Bulletin

Effective Tax Planning 2005/06

Practical Tax Tips to guide you through the tax system

The tax system in the UK is increasingly complex. It may affect you, your family and your business; for instance...

The Family

Could you save tax by a more efficient distribution of assets and income around the family?

Estate Planning

Did you know that simple tax planning now may save at least £110,000 when you die?

Your Business

Do you have a business plan? Is your business structured in the most effective way?

Selling your Assets

Have you planned to make the most of capital gains tax reliefs?

Tax Efficient Savings

Are you making the most of them?

Looking Ahead

Have you made adequate provision for your retirement?

This bulletin will answer all of these questions and more! It will help you make sense of the tax system and make sure you get the most out of it.

Please use it to identify areas where you could take action.

Contact us for further advice and to discuss the most appropriate way forward.

Taxation of the Family

Married couples are subject to a system of independent taxation which means that husbands and wives are taxed separately on their income and capital gains. The effect is that both have their own allowances, tax bands for income and capital gains tax (CGT) purposes and are responsible for their own tax affairs.

2005/06 Income Tax Rates

£	%
0 - 2,090	10
2,091 - 32,400	22*
Over 32,400	40**

* 10% on dividends
20% on other savings income

**32.5% on dividends

Children are independent people for tax purposes and are therefore entitled to their own allowances and tax bands. It may be possible to save tax by generating income or capital gains in the children's hands.

Separation and divorce can have significant tax implications. In particular, the following areas warrant careful consideration:

- current and future tax allowances
- transfers of assets between spouses.

Married couples

Everyone is entitled to a basic personal allowance. This allowance cannot be transferred between spouses. Where one spouse was born before 6 April 1935, a married couple's allowance is available. This is given to the husband although it is possible, by election, to transfer it to the wife.

In general, married couples should try to arrange their ownership of income producing assets so as to ensure that personal allowances are fully utilised and any higher rate liabilities minimised. Generally, when husband and wife jointly own assets, any income arising is assumed to be shared equally for tax purposes. This applies even where the asset is owned in unequal shares unless an election is made to split the income in proportion to the ownership of the asset.

The one exception is dividends from jointly owned shares in 'close' companies which are taxed according to the actual ownership of the shares. Close companies are broadly those owned by the directors or five or fewer people. For example if a spouse is entitled to 95% of the income from jointly owned shares they will pay tax on 95% of the dividends from those shares. This measure is designed to close a perceived loophole in the rules and does not apply to income from any other jointly owned assets.

The tax treatment of married couples will extend, from 5 December 2005, to same-sex couples who have entered into a civil partnership under the Civil Partnership Act.

Tax Tip

Review the income split between husband and wife. Consider transferring assets to even up incomes. If the husband or wife is self employed their spouse could be employed or taken into partnership as a means of redistributing income. The Revenue may however look closely at such situations to ensure that they amount to a commercial arrangement.

Taxation of the Family

continued

Each spouse's CGT liability is computed by reference to their own disposals of assets and each is entitled to their own annual exemption, currently £8,500 per annum. Gains above this level are charged to tax by treating them as the top slice of income and using the rates applicable to savings income. Considerable CGT savings may be made by ensuring that maximum advantage is taken of annual exemptions together with the 10% and 20% tax bands.

This can often be achieved by transferring assets between spouses before sale - a course of action generally having no adverse CGT or inheritance tax (IHT) implications. Advance planning is vital and the possible income tax effects of transferring assets should not be overlooked.

Children

It may be possible for tax savings to be achieved by the transfer of income producing assets to a child so as to take advantage of the child's personal allowance, starting rate (10%) and basic rate (22%) tax bands.

This cannot be done by the parent if the annual income arising is above £100. The income will still be taxed on the parent. However, transfers of income producing assets by others (eg grandparents) will be effective.

Tax Tip

A parent can allow a child to use any entitlement to the CGT annual exemption by using a 'bare trust', ie an arrangement whereby a beneficiary has an absolute right to property and income, but the trustees are the legal owners.

