

helping our clients prosper...



NO SUBSTITUTE FOR DRAGONFLY

If you provide services through an intermediary company and think you are protected from the so-called IR35 rules, you may need to look at your arrangements again. A recent decision in the High Court has made it easier for HM Revenue & Customs (HMRC) to ignore a 'substitution clause' in a contract if, in practice, substitution would not happen.

Although there are many factors to consider, a strong indication that an engagement is not akin to employment is a contractual right for the intermediary to send a different individual to do the work. Until the Dragonfly Consulting Ltd case, many people thought that the presence of a substitution clause was nearly conclusive in taking income outside IR35. The court made it clear that other elements are significant, in particular, the extent to which the client would allow substitution in reality. In the Dragonfly case, the client company wanted the services of the particular individual, a skilled IT system tester, and the manager said substitution would not happen in practice.

A complication in this case was that Dragonfly provided services through an agency, so there were two contracts. The 'lower contract' between Dragonfly and the agency contained a substitution clause, but the contract between the agency and the client did not. This 'upper contract' is usually outside the control of the worker, who often is unaware of its terms.

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Where there's a will...

If you don't make a will, you could end up leaving your relatives with serious problems after your death. Dying without a will increases the complexity and time involved in dealing with your estate. And the resulting uncertainty or disagreements between relatives can sour family relationships.

If a person dies intestate – without a will – the law will determine who inherits what. Many people believe that all their assets will automatically go to their surviving spouse or civil partner, but that is only the case for small estates. Since 1993, the statutory legacy that a surviving spouse (and nowadays a civil partner) can inherit in England and Wales has been set at £125,000 where there are surviving children and £200,000 otherwise.

The Government recently announced that these limits will go up to £250,000 and £450,000 from 1 February 2009. While this will give extra protection to surviving spouses and partners, it will not ensure that your estate is distributed how you would wish. There will still be cases where a family home has to be sold to enable children or other relatives to inherit their share of an estate under the intestacy rules.

The intestacy rules are different in Scotland. A surviving spouse who lived in a house owned by the deceased has a prior right to the home up to a value of £300,000 plus specified amounts of other assets. In Northern Ireland, the limits have been £250,000 and £450,000 since 1 January 2008.

The need for a will is even greater for people who live together without getting married or registering a civil partnership. If one partner dies intestate, their estate will pass to their family, with the only exception being their house if the couple owned it jointly.

Another very good reason for writing a will is to make sure your estate is distributed tax-efficiently. Operation of the intestacy rules may result in more inheritance tax than necessary being paid on the intestate's death or on a subsequent death.

Even if you already have a will, your circumstances and tax legislation may have changed. If you have no will, or have one but have not reviewed it recently, or want to minimise inheritance tax on your estate, please ask us for advice.

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THE CREDIT CRUNCH FALLOUT

The credit crunch started in the US, but first hit the UK over a year ago with the Northern Rock crisis and has grown in seriousness ever since. The sea change in the world's financial structure is affecting more and more people's lives.

Bank deposits The collapse of three Icelandic banks has served as this generation's reminder that even in the world of bank deposits, the rules of risk and reward still apply. The Icelandic banks were regular 'chart toppers' in the interest league tables, but it now appears that the marginal extra rate was there for a good reason, just as it was for BCCI 17 years ago.

On this occasion, individual depositors were lucky in that the government was willing to fill the gaps left by the Financial Services Compensation Scheme (FSCS), notably for deposits above £50,000.

Mortgages US sub-prime mortgages – property loans to risky borrowers – have been blamed by many commentators as one of the main causes of the crisis. Once those mortgages started to default, the effect was felt throughout the world because of the way in which the loans had been repackaged and sold to a wide range of institutions.

The backwash in the UK has seen banks and building societies adopt much more cautious lending policies. In some areas of the mortgage market – notably buy-to-let – there has been an over 70% contraction in the number of mortgage offerings.

If your solution to a cash shortage in the past

has been to remortgage, you may now need to rethink your options.

House prices By October 2008, house prices were falling at an annual rate of 15% according to the Halifax. That drop exceeds the entire fall of the 1990s and looks likely to continue. The Halifax notes that the current ratio of house prices to earnings is 4.92, which is still almost a quarter above the long-term average of 4.0. This view is echoed by data from the Nationwide.

