

J L WINDER & CO AND WINDER (IFA) LTD

NEWSLETTER

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REFORM OF SMALL BUSINESS TAXATION

In December 2004 the Government published a 'discussion paper' on the taxation of small business profits, which concluded that it was unfair that two similar businesses could be liable to pay very different amounts of tax and national insurance contributions, simply because one traded as a company and the other as an individual or partnership - though the paper did recognise that the company does not always enjoy the more favourable treatment.

The solution suggested was a special tax regime for owner-managed small companies which, reading between the lines, meant charging national insurance contributions on profits distributed as dividends. The paper also suggested replacing tax-based investment incentives - for example, first-year allowances for equipment purchases - with grants or subsidies.

Since then, nothing much has happened, except that the zero per cent 'starting rate' of corporation tax has been abolished with effect from 1st April 2006 (having been restricted to profits retained within the company since April 2004). However, the March 2006 Budget Report makes it clear that the treatment of small businesses is still under review, with the intention of ensuring that 'all individuals and businesses pay their fair share of tax and national insurance contributions, irrespective of legal form'. For 'fair share' read 'the amount now paid by whoever is paying the most'.

The first stage of this review will concentrate on 'action to tackle disguised employment through managed service company schemes'. This is the area already targeted by the notorious 'IR35' legislation - the Government's attempt to tax as employees IT consultants and other contractors who work through their own one-man (or one-woman) personal service companies. 'Managed service companies' are simply personal service companies where administration - often including the provision of directors and a company secretary - is carried out on the contractor's behalf by a business set up to provide this service. Such businesses may also operate 'composite' or

'umbrella' companies, each of which services a number of unrelated clients. The Revenue are already challenging some of the 'composites' on technical grounds, but clearly the 'IR 35' legislation is still not, from the Government's point of view, fully effective.

STILL SCOPE FOR 'TURBOCHARGED' PENSIONS

In one recent tax change, the bad news is in the headline and the good in the small print. Last December, the Chancellor announced that he would take steps to block 'pension turbocharging', which had been identified as a tax planning opportunity opened up by the new tax regime for pension funds, operational from 6th April 2006. Basically, 'turbocharging' (also referred to as 'recycling') means taking a tax-free lump sum from a pension fund - available from age 50 even if the individual does not retire - and reinvesting it in a second pension fund. The reinvestment counts as a further pension contribution, which qualifies for tax relief. Alternatively, an individual wishing to make a pension contribution could anticipate the lump sum it would create - as we said in the August 2005 edition of this newsletter.

'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 contributes £20000, the net cost of a pension fund worth £15000 will only be £7000 (after 40% tax relief - £8000 - and a £5000 lump sum) - though this simple example does ignore the effect of the pension company's charges'

The bad news is that 'turbocharging' will indeed be blocked by new legislation, which will impose a special tax charge on the 'recycled' lump sum. But the good news is that the charge will not apply unless the pension lump sums taken in a twelve-month period exceed £15000 - and in some circumstances even more generous recycling ceilings may be available.

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A BUDGET FULL OF SURPRISES

This year's budget package included more surprises than usual - and, frankly, it was mainly bad news. From 2008, the filing deadline for personal, partnership and trust tax returns will be brought forward, from 31st January to the previous 30th November, if the taxpayer or his accountant files on-line, and to 30th September for those who prefer to submit a traditional, paper return. This reduction of at least two months in the time available for preparing tax returns will obviously cause a bunching of work in accountants' offices, which will be exacerbated by another Government proposal, to reduce the time limit for filing company accounts, from ten months to nine, and company tax returns, from one year to nine months, also in 2008.

Clients, also, will inevitably be affected, for some at least will have to send in the papers for their annual tax return much earlier than at present. The good news, however, is that the tax payment dates of 31st January and 31st July will not be changed and the new arrangements should give HM Revenue & Customs plenty of time to confirm tax calculations and send out statements of the amount payable on 31st January.

INHERITANCE TAX CHANGES

The second major surprise in the Budget was the extension of the special inheritance tax rules for discretionary trusts to most other family trusts. This is a very technical subject but the practical consequences are dramatic and wide ranging. For example:

- *There will be an immediate inheritance tax charge when a trust is established by a living person, unless the amount settled is within the settler's nil rate band (currently £285,000). There will be only a few exceptions to this rule - for example, very small settlements within the £3,000 annual exemption and trusts for disabled people.*
- *Where property is left, by Will, to a child or young person, additional tax charges will apply if the beneficiary does not take full control over the capital on attaining age 18. At present, it is usual for the beneficiary to be paid the income from age 18 and then to receive the capital at age 25.*
- *Over time, the majority of trusts—whether set up during life or by Will, and including those set up before the new rules came into force on Budget Day—will become subject to a periodic charge to inheritance tax, charged as 6% of the fund's value, once every ten years.*

These changes will make effective estate planning even more difficult and will require all existing Wills to be reconsidered and possibly redrafted. They will also require all existing trusts and settlements (including life assurance policies and 'bonds' issued by life assurance companies as part of an off-the-shelf inheritance tax plan) to be reviewed - broadly speaking, there is a two-year transitional period during which action, if necessary, should be taken.

Another point to watch is that trusts are often created as part of a divorce settlement or by order of the Divorce Court. Trusts are also frequently used when a claimant receives substantial compensation for personal injury. On current information, it appears that trusts imposed by Court Order will be subject to the new tax regime in the same way as other trusts.

