CLIENT BULLETIN

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A G Kelly Ltd - Accountants

THE AUTUMN STATEMENT

In his Pre-Budget Statement, delivered at the end of November, the Chancellor assured us that the Government has no plans to abolish any of the existing reliefs for pension contributions, or to take away the right to a tax-free lump sum at retirement. There may, however, be some changes in the detailed rules, as he did also promise to simplify the notoriously complex tax treatment of pension contributions.

Value Added Tax

Relatively little was said about taxation, though the Chancellor did make it clear that the Government will be making a determined effort to reduce the VAT lost through avoidance and evasion. For example, Customs & Excise estimate that there are currently between 125,000 and 180,000 businesses, with turnovers above the VAT registration threshold, which have not in fact registered for VAT. There is to be an amnesty - although those registering will still have to pay the back tax, interest and a reduced penalty - followed by a 'crackdown'. Failing to register is, in fact, considered a serious criminal offence and, if large sums of money are involved, can lead to a prison sentence. If anyone you know is tempted not to register, try to talk him out of it!

Customs are also concerned about traders who have registered, but who are persistently late in submitting their VAT Returns and/or paying their tax. The Chancellor put us on notice that Customs intends to make wider use of their powers to require such traders to make a cash deposit against future liabilities, or to provide guarantees. This emphasises the importance of planning cash flow to be able to meet VAT liabilities promptly.

More helpfully, the VAT Flat-Rate Scheme will, in April 2003, be extended to most traders with a VAT-exclusive turnover up to £150,000. Under the Flat-Rate Scheme, a trader does not calculate his VAT liability by deducting his input tax from his output tax; instead, he simply pays tax at a special rate on all his sales. Different rates have been specified for different trade sectors.

The Government claims that adopting the Flat-Rate Scheme can save a trader up to £1,000 a year in administration costs, but this very much depends on the kind of business and how it is run. More important is the fact that the flat rates are set by reference to trade sector averages for input tax paid and, as with any average, some traders will gain by using them and others will lose. Accordingly, before applying to join the scheme, a trader should always compare the projected payments under the flat-rate system with the net tax payable under regular VAT accounting. We would of course be happy to help you with the calculations.

Loan Guarantee Scheme

The Chancellor also announced significant changes to the Small Firms Loan Guarantee Scheme. Under this scheme, the Government guarantees a loan (not an overdraft), usually from one of the major banks, which may help in raising funds for a new business, or expanding an existing enterprise, where there is a good business plan but insufficient assets to meet the banks' usual requirements for security or collateral.

Most importantly, from April 2003 the scheme will be extended to a number of previously-excluded trade sectors, including retailers, hairdressers, motor repairs and servicing, and estate and travel agents.

Guarantees may be given on loans from £5,000 to £100,000 (£250,000 for businesses established for at least two years), with fixed repayment terms of between two and ten years. An annual premium is charged for the guarantee, which in April will rise from 1.5% to 2% of the amount outstanding.

A business qualifies for the scheme if its annual turnover does not exceed £1.5 million, to be doubled to £3 million in April. For manufacturing businesses, a higher limit of £5 million applies.

CONSTRUCTION INDUSTRY SCHEME

The Inland Revenue has published, for discussion only at this stage, proposals for a fundamental reform of the tax arrangements for contractors and subcontractors in the construction industry.

Under the proposed new scheme, contractors and subcontractors would, as now, have to register with the Inland Revenue. However, Registration Cards, Certificates and Vouchers would all be abolished. Instead, a contractor wishing to engage a subcontractor would telephone or e-mail the Inland Revenue, quoting the subcontractor's National Insurance number and other details, to obtain confirmation that the individual is indeed a registered subcontractor. In the official jargon, this process is called 'verification'.

As part of the verification process, the Inland Revenue will advise whether payment should be made gross or net. The contractor will hand the subcontractor a payment advice with every payment, and make monthly or quarterly Returns to the Inland Revenue. The Inland Revenue's computer will crunch the numbers and send each subcontractor a printout of his reported earnings from each contractor, and the sub-contractor will be expected to check the figures.

The proposal does have obvious advantages. At present, subcontractors sometimes find the requirement to present their Registration Card or Certificate in person inconvenient; the voucher system is quite complicated and mistakes are often made; and there is notoriously a 'black market' in stolen CIS documentation.

One potential problem with the proposed scheme is that, when telephoning for 'verification', the contractor will be required to confirm that he has 'checked the subcontractor's employment status' and, the Revenue warn, 'there will be a penalty régime for contractors who make false declarations'. Given the very real difficulty in establishing employment status in borderline cases, and the Revenue's bias in favour of employment and against self-employment, we can foresee some acrimonious arguments.

It is very likely that the proposed scheme will be implemented, but no timescale has yet been suggested.

