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Petersons

It's now the law Darling!

You may recollect that the Chancellor, Alistair Darling, presented his Budget on 22nd April this year. The Chancellor's numerous budget proposals were transformed into hundreds of pages of the Finance Bill. The Bill, first issued on 30th April 2009, bounced around the Commons and House of Lords, receiving a number of amendments, before finally becoming part of UK law on 21st July 2009.

Although a number of the legal provisions came into effect on 21st July, affecting both individuals and companies from that date, numerous other provisions were backdated to the start of the tax year, financial year for companies, or even Budget Day. Keeping up to date with the changes and from when they come into effect, even when they don't become law until a later date can be a significant task, creating tax traps for the unwary, but also tax saving opportunities that many are overlooking. We aim to rectify this by ensuring that we highlight some of the tax traps that can be costly if you are not aware of them and to give you an idea of possible tax saving opportunities in certain situations.

As everyone's circumstances are different, and the rules are constantly changing, we would be delighted to talk to you in detail about how the rules apply to you and how you could save tax. We want to help you pay your fair share of tax… and not a single penny more!

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National Minimum Wage rates increase in October

The hourly rate for the National Minimum Wage will increase from 1st October 2009 to;

- **£5.80 for adults (workers aged 22 and over) (currently £5.73)**
- **£4.83 for workers aged 19 to 21 inclusive (currently £4.77)**
- **£3.57 for young people (currently £3.53)**

In the recent court success for HM Revenue & Customs it was confirmed that employer's must pay their employees at least the National Minimum Wage regardless of any tips, gratuities, service charges or cover charges if they are not paid by the employer to workers through the employers payroll.

Save tax on your second property

Assume you own and occupy more than one property as your home. Within two years of acquiring the second property, you elect for the new property to be your main home for tax purposes.

Where you occupy a property as your main home then a private residence relief will reduce or wipe the tax out when you come to sell it. Because the relief is generous you are only allowed one main residence for tax purposes. The story doesn't end there, because you can change your mind. You decide to change this election so that the first property qualifies as your main home again. In just a couple of letters to HM Revenue and Customs you have managed to wipe out significant amounts of Capital Gains Tax on the second property when you come to sell it.

When you sell the second home, the increase in value that has built up while it was classed as your main home (the period between the two claims) and for the last three years of ownership, is free of capital gains tax. Three years of the ownership period will be free of tax, even if the property has only been designated as your main home for a very short period, perhaps only a week.

The key is to make the first election within two years of acquiring another residence, or within two years of marrying (or civil partnership). If you have missed this deadline on your current properties it may be worth acquiring a very small third property to give you the opportunity to make the election again.

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New Disclosure Opportunity

You may have heard of the New Disclosure Opportunity (NDO) offered by HM Revenue & Customs (HMRC). Although the opportunity is new, it is reportedly the final chance to disclose tax underpayments linked to offshore accounts or assets at a favourable penalty rate.

HMRC have received data from financial institutions regarding money held offshore and are expected to receive much more additional data over the coming months. The Offshore Disclosure Facility of 2007 raised over £400 million and yet many commentators regarded that as the tip of the iceberg. It has been suggested that over £2 billion could be raised this time.

The NDO is not really an amnesty as HMRC still expect all tax and National Insurance Contributions to be paid, plus interest, plus a penalty. Where HMRC had written to the taxpayer in 2007 the penalty is likely to be in the order of 20%, otherwise taxpayers may be able to pay a lower 10% penalty. HMRC will not be as lenient on taxpayers that have not made a full disclosure and are found in the future to have underpaid tax as a result of offshore accounts or assets.

Participation in the NDO means there will almost certainly not be an intrusive and expensive HMRC enquiry and the risk of prosecution is unlikely. The NDO runs from 1 September 2009 to 12 March 2010 with the filing deadline being dependent upon whether submitting electronically or by paper. If you require assistance please do not hesitate to contact us.

