

Newsletter

JANUARY 2006

ARE PENSION PLANS AS SAFE AS HOUSES?

The headline news from the Chancellor's Pre-Budget Statement was that it will not be possible, after all, to invest in buy-to-let houses and flats through a personal pension plan. Nor will it be possible to invest in holiday accommodation or 'alternative investments' such as antiques, collectors' items or fine wines.

For the last two years, it had generally been understood that investments in buy-to-lets, *etc*, would be permitted when the 'simplified' tax rules for pension schemes came into force in April 2006. Many people had pumped money into their personal pension plans, with a view to being ready to invest in buy-to-lets in April. They will not be able to withdraw their money and will now have to find alternative, permitted, investments.

In another part of his Pre-Budget Statement the

Chancellor confirmed that the *Finance Act 2006* will contain legislation enabling 'Real Estate Investment Trusts' (REITs) to be established. REITs will be a tax-efficient 'wrapper' for collective investment schemes investing in residential and/or commercial property, and personal pension plans will be permitted to invest in REITs. However, while this will allow personal pension holders to take a stake in the property market, it will not give them the hands-on control of their investments which most want.

Another problem created by the Chancellor's last-minute *volte-face* is that many individuals had paid deposits on 'off-plan' purchases of new-build buy-to-lets. Some have paid the deposit themselves and may, if they can afford it, complete the purchase as a private transaction outside the pension plan. Others

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REMEMBER:

To send us all the relevant details and information to complete your Tax Returns when you receive a 'notice to file' from HM Revenue & Customs

Edward F. Lowe
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have paid the deposit out of pension plan money and will need advice on how best to unravel the situation.

No ‘turbocharged’ pension plans

The Chancellor also announced legislation to block arrangements, which would otherwise have become possible in April, under which an individual aged 50 or more would have been able to withdraw a quarter of his pension fund as a tax-free lump sum, and reinvest it in another pension scheme to collect a second helping of tax relief. A tax-free lump sum could then be withdrawn from the second scheme to reinvest in a third, and so on until the lump sum was too small to make the exercise economic. This procedure was known in some circles as ‘turbocharging’. In fact, it had a substantial downside, as although it would have maximised the pension, it would have left the individual with a very small tax-free lump sum to enjoy on his final retirement.

TAX CHANGES AFFECTING SMALL BUSINESSES

The second headline news from the Pre-Budget Statement was the abolition of the ‘zero per cent’ starting rate of corporation tax. However, this was less dramatic than it sounded, because since April 2004 distributed profits (profits paid out as dividends) have anyway been taxed at 19%. Following the Chancellor’s announcement, the only real change is that small companies will also pay tax at 19% on profits retained for reinvestment in the business.

The Chancellor’s announcement may prompt some small company proprietors to consider reverting to sole trader or partnership status. However, some businesses have to operate as companies, because their clients or customers will not award contracts to sole traders or partnerships, and others should bear in mind the following points:

- * Trading as a company may offer commercial advantages – for example, a degree of limited liability
- * Providing they are not ‘personal service companies’ caught by the IR 35 legislation, incorporated businesses may still reduce their exposure to National Insurance contributions by distributing a proportion of earnings as dividends
- * Trading as a company may still be tax-efficient if the company is very profitable and reinvests a substantial part of its earnings in the business
- * Disincorporation may incur a tax cost: this could be significant but will depend on the circumstances

Clearly, disincorporation is a major step and we would strongly advise clients considering such action to discuss the advantages and disadvantages with ourselves before taking the decision.

Purchases of plant and machinery

Small businesses will be able to claim 50% first year allowances on purchases of plant and machinery in the year beginning April 2006. This will include purchases of vans and other commercial vehicles, but not ordinary motor cars.

Construction Industry Scheme

Implementation of the revised Construction Industry Tax Deduction Scheme ('New CIS') has been deferred until April 2007, apparently because the required systems could not be put in place in time for the planned April 2006 launch.

Valuation of work-in-progress

We have already discussed, with clients likely to be affected, recent changes which will require work-in-progress to be valued at its contribution to future revenues, rather than cost. The changeover will bring forward the point at which profit is recognised for tax purposes and so create a one-off extra tax charge for the year of change. In his Pre-Budget Statement the Chancellor announced that he would allow the extra tax to be paid in instalments over between three and six years, depending on the amount involved.

VALUE ADDED TAX

A number of recent developments (not all announced in the Pre-Budget Report) will affect a wide range of small, VAT-registered businesses:

- * Where an employer reimburses an employee for the cost of road fuel (petrol or diesel) used for business journeys, VAT Regulations allow the employer to treat the VAT element of the amount reimbursed as deductible input tax. This applies equally to a straightforward reimbursement and to reimbursement by way of a mileage allowance. In order to comply with European law, the Government has tightened the rules, to require the employer to hold a VAT receipt for any amount reclaimed. In practice, this means that employees and directors claiming fuel cost reimbursement, or business mileage allowances, should now be asked to submit petrol, *etc*, receipts with their expenses claims.