Children or any other person whose personal allowances exceed their income are not liable to tax. Where income has had tax deducted at source, a repayment claim should be made. Remember that tax credits on dividends are not repayable.

Child Trust Fund

A new Child Trust Fund has been introduced from April 2005 for all children born from 1 September 2002. The government provides an initial endowment of £250 (£500 for low income families). Other features of the fund include:

- allowing additional contributions to be made by others (family and friends) of up to £1,200 a year
- children not being taxable on the income and gains they make on the investments in their CTF account, but no tax relief for contributions made to a CTF account.
- funds accessible at age 18.

Child Tax Credit

The Child Tax Credit is means tested and potentially available to families who have responsibility for one or more children.

It is a tax-free payment made direct to the main carer.

There are several elements to the credit but broadly the maximum is an annual amount of £1,690 per child together with a family element (one per family) of £545 per annum.

Tax Tip

Many families with children, whether or not the adults in the family are in work, are eligible for the Child Tax Credit. Some credit is likely to be payable in 2005/06 if a family's income is less than £58,175 a year or £66,350 if there is a child under one year old.

Marriage breakdown

Marriage breakdown often involves the transfer of assets between husbands and wives. Unless the timing of any such transfers is carefully planned there can be adverse CGT consequences.

If an asset is transferred between a husband and wife who are living together, the asset is deemed to be transferred at a price that does not give rise to a gain or a loss. This treatment continues up to the end of the tax year in which the separation takes place.

CGT can therefore present a problem where transfers take place after the end of the tax year of separation. IHT on the other hand will not cause a problem if transfers take place before the granting of a decree absolute on divorce. Transfers after this date may still not be a problem as often there is no gratuitous intent.

Employees' income tax is collected by the Revenue under the Pay As You Earn (PAYE) system. Each employee is given a tax code number and the employer deducts tax from earnings by reference to that number.

Many code numbers are incorrect and you should always check your number and contact the Revenue if you are unsure. Code numbers reflect many items, including tax you may owe on benefits in kind. Common benefits include travel and subsistence costs, cars and private medical insurance.

Expense payments

If your employer reimburses you for expenses you incurred whilst out on business, you would have thought that there could be no tax bill. However, this is not always the case and you should check the system used by your employer. Otherwise, you could end up paying too much tax.

At the end of each tax year, your employer has to send a summary of all of your benefits to the Revenue on form P11D. This will include all payments made to you to cover expenses such as subsistence and hotel bills. You, as an individual, can then write to the Revenue and claim tax relief on expenses you originally paid out of your own pocket wholly for business purposes. Of course, the answer may be that nothing is taxable and so employers can ask to be excluded from this process if they write to the Revenue. This is known as a dispensation.

Tax Tip

Check whether your employer has a dispensation. If not you will need to make entries on your tax return to:

- record the benefits and expenses as income
- claim a deduction for the business element of the expenses.

If you do not receive a tax return you should write direct to the Revenue to make a claim.

Tax and the Employee

Mileage claims

Many employers pay a standard rate of mileage to all employees who use their own cars for business.

The maximum rates that can be paid tax-free are as follows:

Up to 10,000 miles - 40p

Over 10,000 miles - 25p

If you are paid for business miles at less than the authorised rate, you can write to the Revenue and ask for tax relief on the difference.

Example

Dave is a basic rate taxpayer and travels 4,100 business miles per year in his car and is paid 32p per business mile by his employer.

Dave's tax relief claim is:	£
4,100 miles @ 40p	1,640
Less: actually paid 4,100 @ 32p	(1,312)
	£328

Repayment due: £328 x 22% = £72.16

Furthermore, the employer is able to pay an additional 5p per mile tax-free to the employee if they take a fellow employee on a business journey as a passenger.

Tax Tip

Remember to check your mileage allowances and write to the Revenue for your repayment of tax if appropriate.

Company cars

Company cars are taxed by reference to the list price and the carbon dioxide (CO_2) emissions measured in grams per kilometre. Low emission cars (up to 140 gm/km in 2005/06) are charged at 15% of the list price building up to a maximum of 35% for high emission cars (240 gm/km and above in 2005/06).

