

CLIENT BULLETIN

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THE SPRING BUDGET

We had expected that the Chancellor would use the Budget to announce his plans for taxing small companies. In the event, he did restrict the nil rate band of corporation tax, but deferred any decision on the taxation of dividends until next year and, in an unexpected move, hinted at a fundamental shift in the line between employment and self-employment, which would have the effect of bringing more small companies within the IR35 net. Taking each of these points in turn:

- In 2002 the Chancellor introduced a nil rate band of corporation tax for companies with annual profits up to £10,000. He has, apparently, been surprised to find that many small company proprietors have chosen to take their profits as a dividend which, unless they were higher-rate taxpayers, was completely tax-free. This, he considers, is taking unfair advantage of his original generosity and so, from 1 April 2004, profits distributed as dividends will be subject to a minimum rate of corporation tax of 19 per cent.
- Last December the Chancellor revealed he was in any case unhappy that, by taking dividends instead of salary, the shareholder-directors of small companies can avoid the National Insurance contributions usually payable on earnings. He promised to 'bring forward specific proposals for action in Budget 2004' but in the event, only announced that 'a discussion paper'

will be published in the late Autumn. Every expert is trying to guess what this paper will say, but in reality we are all working in the dark, as no-one really knows what the rules will be this time next year.

- Shortly after Budget Day the Inland Revenue proposed that all labour-only subcontractors in the construction industry should be treated, for tax and National Insurance purposes, as if they were employees. This proposal has not yet been formally adopted, but it seems likely that it will come into force to coincide with the introduction of a revised Inland Revenue Construction Industry Scheme in April 2006. Once the principle is accepted for the construction industry, it could logically be extended to other sectors, such as ‘knowledge workers’.
- IR35 bites where the worker would be an employee of the ultimate client if there was a direct contract between them. If all labour- or services-only subcontractors are treated as employees, it would be far easier for the Revenue to show a ‘deemed employment’ nexus between the worker and the ultimate client.

50 per cent capital allowances in 2004/05

There was however some hard news in the Budget – and some of it was even welcome. First, the Chancellor announced that small businesses will be able to claim a 50 per cent capital allowance for their purchases of plant and machinery in the year beginning 6 April 2004 (1 April 2004 for companies). This means that half the cost can be deducted from taxable profits in the year of purchase.

The definition of a ‘small’ business for this purpose is in fact very generous: the business must satisfy at least two of the following three tests: annual turnover not exceeding £5.6 million; balance sheet total not exceeding £2.8 million; payroll not exceeding 50 employees.

Employers will no longer pay Tax Credits

Another welcome announcement was that payment of Working Tax Credit by employers will be phased out: many employers have complained that Tax Credits complicate their payroll administration and can cause cash-flow problems. However, it is not yet known when phasing-out will start – October 2004 seems the earliest possible date, with April 2005 more likely – nor how long the changeover period will be.

Employees allowed to use company vans

Here there is some good news and some bad news. The good news is that, from 6 April 2005, there will be no benefit-in-kind charge where an employee is allowed to use a company-owned van for home-to-work travel *provided* he is required to take the van home (for example, because he is on call overnight, or because he will go direct to his first job the next day) *and* private use is expressly restricted to home-to-work journeys.

The bad news is that, where private use is **not** restricted to home-to-work journeys, from 6 April 2007 the benefit-in-kind charge will increase from the present £500 (£350 for older vehicles) to £3,000, with an additional £500 if the company does not charge for the fuel used.

In many cases, therefore, employees will want their employers to restrict private use to home-to-business journeys, especially once the increased tax charge comes into force in 2007. Employers should, therefore, be reconsidering their company van policies.

National Minimum Wage

The Department of Trade and Industry has confirmed that, from 1 October 2004, the National Minimum Wage will rise from £4.50 to £4.85 an hour. The Development Rate (payable to 18- to 21-year-olds and to some new employees undergoing formal training) will rise from £3.80 to £4.10.

The Department has also announced that, for the first time, there will be a minimum wage for 16- and 17-year-olds: it will be £3 an hour. This will not, however, apply to apprentices, for whom the rule will remain that they are not entitled to the minimum wage until they have completed their first year's apprenticeship *and* are aged 19 or more.

Wages paid to family members

A final point to remember is that the minimum wage which will frank an employee's National Insurance record for pension and benefit purposes rises to £79 a week (£343 a month) for the 2004/05 tax year. This is well worth remembering if you have family members working in your business, perhaps on a part-time basis.

TAX CREDITS

People who have claimed Working and/or Child Tax Credits for 2003/04 should note that the Inland Revenue have changed, or at least fine-tuned, the previously-announced arrangements for renewing claims for 2004/05.

