

Psst “Wanna buy a CD?”

The recent security lapse at HMRC when a pair of password-protected disks containing details of 25 million individual child benefit recipients was lost brings home the paramount importance of good information security. It also renews concerns over management and morale at the merged tax department, in the wake of the ongoing tax credits fiasco.



Gaining access to existing accounts is not the primary motive behind identity theft. Personal information such as birthdates, bank account details and national insurance numbers are much more valuable to criminals because they can use the information to set up new accounts or lines of credit.

The fact that a junior official would dispatch a pair of disks on the basis of a telephone call and not comply with departmental rules is a serious indictment of HMRC's information security policies. It is a timely reminder that something as mundane as some computer records stored on a couple of CDs has the potential to bring down a government department. The police are continuing to hunt for the missing disks and the Information Commissioner has been notified and is likely to take further action against the department over breaches of the Data Protection Act.

The size and scope of data loss is huge. In terms of risk assessment, it's reasonable to assume that 'any fool' would understand the stupidity of sending the confidential records of half the country on a couple of CDs by courier or through the postal system. The Chancellor emphasised that a "junior" staff member was responsible and that in future it will only be possible to send data if signed off by a senior manager. This completely misses the point, overlooking the apparent lack of basic access controls within HMRC. There is a key principle within security called the rule of least privilege, which means only allowing access to information by those who need it. What the Chancellor is saying is not only was a junior staff member able unilaterally to send this material, he was able to get hold of it in the first place. Without training or authority, and bypassing all internal controls, someone was able to compile a list of 25 million confidential records and burn them to a CD. The fact that they then popped that CD into the post is almost irrelevant.

There are clearly deep rooted problems at HMRC with regard to information security, far deeper than a lack of process. Fundamental principles of access control and best practices have clearly not been followed. This is guaranteed to be more widespread throughout the civil service.

Issue 51 November 2007

Inside this issue:

<i>Psst “Wanna buy a CD?”</i>	1
<i>Give back our taper relief</i>	2
<i>VAT on home computers</i>	2
<i>UK Companies Act implementation delayed</i>	3
<i>The new tax penalty regime</i>	3
<i>More red tape!</i>	4
<i>Taper relief and surplus cash - the 20% tests</i>	5/6
<i>CGT - what to do?</i>	6
<i>New VAT invoicing rules</i>	7
<i>Let property - the 10% wear and tear allowance</i>	7/8
<i>What's your wife worth?</i>	9/10
<i>Obsession, passion and dedication</i>	10
<i>An entertaining round up</i>	11/12
<i>Commercial property allowance - get renovating</i>	12
<i>Capital allowances on second hand property</i>	13/14
<i>Remittance Basis - Non-Domiciles</i>	15

B H G Chartered Accountants
Bernard Harrington BCom(Acc) FCA
FCCA
B H Group Limited
Blandford House
77 Shrivensham Hundred Business Park
Majors Road, Watchfield, Swindon,
SN6 8TY
t: 01793 780480
f: 01793 780180
bernard.harrington@bharrington.co.uk
www.bhgroup.co.uk

straightforward

Like you, we're straightforward people. We give you straight advice, you take your business forward. No nonsense. Straightforward isn't it?

So what can small businesses learn from HMRC's lapses?

It's not just big companies or government departments that lose important storage media. Most small businesses back up their data, but often forget how valuable those backups are. They are often left on reception desks in public areas, in cars, or worse still are never taken off-site at all. Back up tapes and CDs need to be taken off-site, but should be handled securely and carefully all the way. You may need them one day, and you certainly don't want them falling into the wrong hands.

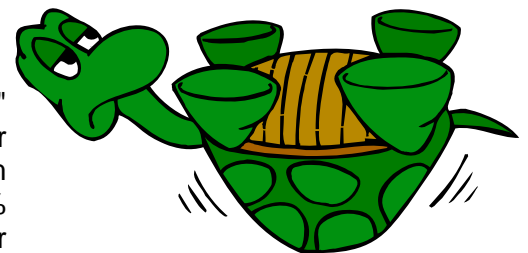
Laptop theft isn't going away. Anyone with sensitive data on their laptop should ensure that it is both encrypted and backed up.

Don't forget the paperwork. In a recent case of a stolen laptop containing details of Standard Life customers, documents containing their addresses and passport numbers were also taken, providing a timely reminder that it's not just computers and storage media that matter.

Once again, it is pleasing to see that the private sector shows itself to be more commercially aware than HMRC. Don't expect an apology from them though!

Give back our taper relief!

As has been widely reported, Mr Darling's move to "simplify" Capital Gains Tax by having a single rate of 18% will remove taper relief, thus promoting short-termism at the expense of longer-term private and business investors. Business owners will now pay 18% on the sale of a business asset held for more than 2 years, rather than the present 10%. The predictable reaction of the CBI and small business organisations shows that this has cost the government a lot of their dwindling support from very business community they need to prop up their flagging tax revenues.



Although the very vocal opposition has already prompted the announcement of one concession, why not tweak Mr Darling's ear by signing a new and growing petition on the Downing St website by following this link? <http://petitions.pm.gov.uk/SaveCGTrelief/>

Two other articles on this and related matters appear on page 5 and 6 of this newsletter.

