

J L WINDER AND CO AND WINDER (IFA) LTD

NEWSLETTER

SEPTEMBER 2005



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HUSBAND-AND-WIFE COMPANIES

Clients may have seen reports, in the 'serious' newspapers or in trade magazines, of the High Court's decision in the Arctic Systems case. In that case, the Judge held that, where a business is carried on by a husband-and-wife company, but one partner (say the husband) actually does the work that earns the money, then dividends paid to the wife can be taxed as if they were the husband's income. This would be significant where, for example, the husband pays tax at the higher rate and the wife at the basic rate.

The decision has caused a great deal of concern, with many family businesses wondering how it will affect their own tax situation. We think that, in practice, relatively few will be affected.

Arctic Systems itself concerned a freelance computer programmer who worked, as a member of a project team, on clients' premises. Had he been paid direct by his clients, rather than through the husband-and-wife company he had set up, it would at least have been arguable that he was the clients' employee, not an independent contractor. The Judge was at pains to emphasise that his decision applies only where the husband-and-wife company exists only to exploit the husband's (or the wife's) earning potential and the other partner plays at most a support role (for example by dealing with VAT returns and other administrative matters).

The Judge went on to say that his decision has no application to the situation where an independent business is carried on as a genuine joint venture by husband and wife - for example, where the company runs a shop in which both partners work. There is no suggestion that, in such a case, dividends have to be paid to husband and wife in proportion to the hours they work, or to the contribution each makes to the business, provided that each is doing enough to play an active role in the enterprise.

MORE THAN ONE HOUSE

Buy-to-lets are a popular investment and some people are, for example, retaining their old house or

flat as a buy to let when they move to a new home. In many cases, the transaction can be structured to obtain tax relief for the interest paid on some or all of the additional money borrowed. What is possible will depend on the exact circumstances, so we would always advise clients to discuss their options with us before finalising the financial arrangements. That said, it is often possible to rearrange existing mortgages to increase tax relief for the future, so it is also worth reviewing current arrangements.

CHILD AND WORKING TAX CREDITS

The Tax Credits system is still relatively new and, quite apart from the widely publicised problems with overpayments and the general administration of the scheme, unexpected difficulties are still arising.

One that has recently been identified is the situation following a bereavement. For example, suppose a married couple are claiming Child Tax Credit. Unexpectedly, the husband dies. His widow has too much to worry about to concern herself with Tax Credits and, in any case, she assumes the family's entitlement will if anything increase because of the loss of her husband's earnings.

In fact, she is liable to a financial penalty if she does not notify the Tax Credit Office within three months of her husband's death. More importantly, the couple's claim expires on the husband's death and so any payments made subsequently are subject to clawback. The widow should make a new claim of her own and, as claims can only be backdated for a maximum of three months, she will lose money if she does not do so within that time limit.

It is hoped that, in the case of a bereavement, the Tax Credit Office would in practice take a reasonable approach and grant concessionary relief, but at the very least the stress of sorting it all out is likely to make a bad situation worse. So if you know anyone who may be affected, it might be kind to have a quiet word with them, or

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alternatively ask them to contact us.

Similar rules apply where, instead of a bereavement, there is a separation, and here the Tax Credit Office is likely to be less helpful.

COMPENSATION FOR MIS-SOLD ENDOWMENTS

A new point has arisen, which we must ask clients to watch when compiling the information for their annual tax return. Compensation for mis-sold endowment policies and other investments may include an element of interest - the most straight forward example is where an insurance company simply refunds the premiums paid, plus interest.

Such interest is taxable (except in the case of mis-sold pension plans, for which there is a statutory exemption) and so should be declared on the investor's tax return. So if you have received this kind of interest, we need to know about it. If you have received a compensation payment but are not sure whether it includes interest, we shall need to see the relevant documentation.

NEW TAX REGIME FOR PENSION PLANS

A completely new set of tax rules for pension plans, and for contributions to pension plans, comes into effect on 6th April 2006. Overall, the new regime will be simpler and will offer more choices for pension savers, but there are still some points to watch.

One widely publicised change is that it will be possible for an individual to purchase a buy-to-let property within his or her personal pension scheme. This has been advertised as an opportunity to buy a house or flat at a 40% discount - on the basis that money paid into the pension scheme to fund the purchase will qualify for tax relief. Also, rental income and capital growth both qualify for tax exemption within the pension fund. The downside is, of course, that the money may only be withdrawn as retirement benefits in accordance with the usual rules for pension schemes.

There will also be an immediate practical difficulty in that, under the new tax rules, a pension scheme will not be able to borrow more than 50% of its net value. Thus if the pension fund consists of a cash deposit of £100,000, the scheme could only borrow a further £50,000, making its

maximum purchase a house or flat worth £150,000. Buying the same property by putting £15,000 into a new pension scheme and taking out a 90% mortgage will not be an option.

Again, in theory it will be possible to buy an overseas holiday home within a personal pension scheme - but there will be even more problems. Firstly, a tax charge will arise if the family uses the property without paying a full market rent. More importantly, the taxes levied by the country in which the property is situated must be considered. As a general rule, it will be necessary to purchase the property within a company, because most European countries do not recognise a personal pension scheme as a legal entity, and that the company will be subject to local taxes on its income and capital gains. Even if the pension plan holder still wished to proceed on that basis, it might be difficult to show that the purchase was a suitable investment for the pension fund, given the potential overseas tax liabilities.