THE END OF THE TAX YEAR

The end of the tax year - Saturday, 5 April 2003 - is an important date in the tax and financial planning calendar, because it is the deadline for:

- Using your 2002/03 Individual Savings Account (ISA) investment allowance of £7,000 (£3,000 for 16- and 17-year-olds).
- Making gifts to utilise the 2002/03 inheritance tax annual exemption. The annual allowance is £3,000 for each donor (so that husband and wife have separate allowances) and if the 2001/02 allowance was not used, it can be brought forward to 2002/03, exempting gifts to a total of £6,000. The annual exemption is often overlooked, but if an individual can afford to make gifts every year, the inheritance tax saving can build up to a worthwhile amount. For example, if husband and wife can each afford to make gifts of £3,000 a year for ten years, the inheritance tax saving would be £24,000.
- Making a disposal which will qualify for capital gains tax retirement relief (which is abolished with effect from 6 April 2003). However, the interaction of retirement relief, taper relief and other capital gains tax rules must be carefully considered, so please consult us as soon as you decide to dispose of substantial assets, and before entering into binding commitments.
- More generally, managing capital gains tax liabilities, by realising losses (to reduce net chargeable gains) or by realising gains (to utilise the annual exempt amount - currently £7,700 - and any available losses). This may include bed-and-breakfasting quoted investments: although straightforward bed-and-breakfasting is no longer effective for tax purposes, the Chancellor has still not acted to prevent 'double bed-and-breakfasting' - sale by one spouse and repurchase by the other - or sale of a personal holding and repurchase within an ISA, PEP or family trust. However, if bed-and-breakfasting is planned, it might be wise to carry out the transaction before the March 2003 Budget.

Managing capital gains tax liabilities may be particularly relevant this year, as the recent fall in the Stock Markets may have given rise to losses that can be utilised against chargeable gains arising elsewhere. It is, unfortunately, a complex subject - for example, in some circumstances, bed-and-breakfasting could lead to a loss of taper relief - and so we would strongly recommend clients to ask us for individual advice, tailored to their own circumstances.

The end of the tax year is also the deadline for an employee or director to make an Additional Voluntary Contribution (AVC) to the employer's pension fund, or a 'Free- Standing' AVC (FSAVC) to an independent pension provider, which will qualify for tax relief in 2002/03. 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 pension while remaining a member of their employer's occupational pension scheme: stakeholder pensions may offer lower charges than FSAVCs and will allow the contributor to take 25 per cent of the pension fund as a tax-free retirement lump sum.

COMPUTERS AND SOFTWARE

Another deadline to remember is that purchases of computers and software qualify for 100 per cent first-year allowances if the purchase is made by 31 March 2003. Later purchases will qualify for a 40 per cent first-year allowance, followed by 25 per cent annual writing-down allowances.

The 100 per cent allowance is given only to 'small enterprises' - but the definition of a 'small' enterprise is one that fulfils at least two of the following conditions: annual turnover does not exceed £2.8 million; assets do not exceed £1.4 million; payroll does not exceed 50 employees.

Eligible purchases include computers; 'peripherals' such as printers, scanners and cables; software and software licences; and WAP and 3G mobile telephones. The cost of installing a dedicated electrical supply for computers may also qualify.

If you have not already done so, we would strongly urge you to consider installing surge protectors and battery boxes to protect your equipment (and data) in the event of blackouts or other problems with the electricity supply.

TAX CREDITS ARE COMING

The new Working Tax Credit and Child Tax Credit, which come into payment in April, have been the subject of a major Government advertising and information campaign. The new Credits will replace the current Working Families' Tax Credit and existing WFTC claimants should by now have received the new, 12-page Tax Credits Claim Form (TC600) and a 48-page booklet of explanatory notes. If not, they can be obtained by telephoning the official Tax Credits Helpline on 0845 300 3900.

One very important point, which has not been stressed in the official advertising and literature, is that the new Child Tax Credit also replaces the current Children's Tax Credit. This is significant because the current Children's Tax Credit is a tax allowance, but the new Child Tax Credit will be a Social Security benefit (even though it will be paid by the Inland Revenue).

Accordingly, it will not be possible to claim the new Child Tax Credit on your Tax Return: all Child Tax Credit claimants will have to complete the 12-page Tax Credits Claim Form in addition to their usual Tax Return. This is so even though, for many middle-income families, the value of the Child Tax Credit will be £10.40 a week, virtually the same as the current Children's Tax Credit, which reduces the tax bill by around £10.20 a week.

It is also necessary to claim the new Child Tax Credit promptly, as claims cannot be backdated for more than three months. Thus, anyone claiming after the beginning of July will lose money. But the best course of action will be to obtain and complete the claim form as soon as possible, and certainly before the beginning of the new tax year.