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CHARTERED ACCOUNTANTS

money matters

Spring 2010

UP TO DATE DEVELOPMENTS IN TAX AND BUSINESS PLANNING

In this issue: The Chancellor's balancing act • 2010: a taxing year ahead • Tax penalties: what all directors must know • Employing foreign workers • Pensions and tax relief • HMRC's new charter makes taxpayer promises

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 January 2010.

The Chancellor's balancing act

December's Pre-Budget Report was a careful balancing act between assuring the markets that the Government was behaving responsibly and not upsetting too many voters in the run-up to the general election.

The Chancellor, Alistair Darling, also felt he needed to avoid hampering the fragile economic recovery. How well he succeeded remains to be seen. The main tax increases and spending cuts are yet to come; this was just the start.

The headlines focused on the 50% payroll tax imposed on banks that pay bonuses of more than £25,000; the extra tax charge will not fall directly on the bank employees themselves. The Chancellor has also frozen all the main tax rates and allowances for 2010/11. The rate freeze is welcome news for small businesses; the planned 1% increase in the small company's corporation tax rate from 21% to 22% is now delayed until 2011.

People with high incomes will be hit by the new 50% income tax super rate on incomes over £150,000 already announced for 2010/11. From 6 April 2011, higher rate tax relief for pension contributions is to be restricted for those with 'relevant income' over £150,000 and the Government has now set out the way in which this will work. In the meantime, the special anti-forestalling rules that prevent people from getting higher rate tax relief on large additional contributions to their pensions before the change have been extended to those with incomes of £130,000 or more.

National insurance contributions are due to rise sharply in 2011/12. Employers, employees and self-employed people will each pay an extra 1%. The good news is that the primary threshold and lower profits limits will be raised to compensate lower income earners.

Further key measures announced by the Chancellor aimed at helping small and medium-sized businesses were as follows:

- **The Business Payment Support Service**, or 'time to pay' initiative, will now continue, although for how long has not been determined. This allows taxpayers to settle their outstanding tax debts over an agreed timeframe with HM Revenue & Customs.
- **The Enterprise Finance Guarantee scheme** has been extended until March 2011. This is a loan guarantee arrangement under which the Government guarantees up to 75% of a qualifying loan, giving the lending bank more security than normal.
- **Research and development (R&D):** The requirement for SMEs to own the intellectual property derived from their R&D expenditure ended on 9 December 2009. This will enable more companies to claim the relief.
- **Business rates:** Businesses that have empty buildings with a rateable value below £18,000 will be exempt from business tax until 5 April 2011.
- **VAT:** The VAT rate returned to 17.5% on 1 January 2010, as previously announced, and percentages applied by businesses using the VAT flat rate scheme have been revised and the new rates have had effect from 1 January 2010.

In addition:

- **Basic state pension:** The basic state pension will rise by 2.5% in April to £97.65 a week for a single person and £156.15 a week for married couples and civil partners.
- **Inheritance tax:** The nil rate band was frozen at £325,000, even though an increase to £350,000 had been previously announced.

2010: planning for a taxing year ahead

Income tax at the rate of 50% will be payable on taxable income over £150,000 with effect from 6 April 2010. In another move to tax higher income taxpayers, their personal allowance of £6,475 will be taken away at the rate of 50p for every pound of income over £100,000, so that the allowance will disappear altogether when a taxpayer's income reaches £112,950.

All this makes the normal end-of-tax-year planning even more important this year:

- **Bring income forward to before 6 April 2010.** Consider how you might legitimately bring forward any income into the current tax year (2009/10) so that the top tax rate payable is 40%. That could be preferable to receiving income in the 2010/11 tax year, if the new 50% tax rate will apply.
- **Remuneration and dividends.** If you have your own company, consider paying bonuses and dividends to yourself and/or relevant employees before 6 April, rather than after. Earlier bonuses will also bring forward PAYE and national insurance contribution liabilities. Dividends received in this tax year are taxable at a top rate of 32.5%. In 2010/11 the top rate on dividends is 42.5%.

