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CLIENT BULLETIN

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IR 35 IS HERE TO STAY

Before the Budget, there was much hopeful speculation that the new Government might abolish, or at least tone down, the notorious 'IR 35' legislation, which empowers HMRC to tax some freelance contractors, working through personal service companies, as if they were employees. Indeed, in their first policy statement last year, the Coalition had promised to 'review IR 35, as part of a wholesale review of all small business taxation, and seek to replace it with simpler measures.'

The Chancellor did not mention IR 35 in his Budget speech, but the printed Budget Report revealed that the Government had decided that abolishing the personal service company legislation would put too much revenue at risk. The research, reasoning and rationale behind this decision were not disclosed. No changes at all to the legislation are proposed. Instead the Government has promised to 'achieve simplification' by asking HMRC to publish more guidance and set up a dedicated IR 35 Helpline.

However, the current problem is hardly that contractors and their accountants are unaware of HMRC's view that anyone earning money ought to be paying tax (and National Insurance contributions) as if he (or she) was an employee. The point is that, so long as those working through a personal service company, or on a self-employed basis, generally pay lower taxes and (especially) lower National Insurance contributions than employees, HMRC must be predisposed to rule that just about anyone is an employee, or a quasi-employee subject to the IR 35 legislation. The fact that there have been so many successful challenges to HMRC's employment status and IR 35 decisions show how difficult it is for them to give truly impartial advice.

The Office of Tax Simplification, set up by the new Government, suggested in a report published earlier in March that the way ahead would be to unify income tax and National Insurance contributions, so that roughly the same amount would be paid whether an individual was employed, self-employed or working through a personal service company. In the Budget, the Government rejected this suggestion outright, saying that it was unwilling to extend National Insurance contributions to dividends, rents or any form of income other than earnings. However, to simplify matters for employers, it will move towards aligning the definition of earnings subject to income tax, on the one hand, and to National Insurance contributions on the other.

INHERITANCE TAX

The Chancellor did announce a new inheritance tax incentive to promote charitable giving – he said: ‘If you leave 10 per cent or more of your estate to charity, then the Government will take 10 per cent off your inheritance tax rate.’ Two words of caution – the first is that the new relief will not be available until April 2012. The second is that the Budget documentation makes it clear that ‘10 per cent off your inheritance tax rate’ means a reduction from 40% to 36%, not to 30%.

On the other hand, the minimum 10 per cent donation to charity is 10 per cent of the estate after deducting the nil rate band (£325,000), any exempt bequests (for instance, to a husband or wife) and any reliefs (for instance, for business or agricultural property).

By way of example, take three estates, each worth £1 million. The first testator leaves his entire estate to his children, the second gives £67,500 to charity (ten per cent of the estate after deducting the nil rate band) and the third £200,000:

Total estate	£1,000,000	£1,000,000	£1,000,000
Charitable gift		£ 67,500	£ 200,000
		£ 932,500	£ 800,000
Tax at 40% on £675,000 (£1m less £325,000)	£ 270,000		
Tax at 36% on £607,500 (£932,500 less £325,000)		£ 218,700	
Tax at 36% on £475,000 (£800,000 less £325,000)			£ 171,000
Remaining for children	£ 730,000	£ 713,800	£ 629,000

If exactly one-tenth of the estate (after deducting the nil rate band) is given to charity, the tax reduction pays for 76% of the gift and 24% comes from the children’s share. As the charitable gift increases (as a proportion of the estate), the amount covered by the tax reduction reduces: to 49.5% of the gift in the third example above.

THE END OF THE CHEQUE GUARANTEE CARD

Anyone accepting payment by cheque for retail sales or private transactions should note that the Banks are withdrawing the Cheque Guarantee Card scheme at the end of June. This means that payments made on or after 1 July 2011 will not be guaranteed, even if the purchaser produces a Cheque Guarantee Card.

This is so even if the Cheque Guarantee Card produced by the purchaser has an expiry date later than 30 June 2011. In fact, most cards will have a later expiry date, because they will remain valid for use as a debit card and / or as a means of withdrawing cash from machines. Businesses currently relying on the scheme will need to consider what their policy on accepting cheques will be from July.