The decline in house prices is a reminder that relying on residential property – be it your home or a buy-to-let – as your only retirement/savings fund can be a dangerous strategy.

Pensions The drop in share prices has inevitably reduced the size of many pension funds. For private sector final salary schemes, deficits will generally have widened as a consequence. That could mean higher employer (and employee) contributions in the future, unless there is a major market recovery. It will also increase the likelihood that these schemes will close to existing members – most have already shut their doors to new employees.

For other types of private pensions, including personal pensions, smaller funds will normally mean lower pensions, although annuity rates have been rising. Once again, higher contributions may therefore be required to restore benefits to the original target levels.

If you need help in dealing with your financial situation, please let us know.

Entrepreneurs' relief on property assets

If you hold business property outside your company, you need to take extra care to make sure you qualify for entrepreneurs' relief when you sell up. Entrepreneurs' relief in effect reduces your capital gains tax (CGT) rate to 10% on the first £1 million of gains on the sale of a trading company or an unincorporated business, subject to certain conditions. But extending relief to assets owned personally can be a bit more difficult.

For a sale of personally owned property to qualify for entrepreneurs' relief, it must be associated with a disposal of shares in the trading company or of an interest in a partnership in which the property is used. In addition, the property disposal must form

part of the withdrawal of the individual from participation in the business. HM Revenue & Customs (HMRC) has said that withdrawal does not mean the individual has to stop working for the business, but there must be a reduction in the partnership share or a sale of shares.

In principal, there must be no significant interval between the disposal of shares or partnership share and the disposal of the property. HMRC does allow some exceptions. If the business has ceased, the sale of the property will qualify for entrepreneurs' relief if the disposal takes place up to a year after the cessation or up to three years if the property has not been used for any other purpose in the meantime.

TAX RETURNS CONTROVERSY FOR SERVICE COMPANIES

A new question on the 2007/08 tax returns has caused controversy because of the ambiguous wording of HM Revenue & Customs' (HMRC) explanatory notes and because it appears designed to highlight taxpayers for enquiry. People who provide services 'through a service company' are asked to state the total amount of income derived from doing so, even though this income – generally employment remuneration and dividends – is reported elsewhere in the tax return.

The term 'service company' is much wider than companies caught by the IR35 rules. IR35 service companies have to account for tax and national insurance contributions under PAYE on income from engagements that would be employment if the individual worked directly for the client under the same terms.

For the tax return question, services are provided through a service company where the shareholders provide intellectual or manual services to the company's clients and more than half the company's income (before deducting expenses) is derived from their work. If more than half the company's income



consists of charges to cover materials or work done by employees, you need not answer the question.

The ambiguity in HMRC's explanatory notes resulted in HMRC issuing a revised explanation in September and a statement that there would be no adverse consequences for taxpayers who completed the question or

left it blank in a tax return filed before then. The new explanation adds that you need not keep any additional records to determine whether more than half the company's income is derived from services performed by the shareholders, but that 'best judgement' may be used.

It is hard to escape the fact that answering the question might result in HMRC opening an enquiry to determine whether the company falls within the IR35 rules, although HMRC's limited resources will mean that only a small percentage of tax returns will be questioned. If it is clear that the company's engagements are outside IR35, such an enquiry would have no consequences apart from being a nuisance.

Not answering the question may also result in an enquiry if HMRC thinks you should have done so. You may also leave yourself open to an enquiry after the normal time limit of one year after HMRC receives your tax return, because HMRC may argue that you have not provided enough information for it to be sure that your tax return is correct.

If you are concerned that you may fall within IR35, you should get in touch with us now.



New rules on PAYE liability

Employers may benefit from yet another change to the rules for collecting tax where HM Revenue & Customs (HMRC) recategorises a self-employed worker as an employee.

Recategorisation for past tax years normally results in the employer having to pay over to HMRC the income tax and national insurance contributions (NICs) that should have been paid for the worker under PAYE. Until 2006, HMRC generally accepted that the worker's self-employed income tax covered the employer's PAYE liability.