- **Approved share schemes.** Consider opening or activating HMRC-approved share and option schemes. They can be very tax efficient and relatively easily established, but it is important to ask our advice on the choice of schemes.
- **Pension contributions.** Tax relief at 40% is available on pension contributions for higher rate taxpayers, although certain restrictions have applied since April 2009. After 6 April 2011, a person with a taxable income over £150,000 will have their tax relief restricted. Therefore, for those affected by these rules, it could be worth making pension contributions that qualify for full relief in the current tax year. (See *'Pensions and tax relief'*.)
- **Capital gains.** A significant gap has opened between the current tax rate on capital gains of 18% and the top income tax rate that will soon be 50%. An increase in the tax rate on gains is expected, so it might be worth making taxable disposals before 6 April 2010 rather than waiting until the new tax year. At the very least it is generally worth making disposals to use the annual exemption – which for 2009/10 is £10,100 per taxpayer.

Please contact us for further information and more ideas for reducing your tax bill.

Tax penalties: what all directors must know

Tax officials expect you to take 'reasonable care' in completing tax returns and other documents. This requirement is central to the new penalty rules HM Revenue & Customs (HMRC) introduced with effect from 1 April 2009.

If you make a mistake but you were found to have taken reasonable care, you will not be penalised. However, if you make a mistake and were found to be careless, then a penalty may apply.

So what does 'reasonable care' really mean? HMRC has released some guidance in its Compliance Handbook Manual. In principle, reasonable care will vary depending on the capabilities and circumstances of the individual, and in particular on the type of business or transaction being dealt with.

In general, HMRC will expect lower standards from an unrepresented taxpayer than a taxpayer who is advised by a professional. Taxpayers are expected to take extra care where they are undertaking complicated or unusual transactions.

HMRC does not just expect taxpayers to take reasonable care in completing the official returns; the duty also extends to the records that a taxpayer must keep in order to report income and gains correctly, and to the systems that a business needs to ensure that it correctly deals with tax in relation to its transactions.

A director has a statutory duty under the Companies Act 2006 to protect the interests of the company and its creditors. This includes being familiar with the various taxes that apply to the company and ensuring that the company has adequate systems in place to maintain accurate books and declare its tax liability. Directors are also required to make sure that the company has adequate systems so that it can meet its obligations for VAT, PAYE and any other relevant taxes.

Some directors are likely to have a better understanding of tax than others and HMRC accepts this. For example, finance directors would be expected to know about filing deadlines and how the tax penalty regime operates in practice; they would also be expected to have a working knowledge of VAT and PAYE.

Directors may also delegate responsibilities to employees. If so, the employees must be properly trained and equipped and HMRC will still hold the director responsible for the employee's mistakes.

If a director does not understand the tax treatment of a particular transaction, HMRC would expect them to ask for advice from a competent person or HMRC.

New points basis for employing foreign workers

If you are employing anyone from outside the European Economic Area (EEA), they must hold a British passport or a visa in order to work in the UK. UK work visas are granted under a points-based system consisting of five different tiers. However, only four are currently available because Tier 3 (low-skilled workers required to cover a temporary labour shortage) is suspended indefinitely.

A foreign worker is entitled to apply for a work visa under a specific tier depending on their skills or their sponsoring employer's type of business.

Each tier has different entry checks, entitlements and requirements and is organised into categories. For example, in Tier 2 there are four categories: general (ie sponsored workers in skilled roles), inter-company transfers, ministers of religion, and elite professional sports people. In April 2009 the qualifications and salary required for general applications under Tier 1 were raised to a master's degree and a minimum salary requirement of £20,000.