Discounts apply to certain environmentally friendly cars. For cars registered before 1 January 1998, the charge is based on engine size.

CO_2 emissions are recorded on the Vehicle Registration Document (V5). If the car has a diesel engine there is a 3% supplement unless the car meets the Euro IV emission standards in which case the supplement is waived. From 6 April 2006, the waiver will cease for cars registered on or after 1 January 2006.

Tax Tip

Consider acquiring that new company diesel before the end of December 2005. The waiver of the 3% supplement will be retained for the life of diesel cars that meet the Euro IV standard and were registered before 1 January 2006.

Private petrol

A separate charge applies where private fuel is provided, unless the employee reimburses the employer for all private mileage (including travel between home and work).

The charge is calculated by applying the percentage figure used to calculate the company car benefit to a fixed figure which for 2005/06 is set at £14,400.

Tax Tip

If you are provided with private fuel, check the amount of tax you are paying compared to the actual cost of petrol on your private mileage. It may be that it is cheaper to opt out of employer provided private fuel and pay for it yourself.

Medical insurance

The provision of private medical insurance is a taxable benefit.

Use of company assets

An annual benefit is generally taxable where employees have the private use of company assets. The annual benefit amounts to 20% of the asset's market value when first made available to any employee.

Phones

Private home telephone bills, including rental charges, which are paid for by the employer will be taxed as a benefit. There is no charge for private calls using a company mobile phone.

Social functions for employees

The Revenue will not tax as a benefit a Christmas party and other annual functions provided the total cost of the events in a tax year is less than £150 per head.

Cheap or interest-free loans

If loans made by the employer exceed £5,000 in a tax year, tax is chargeable on the difference between the interest paid and the interest due at the official rate. This situation often occurs with directors who overdraw their loan or current account and special attention should be paid to this issue, as the Revenue often check up on it.

National insurance

In general employees' national insurance (NI) is not due on benefits in kind except vouchers, stocks and shares, the payment of an employee's personal liability and benefits provided by way of 'readily convertible' assets.

Most benefits in kind however are subject to Class 1A (an employer's NI contribution). As this currently amounts to 12.8% of the taxable value of the benefit, you may need to reconsider the tax efficiency of providing benefits.

Tax Tip

Contributions by your employer to a pension scheme are tax and NI free. This may be far better than any other perk. If you plan to sacrifice some of your 'normal' salary to do this, talk to us to make sure your salary sacrifice scheme is effective.

Childcare costs

- Employees are exempt from both tax and NI where an employer provides a place in a workplace nursery.
- There is a tax and NI exemption for childcare vouchers limited to £50 per week.
- Any formal registered childcare or approved home childcare contracted for by the employer such as a local nursery or childminder is exempt from both tax and NI up to £50 per week.
- Where schemes operate they should be open to all employees.

Pensions, Savings and Investments

Looking ahead

Pensions are one of the most important areas of long-term savings considerations and one of the most tax efficient. A higher rate taxpayer can contribute £100 to a pension fund at a cost of only £60, so why do so many of us put the matter off?

The maximum level of contributions into a personal pension plan is based on a percentage of your 'earnings' for the year but the maximum annual earnings figure that may be taken into account is £105,600 for 2005/06. This limit or 'cap' on earnings does not apply to the old style retirement annuity premiums. The percentage also varies, depending on your age.

Age at the beginning of the tax year	% of Net Relevant Earnings 2005/06 Personal Pensions	 Retirement Annuities
35 or less	17.5	17.5
36 - 45	20	17.5
46 - 50	25	17.5
51 - 55	30	20
56 - 60	35	22.5
61 - 74	40	27.5

A single integrated tax regime applies for stakeholder pensions and personal pensions. Stakeholder pensions are designed to be a simplified and flexible version of personal pensions. They are money purchase schemes with low charges.

Most employers are obliged to offer all employees access to a stakeholder pension or to a scheme considered to be stakeholder compliant unless they have an existing defined benefit scheme.

The limit on contributions is the higher of:

- £3,600 (gross) per year, and
- the relevant limit under the personal pension age and earnings related limits - these can continue at this level for up to five years after the year of the earnings.

