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# INSIGHT

## Hung out to dry

A regular feature of early summer in Parliament would normally be the annual Finance Bill debates. However, summer 2010 is shaping up to be rather different. Instead, an early Finance Act 2010 received Royal Assent on 8 April (with no debate) before preparations for the General Election got underway. Whilst certain proposals contained in the 2009 Pre-Budget and 2010 Budget reports were included, others were not introduced. Rather, the 2010 Budget notes often stated the following 'the government intends to legislate this measure in a Finance Bill to be introduced as soon as possible in the next Parliament'.

The General Election outcome could be compared to a colourful mixed hanging basket as no one party obtained majority power. A second 2010 Budget is now expected following the resulting Conservative-Liberal Democrat coalition. This means that some of the earlier proposals of the previous government may wither as other tax proposals and policies are put on display. The precise nature and effective operational date of any new tax law remains 'hung' until that second Budget is not only presented but also proceeds through the parliamentary process to become a second Finance Act 2010.

We will keep you informed of developments as they unfold but please contact us if there are any issues you wish to discuss.

## SUMMER 2010

## Making every £ count

Since April 2008 most businesses, regardless of size, have been able to claim an Annual Investment Allowance (AIA) of up to £50,000 each year on qualifying plant and machinery. This includes expenditure on commercial vehicles (not cars) and may also apply to replacement expenditure on certain fixtures in buildings (integral features), such as air conditioning and rewiring, where more than 50% in cost terms of the asset is replaced.

The AIA has now been increased from £50,000 to £100,000 in the Finance Act 2010. This will be extremely valuable for larger businesses and some smaller plant intensive operations.

The increase will have effect for expenditure incurred from 1 April 2010 for companies and from 6 April 2010 for the self-employed in business.

### It's all a question of timing

Many businesses will have a chargeable period that spans 1 or 6 April, so the AIA will have to be calculated pro rata for the period before and after the increase. For a company that prepares its accounts for the year ended 31 December 2010, the maximum AIA available for the period overall would be £87,500. This is computed as  $3/12 \times £50,000$  (£12,500) +  $9/12 \times £100,000$  (£75,000).

To ensure the full potential of this relief is achieved the company will need to get the timing of the expenditure right. Only £50,000 can be allocated to expenditure before 1 April 2010 (6 April for individuals in business).



Where qualifying expenditure does exceed the AIA available, the balance from April 2010 only qualifies for Writing Down Allowance (WDA). This is 20% for the general plant pool and 10% for the 'special rate' pool which includes integral features. From 1 April 2009 to

31 March 2010 (2009/10 for the self-employed) a 40% first year allowance was generally available on any excess instead of the 20% allowance on general pool items only.

### Example

Both Red Ltd and Blue Ltd make up accounts to 31 December 2010. They each have £87,500 AIA available.

Red Ltd intends to buy commercial vehicles for £85,000 on 1 September 2010. As this expenditure post dates the increase but does not exceed the overall amount available for the accounts period - 100% tax relief is available on the whole £85,000.

Blue Ltd has also spent £85,000 on qualifying plant. £60,000 was expended on integral features in March 2010 and £25,000 in May 2010. Only £50,000 of the expenditure incurred before 1 April 2010 will qualify for 100% relief. The 40% first year allowance is not available on the £10,000 excess as it relates to an integral feature but 10% WDA of £1,000 is available. This provides £76,000 allowances overall.

# Relationships with records

Establishing and maintaining good business relationships without doubt would be considered important for the wellbeing, development and maybe even the survival of a modern business. Record keeping should be approached on a similar basis.

## Keeping it under control

A good record keeping system saves time in the long run as up to date records will help you:

- keep track of your expenses
- ask for a bank loan or credit if you need to
- see quickly what you are owed by others and how much you owe them
- save accountancy costs
- pay the correct amount of tax
- receive the correct amount of benefits or tax credits
- avoid paying any extra tax or penalties.

## Why you need to keep records

The law says that you should keep all records and documents you need to support the entries on your tax return. If HMRC need to check your return, they may ask to see the records you used to complete it.

## Record keeping penalties

If adequate records are not kept or you do not keep your records for the required period of time, you may have to pay a penalty.

## Penalties for an inaccurate return

If an inaccurate return is submitted a penalty may be due unless you can show that the mistake was made even though reasonable care was taken.

Some of the ways in which you can show you've taken reasonable care include:

- keeping full and accurate records which are regularly updated and saved securely
- checking with HMRC or an agent or accountant if there is something that you don't understand.

