

Bernard Harrington and Company

Business Intelligence

moving forward with you

Issue 17 August 2004

New man at the crease

In recent years, we have been fortunate enough to experience continued growth in our services to individuals and businesses in financial difficulty. This niche specialisation has had the advantage of developing our ability to spot the warning signs and coach some of our clients to manage their businesses more effectively, returning them to profitability and stability. We pride ourselves on the unusually low failure rate amongst our clients – or maybe that should be the unusually high success rate!



In response to this, we are proud to announce the appointment of Alex Twitchen as a potential partner specialising in insolvency and business recovery. Alex's appointment will allow Bernard to devote his time fully to our thriving owner managed business sector and our bloodstock specialism.

Alex joins us from a London firm and was attracted to us by the firm's modern, enthusiastic and client-focused culture. His skills complement our existing range of services and will allow us to enhance the breadth and quality of service offered to all clients!

Alex, pictured with Bernard, is a keen cricketer and, at 6' 5", has the ideal build for a medium pace bowler. As the years go by, we hope his sporting prowess will improve our collective golf skills.

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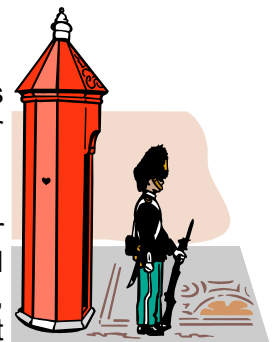
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Small firms failing internet security checks

According to research carried out in winter 2003 amongst 500 European companies with fewer than 20 employees, cybercrime is costing Europe's small firms £14bn a year in clean up and recovery costs.

The survey found that viruses can cause a company's computers to be out of action for days and costs on average €5000 to clean. Many of the small businesses questioned were ignorant of the latest techniques used to protect machines from malicious attacks, and as a result few had firewalls, anti-spam software and virus cleaning software. Just over 20% questioned said they had to close their offices to cope with a virus outbreak and, in the last year, 40% of UK small businesses were infected by a virus.



If you are worried about the risk of viruses or other hazards to the integrity of your computer systems, please call Steve Griffiths for a "without obligation" discussion of the measures you can take to protect your business.

straightforward

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

Why you need a pre-nuptial agreement

Lawyers expect pre-nuptial agreements to become legally binding after two high-profile divorce cases raised the amount that high earners may have to pay to their former spouses.



Readers will have heard of the case involving Ray Parlour, the Arsenal footballer, who was ordered to pay his former wife about 37% of his annual income for the next four years. She will get £444,000 a year for herself and the couple's three children. Previously she had been awarded £250,000. However, her lawyers argued she was entitled to a more equal share because she had rescued her former husband from alcoholism and enabled him to pursue a successful career. The award is in addition to a capital split where again she received about 37% of the family assets. This and a similar less high profile case are ground-breaking decisions for high earners. They will either act as a disincentive for wealthy people to marry, or they will boost the popularity of pre-marital agreements. Such agreements are already legally binding in America and some European countries, and they are likely to become so here. The government has already signalled that it is willing to boost the legal status of pre-nuptial agreements.

Here, we answer your questions on the implications of the divorce cases.

Why are they so significant?

Traditionally, former wives were awarded enough money to meet their "reasonable needs" – usually the family home plus an annual maintenance payment – regardless of the husband's income or capital.

About four years ago, however, there was a landmark ruling in the case of a couple, who had built up a successful farming business over 33 years together. Although the wife was a partner in the business, her contribution had been primarily as a wife and mother. However, she successfully claimed that she was entitled to an equal share of the farming business. The case enshrined the principle of fairness when dividing up a couple's assets. The Parlour case, by contrast, has established, for the first time, the principle of fairness when dividing up income. The amount required to meet Mrs Parlour's "needs" (about 12% of the couple's net income) was found to be £150,000. Her lawyers argued, successfully, that she was entitled to a more equal share, regardless of her needs.

Who will be affected?

High earners whose incomes are far in excess of their former spouse's "reasonable needs" should in future expect to pay out a greater share of their income. Lawyers also point out that the award was so big in the Parlour case because they did not have sufficient assets that could have been passed to the wife to produce an income.

Will high earners have to pay more indefinitely?

In Parlour's case, for example, the courts will review the position in four years in the light of his earning capacity and his former wife's position. His ex-wife is expected to save her "surplus" income so that she becomes self-sufficient. This should mean a drop in the maintenance payments, everything else being equal.

Can high earners protect their income and assets?