In other words contributions of up to £3,600 can be paid each year irrespective of earnings.

Contributions are paid net of basic rate tax. The pension provider will then recover this from the Revenue. Contributions will be eligible for higher rate relief, if appropriate.

Tax Tip

Pension contributions made between 6 April and the following 31 January can be carried back to the previous tax year to take advantage of higher rate relief and/or a timing advantage.

The election to carry back must however be made on or before the contribution is paid. To ensure that you don't miss out please talk to us before making a payment. These timing limits do not apply to old style retirement annuity schemes. Carry back will be abolished when the new pensions regime is introduced in April 2006.

New rules for the taxation of pensions will be introduced in April 2006. The new regime includes a single lifetime limit of £1.5 million on the amount of pension saving that can benefit from tax relief as well as annual limits on the maximum level of pension contributions. Please talk to us if you would like further information on the new regime.

Tax-free savings

Individual Savings Accounts (ISAs)

ISAs provide an income tax and capital gains tax free form of investment.

You can invest either in a maxi ISA or mini ISAs. The maxi ISA route gives you the option to invest up to £7,000 per tax year either fully in stocks and shares or up to £3,000 in cash with the balance in stocks and shares. Under the mini ISA route, up to £4,000 can be invested in stocks and shares and up to £3,000 in cash. 16 and 17 year olds are able to open (mini) cash ISAs.

Tax Tip

The government is committed to retaining the annual limit of £7,000 until 2010 so a couple starting to invest in ISAs now could save a total of £70,000 by 2010.

Tax efficient savings

There are a variety of other tax efficient savings products, many of which work in completely different ways. You should consider your needs in detail before entering into any commitments. Examples include:

National Savings products - these are taxed in a variety of ways. Some, such as Savings Certificates, are tax-free.

Single premium insurance bonds and 'roll up' funds provide a useful means of deferring income into a subsequent period when it may be taxed at a lower rate.

The Enterprise Investment Scheme (EIS) - income tax relief at 20% is available on new equity investment (in qualifying unquoted trading companies) of up to £200,000 in any tax year. CGT exemption is given on shares held for at least three years.

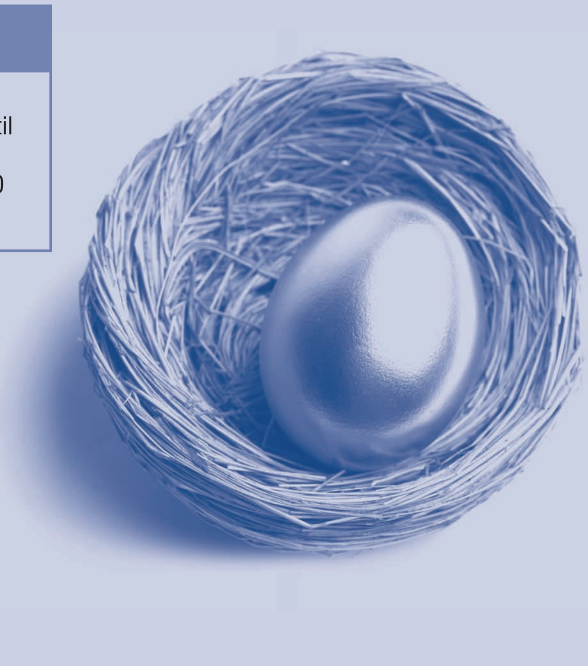
Where gains are reinvested in EIS shares, the capital gains realised on the sale of any chargeable asset (including quoted shares, holiday homes etc) can be deferred.

Venture Capital Trusts (VCT) invest in the shares of unquoted trading companies. An investor in the shares of a VCT will be exempt from tax on dividends and on any capital gain arising from disposal of the shares in the VCT. Income tax relief currently at 40% is available on subscriptions for VCT shares, up to £200,000 per tax year so long as the shares are held for at least three years.

The ability to defer capital gains by investing in VCT shares has been abolished.

