not address the arguments that the taxpayer or adviser have put forward. If you end up going to the appeal tribunal, you don't get repaid the costs of your appeal even if you win, and you can't treat the costs as an allowable expense – so it's only worth doing if there's enough money at stake, or you are very determined to make a point.

So it's good to know that HMRC are testing out a different way of sorting out arguments – it's called 'Alternative Dispute Resolution', and it involves an independent 'facilitator' in HMRC contacting both parties and attempting to find common ground. Even if ADR can't bring the parties together completely, it may help focus on the issues in dispute so that an appeal hearing is more efficient.

HMRC are currently carrying out a trial of ADR in some parts of the country. If you are involved in an argument with the taxman, it may be worth a look. ●

Appy tax

Do you *love* your smart phone? Now you can use it to help you keep excellent business records. A number of software developers have released smart phone apps to help small businesses collect and store the information needed to draw up business accounts for tax purposes. 'Small' in this case means not VAT registered.

The apps have been developed using guidelines set by HMRC, but they have not been tested or approved by HMRC. As most of the apps are free to use, you can explore each app first to see which one suits your business best. ●

Pension contributions: you or your company?

If you are an owner/director of your own company, you'll know that building up a pension pot is a tax-efficient thing to do. But there are several ways of doing it which affect how much tax and national insurance (NI) you pay. In particular, you have to decide whether you pay the pension contributions yourself, or whether the company pays them directly to the fund.

If you pay, you first need to extract funds from the company. If you do this by drawing extra salary, there will be income tax and NI charges. The NI on your salary is paid at 12% on salary up to £42,475 per year and 2% above that. The company also pays employer's NI at 13.8% on your full salary.

There are no NI charges payable on dividends. But your company doesn't receive tax relief for paying dividends as it does for salaries.

You only get tax relief on pension contributions up to the lesser of your earned income and your annual allowance. Dividends aren't counted as earned income. If you have no earned income (salary or benefits), your pension contributions are restricted to £3,600 per year.

Your annual allowance is £50,000, extended by unused allowance from the previous three tax years. If the total pension contributions paid by you and for you exceed your allowance, you have to pay a charge at your marginal tax rate.

Company contributions to your pension fund avoid NI charges, and the company receives tax relief at its marginal corporation tax rate. This applies as long as your total remuneration package, including pension contributions, doesn't exceed a commercial reward for your efforts.

If you control the company you work for, the most tax-efficient solution is almost certainly for the company to pay your pension contributions as your employer. We can crunch the numbers for you and work out how much you can save. ●

Worth every penny

Often you get what you pay for, and sometimes free stuff isn't worth having. Still, HMRC's free software for filing income tax returns is not bad for simple cases – even if it won't do for everyone. VAT returns are fairly easy to file online. Corporation tax, though, is a different matter...

It may be partly because it's new: companies have been required to file electronic accounts and tax returns since 1 April 2011. There is a wide range of commercial packages available – clearly likely to be appropriate for tax agents – but a company which wants just to file its own single set of accounts might be attracted to the offer by HMRC of a way of doing it through their website that you don't have to pay for.

To be blunt, HMRC's free CT software is not as easy to use as their income tax system. Some users have complained that you have to understand accounts and corporation tax before you can use it – which surely means it is aimed at the wrong people, because tax accountants are likely to have invested in a commercial package.

Anyone who wants to file their own computations is of course free to do so – but we are here to help if it turns out to be a frustrating experience! ●

How much to pay yourself?

As the director and shareholder of your own company, you can decide how much salary to pay yourself each month, in order to use your personal allowance in the most tax efficient way. A director doesn't have to take the national minimum wage rate (£6.08 for adults) from a personal company unless there's an employment contract in place.

From 6 April 2012 the tax-free personal allowance is £675 per month (£8,105 per year), so you can take a salary at that level and pay no income tax. However, the monthly thresholds for paying Class 1 National Insurance (NI) are £634 for employees and £624 for employers. So if your salary is £675 gross per month, your company needs to deduct NI of £4.92 and pay employer's NI of £7.04 on top.

A salary just over the NI lower earnings threshold (£464 per month) gives you the NI credit towards your state pension entitlement, but you don't pay any tax or NI, and neither does the company. However, at that level (annual salary of £5,564) you could be 'wasting' £2,541 of your personal allowance.