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Consider your National Insurance top up

Your National Insurance Contribution record is used to determine the amount of state pension that you will receive in the future. Prior to 6th April 2010 a man will need 44 qualifying years and a woman 39 qualifying years to receive a full state pension on retirement. If you achieve state retirement age after 5th April 2010 then you will only need 30 qualifying years.

A pension forecast can be obtained online from the Department for Work and Pensions at www.thepensionservice.gov.uk. Should you have any years where contributions are missing then you may wish to consider making voluntary top up contributions to increase the amount of state pension that you will ultimately receive. It may not always be worth making top up contributions and we would be delighted to review your forecast and advise.

The deadline for paying voluntary contributions for missing years is generally 6 years from the end of the relevant tax year. However due to problems with records and letters not being issued, it may be possible to go back further to top up, as well as considering topping up if you have already reached retirement age. It may even be possible that making such voluntary contributions help you qualify for incapacity benefit or maternity benefit when you need to claim.

Pension problems for high incomes

This year's budget contained a surprise announcement that from April 2011 those with incomes of £150,000 or more would have tax relief on their pension contributions restricted. Whilst those with incomes below £150,000 will still be entitled to the full 40% tax relief, the relief will reduce for those with higher incomes. The amount of tax relief will be tapered so that those earning above £180,000 will receive tax relief at basic rate (20%) only, although how this will work in practice is still to be consulted upon. One of the reasons for the change is the introduction of the new 50% income tax band from April 2010 which, unless something was done, would increase the amount of tax relief received by the high earners.

You may think that you don't need to worry about these new rules until April 2011. Unfortunately not! Complex anti-forestalling rules have already been brought in from April this year. Those individuals making "regular" pension contributions may have nothing to worry about until 2011. Unfortunately the Government's definition of "regular" only includes contributions made quarterly or more frequently. Hence those making six monthly or annual, or exceeding their regular contributions may be affected now.

The anti-forestalling rules limit tax relief to 20% on contributions exceeding the normal "regular" contributions for those with incomes of £150,000 or more, either in the tax year or in either of the preceding two tax years.

Where the total annual pension contributions are £20,000 or less the new anti-forestalling rules will not apply, irrespective of whether the contributions are made regularly or not.

For those making pension contributions into a money purchase pension on a less regular basis than quarterly, a last minute amendment was introduced by the Government, which increases the £20,000 limit under which the new rules do not apply to the lower of:

The average contributions paid for tax years 2006/07, 2007/08 and 2008/09 or £30,000.

In addition where an individual had an active defined benefit arrangement in place prior to 22 April 2009, they may well be protected depending upon the circumstances.

Unfortunately implementing a new salary sacrifice scheme to effectively redirect salary into a pension scheme to reduce an individual's income below £150,000 is one of the example's HMRC give that will be caught by the new anti-forestalling rules. Payment of redundancy can also count towards an individual's income and may take them over the £150,000 threshold, thereby restricting the pension relief available to them.

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All is not lost as there are possible actions, including receiving a refund of excess contributions in certain circumstances or looking at alternative arrangements. If you are interested please let us know.

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Take care with dividends

Dividends are often seen by director/shareholders as a simple and fairly tax efficient way of extracting profits from a company. Care is often needed to ensure that the paperwork is correct and completed on a timely basis. In theory a dividend is the distribution of profits for the year. However in practice many dividends are paid out during the year rather than waiting to see what the profits are. This works fine while the company is profitable and has built up profits in the past.

However should the business be affected by the economic downturn and losses deplete any reserves built up in past years, problems can arise. A dividend paid could be considered illegal if there are insufficient profits to pay out.

The payment may result in an overdrawn directors loan account, which needs to be repaid to the company. Should the company become insolvent then the individuals concerned would be pursued for this debt. It may be possible to clear the loan account tax efficiently, consider other strategies or merely ensure that these problems do not arise by involving us with every dividend payment.