VAT on home computers

HMRC have revised their policy in relation to the VAT treatment of computers made available by employers for use in their employee's homes. The change in policy follows the withdrawal of the Home Computer Initiative ("HCI") for direct tax purposes. Their previous policy to allow full VAT recovery in circumstances where there is any business use, without any adjustment for private use, has been withdrawn with effect from 13 August 2007. It is now necessary to consider why a computer is being provided to an employee to determine the level of VAT that can be claimed.



Businesses will only be able to claim full VAT recovery, subject to any partial exemption restrictions and without any requirement to account for VAT on any private use, where the provision of a computer is necessary for the employee to carry out the duties of his employment. In these circumstances HMRC's view is that it is unlikely that any private use will be significant when compared with the business need for providing the computer in the first place. This mirrors the approach taken for direct tax concerning exemptions for work related benefits in kind where there is no significant private use. Where a business cannot demonstrate that it is necessary to provide an employee with a computer in order to carry out the duties of his employment then only a portion of the VAT incurred will be recoverable as input tax. HMRC will accept any method of apportioning the VAT incurred as long as the result fairly and reasonably reflects the extent of business use. In such circumstances, it may be possible to agree a set percentage with HMRC based on a representative period. Where a business continues to provide a computer under an existing HCI agreement, full VAT recovery can continue until the agreement (normally 3 years) has expired.

UK Companies Act implementation delayed

Key elements of the Companies Act due to come into force next year have been delayed until October 2009 because of problems with Companies House IT systems, the Government has announced. Provisions that will now be delayed include the deregulation of company reporting and keeping directors' home addresses private to protect them from protests and abuse.



The removal of the need for private companies to have a company secretary will still take effect from April next year, as will a less demanding but comprehensive code of accounting and reporting requirements for small companies. The Government has yet to finalise the implementation date for new rules on directors' conflicts of interest.

The Companies Act 2006 was the single largest piece of legislation ever passed in the UK.

The new tax penalty regime

A single new penalty regime for incorrect returns comes into force in 2009. This is part of an initiative to standardise and simplify the existing penalty regime right across the taxes, following the 2005 amalgamation of the Inland Revenue and Customs & Excise. The new rules will be based on both the amount of tax understated and the behaviour that gives rise to the understatement, with no penalties being applied for 'mistakes'. However, at the other end of the scale, there will be higher penalties for 'deliberate action with concealment.'



Legislation was introduced in the Finance Act 2007, which has recently received Royal Assent, to provide for a single new penalty regime for incorrect returns. The penalty is based on the following three criteria:

- amount of tax understated/that would have been lost
- the nature and behaviour giving rise to the understatement,
- the extent of disclosure by the taxpayer

It is expected that the effective date will be such so as to include return periods commencing after 31 March 2008, where the return is filed after 31 March 2009.

The new regime will replace current rules, and there will be:

- No penalty where the taxpayer makes a mistake;
- Moderate penalties for failures to take reasonable care;
- Higher penalties for deliberate action; and
- Still higher penalties for deliberate action with concealment

Each penalty can be substantially reduced where the taxpayer makes a disclosure, more so where it is unprompted, and there will be the right of appeal against penalty decisions. A new concept of suspended penalties will also be introduced. HMRC will be able to impose a penalty which will not be enforced for a period of time; if the taxpayer makes no further errors, the penalty will lapse. This will, no doubt, encourage business to be compliant.

It would be advisable for business to show any visiting VAT officer that every care has been taken in getting the returns correct, so if an error is discovered, no penalty is imposed. In many cases, a VAT inspector fails to understand the details of a business, and so assesses incorrectly or may impose a penalty because he thinks reasonable care has not been taken. Some large businesses have decided to put together a 'pack' explaining what the business does and how the accounting system operates, to help VAT officers understand the business.

More red tape!

A number of new measures came into force on 1 October:

- National minimum wage rates increase: the hourly rates rise as follows: adult rate from £5.35 to £5.52; development rate (18- to 21-year-olds) from £4.45 to £4.60, and (16- to 17-year-olds) from £3.30 to £3.40.
- Increase in minimum statutory holiday entitlement: the first phase of the increase, from 20 to 24, in the number of days' holiday to which employees are entitled came into force on 1 October. Bank holidays are included in the allowance; for instance, if an employee already gets four weeks' paid holiday plus bank holidays, their entitlement will not be affected.
- Changes to trade mark registration: from 1 October, the UK Intellectual Property Office will no longer refuse to register a new trade mark application because of an earlier conflicting trade mark (ie on 'relative' grounds), unless the owner of the earlier mark successfully opposes the new application.
- Expiry of final transitional arrangement under Data Protection Act 1998: from 24 October, pre-October 1998 manual records are no longer exempt from the Data Protection Act, and must be processed in compliance with all provisions of the Act.
- Changes to the Employment Equality (Sex Discrimination) Regulations 2005 (proposed): following the successful High Court challenge by the Equal Opportunities Commission, that the Equal Treatment (Amendment) Directive had not been fully implemented in the UK in respect of some provisions on pregnancy and maternity leave discrimination and harassment, the Government undertook to introduce amending regulations with effect from October; this deadline has now been put back until December at the earliest.