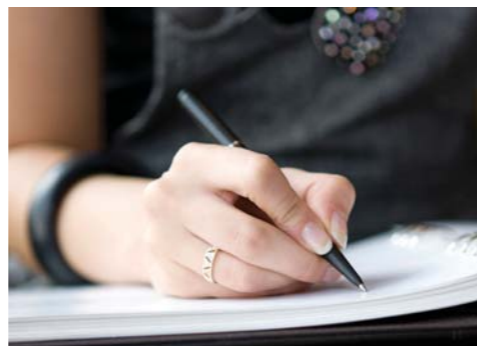
After the Demibourne case in the Court of Appeal, HMRC realised that it could not refuse a subsequent claim by the worker for repayment of the self-employed tax, but it would then be too late to reopen the settlement with the employer. That would leave HMRC out of pocket. Since then, the employer has had to pay the full PAYE amount, unless the worker signed a mandate authorising HMRC to set any repayments of self-assessed tax against the employer's PAYE liability.

A change in the legislation has now introduced a formal procedure under which HMRC will set the worker's self-employment tax against the employer's liability, subject to some conditions. First of all, there has to be a 'trigger event'. This can be an HMRC notice to the employer that tax is due on the payment, or a written agreement from the employer that they are liable to pay the tax, or receipt by HMRC of the mandate from the employee.

Further conditions are that the first trigger event for the liability occurs after 5 April 2008 and that the employer has not paid the tax. The new rules mean that employers no longer have to seek a mandate from self-employed workers.

Recategorisation often follows an HMRC compliance check. If you are subject to such a check, please get in touch with us right away, so we can help you ensure the best outcome.

The salary versus dividend decision



If you are both a director and a shareholder of your company, should you take extra income as a dividend or as a bonus? You can often save money

by paying dividends, but the saving could be marginal and there are other factors to consider in deciding your remuneration strategy.

There are no national insurance contributions (NICs) on dividends, which is what produces the saving. Companies must pay employer's NICs of 12.8% on a bonus and deduct employee's NICs of 11% on earnings below the upper earnings limit of £40,040 and 1% on earnings above the limit. Against this saving is the fact that, unlike dividends, salary and employer's NICs are deductible against corporation tax.

If your company pays corporation tax at the small companies' rate of 21%, the saving from paying dividends is significant. Say, for example, you have profits of £10,000 out of which you want to pay a dividend or a bonus. A dividend would give you net income of £5,925, compared to £5,230 for a bonus. The saving is much less if your company's profits are more than £300,000, so that it pays corporation tax at the marginal rate of 29.75% rate or the full rate of 28%.

Paying dividends may allow profit to be diverted to a shareholding spouse. This could give an additional tax saving if the spouse pays tax at the basic rate.

The government intends to restrict this possibility from 6 April 2009, but there is still plenty of time to pay dividends before then.

Dividends do have some drawbacks however. They have to be paid at the same rate to all shareholders, making them less flexible, though you can overcome this by creating different classes of shares with different entitlements. Salaries can be paid even when the company is making a loss. Dividends can only be paid out of profits of the year or undistributed profits of previous years.

Dividend income cannot support pension payments. Having a low salary may restrict the amount of tax relief you receive when making payments into your pension scheme. And if you are near retirement and your pension will be based on earnings, you may need to enhance your remuneration at least in some years. Dividend income may also be treated less favourably by lenders if you are trying to obtain a mortgage.

We can help you decide which of these and other factors are relevant in your case and devise the best remuneration strategy for your circumstances. Please ask us for advice.

Stamp duty land tax change

If you are buying a residential property between 3 September 2008 and 2 September 2009 inclusive, you can benefit from a temporary increase in the stamp duty exemption threshold to £175,000. The relevant date is normally the completion date and there will be no leeway for transactions just before or just after this period.

Everyone is entitled to the exemption, but the property must be solely residential. Mixed use property, such as a shop with a flat above, does not qualify. However, property being converted to residential use will qualify.

The exemption also applies to leases of more than 21 years where the net present value of the rent is £175,000 or less. The net present value is the rent payable over the whole term of the lease discounted by 3.5% a year.

Tax Calendar 2008/09

Every month

- 14 Instalment of corporation tax due for large companies with year ending 31 August 2007, 30 November 2007, 29 February 2008 and 31 May 2008.
- 19 Pay PAYE/NIC and CIS deductions for period ending 5th of the month. Submit CIS monthly return.
- 22 Due date for PAYE/NIC and CIS deductions if paying electronically.