Action before 'A'-Day

The date the new tax regime for pension funds takes effect - 6th April 2006 - has been dubbed 'A'-Day. Although the new rules are generally more favourable to the pension saver, in some cases an advantage can be gained by taking action before 'A'-Day. In particular:

- Under the new regime it will not be possible, as it has been in previous years, to claim tax relief for a pension contribution in the year before it was paid (usually referred to as 'relating back'). Accordingly, anyone who wants to take the tax relief in 2005/06 - for example, because he has an exceptionally high income this year - needs to make the contribution by 5th April 2006.
- When a pension saver has accrued benefits under a Retirement Annuity Contract originally taken out before July 1988, it is possible that he will be able to take a greater proportion of his total pension fund as a tax-free lump sum if he begins to draw his pension before 'A'-Day. This is particularly likely if the RAC offers a relatively high Guaranteed Annuity Rate. It is not usually possible to begin drawing a pension under a RAC before age 60.

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- At present, it is possible to base pension contributions on the highest earnings in the last five years - thus it is even possible to pay substantial pension contributions after retirement. But from 6th April 2006 post-retirement pension contributions will be limited to £3,600 a year.
- If contributions made after 5th April 2006 take an individual's total pension savings over £1.5 million, the usual pension fund tax exemptions on the excess will be clawed back. Therefore, if anyone wants - and is able - to put more than £1.5 million into their pension fund, they should do so before 'A'-Day. However, this is not likely to affect many people!
- It is currently possible for the proprietors of a business to arrange for their pension fund to buy commercial property, such as a small office building, and then let it to their business. This will remain possible under the new regime but the maximum loan that the pension fund can take to help finance the purchase will reduce, from one equal to 75% of the cost of the building to one equal to 50% of the net value of the pension fund (the same rule as for buy-to-lets). Thus a pension fund worth £200,000 could currently buy a commercial building for £800,000, but after 'A'-Day could only afford one worth £300,000.

Wait until after 'A'-Day

On the other hand, there will be situations where it will pay to wait until after 'A'-Day. For example:

- If benefits begin to be taken from a Free-Standing Additional Voluntary Contribution (FSAVC) Scheme before 'A'-Day, they must be taken wholly in the form of a (taxable) pension. After 'A'-Day 25% of the fund may be taken as a tax-free lump sum. FSAVC's are sometimes used as a 'top up' pension for an employee or director who is also a member of a company pension scheme.
- After 'A'-Day it will be possible for an individual, aged 50 or more, to make a substantial contribution to a pension plan and then immediately withdraw 25% of that contribution as a (tax-free) lump sum, leaving the remaining 75% to accumulate to produce a pension at a later date. For example, if a higher rate taxpayer contributed £20,000, the net cost of a pension fund worth £15,000 would be only £7,000 (after 40% tax relief - £8,000 - and a £5,000 lump sum) - though

this simple example does ignore the effect of the pension company's charges.

SAGE ACCOUNTANT PARTNER

We are pleased to announce that the practice has recently been awarded 'Sage Accountant Partner' status. This recognises the knowledge and expertise within the firm in assisting clients with Sage software.

We are able to offer a complete service to clients including:-

- On site visits to discuss your needs
- Recommendations of the most appropriate packages for your business.
- Installation and configuration
- Training of your staff
- After sales support and assistance

If you would like any help with Sage products or advice about your accounting software, please contact Julie Wilkinson or Stephen Leonard at our office.

EMPLOYING YOUNG WORKERS

There are many businesses which at some time or another employ young workers who are still of school age. What most employers will not realise is that the employment of any person of compulsory school age has to be registered with the Local Authority Education Welfare Service. We have noticed recently that several of our clients have been contacted by the EWS and most have been either:

- Unaware of their obligations or
- Have not carried out the correct procedures

There are rules governing:-

- How many hours they are allowed to work
- The type of jobs they are allowed to do
- Specific items of prohibited employment

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Work permits

Work permits must be obtained for anyone who is still of 'Compulsory School Age'. Young people are deemed to be of compulsory school age until the last Friday in June in the school year in which they reach 16 years of age, NOT on their 16th birthday or when they receive their national insurance number.

Application forms for registering your workers can be obtained from most schools, local authority offices and Education Welfare Offices. The forms need to be completed by the employer with details of the young worker, the type of work to be undertaken, the hours to be worked; they must also be signed by the young person's parent or guardian.

Failure to obtain permits

If employers fail to obtain the necessary permits for all young workers then they are liable for prosecution and also run the risk that their employers liability insurance will be invalidated in the event of any accident involving the young worker.

Summary

We would advise anyone who employs young workers (whether they get paid or not) to

contact the local education welfare service to discuss the matter further and ensure that they are correctly registered etc. The contact details are:

Barrow Education Welfare Service
Nan Tait Centre
Abbey Road
Barrow in Furness
Cumbria
LA14 1LG
01229 894407

OFFICE NEWS

The partners are pleased to announce that Stephen Leonard, who joined the practice in 1992, became a partner in the firm on 1st July 2005. In addition to this, he and another staff member Frances Jackson were married on 16th May 2005. The partners and staff wish them every success in their future together.

Congratulations also go to Lyndsey Faulds who gave birth to her first child, Ruby, in March 2005. Mother and child are both keeping well and Lyndsey is hoping to return to work in mid October.

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.

We believe the details are correct at this time but there may be certain errors or changes for which we cannot be held responsible.

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