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CHARTERED ACCOUNTANTS

money matters

Winter 2009

UP TO DATE DEVELOPMENTS IN TAX AND BUSINESS PLANNING

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This newsletter is for general information only and is not intended to be advice to any specific person. You are recommended to seek competent professional advice before taking or refraining from taking any action on the basis of the contents of this publication. The newsletter represents our understanding of law and HM Revenue & Customs practice as at October 2009.

The road ahead for car benefits

Both employers and employees may wish to reconsider the advantages of a company car, especially at the luxury end of the market, in anticipation of the 50% rate of income tax and changes to tax on company cars from 6 April 2011.

The main change is the removal of the price cap of £80,000. The car benefit is calculated by applying a percentage to the car's list price. This percentage depends on the car's CO_2 emissions figure, and ranges from 15% to 35%. However, the maximum list price for this at present is £80,000. This means that the highest annual car benefit an employee or director could face in a year is currently £80,000 x 35% = £28,000. At a top rate of tax of 40%, this results in extra income tax of £11,200.

From the 2011/12 tax year, the price cap will be removed and the actual list price will be used to calculate the benefit. When you consider that the top rate of income tax will then be 50% for individuals with taxable income of more than £150,000, there may be a nasty surprise in store for some high-earners with luxury, high-performance cars.

For example, Helen drives a car, with a list price of £141,300, provided by her company. Its emissions figure is 396g/km. Helen's taxable income is in excess of £200,000.

In 2009/10, Helen's benefit-in-kind is valued at £80,000 x 35% = £28,000. The tax payable is therefore £28,000 x 40% = £11,200. Class 1A national insurance contributions (NICs) for her employer are £3,584.

In 2010/11, the benefit-in-kind will still be valued at £28,000, but the tax payable will be £14,000 (£28,000 x 50%). Class 1A NICs remain at £3,584.

In 2011/12, however, the benefit will rise to £141,300 x 35% = £49,455, and the tax payable will be £49,455 x 50% = £24,727.50. Class 1A NICs increase to £6,577.52.

This is an increase of almost 121% over the current year, and an 84% increase in the employer's NICs. Other changes include lowering the emissions bands to which each 'appropriate percentage' applies both in the next tax year (2010/11) and the following year. The result for most company-car drivers will be to increase the percentage used by 1% in both years.

For the majority of directors and employees, who have cars below £80,000 in value and earn less than £150,000, the change will of course not be so dramatic. The result of an extra 1% on a list price of £20,000, say, is only £80 in tax per year (at 40%).

Nevertheless, the cumulative effect of the changes is to increase further the tax burden on company cars. No government is likely to reduce the tax in the foreseeable future. Now may be the time to look again at alternative ways of rewarding employees, such as paying the comparatively generous maximum tax-free mileage allowances to employees making use of their own cars on business, or perhaps a salary-sacrifice scheme, or a 'pick and choose' menu of different benefits with varying costs.

Retaining your title?

When a customer becomes insolvent and you have not been paid for the goods you have supplied, a 'Romalpa', or 'retention of title', clause will put you in a much stronger position. A retention of title clause in a sales contract allows a supplier to transfer goods to a customer, yet retain the legal and beneficial title for those goods until they are paid for.

If the customer defaults on payment, the supplier can enter the customer's premises to inspect or remove its goods. The customer will also accept an obligation to insure the goods and store them separately so that they can be identified.

Contract clauses need to be modified for different types of goods and according to what the supplier wants. It depends on what the customer intends to do with the goods after taking delivery.

For example, the most basic retention of title clause will not be effective if the goods are immediately re-sold, or are incorporated into a building or manufacturing process, because they can no longer be separately identified. Where a supplier is selling a high volume of goods on credit to the same customer, it may not be practical to separately identify each item and match it to a particular payment made.

Contract clauses can also be modified to include, among other things:

An **aggregated title** clause, allowing the supplier to retain title of the output, or a portion of it, that has been produced after its goods have been incorporated into a building or manufacturing process.

A **proceeds of sale** clause, which is useful where the goods are to be modified for use in a manufacturing process or building. This will allow the supplier to sell off or acquire the title in the goods or building that is created.

While these clauses provide some protection for the supplier if a customer defaults on payment or goes bankrupt, it is difficult to ensure that goods are not damaged. Conflicts may also arise with other suppliers if they too have included aggregated title and proceeds of sale clauses into their contracts. Of course, a contract will combine several clauses so legal advice is required.

Taxing assets abroad

The most common schemes or arrangements devised to minimise UK taxes (if you are UK resident) place assets in the hands of an offshore trust, offshore company, or non-resident individual. Income from the assets is then taxed offshore and escapes UK tax. The problem is that if you then derive some form of benefit from that income you will find that you have an income tax charge under the UK's anti-avoidance provisions.

When you are ordinarily resident in the UK, you are taxed on your worldwide income whether or not you actually receive it in the UK. When you are non-resident, you are, in general, only taxed on your foreign income to the extent that it is brought in, or remitted to the UK.

Trusts: If you set up an offshore trust, and you retain an interest in the trust (so you are not excluded in any way from benefiting from its income), then you will be taxed on the income of the trust. This will also apply to you if you were non-resident when you set up the trust, and then became UK resident at a later date.

Companies: If you transfer some of your assets to an offshore company, and derive a benefit from the income of those assets, anti-avoidance rules apply to tax you as if the company's income is your own. These apply even if you do not directly own the company.

Offshore companies which are under the control of UK residents are subject to Controlled Foreign Company (CFC) anti-avoidance provisions. These serve to remove any corporation tax advantage that may be obtained by setting up the company in a low tax jurisdiction.