## The records you need to keep

The records you need to keep will depend on the size and complexity of your business and the different taxes that you have to pay, collect or charge.

The HMRC website has a very useful help sheet with specific detailed guidance on records to keep in different situations, for example:

- Self-employed - [www.hmrc.gov.uk/sa/rec-keep-self-emp.htm](http://www.hmrc.gov.uk/sa/rec-keep-self-emp.htm)
- VAT - [www.hmrc.gov.uk/vat/managing/returns-accounts/accounts.htm](http://www.hmrc.gov.uk/vat/managing/returns-accounts/accounts.htm)

## How to keep your records

The law does not say how you must keep your records. You must keep some original paper documents which show that tax has been deducted. An example is form P60 (end of year certificate for PAYE). Generally it is recommended that you keep all original documents you receive.

Most other records can be kept electronically (on a computer or any storage device such as disk, CD, memory stick or microfilm) as long as the method you use:

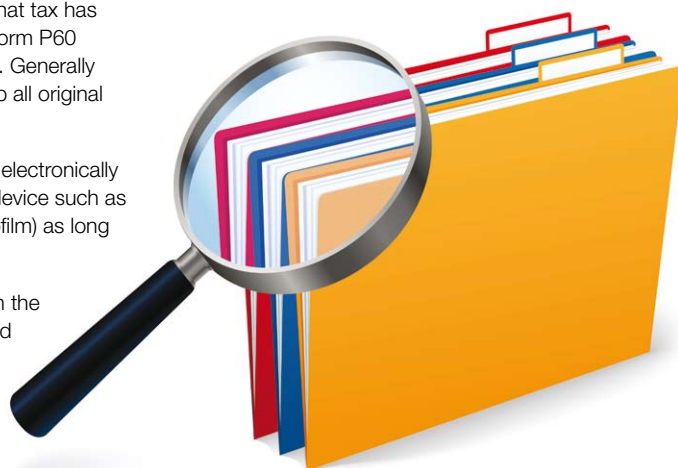
- captures all the information on the document (front and back) and
- allows the information to be presented in a readable format if HMRC need to see it.

## How long to keep records

As a general rule, you should keep your records for a minimum of six years. However, if you are:

- an employer, you need to keep Pay As You Earn (PAYE) records for 3 years (in addition to your current year)
- a contractor in the Construction Industry Scheme (CIS), you need to keep your CIS records for 3 years (in addition to your current year)
- keeping records to complete a personal (non business) tax return, you only need to keep them for 22 months from the end of the tax year to which they relate.

You may need to keep records for other reasons, as well as tax purposes. For example, the Companies' Act requires limited companies to keep specific records. Such records may need to be retained for different time limits, so be careful not to destroy any records you also use for tax purposes too soon.



# A Clean sweep

Reducing the carbon footprint is both an immediate and longer term issue affecting personal and business investment but what help is there for financing energy saving projects.

The Carbon Trust in its financial year 2008/09 offered over £22 million in Energy-Efficiency loans to replace old equipment and they are interest free.

## Financing energy reduction

The interest free loan facility is generally available to small and medium sized businesses (SMEs) where CO<sub>2</sub> savings are made from the expenditure met by the loan.

The unsecured loans with no arrangement fee range from £3,000 - £100,000. However, the size of the loan and the duration is directly linked to

the anticipated CO<sub>2</sub> savings which is now set at 2 tonnes of CO<sub>2</sub> savings per £1,000 of loan.

The maximum loan period is generally set at 4 years, the aim being that loan repayments are offset by energy savings.

Examples of energy saving projects include improved heating, refrigeration, lighting, and insulation processes.

## Who is eligible?

An organisation, for example, a sole trader, partnership, company, club or charity, needs to have been trading for at least 12 months and generally to qualify as an SME.

The definition of an SME currently used by the Carbon Trust is:

- an organisation with less than 250 equivalent full time employees and where

- either turnover does not exceed €50m or balance sheet total does not exceed €43m.

The business must not have a substantial holding in a non SME business nor be substantially owned by a non SME. Substantial means 25% or more of the shares or voting power.

As the loans are government funded some business sectors are not eligible due to European Union rules on state aid. Excluded business sectors include certain agricultural, fisheries, horticultural, transport, coal and export-related activities. However farmers in England can apply for a loan of between £3,000 and £20,000.

For more details about how to apply for an Energy-Efficiency loan contact us or see the Carbon Trust website at [www.carbontrust.co.uk/cut-carbon-reduce-costs/products-services/business-loans/pages/loans.aspx](http://www.carbontrust.co.uk/cut-carbon-reduce-costs/products-services/business-loans/pages/loans.aspx)



## Planned changes for childcare vouchers

During the final session of the previous government the Prime Minister outlined plans for certain changes to childcare vouchers.