Pre-nuptial agreements set out how a couple would wish to apportion their wealth should they divorce. They are not a watertight measure because the courts can, at present, disregard them. But, to date, judges have shown a willingness to follow their guidelines.

You should bear in mind that a pre-nuptial agreement could be disregarded once you have children. The needs of children are the overriding concern of the courts and judges will never allow anything adverse to happen to the children because of terms set out in the pre-nuptial agreement. If such agreements were to become legally binding, lawyers could be expected to recommend that they are updated to take into account the needs of the children. If you own a business with your spouse, consider a shareholders agreement. This will set out the principles governing ownership of the business in commercial terms and will be less easy to manipulate in the divorce courts.

We also recommend that you keep some assets in sole names, particularly if they have been inherited; the courts will not automatically ring-fence these assets, but sole ownership does provide evidence of your intentions throughout the marriage.

Disability discrimination: caution for SMEs

A recent court ruling regarding discrimination against disability could pave the way for a torrent of unfair dismissal claims. The ruling was passed in favour of a Scottish road sweeper who was dismissed due to a physical disability. In view of the fact that the Disability Discrimination Act 1995 (DDA) will shortly apply to all employers, this ruling comes as a timely reminder to all companies, especially SMEs, of the risks involved in ending workers' contracts due to disability.



In the case of *Archibald v Fife Council*, a Mrs Archibald became unable to walk and therefore unable to sweep roads. Fife Council decided her disability was such that they could not make any 'reasonable adjustments' to help her with her road sweeping duties, and so interviewed her for a more sedentary post. She was not successful; the Council appointed a more 'qualified' individual and subsequently dismissed Mrs Archibald.

Appealing on the grounds of being 'disabled' within the meaning of the DDA 1995, Mrs Archibald argued that her employer, Fife Council, had not made 'reasonable adjustments' to prevent her from being 'disadvantaged in comparison with persons who were not disabled'. In this landmark case, the House of Lords found in favour of the employee.

The implications of this decision are potentially very far reaching. Employers seeking to terminate the employment of any member of staff who becomes disabled and consequently unable to perform their duties will need to act extremely carefully, especially if there are other roles vacant within the organisation that the employee might be able to fill. Otherwise they will face claims of discrimination and unfair dismissal before Employment Tribunals where the potential damages available to successful applicants will be unlimited.

Preventative measures are advisable, to avoid a conflict arising. A properly worded contract of employment and a clear disciplinary and grievance procedure can prevent matters escalating. From October this year all employers will be expected to have such processes in place and failure to do so may lead to further financial penalties being imposed in the event of Tribunal proceedings.

Mileage allowance and VAT recovery

If – as is increasingly common - an employer is paying his employees a mileage rate of 40p per mile, can he reclaim any input VAT on this gross amount? Yes, is the answer, but only on the fuel element. The rate of 40p (or any other reasonable rate) effectively reimburses the claimant for all costs of travelling a mile, including depreciation, insurance and servicing costs. We recommend that you use something close to the Inland Revenue "fuel only" mileage rates on which the VAT element would be as follows:



Engine size	Petrol Per Mile	Per mile VAT	Diesel Per mile	Diesel VAT
1400cc or less	10p	1.489p	9p	1.340p
1401 to 2000cc	12p	1.787p	9p	1.340p
Over 2000cc	14p	2.085p	12p	1.787p

Of course, most employers pay the same rate irrespective of engine size which could be a justification for using the highest rates – particularly as they date back to 2002 fuel prices!

If you take advantage of the additional 5p per mile for passengers, we would recommend you claim an extra 0.745 pence per mile – fuel consumption is closely related to weight carried, whilst depreciation is not of course.

Espana por favor!

A holiday home in Spain might be your dream, but it can also turn into a nightmare if you are not careful. Buying the wrong property next to noisy neighbours, a high maintenance building or a property that loses its value or can not be let are all possibilities - but ones that can be avoided with planning and research. Don't be rushed into a purchase either! Understanding the costs and commitment of your property is crucial if you want to succeed in finding your dream home and ending up with a valuable asset - rather than a millstone around your neck!



Here are our 6 top tips for successful buying in Spain:

- 1) Do your homework first! Don't go to Spain without knowing how the buying system works. You'll need to know how much you can borrow or spend and preferably have a mortgage agreed in principle. You will probably not be able to borrow over 75% of the purchase price.
- 2) Don't buy the first property that you see! Even if you fall in love with a property right away, make a few visits if possible before you buy. Visit at night and in the morning for nightlife and traffic. Also, try to imagine what the house would be like at the height of the summer!
- 3) Look to buy in Spring - certainly before July when the hoards arrive - or after the summer rush.
- 4) If buying in a traditionally Spanish area (e.g. Barcelona, Madrid, Valencia) it might be worth renting for a while first - as these areas are unlikely to see massive price growth and you might as well take your time to get to know the area.
- 5) Understand the full costs of buying and maintaining your property before you sign anything. Stamp duties and other costs are generally about 10% of the property cost.
- 6) Use an English speaking lawyer to check your purchase contract.