More importantly perhaps, a number of provisions in the Companies Act 2006 are in force from 1 October:

- The duty of directors to act in a way which they consider most likely to promote the success of the company to benefit the shareholders and that, in doing so, they need to have regard as necessary to long-term factors, the interests of other stakeholders, such as employees, the community, and the company's reputation. In practical terms, no new paperwork is required, but directors will want to continue to make and keep written records of their decisions, as they did before the Act.
- There is no longer a statutory requirement for private companies to hold annual general meetings (AGMs). However, businesses can still hold AGMs if they wish.
- Shareholder meetings for private companies can now all be on a 14-day notice period, unless the company's articles allow different arrangements.
- The procedure to follow for decisions by written resolution of a company's shareholders has changed significantly. Written resolutions now need a signature from a majority of shareholders, not all of them. Special resolutions need a majority of 75%.
- There is a clearer way for shareholders to make a derivative claim to sue directors on behalf of the company - for instance, for fraud.
- Unless a company files small-company accounts, the Directors' Report in its accounts must contain a Business Review.

Visit our website www.bhgroup.co.uk

Taper relief and surplus cash - the 20% tests

The impending removal of taper relief is forcing many business owners to contemplate steps to crystallise gains at what is widely known as the “10% tax rate” which applies to gains on the sale of businesses or shares in trading companies. We all know this is a very valuable relief, but it does apply only to trading entities and is a relief which can be jeopardised, or lost, particularly in very successful businesses. Trying to gauge the trading status of a company for business asset taper relief purposes is not always as easy as it might seem. A company’s trading status may change from one period to the next and different tests to measure status may give variable results depending on the company’s activities at any one time.

Typically, a shareholder will want to know if his shares are business assets or not for the purposes of obtaining business taper relief on a disposal or on a winding up. In order for the shares to be business assets, they must be shares in a company which carries on a trade, profession or vocation on a commercial basis and with a view to the realisation of profits.

A trade includes certain activities such as carrying on a holiday letting business, and farming, but excludes land and property rental businesses. In the case of businesses which have a mix of activities and assets, a trading company means a company carrying on trading activities whose activities do not include, to a substantial extent, activities other than trading activities.

In 2001, the Inland Revenue introduced a number of tests to help determine whether a company had substantial non-trading activities:

The “substantial or over 20%” test looks three factors:

- Income from non-trading activities
- The asset base of the company
- Management time

If investment (ie. non-trading) activities are shown to be more than 20% of any of these, then it may be presumed that a company is not wholly carrying on a trade. However, one needs to consider the company’s history. It may be that some indicators point in one direction and others the opposite way. One has to weigh up the impact of each of the measures in the context of an individual case.



For example, it may be appropriate to consider activities over a longer period. At a particular instant, certain receipts may be substantial compared to total receipts but, if looked at on a longer timescale, they may not. Looked at in this context, therefore, a company might be able to show that it was a trading company over a period, even where that period may have included particular points in time when, for example, non-trade receipts amounted to a “substantial” proportion of total receipts.

In many cases, the asset base of the company comes under scrutiny because the company has basically retained “too much” cash. Whether the troublesome asset is cash or an investment property, the test is the same - “too much” is determined by reference to all the assets employed in the business, not net of liabilities relating to the financing of those assets - in other words, gross assets.

In the case of owner managed companies, there are often very few substantial assets other than cash on a balance sheet, so it is important in these cases to consider goodwill. Here we have something of an oddity, because we should consider all goodwill, as it is still very much an asset used in the business. The problem then is that goodwill is hard to quantify, so it will probably subject to negotiation.

It seems that HMRC will often apply the result of just one of the tests (income/assets/time/history) in isolation. This can have some pretty dire results. The Revenue’s argument in these cases is that the cash surplus is not required for the trade and not related to the conduct of the trade. The difficulty is that HMRC’s guidance seems to say on the one hand that you should look at all the tests, and on the other that a company may change status year on year, which may be so when only one or more of the tests is failed. This is plainly confusing and is, of course, interpreted by HMRC in a way which best suits them!

Business owners also need to watch out for trading status in terms of IHT business property relief. As far as IHT cases go though, the courts do seem to address the problem “in the round”, and so they will apply all the tests and take the overall result.

The answer to the problem is to keep reviewing your accounts, and if cash or investment assets are building up, take steps to remove them. In so many cases, proprietors like the comfort of these assets on their balance sheets as they have spent many years trying to get to this position. It is then a question of recognising the potential tax bill that can result from this approach - that will generally concentrate the mind!

CGT - what to do?

We have been scurrying round trying to get to the bottom of the planned reform of Capital Gains Tax, due early next year. The problem is that each client will need advice specific to his or her situation, and there may be many complex factors to take into account. Here are a few of the issues.



Those who were expecting to pay tax on a band of gains at basic rate (which for CGT is of course 20%) have been disappointed by the proposed changes. Provided taper relief would be sufficient to reduce their gain to below 90%, they face a tax increase next year as compared to this year. If full non business taper were available, the net gain of 60% would be taxed at 20%, producing a compound rate of 12%. So these taxpayers will see their rate rise by 50% on disposals delayed until next tax year. However, once the gain is sufficient to attract 40% tax now, the compound rate becomes 40% x 60%, or 24%, and the taxpayer is better off by waiting.

The computations regarding loss of indexation (on assets held before 1998) are more complex. Essentially, lost indexation must also mean lost taper, as the asset must, at worst, attract maximum non business taper. A double whammy! Even taxpayers with higher rate tax due on their gains will need to consider what to do next.

Last and definitely not least, business asset taper relief. At least here is one that everyone understands. The loss of business asset taper relief of the maximum amount hits every taxpayer hard. Higher rate taxpayers will see their effective rate of tax rise from 10% to 18%, and if any basic rate element is affected, the gain would be taxed at only 5%, giving an even more substantial increase in the tax due.

