

the bottom line

Welcome to the Winter edition of "the bottom line" our taxation and accountancy newsletter. This edition covers the Pre Budget Statement, Taxation of husband and wife companies and partnerships and News in Brief.

Pre Budget Statement

The Chancellor Gordon Brown presented his Pre-Budget Report on Thursday 2 December. The speech itself appeared short in content but as ever, the devil was in the detail of the accompanying Press Releases and other documents. In particular, corporation tax reform was the subject of a detailed technical note. In addition there will be consultation on a single tax return to bring together all small business taxes. One announcement which has caused controversy is the possibility of retrospective legislation being used in the future to block tax schemes. Our summary covers this and a raft of other measures announced in the speech.

PERSONAL TAXATION

Allowances

The Chancellor confirmed the level of income tax allowances for 2005/06. The personal allowance for those aged under 65 is increased in line with inflation to £4,895 for 2005/06. Personal allowances for those aged 65 and over will be increased in line with earnings.

Child Tax Credit & Working Tax Credit

The Child Tax Credit which is means tested is potentially available to families who have responsibility for one or more children. There are several elements to the credit but broadly the maximum for 2005/06 is £1,690 per child together with a family element of £545 per annum. Some credit is likely to be due for 2005/06 if a family's income is less than £58,175 a year, or £66,350 if there is a child under one year old. The Working Tax credit is also increased.

Child Trust Fund

The Child Trust Fund (CTF) is being introduced for all children born from September 2002. The government will provide an initial award of £250 (£500 for children from low-income families who also qualify for full Child Tax Credit). A child will be eligible if Child Benefit has been awarded for them and they are living in the UK. If these conditions are met the award is made automatically with no need for a separate application. Vouchers will be sent to the Child Benefit claimant and should be used

to open a CTF account when they become available in 2005. A further payment will be made to every child for its seventh birthday. Family and friends of the child can make additional contributions of up to £1,200 a year between them. The income and gains in the CTF will be tax free and may be accessed by the child at age 18.

Civil Partnership Act

The Civil Partnership Act which gives legal recognition to same-sex couples received Royal Assent in November. However the Act is not likely to come into effect for about a year. The Act will allow same-sex couples to make a formal legal commitment to each other by entering into a civil partnership through a registration process. The Pre-Budget Report confirms that the tax consequences of the Civil Partnership Act will be dealt with in the 'first available' Finance Bill. For tax purposes, registered same-sex couples will be treated in the same way as married couples.

Pensions Earnings Cap

With effect from 5 April 2005 the earnings cap is increased to £105,600. In addition the limits on final remuneration imposed on members of company schemes is increased to be aligned with this figure.

Individual Savings Accounts

The annual investment limits of £7,000 and £3,000 which were due expire on 5 April 2006 are to be extended to 5 April 2009.

Charitable giving

In order to encourage more charitable giving, some of the current rules for Payroll Giving and Gift Aid are to be relaxed.

EMPLOYMENT ISSUES

National Insurance Contributions

For 2005/06 although the rates with the exception of Class 2 and 3 remain the same, thresholds are all increased.

Childcare

As announced in the 2003 Pre budget statement, with effect from April 2005, the first £50 of employer childcare vouchers or provision will be tax and national insurance free. Further measures are to be introduced including:

- A 10 year strategy setting out the Government's vision of providing quality childcare.
- An extension of paid maternity and paternity leave.
- The right to transfer a proportion of maternity leave to the father.

Company Car Tax

Currently the car benefit is calculated by reference to the level of CO2 emissions. This has the effect of making Diesel powered cars more popular with company car drivers despite a 3% surcharge which is applied if a diesel car does not comply with cleaner Euro VI standards. With effect from 6 April 2006 this surcharge will be removed for vehicles registered after 1 January 2006. The surcharge will continue on cars registered previously.

BUSINESS AND CORPORATION TAX

A Technical Note takes forward the government's commitment in this year's Budget to publish further legislative proposals on the reform of corporation tax. The note covers topics addressed in previous consultation documents namely:

- the reform of the schedular system for companies
- the tax treatment of capital assets
- the taxation of leasing transactions
- the tax differences between trading and investment companies.

New small business unit at HM Revenue and Customs

A Bill which will provide the authority to integrate the Inland Revenue and HM Customs & Excise and create HM Revenue and Customs (HMRC) has been introduced to Parliament. Details of a new small business unit of HMRC have been announced. It will be charged with improving customer experience and compliance as well as reducing costs for both businesses and HMRC. The long term goal for HMRC is to enable its support and compliance staff to take a 'whole view' of each customer, by providing:

- joined-up systems so that a business needs to provide information only once, where possible through a single form
- integrated audits covering direct and indirect taxes

- a single account through which all payments and repayments may be made.

As a first step the Inland Revenue and Customs and Excise will now begin consulting on the scope for a single tax return that would bring together all small business taxes.

Proposed Business Premises Renovation Allowance (BPRA)

In their aim to raise investment in Enterprise Areas the government has issued a consultation document in respect of a BPRA scheme. This scheme would provide 100% first-year capital allowances for costs of converting or renovating business property in Enterprise Areas.