December 2008

- 1 Corporation tax due for companies that pay the tax annually with year ending 29 February 2008.
- 29 File accounts at Companies House for private companies with year ending 29 February 2008.
- 30 Last day to submit 2007/08 tax return online to have unpaid tax of up to £2,000 collected through the 2009/10 PAYE code.
- 31 Submit CT600 for companies with year ending 31 December 2007. File accounts at Companies House for public companies with year ending 31 May 2008.

January 2009

- 1 Corporation tax due for companies that pay the tax annually with year ending 31 March 2008.
- 30 File accounts at Companies House for public companies with year ending 30 June 2008.
- 31 Submit 2008 self-assessment return electronically (up to £100 penalty if late). Balance of 2007/08 income tax and capital gains tax due, plus first payment on account for 2008/09 (interest charged on late payments). File accounts at Companies House for private companies with year ended 31 March 2008. Submit CT600 for year ending 31 January 2008.

February 2009

- 1 Corporation tax due for companies that pay the tax annually with year ending 31 March 2008.
- 2 Last day for employer to notify car changes in quarter to 5/1/09 – P46 (Car).
- 28 5% surcharge IT and CGT for 2007/08 if paid after this date. File accounts at Companies House for private companies with year ended 30 April 2008 and public companies with year ended 31 July 2008. Submit CT600 for year ending 29 February 2008.

MANAGING THE FINANCIAL CRISIS – WHAT'S YOUR PLAN?



The Federation of Small Businesses (FSB) conducted a snap poll in September that highlights the impact of the credit crunch on small businesses. The results revealed that over 80% of respondents said their costs had increased in the last year and 46% had seen a decrease in trade.

Worrying developments include increases in the cost of finance, such as loans and overdrafts, and extended payment times on invoices. But there are practical ways in which firms can manage their response to the present crisis. For example:

Focus on cash flow Issue invoices promptly and chase up debtors. Don't buy more stock than necessary and where possible negotiate longer credit terms with suppliers. Be aware that some larger firms could be extending their payment terms at your expense, so keep on top of the paperwork.

Review sales and marketing plans You can't just stop telling people you are in business, but you can look at the return on investment of marketing activity. Try an email campaign instead of direct mail and review how effectively you use your website.

Retain your customers Apply the

'80/20 rule' – work out who your most profitable customers are (the 20%) and focus on looking after them. Loyalty schemes, small discounts and regular communication should help you maintain key relationships.

Cut back on costs Look for savings in every part of your business. This could include selling redundant equipment, changing office space or clamping down on everyday expenses. Review existing contracts and get new quotes from suppliers – it never hurts to ask.

Credit check customers Protect yourself from bad debts by conducting credit checks and agreeing clear payment terms up front with all your customers, not just new ones. It might only take one major customer to go bust to jeopardise your business.

Avoid borrowing at high rates Bear in mind loans can be more difficult to obtain and more expensive in a slump. If you had plans for expansion, make sure your finance-raising strategy will not leave you further in debt.

If you find yourself in difficulty and need help, ask for advice sooner rather than later. Getting independent help in time can save you from experiencing more serious problems in the future.

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Coupled with the need to find out what the client would allow in practice, this makes it very difficult for the worker to decide up-front whether income falls within IR35. And it is difficult to argue against a ruling by HMRC that it does.

If the ultimate client wants the services of a particular individual, it now appears to be very difficult to put in place contracts that take the arrangement outside IR35. This leaves the worker

having to suffer the full tax and NICs equivalent to an employee without the protection that employment legislation would provide if he or she were employed directly by the client or even by the agency.

If an arrangement is otherwise indicative of self-employment, then the lack of a clear substitution right is unlikely to be decisive. If you would like to discuss this issue with us, please get in touch.

Payroll Solutions

- We offer an affordable payroll service for businesses of all sizes. If you are struggling with PAYE records, confused by complex legislation and just want a cost effective alternative for running your payroll, call Karen Rowland on 01872 272100.
- Karen Rowland can also provide assistance with the Construction Industry Scheme, including on-line verification of deduction status, monthly returns, production of contractor statements, and employment status advice.

This newsletter is for general information only and is not intended to be advice to any specific person. You are recommended to seek competent professional advice before taking or refraining from taking any action on the basis of this publication. The newsletter represents our understanding of law and HMRC practice as at 7 November 2008.