The problem here is how to access the taper? Many business owners will be unable to realise their gains to take advantage of the current rate. They may not be ready to sell, or may not be able to find a willing buyer in the time available. The use of trusts may look attractive, but these are not without problems of their own, and the costs may in some cases pose a significant burden - in addition to financing the tax payable in the absence of cash proceeds.

Where an asset has mixed business and non business taper, it's back to detailed calculations of the gain, and the net taper relief applying to the gain on the whole asset, to decide when it is best to sell.

If you think you have a problem, you're probably right! Please do call us if you are at all concerned about your exposure to Capital Gains Tax in future. In the meantime, we should all start praying that Mr Darling takes notice of representations being made by the various business groups who are understandably outraged by the proposed changes.

Visit our website www.bhgroup.co.uk

New VAT invoicing rules

New rules regarding the content of VAT invoices came into force on 1 October 2007. The changes are explained in VAT Information sheet 10/07 which has been issued recently. Many businesses will not have to change their procedures, as they already voluntarily comply with the rules, but all businesses need to be aware of the change in the law.



Those making supplies under second hand margin schemes and the Tour Operators Margin Scheme will need to change their invoicing procedure. However, the main changes will affect businesses making cross border supplies into the EC. The following summary illustrates the full scope of the changes.

- All invoices will be required to be sequentially numbered by law. This is the only aspect of the changes that affects every VAT registered trader, and as many already number their invoices, there will be no change. However, businesses which “restart” their invoicing sequence each financial year will now have to ensure that every single invoice has a unique number, and that number sequences are not repeated. Where businesses use separate sequences for different customers or product types this is acceptable, provided each sequence is identifiable and unique. Using customer prefixes is also permitted, provided the sequencing is discernable. Any system under which invoice numbers are duplicated for whatever reason is unacceptable.
- If a business supplies goods under the second hand margin scheme this will have to be indicated on VAT invoices. The invoice may make a reference to the relevant legislation (either UK or EC) but the simplest is to put a statement on invoices such as “This invoice is for a second-hand margin scheme supply”.
- Similarly, supplies made under the Tour Operators Margin scheme will have to be identified as such from the invoices. Example statements are provided in the information sheet, but a simple statement such as “This is a Tour Operators Margin Scheme supply” will suffice.
- Cross border EC supplies will need a reference where the supply is either one which would be exempt if made in the UK, or is subject to the reverse charge arrangements. HMRC will not dictate what the statement needs to say, and indeed the requirement for such a statement is in fact determined by the recipient’s member state and the VAT rules applying there. Most businesses making intra-EC supplies which are exempt will probably include a statement such as “Exempt supply for VAT purposes” on all of their cross border supply invoices to avoid having different procedures for different member states. Reverse charge supplies will need to state “Subject to reverse charge in the country of receipt” or similar on the invoice.
- Finally, on intra-EC supplies of goods, which are therefore zero rated for VAT in the UK, a statement to this effect must be included. In many cases, the existing invoicing procedures will suffice, but the statement might read “Intra-Community supply subject to VAT in the country of acquisition”.

Let property - the 10% wear and tear allowance

The wear and tear allowance is calculated by taking 10% of the net rent received for the furnished residential accommodation. To find the ‘net rent’ you deduct charges and services that would normally be borne by a tenant but are, in fact, borne by the landlord (for example, council tax, water and sewerage rates etc).

The 10% wear and tear allowance is only designed to provide a measure of relief for the depreciation of the machinery and plant within a residential property. It isn’t intended to cover:

- the capital cost of the residential property itself or the cost of improvements to the property; but you may be able to claim relief for repairs
- machinery and plant in other kinds of furnished accommodation, such as offices (where capital allowances may be claimed).



The 10% deduction is given to cover the sort of machinery and plant assets that a tenant or owner-occupier would normally provide in unfurnished accommodation. These are things like movable furniture or furnishings, such as beds or suites, televisions, fridges and freezers, carpets and floor-coverings, curtains, linen, crockery or cutlery. It also covers machinery and plant chattels of a type which, in unfurnished accommodation, a tenant would normally provide for himself (for example, cookers, washing machines, dishwashers). This is not intended to be an exhaustive list, only to give an idea of the assets the wear and tear allowances covers.

Entitlement to the 10% deduction does not depend on the provision of each and every item in the list. The relief is calculated simply on the net rents and not on the cost of particular items. But the deduction is only due if furnished accommodation is genuinely provided. A furnished property is one which is capable of normal occupation without the tenant having to provide their own beds, chairs, tables, sofas and other furnishings, cooker etc. The provision of nominal furnishings will not meet this requirement. If the accommodation isn't furnished, or only partly furnished, the 10% wear and tear allowance isn't due.

The possible advantages of the 10% wear and tear allowance over the alternative, (the renewals basis) are that it is simple to calculate and the property owner gets a deduction from the outset; the renewals basis, outlined below, only gives relief when the furnishings etc are replaced.

If a property owner chooses to take the 10% wear and tear allowance, they can't later claim for the cost of replacing the assets (but they can claim the cost of repairing them). Nor can they deal with some assets on one basis and some the other. If they take the 10% wear and tear allowance, that is the only relief they can have for the depreciation of furniture, furnishings and fixtures etc which the tenant would normally provide for himself (see the list above).

In addition to the 10% allowance, a landlord can also deduct the net cost of renewing or repairing fixtures which are an integral part of the building. The net cost means the cost of the replacement less any amount received for the old item. See below for renewals of fixtures in unfurnished property.