Tax Tip

When choosing between investments always consider the differing levels of risk and your requirements for income and capital in both the short and long term. An investment strategy based purely on saving tax is not appropriate.



Capital Gains Tax (CGT)

Do you sometimes have to pay CGT? Or do you own assets which might give rise to a chargeable capital gain when sold? If so then read on for important information about the CGT system.

Taper relief

Taper relief has the effect of reducing the CGT charge on a disposal according to the period of ownership of the asset and the type of asset.

Amount of taper - non-business assets

Taper relief is given by reference to the number of complete years of ownership after 5 April 1998. In addition a bonus year is added where the asset was acquired before 17 March 1998.

The taper relief table is as follows

Number of complete years asset held after 5.4.98 (including 'bonus' where relevant)	Non-business taper %
1	0
2	0
3	5
4	10
5	15
6	20
7	25
8	30
9	35
10 or more	40

Definition of business asset

The following assets are currently eligible for business asset taper relief:

- one used for the purposes of an individual's (or partnership's) trade
- an asset owned by an individual but used in the individual's qualifying trading company
- property let to any trade
- all shareholdings in unquoted trading companies (whether or not the shareholder works in the business)
- all shareholdings held by full-time or part-time employees in quoted trading companies
- shareholdings in quoted trading companies where the shareholder is not an employee but can exercise at least 5% of the voting rights
- shareholdings held by full-time or part-time employees in non-trading companies provided they and their associates do not own more than 10% of the company.

Amount of taper - business assets

The taper relief table is as follows:

Number of complete years (after 5.4.98)	Business taper %	Effective rate of CGT for higher rate taxpayer %
Less than 1	0	40
1	50	20
2 or more	75	10

Change in the asset's status

In some circumstances an asset will not wholly qualify for full business asset taper relief. This may be due to a change in the definition of business assets or because the asset has not always been used for a qualifying purpose. In these circumstances part of the gain will qualify for business asset taper and part for non-business taper relief. Please contact us for further information on this point.

Main residence

An individual's or married couple's only or main residence including land up to half a hectare is exempt from CGT. If a property has not been your only residence throughout your period of ownership the relief may be restricted.

Periods of absence from your main residence may not qualify for the relief although the last three years of ownership will automatically qualify provided the property has qualified at some point during your ownership. In addition if a property has been let during any absences you may qualify for a further 'letting relief'.

Tax Tip

If you have more than one home, you can choose which one should benefit from the CGT exemption. This requires an election and needs careful thought to ensure any available exemption is maximised.

Bed and breakfast - alternatives

Bed and breakfasting is the term used for the sale and almost immediate repurchase of the same shares. It used to be an effective way of realising gains which would be covered by the annual CGT exemption or to utilise losses. However changes to the CGT rules have rendered this ineffective.

Tax Tip

There are ways around this:

- sell shares from your personal portfolio and repurchase through an ISA
- a sale by one spouse followed by the repurchase in the name of the other spouse
- wait 30 days before repurchase.

Deferring gains through EIS investments

The Enterprise Investment Scheme (EIS) allows individuals to defer capital gains made on the disposal of any asset so long as the gain is reinvested in shares in an EIS qualifying unquoted trading company.

The deferred gain crystallises on a subsequent disposal of the shares unless certain conditions are breached before that time.

Please note:

- certain trades (eg property development and farming) are excluded
- the shares must be acquired by subscription - ie only new shares qualify
- the EIS scheme is complex and advice is essential.

Inheritance Tax (IHT) Planning

Speculation that the government will tighten up the rules surrounding IHT has so far proved to be wrong.

IHT is charged on a person's estate when they die and on certain gifts made during their lifetime.

The rate of tax on death is 40% and 20% on lifetime chargeable transfers. The first £275,000 is not chargeable.

Most gifts made more than seven years before death will escape tax. Therefore, if you plan in advance, gifts can be made tax-free; the result can be a substantial tax saving.

This section of the bulletin gives guidance on some of the main opportunities for minimising the impact of the tax.

Estate planning

Much estate planning involves making lifetime gifts of capital to use exemptions and reliefs or to benefit from a lower rate of tax on lifetime transfers.