Small businesses – discussion paper

In the recent past the Chancellor has hinted that he will look at the differences in the tax treatment between small businesses that chose to operate through sole trader, partnership or corporate structures. Earlier this year the government introduced the much publicised 19% minimum rate of corporation tax on profits distributed to non-corporate shareholders. In the government's words this was to address its 'concerns about the increasing numbers of self-employed individuals adopting the corporate legal form for tax reasons rather than as a step to growth'. The government intends to monitor this area to ensure that its objectives for the tax system continue to be met. A discussion paper has now been issued and invites comments on the strategic development of the personal and corporation tax regimes as they relate to businesses.

Anti-avoidance measures

A number of measures have been announced aimed at tackling fraud and avoidance. Some of these measures arise from the disclosure of tax scheme rules introduced in Finance Act 2004 to provide early warning to the Inland Revenue and Customs and Excise of schemes. In addition, the Paymaster

General has announced that retrospective legislation may be used to stop other tax schemes arising in the future which attempt to avoid rewards to employees being taxed. When the government becomes aware of such arrangements, it will introduce legislation to close them down, effective if necessary from 2 December 2004.

Property Investment Funds

Following consultation, the government continues to believe that tax reform in this area has the potential to improve the efficiency of the property market. However there will not be legislation in 2005 but a discussion paper will be issued.

Taxation of Husband and Wife Companies and Partnerships

Many of you are aware that the Inland Revenue have been unhappy in the way some husband and wife businesses have been sharing profits/dividends. They believe that often the arrangements are driven almost exclusively by tax avoidance motives.

One of the weapons the Inland Revenue are using to attack such situations is the settlements legislation. Opinions are divided on the correctness of their interpretation and a recent test case before the Special Commissioners has done little to clarify the position. The two Commissioners managed to disagree on virtually every point at issue and although technically the Revenue won the case on a casting vote by the presiding Commissioner no firm general conclusions can be drawn.

By way of background the case concerned an information technology company (Arctic Systems) where both husband and wife (Mr and Mrs Jones) initially subscribed for shares in the company when it was formed but Mr Jones did most of the work in the company. Mr Jones was a director and Mrs

Jones the company secretary. The company employed no one other than Mr and Mrs Jones. The company's profits were paid out to the couple partly as salary but mainly as dividends in order to optimise the tax position of the couple. The Inland Revenue sought to tax the wife's dividend as income in the husband's hands and thereby collect some extra tax.

The taxpayers, supported by the Professional Contractors Group, have confirmed that they will appeal the decision to the High Court and we expect the case to be heard in Spring 2005. In the meantime the Revenue has issued some guidance on the approach to be taken when completing 2003/04 personal tax returns for individuals potentially affected by the case. As you are aware the deadline for submission of 2003/04 returns is 31 January 2005. Having reviewed the guidance our view is that it is wise to complete your tax returns in the same way as always and consider the position again once the High Court case has been heard.

However, there are a number of alternative ways of dealing with the situation.

- Complete your returns on the basis that you agree with the Inland Revenue's view on this matter i.e. accept the decision in the Arctic Systems case so far. This will draw immediate attention in respect of earlier years.
- Complete your returns and put on them that you do not accept the Inland Revenue's view but this will also draw immediate attention for both the current and earlier years.
- Make a full disclosure of information for the current year (such as business accounts and computations, a summary of how the business operates and in particular what is done by each of you in running the business) but this only protects the current year and draws attention to the position for earlier years.

We do not feel that any of these approaches is currently necessary or indeed attractive.

Clearly the continuing uncertainty surrounding this case is unsatisfactory and future editions of "the bottom line" will keep you updated on developments.

NEWS IN BRIEF

Pensions simplification

Further to our Summer Newsletter we would remind readers that the Pensions simplifications legislation is due to come into effect on 6 April 2006. We therefore recommend that your existing arrangements are reviewed as soon as possible to ensure that appropriate action is taken before April.

Increased Annual Return Fees

Companies House are to increase the annual return filing fee for non-electronically filed returns from £15 to £30. We have already written to all clients for whom we deal with Company Secretarial services as we are introducing an electronic lodgement service. If you

have not already done so please return your authorisation as soon as possible, as this initiative will now result in a financial saving for you. If we do not currently act for you in Company Secretarial matters but you would like us to do so, please contact us.

International Accounting Standards (IAS's)

International Accounting Standards are to become compulsory for all UK quoted companies for accounting periods beginning on or after 1 January 2005, as a result of EU regulation. The DTI have announced that unquoted companies have the option to adopt IAS's rather than applying UK generally accepted accounting practice (GAAP). UK subsidiaries of overseas parents may have pressure put on them

by their parent companies to adopt them. Other unquoted companies will have to decide whether the usefulness of having accounts which are comparable with companies adopting IAS's is outweighed by the costs of compliance and the impact on distributable profits and taxation.

International Auditing Standards (ISA's)

With effect for accounting periods commencing on or after 15 December 2004 new International Auditing Standards are in place for the audit of all businesses. The practical effect of the adoption of ISA's throughout Europe will mean that entities are subject to the same standards of audit no matter where they are located or where the audit takes place.

Greenback Alan News

As mentioned in our Autumn Newsletter we did not send Christmas Cards last year. Instead we chose to make a contribution of the costs to various Charities. We invited your suggestions for suitable organisations and we are delighted to announce that

the donation was split between Leukaemia Research Fund, Meningitis Research Foundation, Theatre for a Change and Mind (Kensington and Chelsea).



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