Get your Capital Gains Tax back

If you have made a capital gain in the last 3 years then it may be possible to roll this over into an investment known as an Enterprise Investment Scheme (EIS) and get back the Capital Gains Tax that you paid.

Unfortunately you won't be able to keep the tax forever, as it would become payable when you sell your shares in the EIS business. On top of the cash flow advantage, for gains that may have been taxed in the past at up to 40% then it is possible to reduce the ultimate gain to 18% using the EIS investment.

Other benefits of the investment include;

• You may be entitled to 20% income tax relief on the EIS investment.
• After two years of holding an EIS investment then it will effectively be exempt from Inheritance Tax.
• There will be no Capital Gains Tax payable on an increase in value of the investment.

There are a number of EIS investments around, some of which may expect a reasonable return. Financial advice should be taken before considering any such investment and the risks involved.

Save tax and party

Around this time of year some businesses start to think about their Christmas party. When it comes to entertaining your employees, all of the costs are usually allowed against business profits. On top of this VAT on the party costs relating to the employees can also be reclaimed by the business.

What about the £150 limit that you have heard about? Well this actually relates to the employees themselves. Should the total cost of all the functions in a tax year exceed £150 per head, then the employees will be taxed upon the full cost as a benefit in kind. The company would be liable to National Insurance on this amount. HM Revenue & Customs generously define employees as including; current employees, retired employees, and partners of existing and past employees.

Should your parties start becoming costly, one option may be to charge nominal fees for some functions to keep the total cost to the business below £150 per head per year.

Don't overpay Inheritance Tax

The rise in property prices over the past decade have taken the estates of many individuals over the Inheritance Tax threshold (currently £325,000). Where the values of estates exceed this limit on death then 40% Inheritance Tax is generally payable. The calculation of the Inheritance Tax payable will in part be based upon an estimated valuation of property within the estate, of which the largest is often the family home. As the valuation can often be an estate agents marketing valuation this can be overstated and result in too much Inheritance Tax being paid.

The current downturn in the market can mean that many properties are ultimately being sold at prices significantly less than the estate agents first estimate. It can be difficult to be any more accurate when calculating the Inheritance Tax, as the property can take a long time to sell, often after the Inheritance Tax on the estate has been calculated and paid over. Generally if the property is sold within four years of death to an unconnected party it is possible to make a claim to reduce the value used in the estate, and use the eventual sale value. HM Revenue and Customs would then repay the excess Inheritance Tax paid.

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Watch out for the VAT trap when registering

If you, your partnership, or your limited company, register for VAT purposes, then the registration will apply to all income of the registered body. Care should always be taken and the full implications of registration considered.

For example assume you are self employed earning around £70,000 and have just exceeded the VAT threshold. You inherited your parents home when they passed away two years ago. You now rent out the property and make a reasonable return on it.

You are obliged to register for VAT purposes because your self employed income has exceeded the VAT threshold (currently £68,000). Unfortunately in this case you register YOU for VAT purposes and not your self employed business. In which case, the VAT rules would apply to all of your income and related expenses. If you registered a partnership or limited company for VAT purposes then the rules would apply to all income of that partnership or limited company respectively.

Renting residential property is exempt from VAT. Great you say, we don't have to charge VAT on the rent. The bad news is that you may need to restrict what input VAT you reclaim on your sole trader business as a result of the exempt rental income which you receive, using what are known as "partial exemption" rules. With careful planning there are a number of possible solutions to save VAT, including holding the property in partnership with your spouse, or transferring the sole trader business into a company to name a few. The exact solution will depend upon circumstances and how other taxes can be kept to a minimum.

We can help

Despite statements about simplifying the UK tax system, the truth is that it gets increasingly complex each year. But we can help. We can guide you through the complexities of the legislation and help you to pay much less tax.

So if you would like to discuss ways in which we can help you to make tax savings, or if you would like to discuss any of the issues identified in this edition of 'Pay Less Tax' please do not hesitate to contact us.

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