Any plan must take account of your circumstances and aspirations. The need to ensure your financial security (and your family's) cannot be ignored. If you propose to make gifts, the interaction of IHT with other taxes needs to be considered carefully.

If you do nothing you may become exposed to a large IHT liability. There are straightforward cases where just one extra sentence in your Will could save £110,000 of tax.

Wills

As the main IHT liability is likely to arise on death, a sensible and up to date Will is important.

Checklist

- Do you have a Will?
- Where is it kept - do you and your family know?
- Is it up-to-date?
- Does your Will make full use of IHT exemptions and reliefs?
- Do you have adequate life assurance?

Tax Tip

In the two-year period following a death, the terms of a Will can be varied or disclaimed by using a Deed of Variation.

Exemptions

There are many valuable IHT exemptions. The main ones follow. Ensure you're making full use of them!

Annual exemption
£3,000 per tax year may be given by an individual without an IHT charge. An annual exemption may be carried forward to the next year but not thereafter.

Small gifts
Gifts to individuals not exceeding £250 in total per tax year per recipient are exempt.

Normal expenditure out of income
Gifts made out of income which are typical and habitual and do not result in a fall in the standard of living of the donor are exempt. Payments under a deed of covenant and the payment of annual premiums on life insurance policies would usually fall within this exemption.

Family maintenance
A gift for family maintenance does not give rise to an IHT charge. This would include the transfer of property made on divorce under a court order, gifts for the education of children or maintenance of a dependent relative.

Wedding presents
Gifts in consideration of marriage are exempt up to £5,000 if made by a parent with lower limits for other donors.

Gifts to charities
Gifts to registered charities are exempt provided that the gift becomes the property of the charity or is held for charitable purposes.

Reliefs
When business or agricultural property is transferred there is a percentage reduction in the value of the transfer. Often this provides 100% relief. In cases where full relief is available there is little incentive, from a tax point of view, to make lifetime transfers of such assets. Additionally no CGT will be payable where the asset is included in the estate on death. However the reliefs may not be so generous in the future and therefore gifts now may be advisable.

Tax Tip

Gifts between husband and wife
Gifts between husband and wife are generally exempt. It may be desirable to use the spouse exemption to transfer assets to ensure that both spouses can make full use of exemptions and the £275,000 nil rate band. The spouse exemption will also apply to same-sex couples from 5 December 2005 if they have registered their partnership under the terms of the Civil Partnership Act.

What will happen to any business or agricultural property included in your estate on death? Leaving it to your spouse will waste any available relief. Consider leaving such property to someone else.

Tax Tip

Use of trusts
Trusts can provide an effective means of transferring assets out of an estate whilst still allowing flexibility in the ultimate destination and/or permitting the donor to retain some control over the assets. Provided that the donor does not obtain any benefit or enjoyment from the trust, the property is removed from the estate.

Life assurance

Life assurance arrangements can be used as a means of removing value from an estate and also as a method of funding IHT liabilities.

A policy can also be arranged to cover IHT due on death. It is particularly useful in providing funds to meet an IHT liability where the assets are not easily realised, eg family company shares.

Tax Tip

Have you considered a trust to ensure any life assurance proceeds are not taxable as part of your estate on death?

Tax and your Business

The most important word to bear in mind when you start out in business is 'preparation'. Spending some time creating a business plan can be invaluable. It will bring to mind many issues which you may not have considered, such as financing, numbers of employees and the business structure, which will help you meet your aims. Do you want to run the business by yourself or in partnership with someone else, or would you rather trade under the umbrella of a limited company?

Sole trader

This is the simplest form of business since it can be established without legal formality. However, the business of a sole trader is not distinguished from the proprietor's personal affairs.

Partnership

A partnership is similar in nature to a sole trader but because more people are involved it is advisable to draw up a written agreement and for all partners to be aware of the terms of the partnership. Again the business and personal affairs of the partners are not legally separate.

Company

The business affairs are separate from the personal affairs of the owners but there are legal regulations to comply with.

