A pocket guide of everyday tax issues

2006/07

Hendersons

Chartered Accountants
& Business Advisors

www.hendersonsca.co.uk

Practical tax tips to guide you through the tax system and help you plan to minimise your liability.

Please use this guide to identify areas where you could take action, then contact us for advice and to discuss the most appropriate way forward.

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A FEW ESSENTIALS

Introduction

In the UK the greater bulk of **income tax** which flows into the exchequer does so by deduction at source. The tax is taken from income before it is paid to the taxpayer and most of this happens by way of Pay-As-You-Earn (PAYE). This collection system will no doubt be familiar to almost everyone who is in employment and also to those who receive pensions.

Most of the rest of the income tax collected at source comes from deductions made by banks or building societies from interest paid to savers. Most of us, children, retired folk or working people alike, will have savings accounts of one sort or another and many might also have shares from which income arises in the form of dividends. These too are treated as having suffered income tax at source.

As these circumstances cover the overwhelming majority of individuals, more than 80% of the population will have little or no regular contact with HM Revenue and Customs (HMRC), the organisation that administers and regulates all taxes in the UK.

Around 9 million taxpayers, however, will have something more than a regular income taxed under PAYE and interest on savings. Instead they might have income from their own business or receive rent from a property. Alternatively, it may be that their income is high enough to attract higher rate tax so that the tax deducted at source is insufficient. These taxpayers may be asked to complete a self assessment return each year and then they will have direct contact with HMRC.

However, income tax is not the only means by which the government relieves us of our hard earned cash. You may own assets such as a precious antique, a second home or shares. If such an asset is sold, the chances are that a profit will arise and this may give rise to a liability to **capital gains tax**. Details of any capital gains may have to be included on the self assessment return.

Tax Planning

If not asked to complete a tax return, it remains the taxpayer's responsibility to advise HMRC if there is a new source of untaxed income or a capital gain that will lead to a tax liability. Please contact us for further advice if this affects you.

Inheritance tax may be payable on the assets that you give to others in your lifetime or leave behind when you die. At one time very few individuals had to worry about this tax. However, rises in house prices have changed that and many more estates have now become liable. Careful planning can help to minimise this tax but it means that more and more of us cannot ignore this potential burden on our estate.

Many of those in business have to understand the principles of **value added tax** because they will have to act as an unpaid collector of this duty. In addition, those who run their business through a limited company will be concerned about **corporation tax** - a tax on their company's profits.

This booklet is designed to provide you with a simple guide to all of these taxes from five perspectives - that of the family; the working man or woman in employment; the person running their own business; the taxation of investments; and, finally, knowing that nothing is certain except death and taxes, the potential liability on your estate!

Please use the guide to help you identify planning opportunities, pitfalls to avoid and areas where you may need to take action and then contact us for further advice.

Tax Planning

Remember to keep all tax related documents such as interest statements, dividend vouchers, P60 etc. Place everything in an envelope or folder through the year as it is received. Then you can simply hand this to us when we need to prepare your SA return.

Self assessment (SA) timetable

- Income tax and capital gains tax are both assessed for a tax year which runs from 6 April to the following 5 April.
- Shortly after 5 April - SA returns are issued by HMRC.
- 30 September following - paper returns must be submitted if HMRC are to calculate the tax due.
- 31 January following - final date for submission of return and all outstanding tax to be paid.
- There is an automatic penalty for late filing of the return of up to £100 and more serious penalties for on-going default.

FAMILY MATTERS

Husband and wife

2006/07 Income Tax Rates

£	%
0 - 2,150	10
2,151 - 33.300	22*
Over 33,300	40**

*10% on dividends, 20% on other savings income
**32.5% on dividends

Today, married couples are taxed as independent persons, each of whom is responsible for their own tax affairs. All individuals are entitled to a basic personal allowance of £5,035 before any income tax whatsoever is paid. The tax bands and rates shown in the box are applied to each spouse separately, so that each may earn up to £38,335 before they start to pay higher rate tax. There is no aggregation of income, no sharing of the tax bands and the basic personal allowance may not be transferred from one spouse to the other.