All current arrangements incorporating trusts will need to be reviewed - which will be particularly difficult where the trust was used to settle contested property rights on divorce. However, unless there are exceptional circumstances, it would probably be better to defer the review until the final legislation is enacted, probably at the end of July. This is because the draft has attracted so much adverse comment, especially from the legal profession, that it is possible significant, if highly technical, changes will be made, indeed some have already.

FLAT RATE VAT SCHEME

The Flat Rate VAT Scheme was introduced in April 2002 and is designed to simplify and reduce the administration and paperwork required by small VAT registered traders. The scheme can be used by any trader whose VAT exclusive turnover is less than £150,000 per annum.

A business that joins the scheme avoids having to account internally for VAT on all purchases and supplies, and instead calculates its net liability by applying a flat rate percentage to the tax inclusive turnover. The flat rate percentage depends on the trade sector into which a business falls for the purposes of the scheme. There is a wide spread of applicable percentages ranging (on introduction of the scheme) from 5% to 14.5%.

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Under the flat rate scheme businesses:

- *continue to charge their customers the normal rate for the supply (ie not the flat rate percentage) on all taxable supplies of goods or services.*
- *issue tax invoices to their VAT registered customers, and also to all other customers if the business chooses to do so (these invoices show the normal rate for the supply and are used for the customers VAT reclaim).*

They do not have to record all the details of the invoices issued or purchase invoices received to calculate the amount of VAT they must pay to Customs, the output VAT is simply the gross amount of sales multiplied by the relevant flat rate.

Capital assets

If capital assets are purchased with a VAT inclusive value of £2,000 or more, the VAT can be recovered in the normal way. This concession, however, cannot be used where the assets were

- *acquired for resale, or for incorporation in goods to be sold*
- *acquired to be hired out, leased or let*
- *for consumption within one year, or*
- *covered by the capital goods scheme.*

Discount

There is a discount of 1% off the relevant flat rate for the first year in which newly registered traders join the scheme. The discount is not applicable to clients who have already been using the normal VAT rules for more than a year.

Voluntary registration

In some cases it may even be beneficial for cashflow purposes to voluntarily register for VAT even if the turnover of the business is less than the registration limit. This could be the case for a business which provides all their services or products to VAT registered customers and who have little or no input VAT on their purchases eg a business which provides consultancy services.

Joining the scheme

Joining the scheme is simple and only requires one form to be completed with details of your business activities and your chosen flat rate;

the application will then be reviewed and approved by HM Revenue & Customs.

If anyone feels that they maybe interested in using the scheme please contact your usual staff member or partner who will be able to review your case and advise if it would be suitable for you to apply.

ACCOUNTING SOFTWARE

In the modern computer age, more and more clients are now interested in using accounting software for their business records, instead of the traditional manual cashbooks. If the correct software is purchased and used correctly, it can lead to many benefits including:-

- *up to date management information,*
- *reduced time for completing paperwork,*
- *reduced time (and costs) of producing annual accounts,*
- *possible marketing tools.*

However if the wrong software is used or the person using it is not trained or advised properly then the opposite effects can occur ie:-

- *Misleading management information*
- *Additional time for completing business records*
- *Increased time (and costs) of producing annual accounts*

All too often we are told by clients that they have purchased a particular piece of software and are having problems with it, we then have to spend time (and your money) solving problems that could easily have been prevented if we had been consulted before the software was bought.

Our staff are experienced in many types of accounts software and we would advise anyone who is considering purchasing new software to give us a quick ring beforehand and we will be able to advise you of the best software for your particular business, provide training for your staff and ongoing support as required. We are also able to obtain discounted prices on software and stationery which we can pass on to you.

A simple phone call now could save a lot of hassle and money in the future.

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PAYROLL

As some of you will know we have a specialist Payroll department within our office and we would advise you to look at the enclosed leaflet outlining how we may be able to assist you with your payroll needs.

- *The change in the number of people making the claim ie by marriage, divorce or by entering or leaving a civil partnership.*
- *Change in the number of children involved in a Child Tax Credit claim ie by birth, death or adoption.*
- *If you stop or start working, or your hours fall below the number required to claim working tax credit.*

TAX CREDITS

The time has arrived again where you need to consider the issue of tax credits. Many of you will have received your annual review/declaration packs which need to be dealt with before 31st August 2006. As many of you will know the tax credit regime has been beset with problems of underpayments, overpayments, lack of availability of telephone support etc. This has led many people to question whether it is actually worth applying for tax credits, we still believe that it is and if anyone requires assistance in reviewing or completing their forms please contact us and we will be happy to assist.

There are however several matters which **you** must advise the Tax Credit Office of as soon as they happen. Failure to do so can result in the wrong amount of tax credits being paid and/or penalties being imposed. These include:

BABY BOOM

There have been several new arrivals for the staff of JL Winder & Co.

First to arrive was Joseph, a son to Stephen and Frances Leonard, in October 2005.

He was followed closely by Billy Jack, a son for Scott and Michele Gomersall also in October 2005.

Finally, a third baby boy, Ben being the second child for Christine & Colin Niven was born in February 2006.

All the babies are happy and healthy, although the parents seem a little tired at times!

If you would prefer to receive future copies of our newsletter via e-mail please send your details to enquiries@jlwinder.co.uk

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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