Limited Liability Partnerships (LLPs)

LLPs are a halfway house between partnerships and companies. They are taxed in the same way as a partnership but are legally a corporate body. This means that the personal affairs of the members can be separated from the business affairs.

The appropriate structure will depend on a number of factors including consideration of taxation implications, the legal entity, ownership and liability.

Important choices

Some matters are broadly the same no matter which route you take.

Year end

Choosing the right year-end may, in some circumstances, defer a tax bill but there will also be other commercial issues to consider.

Expenses

Tax will be due on the profits of your business but not all expenses the business incurs are tax deductible. Careful thought needs to be given as to when and how much money is going to be spent.

In general, it is best to incur expenditure just before rather than just after the year-end, as this will accelerate your tax relief. However, it is important that you keep proper and comprehensive business records so that relief may be claimed. Examples of the type of expenditure to consider bringing forward include:

- building repairs and redecorating
- advertising and marketing campaigns
- redundancy and closure costs
- expenditure on plant and machinery.

Capital allowances

Generally an annual allowance of 25% is given for expenditure on plant and machinery. Small and medium-sized businesses (as defined by company law) qualify for higher allowances in the year of expenditure (generally 40%). 100% allowances are available to all businesses for expenditure on certain specific energy saving equipment and, until 31 March 2008, on certain environmentally friendly cars.

Allowances are also available for investments in certain types of building.

Unincorporated businesses

Whether a sole trader, partnership or LLP, your profits will be taxed on a 'current year' basis, so that the business is taxed on the profits it makes during its lifetime; for example, if the business makes up accounts to 30 April each year, the profits for the year ended 30 April 2005 will be taxed in 2005/06.

By choosing the most appropriate accounting date, the payment of tax can be delayed, with significant cash flow advantages.

Unincorporated businesses usually pay higher rates of tax than a company but significantly less national insurance. Administrative costs are generally lower but you are personally liable for debts the business may incur. LLPs go someway to addressing this issue.

Limited companies

A limited company may be advantageous, as the directors are not personally liable for outstanding debts. However, a creditor, such as a bank, may require personal guarantees from the director.

Tax rates paid by the company will generally be lower than those paid by an unincorporated business. However, there are effectively two layers of tax, one payable by the company and the other payable by employees/directors. Thus, profits made by the company need to be extracted by the directors in the most tax efficient manner.

You may wish to consider extracting profits in the form of dividends rather than as increased salary or bonus. This can result in substantial savings in national insurance. However, dividends paid out by certain companies may affect the company's corporation tax. Planning should be undertaken before any money is taken out of the company.

Tax Tip

There are various ways of extracting profits from a company although careful consideration of the level and method needs to be given. For example payments by the company to an approved pension scheme are tax and NI free!

And finally...paying the tax

The self-employed may have to pay tax three times a year, namely:

- 31 January in the tax year
- 31 July following the tax year
- 31 January following the tax year.

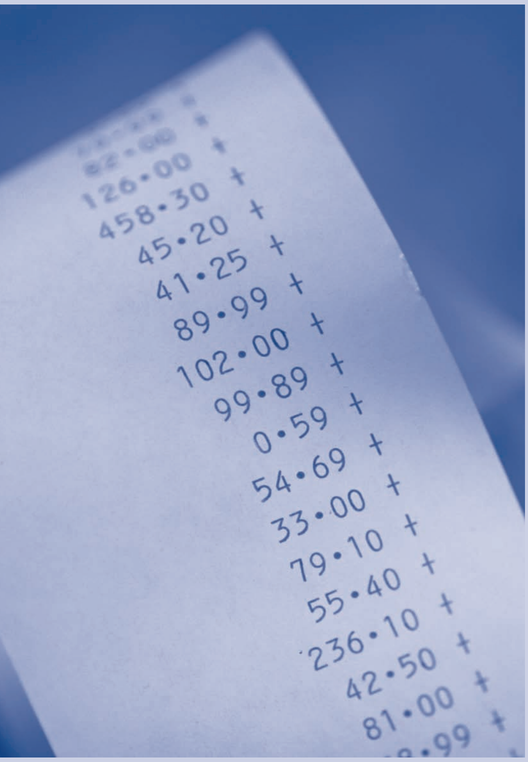
In certain circumstances, the first two payments can be waived.