Higher allowances for those aged over 65

The basic personal allowance is increased to £7,280 where the taxpayer is aged 65 or over on the last day of the tax year in question and to £7,420 where the age on that day is 75 or over. This more generous allowance is, however, reduced by £1 for every £2 that the taxpayer's income exceeds £20,100. It cannot be reduced below the basic allowance of £5,035.

Married couples allowance

In the past, a married couples allowance was available, given in the first instance to the husband. This is now only available to those couples where at least one spouse was born before 6 April 1935.

This allowance can be worth over £600 per year to a couple depending on age but its detailed application is complex. It is worth noting, however, that this allowance can be transferred to the wife or shared between the spouses if they so choose.

Minimising the tax bill

It follows from the basic rules set out above that tax is minimised if husband and wife equalise, as far as possible, their income so that all personal allowances are fully utilised and higher rate tax is minimised.

Example

Alan and Angela have employment income of £100,000 and no savings income.

If this is split equally between them, the total tax bill for the couple is £23,468. If only one spouse has income of £100,000 and the other has nothing, the total tax bill leaps to £31,734 - an additional £8,266!

Jointly owned assets

Married couples will often own assets in some form of joint ownership and, if they do not, then it is usually advantageous for tax purposes for transfers to be made to ensure joint ownership. This can have benefits for income tax, capital gains tax and even inheritance tax.

Where assets are owned in joint names any income is deemed to be shared equally between the spouses. If the actual shares of ownership are unequal, income is still deemed to be split equally unless an election is made to split the income in the same proportion as the ownership of the asset. One exception to this rule is shares in close companies (almost all small, private, family owned companies will be close companies) where income is always split in the same proportion as the shares are owned.

Tax Planning

If you and your spouse are both involved in running a business, income will be equalised if you are equal partners or equal shareholders; or, if only one of you is involved, the other could be employed even if only to use up their personal allowance.

Example

A buy to let property is owned three quarters by Helen and one quarter by her husband Mark. If nothing is done the net rental income on which tax is payable will be split 50:50. If an election is made, however, the income will be split 75:25. A choice can be made according to which is most desirable when other income of the spouses is taken into account.

Capital gains tax

Independent taxation also applies to capital gains tax. Each spouse is entitled to take advantage of the annual exemption of £8,800 before any capital gains tax has to be paid.

Therefore it is often most tax-efficient for sales of assets to be made by husband and wife jointly. Transfers may be possible shortly before a sale with no adverse consequences because transfers between husband and wife do not give rise to capital gains tax.

Capital gains tax is payable on the amount of capital gains over the annual exemption at 10%, 20% or 40% depending on the income of the taxpayer in the year of sale.

In effect the taxable gains are treated as the top slice of income and this allows further potential saving if assets are owned jointly, as maximum use can be made of each spouse's 10% and 20% bands.

Separation

The breakdown of a marriage will often involve the transfer of assets between spouses. The marriage continues until the decree absolute but, for transfers of assets to be entirely free of a charge to capital gains tax, the transfer must be made before the end of the tax year in which the separation takes place. Separation is deemed to happen when the couple cease to live together as man and wife - quite different to the date of the decree absolute which is often much later.

Example

If a couple cease to live together on 30 April 2006, transfers of assets must be made between them by 5 April 2007 for capital gains tax to be avoided.

Conversely, for inheritance tax, transfers taking place before the granting of a decree absolute will continue to be exempt. Even after this date, transfers will not usually be a problem.

There is usually no tax relief on maintenance payments made by one former spouse to another nor on any payments required by the Child Support Agency.

Children

It is often assumed that children are not taxpayers until they achieve some particular age.

In fact HMRC will tax a child just as readily as anyone else if the child has sufficient income to make them liable.

Transferring income to children

Children have their own personal allowances and tax bands. Where their only income is, at best, a few pounds from a paper round or a Saturday job, there may be scope for transferring income producing assets to the children to use up their personal allowance.