More and more people are enjoying Spain as Europe's 'Californian Coast' - and the migration of 'sun poor' Europeans is getting faster every year. Here are three reasons why you might want to get a move on:

- 1) Prices are expected to continue to rise - Spanish property is still cheap relative to most north European cities - the euro makes it easy to see the 'cheapness' of Spanish property and also removes the currency risk for many European buyers.
- 2) Communications - more and more working people are based in Spain, either commuting back to northern Europe or running their businesses via the internet or by phone.
- 3) Currency - sterling is around the middle of the band in which it is expected to float against the euro, so now is probably a fairly good time to buy if you are transferring cash or deposits from sterling to euros.

In summary, if you are thinking about a dream home in Spain, get on with it! However, it's important to do your research and get it right.

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A lesson in Chinese

There is a character in the Chinese language made up of 2 parts: the upper part translates to “**OPPORTUNITY**” and the lower part to “**DANGER**”. When put together they translate to “**TURNING POINT**”. In the SME sector, businesses pass through turning points far more frequently than in the corporate sector, so recognising them and doing the right thing at the right time is a critical skill.



Small and medium size enterprises are generally busy doing the thing they do best - plying their trade or profession. Change rarely arrives announced. Evolution, not revolution, is the natural order. It is a creeping progressive thing.

It's a bit like the frog in the saucepan. If you put a frog into very hot water it immediately leaps out in order to save its own life. However, if you put the same frog into cold water and heat it slowly the frog will remain placid and simply boil to death.

Many businesses are not much smarter than the frog. When things change almost imperceptibly, day by day, what is the stimulus to act today when you didn't act yesterday. There's always tomorrow.



If this example has focussed on the “**DANGER**” side of our “**TURNING POINT**” character, the same is equally true of the “**OPPORTUNITY**” side. Like the frog, when things change almost imperceptibly, day by day, what is the stimulus to act today when you didn't act yesterday.....there's always tomorrow, isn't there?

If you can see that this approach means you fail to exploit opportunities, you have the right mindset. The next stage is developing a strategic plan - and that's where we come in to help you.

Unprepared, uninformed and unsure of success

First time entrepreneurs are continuing to make the same mistakes and begin in business with little or no adequate training or planning, according to a recent report. The report includes entrepreneurs' views on a range of subjects linked to the risks involved in starting up a business venture. Perhaps most surprising was the price entrepreneurs were willing to pay in pursuit of their business dream:



- 11% said they would risk their relationship with their partner
- 26% were prepared to get into heavy debt
- 30% were willing to risk losing all their savings
- A small number, 4%, were even willing to pay the ultimate price and risk their health.

Insufficient planning obviously increases the chances of a business failing and 29% of respondents felt they were unprepared before they started their own business, with a further 8% suggesting they were 'very unprepared' before opening the doors for trading. With such a large number realising they were unprepared it is perhaps no surprise that 42% of all respondents gave 'fear of job insecurity' as the biggest barrier to starting a business in the first place. With just under 380,000 businesses closing in 2003 alone, the research revealed a worrying statistic, 98% of respondents had never undertaken any business training before starting up in business. Despite the stress and risks involved, being a successful entrepreneur still has numerous benefits:

- 75% of respondents suggesting that being your own boss is the number one reason for running your own business.
- followed by 17% enjoying the greater work-life balance it gave; and
- lastly 7% of respondents citing the share of the profits it gave them.

We recommend that entrepreneurs do not 'risk it all', but rather invest in business training early on. The relatively small costs involved in undertaking business training could prove to be critical in saving a business in the long run. Through government initiatives, business training is now easily accessible in areas such as financial planning, IT, compliance issues and sales and marketing. Call us for more information. Although we do not provide training directly, we “know a man who can”.

Should you be stopping pension contributions?

Believe it or not, for some, the best way to protect their pension pot may soon be to stop making contributions. The Chancellor has announced that simplification of pension taxation and regulation will start from 6 April 2006. With it comes a lifetime limit on pension funds, initially set at £1.5 million, increasing to £1.8 million in 2010. This limit – and the annual contribution limit, initially set at £215,000 – will be reviewed every five years.