- * One of the rules governing deregistration has changed: deregistration will no longer be permitted on the grounds that turnover in the last twelve months fell below the registration threshold (currently £60,000). Instead, deregistration will only be allowed where the trader can convince HM Revenue & Customs that his turnover in the coming year will not exceed the deregistration limit (currently £58,000). As with anything to do with tax, this broad statement is subject to exceptions, principally concerning farmers and traders making mainly zero-rated supplies. In any case, we recommend that you discuss the advantages and disadvantages of deregistration with us, before contacting HM Revenue & Customs.
- * As part of his Pre-Budget Report, the Chancellor announced that the turnover ceiling for the Annual Accounting Scheme will more than double (from £660,000 to £1.35 million), with effect from April 2006. As its name suggests, this scheme allows a trader to submit a single VAT Return covering a whole year, but this must be preceded by quarterly or monthly payments on account, based on the previous year's figures. The possible disadvantages are that, if the trader's VAT liability reduces, he will have to wait until the end of the year to enjoy the benefit, and if his VAT liability increases, a substantial 'catching-up' payment may be necessary when he makes his annual Return.
- * Subject to European Commission consent, the turnover ceiling for the Cash Accounting Scheme will also rise from £660,000 to £1.35 million. Accounting for VAT on a cash received / cash paid basis (rather than an invoice date basis) may produce a cash flow advantage – though in other circumstances it may equally produce a cash flow disadvantage! A 'hidden advantage' is that cash accounting gives automatic relief for VAT on bad debts.

HM Revenue & Customs often follow the Government in presenting both Annual and Cash Accounting as deregulatory measures which will benefit all qualifying traders. In reality, neither scheme is suitable for everybody and so we would strongly advise clients to discuss their individual circumstances with ourselves before taking the decision to join either.

PAYE POINTS FOR EMPLOYERS

Many employers have traditionally submitted their annual PAYE Returns in two or more parts – for example, separate Forms P35 for monthly paid staff and weekly paid employees, or (for reasons of confidentiality) a separate P35 for the directors.

HM Revenue & Customs have given notice that, for 2005/06 and future years, employers must submit a single Form P35 which includes all the employees and directors covered by a PAYE scheme reference. If they do not, each Form P35 will be treated as an incomplete Return and a fine may be levied accordingly.

Once again, for all their protestations of ‘working together’ with employers, HM Revenue & Customs are putting their own convenience ahead of employers’ legitimate concerns and expectations.

New employees – Forms P45 and P46

When an employee changes jobs, his Tax Code, and whether he is required to make student loan repayments, should be notified to his new employer via the long-established Form P45 procedure. However, the system is no longer working well, because nearly three-quarters of job-changers fail to give their new employer a Form P45.

From 6 April 2006 a new version of Form P46 (the form completed by a new employee who does not produce a Form P45) will be used. This will:

- * Ask for more personal information, to enable a correct Code Number to be implemented as quickly as possible
- * Require the employer to operate Code BR (to deduct tax at the basic rate from all earnings) if the employee has another job, or is in receipt of a pension
- * Require the employee to state whether or not he is liable to make student loan repayments

AND FINALLY

Don't forget that virtually everyone who reached their 60th birthday by 25 September 2005, whether retired or still working, is entitled to a Winter Fuel Payment. (The main exceptions are some long-term hospital in-patients and care home residents.) The benefit is not means-tested and is worth £200 (for either a single person or a couple), or £300 if any member of the household is aged 80 or more. Payments are normally made automatically by Christmas. If any qualifying member of your family has not yet received their 2005/06 payment, they should telephone the Winter Fuel Helpline on 08459 15 15 15 (8.30am to 4.30pm, Monday to Friday only) or log onto www.thepensionerservice.gov.uk/winterfuel and download a claim form.

News from Franklin House

I am happy to say that another Tax Return deadline, 31 January 2006, has passed and that we have again successfully

completed and filed our clients tax returns. I would like to thank my staff for the hard work they put in during the period leading up to the deadline.

I am disappointed that there were still a small number of clients who brought in their details late resulting in staff members having to burn the midnight oil to ensure these clients did not receive a £100 penalty for late submission of their tax return.

This has also meant that clients with year ends in October to December having to wait a little longer to have their accounts prepared.

From this coming year clients who have a year end before the 31 March bringing in their records after the 31 October (6 months after we would expect them) will have their accounts prepared as part of our normal work schedule without any priority and will run the risk of having their tax return submitted late. I would urge these clients to take note.

Ed Lowe 1 February 2006

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 facts are correct as at January 2006 but there may be certain errors and omissions for which we cannot be held responsible.

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