Fixtures integral to the building are those which are not normally removed by either tenant or owner if the property is vacated or sold. For example, baths, washbasins, toilets, central heating installations. Expenditure on renewing such items is normally a revenue repair to the building. It is due even though the 10% wear and tear allowance has been deducted.

For that reason, a landlord cannot deduct the original cost of installing these fixtures or, theoretically at least, the extra cost of replacing a fixture with an improved version; for example, where a worn out but basic, cheap bathroom suite is replaced with an expensive, high quality suite they can only deduct the cost of replacing like with like.

Frequently, it is impossible to find the current cost of replacing an old asset with something identical. Common sense has to be used to find the cost of a reasonable equivalent modern replacement.

[Renewals: furnished & unfurnished property](#)

The cost of replacing machinery and plant supplied with the property can be claimed as an expense where neither the 10% wear and tear allowance nor machinery and plant capital allowances are claimed. This is called the 'renewals basis'. It is like the wear and tear allowance for furnished letting in that the renewals basis covers the same kind of assets; that is, free-standing movable machinery and plant assets like furniture, carpets, curtains, cookers, fridges etc, and as a separate matter, revenue relief may also be due for replacing fixtures in the same way as in the wear and tear case (see above).

The renewals allowance is also available for unfurnished property. Here we will mainly be concerned with fixtures, but the landlord may also provide some machinery and plant assets to the tenant (such as a heating boiler) although the let can't be regarded as 'furnished'. The landlord can claim a renewals deduction in the same way but they can't claim the 10% wear and tear allowance in such cases.

Whatever basis is chosen must be followed consistently. It isn't possible to chop and change between the wear and tear allowance and the renewals allowance from year to year.

What's your wife worth?

If you employ your spouse or partner the traditional view is that he or she should be paid the same amount as you would pay a third party at arm's length; anything higher may be challenged by HMRC and, if deemed excessive, can be disallowed for tax purposes. A recent divorce ruling and revelations about MPs' wives' salaries may challenge our perceptions as to what is normal or commercial, or fair.



A tax deductible payment is supposed to be “wholly and exclusively for the purposes of the (company's) trade”. If there is another purpose (either in addition or instead) then a tax deduction will not be allowable.”

The wife (or husband or partner's) “wages” debate is one that is ever topical, and by wages here we mean the whole remuneration package. In the notorious - and ongoing - case of *Jones v. Garnett*, Mrs Jones was paid something approaching the National Minimum Wage (NMW) for her services to her husband's company. Despite the fact that she was an experienced business manager, this was deemed by HMRC to be just fine! In other words, low pay is fine but high salaries are not acceptable!

Following requests under the Freedom of Information Act, it has recently been revealed that several MPs employ family members. One employs his son, who is a full time student, but still manages to put in sufficient hours, it seems, to warrant a salary of £950 per month from dad - coincidentally, probably just enough to see sonny-boy through Uni! Many more employ their wives (£28k to £35k p.a.), which mean that they also share in MPs' generous pension entitlements and other perks. The main criticism of these types of employees is that they do not actually put in the hours - pretty much the argument advanced against the self-employed by those other public servants at HMRC.

Back to mere mortals who are in business, and do actually employ the spouse, however. What rate of pay is “commercial” for a spouse these days? The findings within leading tax cases - there are not too many of them - are:

- Simply diverting income to (adult) children may be attacked (*Stott & Ingham v Trehearne*). In *Copeman v William Flood & Sons*, wages paid to a 17 year old daughter and a 24 year old son were reckoned to be excessive by the Revenue, but we never found out whether or not that was actually the case. That case confirms the principle that HMRC cannot interfere with the prerogative of the company to pay to its directors whatever it thinks fit, but they can find that sums so paid are not wholly and exclusively laid out for the purposes of the trade.
- As commonly happens, in *Moschi v Kelly*, Mr Moschi claimed a deduction in his accounts for wife's wages, but did not physically make payment and he was found to be a cheat (more serious than it sounds!). Since 1989, in order to qualify for a tax deduction, wages should be paid within nine months of the end of an accounting period. The solution - make sure you do actually make payment to the recipient and don't just expect us to deal with that matter.
- The most modern case on disallowed wages is *Earlspring Properties Ltd v Guest*. This has some rather odd twists. A woman was the sole director and owner of a close investment company and her husband made it into a trading company (thereby reducing the rate of Corporation Tax it suffered), by diverting some of his business' activities through hers, improving profitability dramatically. He was not employed by the wife's company nor she by his. The accountant appears to have decided what should be paid out of the wife's company as wages to her, based on the profits of the year. This meant that her remuneration in her company's accounts jumped from £1,000 in 1982, to £51,488 in 1983 and back to about £20,000 thereafter. The arrangement was reckoned to be “in part a diversion of income made to achieve a fiscal purpose” and the Commissioners disallowed all but 5% of the remuneration, as it appeared that the director's duties were “social”.