The renewal process has two objectives. Firstly, payments made during the 2003/04 tax year were made under provisional awards based (usually) on a declaration of income for the 2001/02 tax year. Those awards must now be finalised by being reworked to take account of the claimant's actual income for 2003/04, which may give rise to either an additional payment of Tax Credit for 2003/04 or a clawback of Credits already paid. Secondly, 2003/04 income details are required to set the provisional award for 2004/05.

To smooth the workload, renewal forms will be sent out between April and July, with a return date in August or September. Meanwhile, Tax Credit payments will continue at their existing rate. We would however recommend that the forms be dealt with as soon as possible: if an additional payment is due, the sooner the form is submitted, the sooner the money will be received; and if the existing rate of payment is overgenerous, the sooner it is corrected, the sooner the overpayment will cease accumulating.

In most cases, any overpayment for 2003/04 will be collected by reducing the Tax Credit award for 2004/05. Any underpayment will be corrected by a lump sum payment.

Renewal procedures simplified by personalised forms

The renewal forms will be personalised, setting out details (such as the names and dates of birth of children) which the claimant will be asked to confirm or correct. People who received only the Family Element of Child Tax Credit in 2003/04 will, in most cases, simply be asked to confirm that their income for 2003/04 fell between stated minimum and maximum figures; other claimants will be required to submit a full Declaration of Income. (The Family Element is equivalent to the old tax allowance and worth £545 a year, or doubled to £1,090 for a baby under a year old.)

Notify changes in circumstances promptly

If there is any change in your circumstances – such as the birth of a new baby or an increase or reduction in childcare costs – you should not wait for the renewal form but telephone the Tax Credit Helpline immediately. In some cases, there is a legal requirement for prompt notification, in others it may increase the Tax Credit payable.

Furthermore, if you wish, you need not wait for the renewal forms, but can telephone details of your taxable income for 2003/04 as soon as these are known. This may be worthwhile if your actual income for the year was substantially lower, or higher, than that assumed in the original Tax Credit calculation, as it will bring forward the additional payment due, or stop the overpayment accumulating.

Childcare during the summer holidays

Finally, a point that is sometimes overlooked is that the Childcare Element of Working Tax Credit is not limited to permanent childcare arrangements, but can be claimed for blocks of childcare lasting four weeks or more, and up to the beginning of the September following a child's 15th birthday. Thus, for example, it can be claimed for children attending the summer holiday activities offered by some schools, local authorities, clubs, *etc*: the organisers will be able to tell you whether their activities qualify.

BIG BROTHER IS LISTENING

Traditionally, a client has been able to discuss his financial or tax problems with his lawyer or accountant in strict confidence. Such a professional advisor would certainly not help a client carry out some illegal scheme, and he might even refuse to continue acting for the client altogether, but he would not 'blow the whistle' by reporting any wrongdoing to the authorities.

All that has now changed. The so-called 'money laundering legislation', which originally covered only drug dealers' profits and the activities of terrorists, has now been extended to include all crimes for gain. 'Money laundering' itself has been redefined to include not only introducing the proceeds of crime into the legitimate financial system, but also simply retaining the proceeds of any criminal offence.

In an accountancy context, it is important to remember that tax evasion – for example, the deliberate understatement of taxable business profits – is a criminal offence, even though it is rarely prosecuted. It is a crime for gain, covered by the new money laundering legislation, because the trader retains the money he should have paid in tax. Accordingly, if a client confesses that he has deliberately understated his profit, his accountant must make an immediate report to the National Criminal Intelligence Service, who will no doubt pass the information on to the Inland Revenue.

It is a criminal offence, punishable by imprisonment, for the accountant not to make the report, or for him to warn the client that a report has been or will be made.

Nor is it only tax evasion which is in issue. A report would have to be made if, for example, an accountant discovered that a client had deliberately overclaimed Tax Credits, or even if he had simply failed to insure a business vehicle (driving a vehicle without insurance is, technically, a criminal offence and the owner has retained the money he should have paid in insurance premiums).

There is no exemption for small amounts and, in the first case to reach the Courts, a senior Judge held that a solicitor should make a report if he discovered that his client (here a deserted wife in matrimonial proceedings) had deliberately overclaimed Social Security benefits by as little as £10.

On the other hand, of course, mere carelessness or lack of attention when filling in Tax Returns and other official forms is not a criminal offence (even though it may be punishable by an Inland Revenue surcharge or penalty). To be a crime, there must be a deliberate lie, or at least a deliberate attempt to mislead.

Our advice has always been that a client who realises he has provided incorrect figures to the Inland Revenue (or to HM Customs & Excise) should correct the position as soon as possible. Both Departments have traditionally offered reduced penalties to those who come forward and co-operate in correcting any errors on their Tax Returns, and both have confirmed that this approach will not be affected by the new legislation. In practice, therefore, those willing to accept our advice will not be affected by the new money laundering regulations.

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.