TAX ALLOWANCES FOR MACHINERY AND COMMERCIAL VEHICLES

Political ping-pong: one of the last acts of the outgoing Labour Government was to increase the ceiling on expenditure qualifying for the Annual Investment Allowance (the 100% write-off for most purchases of machinery and commercial vehicles) from £50,000 to £100,000 a year. Then one of the first announcements by the new Coalition Government was that the ceiling will be reduced to £25,000 – but not until April 2012. Accordingly, there is still a window of opportunity to make major purchases before the Annual Investment Allowance is reduced by three-quarters. If you need to buy new machinery or vehicles, it is particularly important to take advantage of this window because, from April 2012, expenditure in excess of the reduced Annual Investment limit will qualify only for writing-down allowances at a maximum of 18% per annum.

Great care must be taken in timing the purchase, because for most traders the transitional rules mean that the window will in fact close before April 2012. This is because the £100,000 allowance is tied to the tax year – the year to 31 March for companies and the year to 5 April for other businesses. If the accounting date is other than 31 March, it will be necessary to apportion the Annual Investment Allowance between accounting years. For example, suppose a company makes up its accounts to 31 December annually. The Annual Investment Allowance ceilings will be:

Year to 31 December 2011

January to March:		
3/12 × £100,000 (ceiling for the year to 31 March 2011)	£	25,000
April to December:		
9/12 × £100,000 (ceiling for the year to 31 March 2012)	£	75,000
		£100,000

Year to 31 December 2012

January to March:		
3/12 × £100,000 (ceiling for the year to 31 March 2012)	£	25,000
April to December:		
9/12 × £25,000 (ceiling for the year to 31 March 2013)	£	18,750
		£43,750

However, of that £43,750, only £18,750 can be spent after 31 March 2012. Thus for this company, the maximum expenditure qualifying for an Annual Investment Allowance is:

Year to 31 December 2011	£100,000
1 January to 31 March 2012	£ 43,750
1 April to 31 December 2012	£ 18,750 *

* or if less, £43,750 minus the amount spent between 1 January and 31 March

Similar computations have to be made in the case of an unincorporated business, unless the accounting date is 31 March or 5 April.

And as if that wasn't enough, there are some very complicated rules for deciding when expenditure is incurred for the purposes of Annual Investment Allowance claims – and as will be appreciated from the above, the exact day expenditure is incurred may make an enormous difference.

Accordingly, we would strongly encourage any clients considering major investments in machinery or commercial vehicles to contact us for individual advice on maximising their tax relief as soon as possible.

JUNIOR ISAS

Child Trust Funds were introduced for children born on or after 1 September 2002 and discontinued for children born on or after 3 January 2011. The Funds were opened with a contribution from the Government, but one of their main advantages was that they also acted as a 'Children's ISA' – parents, grandparents and anyone else could contribute up to £1,200 in total a year to each child's Fund, and the investment was completely tax free. Where a Fund has already been set up, it will continue until the child is 18 and family members and other well-wishers may continue to make contributions.

Last year the new Government promised to introduce a 'Junior ISA' to allow families to save, tax-free, for babies born on or after 3 January 2011. Further details were recently announced, and one of the most important points is that it will be possible to open a Junior ISA for any United Kingdom resident, under the age of 18, who does not have a Child Trust Fund. Thus it will be possible for families to open Junior ISAs for children and young people born before 1 September 2002, as well as for babies born on or after 3 January 2011.

It is expected that Junior ISAs will be available from 1 November 2011, but this is subject to confirmation. The maximum annual investment will be £3,000 (again subject to confirmation), in either a Cash ISA or a Stocks and Shares ISA, or any combination of the two. Contributions may be made by anybody, but the Junior ISA must be opened and managed by a person with parental responsibility for the child. From age 16, the child will be able to manage his or her own account, but no withdrawals will be permitted until age 18 is attained.

It will not be possible to switch money between a Child Trust Fund and a Junior ISA. But as for a Child Trust Fund, neither the child nor his or her parents will be liable to income tax or capital gains tax on investments held in a Junior ISA.

It will be noted that the annual investment limit for a Junior ISA, at £3,000, will be more than twice that for a Child Trust Fund, which is only £1,200. It is possible, of course, that the Government may decide to level-up the latter, but there has been no announcement so far.

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.