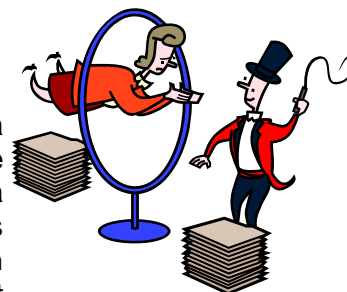
Recently, the divorce courts in *Charman v Charman* decided that the wife deserves 50% of her husband's wealth; this was because just being the spouse, irrespective of her involvement in the business, gives an expectation to share in the income created during a "high money" marriage. On this basis, any spouse is surely deserving of a fairly decent rate of pay if seeking employment from their spouse? This brings us back to the MPs' wives, they outwardly appear to qualify for a really good "spouse rate". So, how much is it acceptable for a spouse to be paid these days? Do you go for National Minimum Wage, or should you be thinking more on the scale of *Charman v. Charman* "rates"? MP's wives' rates might seem tempting, or possibly something in between is more reasonable? It's tricky, and given the extremes of modern society, working out what is excessive or non-commercial just seems to get harder and harder.

Our advice is:

- Establish a formula for payment based on responsibility taken, hours worked and the type of work actually completed. This may change during the month or year.
- Actually pay the weekly or monthly amount from the business bank account to an account in the name of the wife. It is wise to avoid a joint bank account in these circumstances.
- If the payments take the wife above the lower earnings limit for NIC or within the scope of income tax, then establish a PAYE scheme. This involves some administrative work, but it is better to be safe than sorry.

Obsession, passion and dedication

Yes, these sound like the names of perfumes but they are also some of Martha Lane Fox's tips for business success. She admits that the last 10 years since she co-founded the groundbreaking website *lastminute.com* have been a "rollercoaster". Launched at a time of huge interest in the internet and its possibilities, she later lived through the dark days of the dot com crash when her company's share price nosedived. But the company survived and in 2005 it was sold for £577m. She says there are four main principles she learned while building up her business.



1. Focus on your customer - "Regardless of whatever was happening in the business we tried all the time to be obsessive, passionate and dedicated to the customer" she says
2. Exploit modern marketing opportunities - Marketing is of course one of the most important areas of running a business and nowadays online marketing is the main driver. But Lane Fox says entrepreneurs should make sure they are using the internet for what it's best at: building networks and making sure other people spread the word for you. Back in 1997, the entrepreneur relates, offline word of mouth was still important. Things however have now changed. Think about how you get your product, service or content out through other people's networks. Let your customers talk about it, market it and spread it in their own way. It's not something that's easy to do or get right but it's very important. Even social networking options such as Facebook and MySpace can be important for some classes of business and online forums like UK Business Forums can be used by small businesses to get the word out.
3. Employ a good team - although entrepreneurs should be optimistic, expecting things will come good and that the product they're passionate about is something other people will become passionate about too, they should not do it blindly. Do not shut yourself off to other people's ideas, help and talents; you're only able to do so much as an individual. You can achieve so much more in a partnership and hiring really good people is critical. "Getting that talent can take you in completely new directions and speed up your journey in an exciting way." she points out.
4. Keep on fighting - Lane Fox worked with the late Anita Roddick on several occasions and she relates how one of the last things *The Body Shop* founder said to her before her untimely death was "keep on fighting, keep on fighting." If you're starting a new business it's definitely a bit of a fight, but most of us have an enormous amount of fun along the way.

Visit our website www.bhgroup.co.uk

An entertaining round up

When a company incurs entertaining expenditure what are the tax rules? Most people understand that client and customer entertaining is not allowed as a business deduction, but what about related expenditure such as travel, and what about staff entertaining, and those employees of your sister company? Does it make any difference if you split the bill?

Customers, clients and suppliers

This category includes any non staff related entertaining. Business entertaining is defined as including hospitality of any kind, provided by the company or an employee of the company in connection with the trade. Entertaining provided for bona fide employees is excluded from the ban unless the provision to those employees is incidental to the provision of entertaining to others.

So any entertaining provided for persons other than employees is specifically disallowed, and the costs relating to members of staff also attending would also be added back in the tax computation. In addition, one is required to rule out incidental costs such as travel and related accommodation. The travel of an employee to meet a client for lunch would, however, be allowed as the travel is not itself incidental to the entertaining - it relates to the need for the employee to meet the client. If the employee and client travel together then the cost becomes incidental to entertaining and disallowed!

The VAT treatment of such provision is also simple - all of the expenses of entertaining are VAT blocked, once again including the costs relating to members of staff attending as hosts or representatives of the company. However, the VAT disallowance does not include a parallel for incidental expenditure.

Gifts

A similar exclusion exists for the cost of providing gifts but a gift carrying a conspicuous advertisement for the donor, and which is not food drink or tobacco, or a token exchangeable for goods, and which costs no more than £50 in total in an accounting period (per recipient) is an allowable expense.

Here, the VAT rules differ quite significantly, as there is no requirement that the gifts carry an advertisement, nor is the restriction applying to food drink or tobacco relevant to VAT recovery. The financial value of VAT recoverable gifts is £50 a year per recipient also.

Gifts to employees are normally regarded as a benefit in kind; however, there is in practice an exemption relating to small gifts at Christmas, such as a turkey or bottle of wine.

Employee entertaining

Entertaining provided to employees is tax deductible, and any VAT incurred on it is also recoverable. This results from the exclusion of employee entertaining from the relevant legislation blocking deduction of entertaining expenditure. Both the direct tax and VAT provisions are very similar and thus the treatment is the same for both profit computation and VAT recovery. As the main expenditure is acceptable, clearly incidental expenditure will also be fine.

However, when individuals other than employees are invited to an event, this will cause a problem. Provided the purpose of the event remains to entertain staff, then the VAT can be apportioned. In addition, the treatment for direct tax also would permit apportionment provided that the expense is one which it is appropriate to apportion - that is, for example single ticket prices, for which an allowance is given for the number of tickets relating to staff members. The cost of entertaining staff is deductible provided it is wholly and exclusively for the purpose of the trade, and only incidental to any other business entertaining aspect.