The problem is that if the parents do this the income will still be treated as belonging to them (until the child is 18 or marries) unless the gross income arising from such sources is not more than £100 per annum.

However grandparents and others are not subject to this rule.

Tax Planning

There is nothing to stop you employing your children in the family business so as to take advantage of their personal allowance provided that they are old enough (generally they must be at least 13 years old), they do not work more hours than is legal and they do actually carry out work for the business.

Children and capital gains

Children also have their own annual exemption for capital gains tax so that assets transferred to them which have a bias towards capital growth rather than income may prove to be more advantageous.

Repayment claims

Where children have significant sources of income from which tax has been deducted, such as bank interest or trust income, they will almost certainly be entitled to a repayment. In such cases a repayment claim should be made.

Child Trust Fund

For children born on or after 1 September 2002 a Child Trust Fund has been introduced. The idea is to encourage tax efficient savings, with the government's help, to build a savings fund which the child can access once he or she reaches 18. The government's initial contribution is £250 or £500 for low income families, with a further payment of £250 (and again £500 for lower income families) once the child reaches the age of seven.

Other contributions of up to £1,200 per annum can be added to the fund by friends or family and, although there is no tax relief on making the contributions, the fund is tax exempt. This is therefore a tax efficient medium to which regular transfers can be made.

Tax Planning

There are still quite a few ways income can be transferred to children tax efficiently:

- buy them premium bonds - winnings are tax free
- buy National Savings Childrens' Bonus Bonds or National Savings Certificates - these are tax free
- Friendly Societies offer 10 year, tax exempt savings plans for children for up to £25 per month
- a parent can contribute to a pension scheme for a child contributing up to £300 per month gross (net cost £234 per month) even though the child has no earnings.

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 and it will be available where combined income is less than £58,175 or £66,350 if there is a child under one year old.

There are several elements to the credit and claims can be complicated. Please talk to us.

Tax Planning

Many couples who are entitled to a tax credit do not receive it because they fail to apply.

Civil partnerships

All the special rules for married couples, both those dealt with in this section and those covered in other sections of this booklet, apply equally to same-sex couples who have entered into a civil partnership.

What about unmarried partners?

It still pays to equalise income as much as possible, as income tax will be minimised. However, transfers of assets may be liable to capital gains tax and, if substantial, could also lead to an inheritance tax liability. It is vital for unmarried couples to each make a Will if they wish each other to benefit from the other's estate at death.

A word of warning

There is a limit to the extent to which a couple should allow the tax tail to wag the familial dog! To do so has been known to have a high cost in terms of family relationships. There must be as much trust in matters of finance as in those other areas that go with the institution of marriage!

Moreover transferring assets or interests in a business between husband and wife can, and often does, attract the interest of HMRC. This is especially where it is obvious that it has been done primarily for tax saving purposes. Transfer of ownership of an asset must be real and complete, with no right of return and no right to the income on the asset given up.

If a spouse or child is employed in a business it must be a real job for which work is clearly being undertaken and if a non-working spouse is given shares in an otherwise one-person, private company, HMRC may regard this as a sham and continue to tax the working spouse on all of the dividends.

Always seek advice from us to determine the best way to arrange your business and personal affairs within the family unit.

Checklist for couples

- Try to equalise your income.
- Consider placing assets in joint names.
- If you have children consider making use of their personal allowance.

WORKING FOR OTHERS

Few avoid working for others at some time in their life and most will have encountered the PAYE system operated by employers to collect the income tax and national insurance (NIC) due on wages and salaries.

The tax code

Ensuring the right amount of tax is taken relies on a PAYE code, issued by HMRC and based on information given in a previous self assessment return or on returns supplied by the employer. The employee and not the employer is responsible for the accuracy of the code.

Tax Planning

If you are unsure about your code and are anxious not to end the tax year under or overpaid, then you should have it checked. Please talk to us.