Talk to us about the best salary level for you – that will take into account your other sources of income. ●

Castles in the air

HMRC think they know how businesses work, and if an expense is a little out of the ordinary, they may be sceptical about whether it's deductible. If you have a genuine business motive and the numbers are large enough, it's worth sticking to your guns – the appeal tribunals take a more rounded view.

In a recent case, a landed estate was registered for VAT in respect of a wide range of activities. Input tax was claimed on the costs of repairing a Grade I listed castle which had fallen into a dangerous condition. HMRC started by ruling out any deduction, then said they would allow a proportion as an overhead of the whole operation. That may seem reasonable, when there wasn't any current income, but the tribunal looked further – the owner argued that the purpose of carrying out repairs was to make it possible to rent the castle out as a film set, and the income from that activity would be 100% standard rated.

It might not happen straight away, and he might never recoup the full cost, but it was enough to justify a 100% deduction.

If you have different activities and have to allocate your expenses in order to determine what VAT to deduct, we can help you claim the right amount – no more, and no less, than you are entitled to. ●

Surprise visits from HMRC

Tax officers have wide powers to inspect business premises, but they are supposed to give the business owner at least seven days notice of their arrival. Surprise visits are allowed, but only in exceptional circumstances, such as where tax is immediately at risk. In such cases the inspecting officer should get approval for the visit from a more senior HMRC official.

In spite of these strict rules we have heard of tax inspectors turning up at businesses unannounced, and demanding access to the business computer records. If this happens to you remember:

- If they haven't given you notice, you don't have to let the tax officers into the building, and their rules say they must not gain entry by force.
- If you do let them in, you are required to provide access at any reasonable time to any computer used for the business, and help the tax officer extract the computer records, but that's where your responsibility ends.
- You and your staff are not obliged to answer questions put by HMRC officers – particularly if the interview has not been agreed to in advance.
- Tax officers are authorised to inspect business premises and statutory records, but they don't have search powers. They are not supposed to rummage around in your stuff.

If HMRC officers turn up unannounced, ask to see their ID, which they must carry. Check this ID is genuine by telephoning the HMRC office they claim to be from. Also call us without delay! ●

Keep an eye on it

For income tax, you have 10 months from the end of the tax year to prepare your accounts. For corporation tax, you have 12 months from your accounting date, although you're supposed to pay the tax earlier. These are reasonable time limits. But if you are not registered for VAT, you may need one key number – sales – much more quickly than that. If your turnover for the last 12 months has gone over £77,000, you have just 30 days to tell HMRC. You'll normally be registered for VAT from the beginning of the month following. You're supposed to check this every month.

The problems this causes were well illustrated by a recent case. A trader's accounts were prepared for income tax purposes and submitted to HMRC, but the accountant failed to realise that the sales were over the VAT limit. HMRC's computer picked it up before anyone else, which meant there was a penalty for late notification of liability – and he would have to pay over VAT that he hadn't collected from his customers.

If you are below the VAT threshold, keep us informed about your turnover – working it out with the annual accounts may not be soon enough. ●

Service for the bereaved

When a relative dies, and you have to inform the authorities, the Tax Office can be one of the most difficult branches of Government to deal with. However, that should now change as HMRC have taken steps to improve the service they provide to the bereaved. There is now a single point of contact within HMRC and a new helpline number: 0845 300 0627 (choose option 2 then 4 to speak to a real person).

There is also just one form (R27) to complete in order to finalise the deceased's tax position. This form can also be used appoint a tax advisor for the deceased's estate. This is necessary because when someone dies any authority to act for that person disappears. So even if we acted for your relative during their lifetime, the form R27 must be completed to allow us to help finalise the deceased's tax affairs up to the date of death.

Quite often the final tax return will produce a tax repayment. Form R27 asks for details of where any refund should be sent: this may need to go to the executors of the estate rather than to the surviving spouse. R27 also asks some fairly technical questions about the administration period of the estate. We can help you with all those details at that difficult time. ●

Problem in Germany

Reading the papers, you could believe that the last people in Europe to go bust will be the Germans. Two recent VAT cases have shown that you can't rely on anyone.

One featured a UK motor dealer who bought some cars from a German supplier. Normally that would be free of German VAT as an intra-Community despatch – but the supplier insisted on a 'security deposit' equal to the German VAT as protection against the possibility that the UK customer didn't qualify for a VAT-free supply. The other featured an individual who bought a motor-home in Germany and brought it back to the UK when it was still new – a 'new means of transport' should be subject to VAT in the country in which it's registered, rather than where it was originally bought, even if it's taken there by an individual. The German dealer should have refunded the VAT charged.

