

CLIENT BULLETIN

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TAX & FINANCE TIPS

The season of goodwill is upon us, when uncles are expected to give their nephews and nieces half-a-crown each and grandparents should be good for ten bob at least. Children will, of course, be encouraged to save some of this largesse and our first tip is that they should have two savings accounts: one for money donated by their parents and another for gifts from other relatives. This is because the interest from money donated by their parents can be taxed as the parents' income, while interest from other money will be taxed as the children's own income. As it will usually be less than the tax threshold, this means that in practice it will not be taxed at all.

Annuity purchase at retirement

Turning to the grandparents themselves, at retirement the pension fund accumulated within a personal pension scheme is converted into a pension by buying an annuity. The Government has recently sponsored a publicity campaign to remind pension plan holders that they have an 'open market option' – the right to buy their annuity from any authorised financial institution, rather than being tied to the annuity offered by their pension plan manager.

It is certainly true that another institution may offer a better annuity rate. But many pension plan managers pay a higher terminal bonus (on the pension fund itself) to

plan holders who choose to buy their annuity from the manager, rather than exercise their 'open market option'. The enhanced bonus can often outweigh the advantage of another institution's higher annuity rate, so it is important to have all the information before you make a decision. And staying with pensions, there are

Problems with pension mortgages

The problems with underperforming endowment mortgages are well-known and many homebuyers have received letters warning them that their policies are no longer expected to produce enough to repay their mortgages. There is a parallel, but hidden, problem with pension mortgages – where the mortgage is to be repaid out of the retirement lump sum payable under a personal pension scheme.

Pension plans are invested in the same underlying assets as endowment policies and so are suffering a similar level of underperformance. However, because pension plans are not formally mortgaged in the way that endowment policies are, the life assurance company or other pension plan manager is not required to issue warning letters. Accordingly, it would be sensible for anyone with a pension mortgage to obtain an up-to-date estimate of his retirement lump sum from his pension plan manager.

Do you know TESSA?

It has not been possible to open a new TESSA (Tax Exempt Special Savings Account) since 5 April 1999, but existing accounts are allowed to complete their five-year term. On maturity, the investor has six months to transfer his capital to a 'TESSA-only ISA' (Individual Savings Account), so that his savings can continue to earn tax-free interest.

The TESSA provider (a bank or building society) usually suggests reinvestment in its own TESSA-only ISA but it is worth remembering that the investor is entitled to transfer his savings to another institution, if he can find a better rate of interest.

THE END OF THE TAX YEAR

It is not too soon to start thinking about the steps which can be taken, before the end of the tax year – Monday, 5 April 2004 – to reduce your income tax and capital gains tax liabilities. They include:

- Using your 2003/04 Individual Savings Account (ISA) investment allowance of £7,000 (£3,000 for 16- and 17-year-olds).
- Making gifts to utilise the 2003/04 inheritance tax annual exemption. The annual allowance is £3,000 for each donor (so that husband and wife have

separate allowances) and if the 2002/03 allowance was not used, it can be brought forward to 2003/04, exempting gifts to a total of £6,000. The annual exemption can be a simple and sure way of reducing inheritance tax liabilities. For example, gifts of £3,000 a year for ten years will produce an inheritance tax saving of £12,000.

- Managing capital gains tax liabilities, by realising losses (to reduce net chargeable gains) or by realising gains (to utilise the annual exempt amount – currently £7,900 – and any available losses). Straightforward bed-and-breakfasting is no longer effective for tax purposes, so please contact us for individual advice on the best stratagem for your own circumstances.
- If you are an employee or company director, making an Additional Voluntary Contribution (AVC) to your employer's pension fund, or a 'Free-Standing' AVC (FSAVC) to an independent pension provider, which will qualify for tax relief in 2003/04. But here a point to watch is that employees earning up to £30,000 a year – other than controlling directors – are able to contribute up to £3,600 a year to a stakeholder or personal pension scheme while remaining a member of their employer's occupational pension scheme: stakeholder pensions will probably offer lower charges than AVCs or FSAVCs and will allow the contributor to take 25 per cent of the pension fund as a tax-free retirement lump sum.

Finally, following changes introduced by the *Finance Act 2003*, group life policies of the kind often used by partnerships for succession planning must be reviewed before 5 April 2004, and if necessary amended, to ensure that no unexpected tax charges arise when a claim is made. Your insurance broker, or the life assurance company itself, should be able to advise you.