Gordon Brown wrote:

'I have already made clear that no family currently in receipt of tax relief for their childcare vouchers will see any change in the support they receive. But following our discussions I can now also say that we will retain tax relief for new childcare vouchers issued in the future. However, there still remains a concern that a disproportionate benefit is accruing to higher rate taxpayers. So in order to ensure that this tax relief is given on a fairer basis to all families, we will ensure that all taxpayers get the same income tax relief as basic rate taxpayers do currently. This will take place from April 2011 and will not affect those receiving vouchers issued before that date.'

Subsequently, HMRC have issued more guidance on this proposed area of change.

The current position is that an employee in a childcare voucher scheme is entitled to £55 per week free of tax. This equates to a tax saving of £11 per week for a 20% basic rate taxpayer, £22 per week for a 40% higher rate tax payer and £27.50 per week for any 50% taxpayers.

However, from April 2011 all new recipients of childcare vouchers (including previous recipients who change employment) may only get the equivalent of basic rate tax relief. This means that for a recipient who is expected to have employment income chargeable at the 40% rate, only £28 will be received tax free, which saves £11 tax. This is the same tax saving as a basic rate tax payer. The respective tax free amount for a 50% taxpayer will be £22 tax free weekly.

If you would like to review your childcare provision options in light of the above please do get in touch.

# Neither a lender nor a borrower be

Managing the budget deficit will be high on the economic political agenda with no doubt some consequential impact on taxation matters. Meanwhile in the micro economy, borrowings frequently arise between a company and its 'director shareholders'. This article considers the overall taxation perspective for both lender and borrower beginning with the common situation of where loan advances are made from the company to the individual.

## The company perspective

A tax charge arises where a loan advance (or an increase in a loan) made to a director shareholder during the accounting period remains outstanding nine months and one day after the accounting period end. The tax rate is 25% of the amount of the loan which existed at the accounting period end and which is still outstanding at the due date.

If the loan is repaid in full (or in part) in a later accounting period, this tax (or part thereof) will then be repaid nine months and one day after the end of that accounting period. For example, if a loan was repaid on the first day of a 12 month period ending 31 December 2010, the tax relating to that loan would not be due for repayment until 1 October 2011 – nearly two years after the repayment of the loan! If instead the repayment was made on the last day of that same accounting period on 31 December 2010, the tax refund would still be due on 1 October 2011.

## What happens if the loan is written off?

From the company's point of view, the loan write off is essentially a bad debt for accounts purposes and is initially treated as an expense in the profit and loss account. But is it deductible for corporation tax? Such a bad debt has never been allowed as a trade deduction for tax purposes, but in recent years some have argued that a claim could be made for it to be relieved as a non trade debt under company loan relationship rules. There has always been a risk of HMRC challenge associated with this course of action but in any case this 'loophole' was closed by the Chancellor on 24 March 2010 in a Budget announcement now reflected in the Finance Act 2010. Essentially there is no corporate tax deduction for shareholder loan releases or write offs made on or after 24 March 2010.

## What tax implications will there be for the director shareholder?

Firstly, if loans generally exceed £5,000 at any time in the tax year and interest is either not charged or is charged at less than the official HMRC rate (currently 4%), a taxable benefit will arise. This is generally calculated on an average basis, using average capital outstanding during the tax year and the average interest rate prevailing. Where there is significant fluctuation in loan balances and/or HMRC interest rates then an actual basis (amounts and rates) may apply instead. Whatever the resulting benefit, this is then charged to income tax at 20%, 40% or 50%, depending on the circumstances of

the individual. The company as employer (but not the employee) will have to pay 12.8% national insurance contributions (NIC) on the employment benefit.

There is no taxable benefit if interest is charged at the official rate or for certain qualifying loans. There is also an exemption where non qualifying loans do not exceed £5,000 at any time in the tax year.

## And a loan write off?

If a loan is written off, a director shareholder is assessed on the income as dividend income, as opposed to earned income. The total taxable income includes the amount written off grossed up for the 10% dividend tax credit available on all dividends. This is then charged at either 10%, 32.5% or 42.5%, depending on the individual's circumstances. The associated 10% tax credit, (though non refundable) is available to reduce any tax liability.

Although from a tax view point the income is not assessed as earned income, it is generally considered to be subject to Class 1 employer and employee NIC.