In both cases, the suppliers had gone bust. The two customers protested against having to pay VAT in the UK as well as the VAT they'd paid in Germany – after all, surely there shouldn't be a double charge to VAT within the EU?

The appeal tribunal sympathised with both of them, but couldn't give them any remedy. The UK authorities were right to collect the money, and the German VAT couldn't be deducted from the UK liability. The problem, and any possible solution, was in Germany. HMRC agreed to write to the German tax authority to confirm that the individual had paid VAT on his motor home in the UK, but they said that this would probably only lead to a refund if the dealer had paid over the German VAT before going bust.

Foreign trade is a risky business – it's important to appreciate as many of those risks as possible. ●

Student loans

The earnings threshold from which student loans have to be repaid through the payroll has increased from £15,000 to £15,795 (£1,316 per month) from 6 April 2012. Some payroll software has not caught up with this change, so do check that your software is calculating the required deductions correctly.

There are also problems with the new style of form P45, where some employers have not completed box 5 correctly. If the employee needs to repay a student loan this box should contain 'Y'. Call the Employer Helpline on 0845 7143 143 if you are uncertain about making student loan repayment deductions for a new employee. ●

A question of timing

Companies pay lower rates of tax than sole trades. It's common practice for businesses to incorporate in order to enjoy the 20% small profits rate on earnings up to £300,000 and the ability to pay out dividends without incurring NIC. It's less common, but sometimes advantageous, for a sole trader or partnership to own a company with which they do business – to an extent, income can be realised in different places to pay the least tax.

There are limits, of course. In a recent case a landscape gardener raised two invoices from his company to his sole trade. The total was £110,000. One bill was dated 30 April 2006 – the sole trade's year-end – and the second was raised on 1 May 2007. Surprisingly, HMRC didn't dispute that the expenses were genuine – they might have taken that harder line – but they argued that only a small fraction related to the year to April 2006. They wanted the deduction spread over three years. The Tribunal agreed that this seemed a reasonable approach, given that the company had only been incorporated in March 2006.

If you want to use a company to reduce your business tax bills, we'll be happy to explain how it works – as well as what works and what doesn't work. ●

Hobby losses

If an activity is not carried on with a view to making a profit, the taxman doesn't accept that it's a real trade – it's more like a hobby – so any small surplus isn't taxed. The flip side is that losses from the 'hobby' activity are not recognised for tax purposes and can't be set against the taxpayer's other income.

Sometimes it's difficult to prove that a business is carried on with view to a profit, and that's particularly the case with farming. There may be significant initial costs, and stock animals can take years to deliver the desired products. Some people undertake farming activities in their spare time – hard work, but very close to a hobby.

As a result there is a specific tax rule for farming and market gardening businesses: a farmer must make a profit at least every 6 years if losses are to be set against the farmer's other income in the bad years. If the farmer can show a reasonable expectation of making a profit, this so-called 'hobby farming' rule is ignored.

If you are having a long run of losses with your farming business, talk to us before the sixth year is over, so we can plan how to avoid your losses being denied. ●

No goods, no deduction?

If you have to pay for goods in advance, you are taking a risk – you hope the goods will arrive. If they do, you'll have recovered the input tax on the invoice when you received and paid it. But what if the goods never turn up? You've got a VAT invoice and a payment on your bank statement – as well as a grievance – but HMRC are likely to say that you have to reverse the input tax claim. The rule is that you need a VAT invoice as evidence that you paid VAT on a supply, but you also need the supply to have taken place – the invoice isn't enough on its own.

In a recent case, it appeared that the vendor had carried out a fraud by selling the same equipment to several different people. His company went into liquidation, and the purchasers were unable to obtain all the assets that they had paid for. HMRC refused deductions for the VAT.

The Tribunal examined the facts underlying the transactions for one purchaser. A director had visited the vendor and selected the goods. An unconditional contract was signed. The goods were 'ascertained' – physically available and in a deliverable state – rather than being a mere picture in a catalogue. Under the Sale of Goods Act, the effect of the payment of the invoices was therefore to transfer ownership, even if not possession, of the goods. As a result, there had been a supply, and the purchaser was entitled to input tax deduction. HMRC may appeal this, as on the face of it several different victims of the same con could all claim the VAT.

Losing the VAT would be the icing on the cake – but losing an argument with the VATman would be worse. We can advise you on what is deductible and what isn't. ●