“Staff” for these purposes include retired members of staff and the partners of existing and past employees, but not the staff of associated companies. In a partnership, the partners are not staff (obviously) so the element relating to the partners should also be disallowed - provided the wholly and exclusively rule is appropriately observed.



Benefits in kind

The treatment of the “annual Christmas party” or other annual event is well known. There is no benefit in kind on staff provided the average cost per head of the event (which is open to all staff, or all at a particular location) does not exceed £150. Where a party is organised on a departmental, rather than a whole company basis, the treatment is extended to include these events, provided that all staff are invited to one event.

The exemption relates only to an annual event, and not a one-off event, such as a party to celebrate gaining a major contract. If there are two or more annual parties or functions, then the £150 limit can be taken to apply to both. The average cost per head should be calculated separately, and if the total does not exceed £150, then none of the events will be taxable as a benefit in kind. The employer can choose which events are to be regarded as within the £150 limit when the limit is exceeded, so as to obtain the most beneficial result.

It is, however, possible that a benefit in kind charge can arise on entertaining expenditure already added back in the profit computation. An employee who is the beneficiary of “excessive” entertainment in the course of entertaining clients may be liable to tax on the benefit of that entertaining. This treatment is unusual, but should be borne in mind when considering employees with substantial entertaining “budgets”.

Commercial property allowances - get renovating!

The Business Premises Renovation Allowance was legislated for in the Finance Act 2005, before the last general election. However, it took a full five years to get the allowance past the scrutiny of the EU State Aid bods, so the allowance only went live on 11 April 2007.

On the basis that we have been waiting so long for this, some people may have forgotten that it is there - or at least what it was for, so we felt a summary of how it might be used would be useful. The policy objectives are to accelerate regeneration in the designated areas and to provide job - once the properties are brought back into use for business they will also provide employment.



The allowance provides a 100% initial capital allowance for expenditure laid out bringing empty commercial property in designated development areas back into use, either for owner occupation or letting, but not for the initial purchase price. If the claimant does not claim the full 100% in the first year, an allowance of 25% on cost (that is, on a straight line basis) will be available in subsequent years, until the full cost has been allowed.

The scheme is broadly similar in structure to the flat conversion allowance introduced in Finance Act 2001, but under this scheme the premises must be situated in a designated development area, and must be non residential premises which have been empty for at least 12 months when work starts.

The investor may rent out the premises or occupy them for the purpose of his trade, when complete but disposal within 7 years will produce a balancing adjustment, likely to claw back.

The allowance of 100% is available when the expenditure is incurred, but will be clawed back if the premises do not qualify on first use. To qualify, they must be used or let for use in a trade, profession or vocation, or as offices (but new limitations on some businesses were introduced in 2007). The building must not be used (or have been used) as a residence. Part buildings can also qualify for the allowance.

There is no doubt that this favourable relief, which is available for five years only, will be of interest to many property developers and investors.

Visit our website www.bhgroup.co.uk

Capital allowances on second hand property

Many businesses and investors are overpaying tax because of a failure to claim the tax allowances due on their property assets. Of course many investors rely on their accountants to deal with this, so whilst capital allowances should be an opportunity to save tax, failure to act may result in dissatisfied clients and, at worst, legal action.

The issue

Whereas property purchasers regard themselves as having simply acquired a building, in fact they have acquired not only bricks and mortar, but also the plant and machinery that it contains. This plant attracts tax relief in the form of capital allowances, whereas the structure of most buildings does not.

There is no set list of items qualifying for plant allowances, and what is appropriate for an office building may not be the same for a pub or nursing home, although some items would be common to all, such as heating, sanitary ware, etc.

Legislation requires the value of the plant to be determined by a 'just and reasonable apportionment' of the total purchase price between land, buildings and plant. This in turn requires the valuation of the bare site value, and a calculation of reconstruction cost estimates for both the building itself, and the plant within it.

This is evidently a complicated exercise, which explains the low take-up of this form of tax relief. There are a number of specialist firms which carry out this exercise, although as ever, some are better-qualified and have greater experience than others.

We repeatedly come across various 'traps' that can catch out the unwary purchaser, and have outlined the most common ones in this article.

Reliance on contract allocations

Contracts often include an amount allocated to 'fixtures', generally for Stamp Duty Land Tax purposes. It is commonly thought that this same allocation is used for claiming capital allowances but in most cases it has no bearing on the true value of the allowances available. Reliance on contract allocations can give rise to a number of potential traps:

- contract allocations are not binding on HM Revenue & Customs, so a claim based on such allocation may be challenged
- allocations are generally very low. Typically, the true amount qualifying for capital allowances is up to ten times the contract allocation
- allocations to 'fixtures' commonly include assets such as furniture, which are not fixtures at all. For capital allowances, it is important to separately identify fixtures and movable plant, and apply the correct tax treatment to each.

Example

XYZ bought an office building for £1m, under a contract which allocated £12,000 to fixtures and fittings. XYZ was initially advised that having this figure in the agreement would prevent any further claims. However, a specialist exercise identified further plant to the value of £288,000 - saving the client income tax of over £100,000.

Vendors 'selling' allowances

Sometimes, vendors offer to 'sell' the tax allowances for additional consideration. Commonly, such an offer is made late in the sale process, when the purchaser feels unable or unwilling to pull out. The default position in many scenarios is that allowances transfer automatically, so the purchaser is in effect being asked to pay for something which he would otherwise get for nothing.