Those with pension funds in excess of the fund limit when the new rules start will be able to ring-fence their funds, to protect themselves from the tax charges on funds in excess of the new limit. This means that these funds will not be subject to the lifetime limit and if the tax-free cash to which they are presently entitled is greater than 25% of the fund, that right is carried forward. For example, the amount of tax-free cash that can be taken from a company pension scheme is based on a multiple of salary, rather than a maximum of 25% of the fund.

A punitive tax charge will be applied on funds in excess of the limit applying at the date of retirement which may mean that those with funds currently less than the lifetime limit should also ring-fence funds and make no further contributions.

With the lifetime limit rising with inflation and funds (hopefully) growing at a faster rate, there could be many cases where funds below the initial £1.5 million level will breach the lifetime limit by the time the plan holders come to retire.

For example a person with 10 years to go to retirement at April 2006 might expect the lifetime limit to be just over £2 million by the time they retire. However, if their fund is currently just over £1 million – well short of the current lifetime limit a net fund growth rate of 7% p.a. could easily result in the lifetime limit being breached. The result of this will be that if tax free cash is taken in excess of 25% of the then current lifetime limit tax will be charged at a rate of 55% on the excess.

A major additional consideration is that all funds must be revalued as at 6 April 2006. Where property is currently undervalued, for whatever reason, or equities bounce back at a faster rate than anticipated, this will clearly impact on the fund value.

On the other hand, in some cases continuing with contributions could make sense, even though the 55% tax will apply to any excess over the indexed lifetime limit. This will probably only be the case where the contributing company pays corporation tax at 30% (or more).

Questions to ask yourself:

- Is my fund likely to exceed the lifetime limit, by the time I retire?
- If it will, am I prepared to pay 55% tax on the balance over the then current limit?
- Have I additional ways of providing for retirement, that allow me to stop making additional contributions now?

If so, stopping making contributions just before 5 April 2006 could be an option for you. We are happy to advise any reader on their individual circumstances.

Small business rates to be reduced at last

Proposals to ease one of the burdens on small business by introducing relief from business rates have been announced. The plans were originally mooted in 2001 and will only come into force on 1 April 2005. Under the new scheme, we will see rate relief available at 50 per cent for business properties with a rateable value of £5,000. The relief will decline on a sliding scale as rateable value increases, reaching no relief at a rateable value of £10,000. A buffer zone for small businesses with an rateable value of between £10,000 and £15,000 will also be introduced, but it is not yet clear how relief will be available for those in the buffer zone.



Whilst undoubtedly good news, the average business ratepayer will still lose out, with recent research suggesting that the average RV for a small business is £15,375! In other words, just too much to qualify for assistance.

Casual labour

We are often asked how one should deal with casual labour, for example casual waiting staff in restaurants. This is an aspect of tax regulation which is always of interest to PAYE inspectors and failure to comply with what are often seen as tiresome complications can prove costly.



Basically, the rule is that for students working in their school/college holidays (but not outside of those dates) you can ask them to complete form P38S, which is a declaration that earnings will be below tax limit in year and therefore no tax/NIC liability arises. This form only applies to students working in their holidays and does not apply to people who are occasional employees. It should be retained by the employer. Otherwise, all employees should be asked to complete a P46 if no P45 is produced and the appropriate procedure used depending on which part of the form is signed.

One of the problems of labelling staff as casual is that you can forget that they may qualify as workers and with that comes a whole plethora of rules and regulations such as minimum wage, paid holidays and rest breaks.

Late-payment interest rise

Business owners are reminded that the amount of late-payment interest they can charge rose on July 1 in line with the last increase in the Bank of England base rate. Late-payment legislation allows businesses to claim interest on overdue commercial debts. Interest is accrued on a daily basis until a late invoice is paid. Although firms do not have to charge, those that do should calculate it according to the Bank of England base rate plus 8 per cent. The base rate increased from 4.25 per cent to 4.5 per cent at the beginning of August, meaning that the late-payment interest rate will increase to 12.5 per cent.



Late-payment interest rates are set every six months —from July 1 to December 31 and January 1 to June 30. Compensation of up to £100 can also be claimed to wards debt collection costs in certain circumstances.

Care with insurance

If an employee is using his own car for business journeys, be sure that he is properly insured for business trips. Very often, when the police ask you to produce insurance documents, they are more concerned to check the purpose of the journey and that the cover held is actually adequate. The risk is that if you are using a private car on business and have an accident, you could find not only that the damage is not covered but that you are also prosecuted for driving without insurance. Employers who require employees to drive their own cars on business without alerting those employees to the risks could be considered partly liable.



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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.

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