Individuals: If you transfer your property to another individual, whether resident or non-resident in the UK, but you continue to derive benefit from that income, you will be taxed on it as if you still owned the asset which produced it. There will not be a double tax charge if your property is already taxed in the UK under the remittance basis.

The rules targeting tax avoidance through the transfer of assets abroad are very far-reaching, and anti-avoidance legislation is extremely complex. Please contact us if you are thinking of transferring assets abroad or if you think you might be affected by these rules.

Ready to face 17.5% VAT?

The temporary reduction in the rate of VAT to 15% ends on 31 December 2009. If your business is not ready for the return to 17.5% that will take effect from 1 January 2010, then you are rapidly running out of time.

As well as the accounting issues involved with the rate change, you may be able to save some VAT by invoicing your customers in advance of the rate change, or by encouraging them to pay for goods or services before they have been received and able to fully reclaim the VAT they are charged.

For example, if you are a retailer who makes sales that include VAT, then the fraction used to work out the amount of VAT included in a sale will change from 3/23 to 7/47. So if a sale of goods is made for £1,081 including VAT, then the VAT element of the sale is £141 (£1,081 x 3/23) before 1 January and £161 (£1,081 x 7/47) on or after 1 January – a potential tax saving of £20.

There are special rules that could save tax for you or your customers. But do not forget that the rules are only worthwhile if your customers cannot reclaim VAT, for example if you make sales to the general public. If all of your customers can claim back the VAT you charge, or only small amounts of money are involved, then it will be easier just to charge 15% VAT on all of your sales or payments up to 31 December and 17.5% after this date.

Here's a reminder of a couple of possible tax savings:

- Where goods are invoiced or paid for in December or earlier, they will still be subject to 15% VAT, even if they are delivered to a customer on or after 1 January. There is an exception if the value of the goods exceeds £100,000 or the invoice is payable more than six months after it is raised, but these situations are limited.
- If you supply services to a customer on a continuous basis, then VAT is normally due according to the rate in force when you raise an invoice or receive money from the customer. However, if an invoice raised or payment received in January or later includes work done before 31 December, then 15% VAT can still be charged on the value of the work carried out up to this date (and 17.5% VAT charged for work carried out on or after 1 January). In effect, there will be opportunities to boost business cash flow and encourage customers to pay in advance for goods or services they will receive in January or later to take advantage of the lower rate of VAT.

New procedures are also being introduced on 1 January 2010 which will be relevant if you pay VAT on business expenses in other EU countries. Please let us know if this could affect your business.

Redundancy: not just a numbers game

Employers need to take great care when dismissing an employee – especially where age discrimination may be involved, as a recent case has shown. They must act reasonably and follow statutory procedures, or else they could end up facing a potentially expensive claim for unfair dismissal.

A dismissal is treated as 'fair' if it is for any of the following reasons:

- Bad conduct or the employee's inability to do the job, or some other duty as imposed by the employment contract.
- Redundancy, which can occur for economic reasons or changes in the business.
- Retirement, where the employee has reached retirement age for that employment, or the default retirement age of, for example, 65.
- Some other substantial reason, for example, where a temporary post has come to an end.

However, employers must show that they followed the correct procedures:

- If dismissal is on the grounds of conduct, employers must use an established disciplinary procedure.
- Where an employee is being dismissed because of incompetence or lack of capability, it must be shown that an opportunity to improve was offered.
- When redundancy gives rises to dismissal, employers must consult with the employee, or employee representatives. Employees should be selected for redundancy on grounds that do not discriminate against workers. The chosen criteria must be consistently applied and be objective and fair.
- Employers must give six months' notice if dismissal is due to retirement, but employers are also obliged to consider an employee's request to work beyond retirement age.

Age discrimination may affect the selection of an older worker for redundancy following the judgement in *Killa v Electronic Motions Systems Ltd* (2008).

59 year-old Mr Killa was selected for redundancy and was immediately dismissed. The Tribunal found that his employer had failed to use objective criteria or a proper selection process to determine which employees were to go, and although there was alternative work available in the company it was not offered to him.

In awarding damages for future loss of earnings, the Tribunal increased them to counter the effect of discrimination against older workers when considering Mr Killa's chances of gaining future employment.

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What price accommodation?

The huge increase in house prices in recent years has led some employers to provide free accommodation for directors and employees.

But employers should remember that there is a special tax charge when they provide living accommodation for a director, employee, or a member of their household. Some accommodation is exempt from tax, where, for example:

- Accommodation is usually provided for the better performance of an employee's duties.
- It is provided in line with customary practice.

The exemptions for better performance and customary practice do not apply to directors, unless the company is non-profit making or is set up for charitable purposes only.

When accommodation costs less than £75,000, the tax charge is based on the gross rateable value of the property, or the actual rent paid by the employer, less any amounts contributed by the employee. When accommodation costs more than £75,000, there is an additional tax charge which is calculated as follows:

Lightyear Ltd buys a home for its director, Woody, who is a 40% taxpayer. The home costs £310,000 and the company spends a further £90,000 on improvements. The official rate of interest is 4.75%, the annual rateable value is £1,200. Woody contributes nothing toward the cost.

He is taxed on a benefit of:

Basic charge:	
annual rateable value	£1,200
Additional tax charge:	
Cost and improvements	£400,000
Less:	£75,000
	£325,000 x 4.75 = £15,437
Benefit	£16,637
Less: contribution	–
Taxable benefit	£16,637

As a 40% taxpayer, the accommodation costs Woody £568 a month in tax and national insurance contributions.

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