Valuing allowances

Sometimes, when such an offer is made, the purchaser may make a commercial decision to 'buy' the allowances. However, it is worth taking independent advice on the value of these allowances, rather than just accepting the vendor's valuation. A common problem is that the vendor's claim was itself inadequate, and in such cases, the purchaser is well advised to establish his own claim, rather than simply 'inherit' the vendor's inadequate one.

Transfer at tax written-down value

Sometimes the vendor will offer to transfer the allowances at tax written-down value, claiming that this is 'fair' to both parties. Their rationale is that it is only fair for them to retain the allowances that accrued during their ownership, and for the purchaser to have the allowances that accrue during its ownership.

In fact, if the property is being sold at a profit, transferring the allowances at written-down value is inherently unfair, as demonstrated.

Example

ABC bought a property for £1m, and claimed allowances on fixtures of £250,000. After six years, their written-down value was £45,000. ABC then sold the property to DEF for £2m and proposed transferring the plant at written-down value. The effect of the proposal is that ABC makes a profit of £1m, and has had tax relief on £205,000. DEF can only claim allowances on £45,000.

Ignoring the proposal, the default position would be that ABC would account for a disposal value of fixtures limited to original cost (i.e. £250,000) and DEF would claim allowances on the same amount. So, if DEF agrees to ABC's proposal, it will effectively cost up to £82,000, depending on DEF's rate of tax.

Elections to transfer allowances

As an alternative to the apportionment procedure described above, vendor and purchaser can make a joint election to transfer fixtures for an agreed amount, which is also binding on the Revenue. This seems an attractive alternative, because the amount qualifying for capital allowances can be determined without the need to incur fees on a specialist exercise.

However, all too often, purchasers sign these elections without really understanding what they are, and in particular without appreciating that they could be signing away thousands of pounds of tax relief. In most cases, purchasers will get a better result using an apportionment, with the cost of employing specialists covered many times over by the extra tax savings.

Such elections can only cover fixtures, and furthermore can only cover assets for which the vendor has claimed allowances. Many elections purport to fix the transfer value of chattels, or of assets where no claim has been made by the vendor, and are therefore invalid.

Failure to answer pre-contract enquiries

The purchaser's solicitor should always ask about capital allowances; the Commercial Property Standard Enquiries form (CPSE 1) includes a section devoted to the subject - these questions are obviously there for a reason. However, complete and adequate replies are rarely given. For example, the question which asks whether the vendor owned the property on capital or trading account, is commonly answered 'not applicable'! Other common replies include 'don't know' and 'accountant to advise'.

The purchaser and his solicitor should insist on proper replies being given to all enquiries, to do otherwise is tantamount to negligence.

Conclusion

Falling into any of these 'traps' could cost the purchaser dearly. Specialist advice should always be sought when buying commercial property, ideally before the transaction completes. However, capital allowances claims can often be made retrospectively, in which case tax savings and repayments can be an unexpected windfall for the purchaser. If you believe that you or any of your clients may have overlooked to claim allowances which are available, we shall be pleased to assist you.

Remittance Basis - Non-Domiciles

The following changes are proposed from 6 April 2008:

- Resident non-domiciles who have been in the UK for longer than seven out of the past ten years will only be able to access the remittance basis of taxation on payment of an annual charge of £30,000, unless their unremitted foreign income or gains are less than £1,000;
- People who use the remittance basis of taxation will no longer be entitled to income tax personal allowances. Again, people with small amounts of foreign income will be exempt;
- The Government will introduce changes to the residence rules so that days of arrival in and departure from the UK will count toward establishing residence. This brings the UK into line with international practice; and
- The Government will amend the current rules to remove flaws and anomalies that allow individuals using the remittance basis of taxation to sidestep UK tax, where it is due on foreign income and gains.

The Government also announced that it will consult on the detail of the above proposals before the changes are introduced to ensure non-domiciles pay their fair share of UK tax.

There will also be consultation on other potential changes including whether people who have been resident in the UK for longer than ten years should make a greater contribution.

There is a current restriction on the remittance basis and its application to Irish source income in that the remittance basis does not apply (even if non UK domiciled) to either investment or employment income earned in Ireland, which is currently charged to tax on the arising basis. From 6 April 2008 the restrictions are to be removed so that the rules apply equally to all income regardless of the country of origin



Visit our website www.bhgroup.co.uk

B H G Chartered Accountants
Bernard Harrington BCom(Acc) FCA FCCA
B H Group Limited
Blandford House
77 Shrivenham Hundred Business Park
Majors Road, Watchfield, Swindon,
SN6 8TY
t: 01793 780480
f: 01793 780180
bernard.harrington@bharrington.co.uk
www.bhgroup.co.uk

Registered to carry on audit work and regulated for a range of investment business activities by the Institute of Chartered Accountants in England and Wales

Newsletter Content

This newsletter deals with a number of topics which, it is hoped, will be of general interest to clients. However, in the space available it is impossible to mention all the points which may be relevant in individual cases, so please contact us for personal advice on your own affairs.

Disclaimer

This update is provided without charge and no responsibility can be accepted for action taken or not taken as a result of its contents. Formal advice will be provided on request under terms that will be agreed in advance.

straightforward

Like you, we're straightforward people. We give you straight advice, you take your business forward. No nonsense. Straightforward isn't it?