WORKING AT HOME

A recent decision of the Lands Tribunal (the senior Court for hearing appeals against rating assessments) has clarified the rules for deciding whether business rates are chargeable when a householder uses a room for business purposes – for example, as a study, office or workroom. This is important because, over the last two or three years, the Valuation Office Agency (which assesses liabilities to Council Tax and business rates) has been claiming business rates from a widening range of people, both small business proprietors and ordinary employees, who work at home.

The story so far

Until the recent case, the general approach was that business rates were payable unless the business use was *de minimis* – lawyers’ shorthand for ‘small enough to be ignored’. Unfortunately, how small was small enough was never defined, though it was generally thought that the main criteria were the number of hours the employee or trader worked at home, and whether or not a room was devoted to business use.

..... and the latest development

However, the President of the Lands Tribunal decided that this was altogether the wrong approach. He held that both the number of hours worked, and whether a room was devoted to business use, were quite irrelevant. Simply working at home does not turn a house into business premises. What matters is whether the premises have been physically adapted for business use; whether equipment that would not normally be found in a private home is used; and whether there are a significant number of business visitors.

To take each of these three criteria in turn:

- Business rates liability is likely to arise if a separate building has been erected for use as an office or workroom, or if an integral garage has been converted for such use. Liability may also arise if there is any sign or advertisement for the business that could be read by passers-by, even a small brass plate. By contrast, simply furnishing a spare bedroom for use as an office will not create a liability to business rates.
- Using equipment not normally found in private homes may create a liability to business rates. However, the Lands Tribunal specifically ruled that personal computers, inkjet printers, *etc*, are commonly found in private homes and so their presence will not be relevant.
- Business rates liability is likely to arise if anyone other than the householder and his immediate family works on the premises – for example, if a secretary or book-keeper (who is not a family member) is employed, even on a part-time basis. Liability will also arise if a significant number of customers, clients or patients are seen at home, or if there is a regular traffic of other business visitors.

The recent decision does not affect the statutory rule, that a garage with a floor area not exceeding 25 square metres is not subject to business rates, even if it is used to garage a van or other business vehicle. The special rules for ‘bed and breakfast’ accommodation are also unaffected by the Lands Tribunal ruling.

PARENTS TO THE RESCUE

What with student loans and easy consumer credit, these days many young adults suddenly find themselves with serious debt problems. Sometimes the debts just grow until they reach critical mass; sometimes a crisis is triggered by redundancy, reduced earnings or a relationship breakdown. Parents may want to help their children through a difficult time, but they should not simply offer to pay the most pressing creditors. By adopting a more businesslike approach, they can maximise the benefit obtained from the contribution they are willing to make.

The first step must be to establish the facts – all the facts. There is no point in repaying debts of £10,000 if other creditors are owed £20,000 and one of them will petition for bankruptcy if he is not paid. Very often, the smallest creditors are the least patient and most dangerous: after all, the mortgagee has security and official Student Loans are repaid through the tax system, but the only hope a finance or credit card company may have of collecting its money is to take legal action.

Once the facts are established, it may be that the parents are able and willing to repay enough of their son's or daughter's short-term, high-interest consumer debt to resolve the immediate crisis and leave him or her able to manage long-term liabilities, such as mortgage and student loan repayments. On the other hand, they may have £10,000 available and £30,000 of high-interest debt to repay.

The general rule of law, in England and Wales, is that an agreement to accept less than the full amount owing is not legally binding. (The position in Scotland is different, but someone living in Scotland may still find that his credit card agreement is governed by English law.) However, there are a number of exceptions to this general rule, one of which is that if a third party offers a reduced sum 'in full and final settlement', and the creditor accepts, then the agreement is legally binding. This principle was, in fact, established by a series of nineteenth- and early twentieth-century Court cases concerning fathers who settled their sons' debts to moneylenders.

The worse the son's or daughter's financial problems, the stronger the parents' bargaining position as they can say, politely of course, 'take what I am offering or be satisfied with nothing'. When house prices slumped in the 1990s, it was not unusual for parents to settle their children's negative equity for less than ten per cent of the total amount outstanding. Creditors are pragmatic people and know that the alternative may be to write off the debt, or sell it for a few pence in the pound to a collection agency.

Finally, be aware that many debt advice services charge high fees or are really in the business of selling 'consolidation loans' – a new loan to repay existing debts. They

may even recommend remortgaging the parents' home to repay the son's or daughter's debts, which is unlikely to be a good idea.

If someone in your family has serious debt problems – however they arose – please contact us for a confidential discussion. There is an old saying, that a debtor is like a donkey in a quagmire, but it should be possible to find a rope to pull him out!

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.