For limited companies, the payment system can be more complicated:

- PAYE and NI needs to be paid monthly even if the director is the only employee (although for smaller businesses it can be paid quarterly)
- for most companies corporation tax is payable nine months and one day after the end of the accounting period.

As you can see, there are many issues to consider in deciding the best vehicle for your business. Please contact us to discuss the situation in detail.

Value Added Tax (VAT)



VAT is a tax payable by the consumer but many businesses are forced to act as unpaid tax collectors. HM Revenue & Customs (HMRC) currently police the system and there are heavy fines for failing to operate the system properly. Consequently, you cannot just ignore VAT and there are certain areas you should consider in detail.

What does VAT apply to?

VAT applies to businesses that make supplies of goods or services. Businesses charge VAT on their sales and this is known as output VAT. Similarly, VAT will be suffered on purchases and this is known as input VAT.

If outputs exceed inputs, payments of tax have to be made to HMRC on a regular basis. If inputs exceed outputs, a repayment of tax will be made to the business. However, there are some types of input VAT, such as VAT on entertainment that are never reclaimable.

Supplies

Certain supplies are not taxable at all and are known as exempt supplies. Others are taxable at the zero-rate (0%), reduced rate (5%) or standard-rate (17.5%). If the business makes totally exempt sales, you cannot register for VAT or reclaim any of the input VAT suffered. This can affect the competitiveness of your business.

If the business makes zero-rated sales, you can register and reclaim the input tax suffered. Your business can benefit significantly in this situation. However, what constitutes an exempt or zero-rated supply can be difficult to decide and may need careful consideration.

There is a flat rate scheme available for smaller businesses – see below.

Do I need to register?

You only have to register if the taxable supplies made by the business exceed an annual figure, currently £60,000. If your supplies fall below this you may be able to register voluntarily and obtain a repayment. This usually happens when you are making zero-rated sales.

Tax Tip

If you are setting up a business but have not yet started making supplies, you should register so that you can reclaim your input tax on start-up expenses.

Record keeping

You must keep detailed records of purchases, sales and expenses, as well as a summary of input and output tax. These records must be kept for six years. Failure to do so can lead to substantial penalties.

When do I have to make a return to HMRC?

Generally, once registered you will make a quarterly return to HMRC, summarising the outputs and inputs. It must reach them within one month after the end of the quarter.

Businesses that make zero-rated supplies and receive repayments of VAT may find it beneficial to submit monthly returns.

Businesses with expected annual taxable supplies under £660,000 may apply to join the annual accounting scheme whereby they will make monthly or quarterly payments of VAT but will only have to complete one tax return at the end of the year.

Inspection of records

The maintenance of records and calculation of the liability is the responsibility of the registered person but HMRC will need to be able to check that the correct amount of VAT is being paid over. From time to time therefore a VAT officer will come and inspect the business records. This is known as a control visit.

The VAT officer will want to ensure that VAT is applied correctly and that the returns and other VAT records are properly written up.

Offences and penalties

HMRC have wide powers to penalise businesses who ignore or incorrectly apply the VAT regulations. Penalties can be levied in respect of the following:

- late returns/payments
- late registration
- errors in returns.

Cash accounting scheme

If your annual turnover is below £660,000 you can account for VAT on the basis of the cash you pay and receive rather than on the basis of invoices.

Retail schemes

There are special schemes for retailers as it is impractical for most retailers to maintain all the records required of a registered trader.

Flat rate scheme

This is a scheme allowing businesses with taxable turnover not exceeding £150,000 and total turnover not exceeding £187,500 to pay VAT as a percentage of their total turnover. Therefore no specific claims to recover input tax need to be made. The aim of the scheme is to simplify the way small businesses account for VAT.

The Key

Most problems with VAT arise from poor record keeping and lack of understanding of the VAT system. Remember, we can help you with both and make life a lot simpler.

If you would like to discuss anything in more detail please get in touch.