The Home Office's Border Agency provides useful information for employers who want to recruit workers from outside the EEA or to retain foreign workers they already employ (www.ukba.homeoffice.gov.uk/employers/points/). The information includes how to go about obtaining a sponsor licence, which you will need if you want to sponsor foreign workers. It is not specific to any individual employee. At the moment the Home Office's published commitment is to decide 95% of sponsorship licence applications within four weeks. To obtain a licence, you will need to provide supporting documentation and comply with certain requirements. For example, Tier 2 skilled jobs must now be advertised through Jobcentre Plus for a total of at least four weeks.

Employers can face a civil penalty of up to £10,000 for every foreign worker they employ illegally, and so it pays to check the Home Office and Border Agency's guidance on preventing illegal working. Support is available to help you to avoid this pitfall: Business Link (www.businesslink.gov.uk) will help you check an individual's eligibility. It is also worth ensuring that, in preventing illegal working, your actions are not perceived as contravening human rights and racial discrimination laws. Again, there is official guidance available if you are unsure.

Pensions and tax relief

People with high incomes will cease to benefit from higher rate tax relief on pension contributions after 5 April 2011, and 40% relief will be restricted in the tax years 2009/10 and 2010/11. The Government has produced a consultation paper setting out the proposed rules that will apply in the longer term as well as tightening up on the so-called anti-forestalling rules that apply now.

After 5 April 2011, the big dividing point for income will be £130,000 – and that is income from all sources. If your pre-tax income is less than this amount, the new rules will not apply to you even if your employer makes a very substantial contribution to your pension scheme.

If your income is £130,000 or more, then you will potentially be affected by the rules, because the value of your employer's contributions to your pension scheme will be included in the definition of income. If your income including employer pension contributions is £150,000 or more, then HMRC will taper the amount of 40% or 50% higher rate tax relief that you receive. If your income is £180,000 or above then you will receive only 20% basic rate tax relief on all of your pension contributions. The reduction in the tax relief will be made by a special charge on you personally.

The current anti-forestalling rules for 2009/10 and 2010/11 have been amended so that a £130,000 threshold has also applied from 9 December 2009. The rules apply if the limit is exceeded in the year of the contribution or in either of the two preceding years. Regardless of your income, it is possible to make limited pension contributions that qualify for full higher rate tax relief. The amount that can be invested in this way is at least £20,000 but could be more depending on your circumstances.

It will make sense to contribute as much as possible while you are still able to get full tax relief. Pension contributions that qualify for just 20% basic rate tax relief will be significantly less attractive.

For some people the challenge will be to keep their income below the £130,000 (or £150,000) threshold without affecting their standard of living too much.

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HMRC's new charter makes taxpayer promises

HMRC has continued in its attempts to improve its relationship with taxpayers by issuing a new taxpayers' charter. It is called 'Your Charter' and was launched on 11 November 2009. The Charter was included in the Finance Act 2009 and sets out taxpayers' rights and how they should expect to be treated by HMRC.

It also outlines what HMRC expects in return. The new Charter says that, as a taxpayer, you can expect HMRC (among other things) to respect you, help you to get things right and treat you even-handedly.

HMRC also pledges to treat you as being honest, to protect your information and privacy and to 'tackle people who deliberately break the rules and challenge those who bend the rules'.

In return, HMRC expects taxpayers to be honest, respect HMRC staff and take care to get things right. The Charter is published alongside the 'HMRC Vision' (launched on 3 November 2009) which is a statement of HMRC's aspirations.

The Vision is closely linked to the Charter and is relatively brief. In some respects, it is similar to the vision (or mission) statements of many other large organisations (stating a commitment to professionalism and integrity, continuous improvement and success), but it also stresses HMRC's aspirations to understand and meet taxpayer needs. The Vision itself is as follows:

'We will close the tax gap, our customers will feel that the tax system is simple for them and even-handed, and we will be seen as a highly professional and efficient organisation.'

You can read both the Charter and the Vision in full on HMRC's website: www.hmrc.gov.uk/charter/index.htm

If you feel that HMRC is not acting towards you as a taxpayer in accordance with the Charter, the first step is to contact us.

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