## Company as borrower

Of course, it may be that a loan account is not actually overdrawn, and the company actually owes money to the director shareholder. Clients who find themselves in this position can use it to extract money from the company in a tax efficient way.

From the director shareholder's point of view, there is no reason not to charge interest on the amount lent to the company. If the company was borrowing the money from any other source, it certainly would have to pay interest. Commercial interest will generally be tax deductible for the company.

In the hands of the director shareholder, the income will be taxable as savings income, and will usually be taxed at 20%, 40% or 50%, depending on their individual circumstances. Exceptionally where an individual has less than £2,440 of other income (excluding dividends), some taxable savings income, may only be subject to a rate of 10%. Also, no NIC will be due as this only applies to earned income. This will benefit both employer and employee.



# Curiouser and curiouser

Have you installed new 'plant' in a building used for the purposes of your trade recently? 'Plant' includes such items as lifts, central heating, air conditioning and electrical systems. All these items qualify for plant capital allowances.

But a tax allowance is not necessarily limited to the plant. It can include capital expenditure on alterations to an existing building incidental to the installation of plant in a building. For example, the installation of a lift to upgrade an office block will require the construction of a lift shaft. The lift qualifies as plant but the lift shaft does not. However, the shaft qualifies for plant allowances under the 'incidental' rule. In contrast, expenditure on installing a lift shaft when constructing a new building does not qualify as it is not expenditure on alterations to an existing building.

How much expenditure falls into the extended meaning of plant has been considered in a recent tax case. Wetherspoon pubs had submitted significant claims for expenditure incurred on the conversion of all sorts of premises into pubs. Some of the claims were disputed by HMRC. Much of the disputed expenditure related to whether non plant costs can be classed as incidental to the plant and thus qualify as deemed plant.

One example of expenditure where the Tribunal agreed with Wetherspoon was a cement floor. A cold store was created within one pub in order to chill and maintain the temperature of draft beer. Because of anticipated spillages and associated washing down, the floor had to be inclined to a new drainage channel by means of which liquids would be pumped out by pumping equipment within the cold store. Wetherspoon claimed the cost of the cement flooring as expenditure on an alteration to the existing building which was incidental to the installation of the drain and pumping equipment.

HMRC took the view that some of the expenditure was eligible for allowances, being the proportion which related to the provision of the incline. But they argued that:

- 94.4% of the cost should be disallowed because that represented the proportion which would have been incurred anyway if a level floor had been installed.
- there was a lack of proportion between the provision of the inclined floor and the drain which made it inappropriate to regard the former as incidental to the provision of the latter.

The Tribunal considered that full relief was due. There never was any intention to provide a level floor which was then altered to an inclined floor - it was to be an inclined floor from the start. The fact that the cost of altering the existing building to provide the inclined floor was relatively higher than the cost of the plant to whose installation the alteration was incidental is immaterial.

In order to maximise the claims that can be made for both plant expenditure and incidental costs, it is very helpful to plan the potential capital allowances claim before the work begins on the building. This helps to ensure that purchase orders, invoices and other documentation provide sufficient analysis of the costs involved. Please contact us if you are planning to incur capital expenditure on your building.



## CIS problems

There have been a series of cases over the last few months regarding decisions by HMRC to refuse to allow taxpayers to be paid gross within the Construction Industry Scheme (CIS).

One particular case illustrates some of the issues. HMRC wrote to the taxpayer, stating that the tax treatment for CIS purposes would change from a gross payment position to payment under deduction of tax with effect from 90 days from the date of the letter unless there was an appeal.

The reason for HMRC's decision was stated as follows:

- the self assessment first payment on account due on 31 January 2007 was not paid in full until April 2007 and
- the contractor's monthly return for 5 May 2007 was outstanding.

The individual stated that he was distracted by personal problems in the nature of serious health problems affecting both himself and his immediate family and then work commitments and that these were the causes of the payment being made late. The taxpayer was 61 years old and argued that the withdrawal of gross payment status was likely to result in his having to close down his business, with no prospect of employment.

The Tribunal held that the taxpayer had both shown a reasonable excuse for his failure and that he had made the payment on account without unreasonable delay after the grounds for the excuse had ceased. The excuse consisted of the inability to make the payment on account without prejudicing his business cash flow and the stress suffered by reason of his health and other personal problems in the nature of family illnesses. However, in many of the other cases taxpayers have not been so lucky and have lost their gross payment certificates.

If you are experiencing any difficulties in meeting your tax obligations, it is far better to talk to HMRC before they talk to you. Please do get in touch if you have concerns about this issue.