Code numbers try to reflect both your tax allowances and reliefs and also any tax you may owe on benefits in kind, on untaxed income or from an earlier year. The code may even try to allow for higher rate tax that has to be paid on investment income. As can be imagined, with this many complications, and some guess work involved, getting the code exactly right can be difficult and the right amount of tax will not always be taken.

For many employees things are simple. They will have a set salary or wage and only a basic personal allowance. Their code number will be 503L and the right amount of tax will be paid over under PAYE.

Others will be provided with perks in their employment or they may be paid by the employer for expenses incurred. The more common examples of these complications are considered below.

Benefits in kind

Company cars

Company cars remain a potent benefit and for some a real status symbol, despite recent increases in the tax charge they give rise to.

The charge on cars is calculated by multiplying the list price of the car by a percentage which depends on the CO_2 emissions of the car. The table overleaf shows the percentages for 2006/07. Remember this is the amount being charged to tax, not the tax itself. Only the list price is used, irrespective of age (except that there are special rules

for classic cars), and the cost of any extras must also be added.

The CO_2 emissions of all cars are listed in well known car magazines or can be found on the internet. The definitive official figure for each car can be found on the Vehicle Registration Document.

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

If the car has a diesel engine the charge is increased by 3% (except that it cannot exceed 35%). However, diesel cars registered before 1 January 2006 and which met the Euro IV emission standards do not suffer this supplement.

Example

Paul has a BMW 320d (diesel) registered on 1 February 2006. It has an original list price of £20,955 and CO_2 emissions of 169. Paul had extras fitted to the car costing £1,000.

In 2006/07 the taxable benefit will be £5,050 ((20,955 + 1,000) x 23%). If Paul is a higher rate taxpayer the tax due on this will be £2,020 for the year.

2006/07	
CO_2 emissions (gm/km) (round down to nearest 5gm/km)	% of car's list price taxed
up to 140	15
145	16
150	17
155	18
160	19
165	20
170	21
175	22
180	23
185	24
190	25
195	26
200	27
205	28
210	29
215	30
220	31
225	32
230	33
235	34
240 and above	35

Fuel for private use

A separate charge applies where fuel is provided by the employer for a company car. The charge is calculated by applying the percentage figure used to calculate the company car benefit to a fixed figure which for 2006/07 is set at £14,400.

Tax Planning

The fuel benefit charge can be expensive. On a typical mid-range diesel car, for example, the cost to a 40% taxpayer is roughly equivalent to paying for 11,000 miles worth of fuel.

It may be cheaper for the employee to pay for all the fuel and to reclaim from the employer the cost of business miles driven based on a specific log of business journeys undertaken. HMRC have advisory rates for the cost of fuel which can be used for this purpose.

Engine Size	Petrol	Diesel	LPG
1400cc or less	11p	10p	7p
1401cc to 2000cc	13p	10p	8p
Over 2000cc	18p	14p	11p

Note that, for all purposes, travel from home to work and back is not usually business travel.

Medical Insurance

The employee is taxed on the amount of the premium paid by the employer.

Home and mobile telephones

There is no benefit on the provision of a company mobile phone even where it is used privately. However, this is limited to one phone per employee and their family. Where home telephone bills are paid by the employer, the amount paid will be taxed as a benefit. The employee may make an expense claim for the cost of business calls only but none of the line rental.

Cheap or interest free loans

If loans made by the employer to an employee exceed £5,000 in a tax year, tax is chargeable on the difference between the interest paid and the interest due at an official rate - currently 5%.

Tax Planning

Contributions by an employer to an approved pension scheme are tax and NIC free. This may be far better than any other perk. You may want to sacrifice some of your 'normal' salary to do this. Please talk to us to make sure your salary sacrifice scheme is effective.

Childcare costs

Childcare costs paid for by an employer are exempt from both income tax and NIC. This applies to a place in an employer operated nursery or where the employer pays for registered or approved childcare. In this latter case, however, the exemption is limited to £55 per week and any excess over this is subject to tax and NIC.

The costs will normally be paid in the form of vouchers or alternatively paid direct to the childcare provider. Any scheme must be open to all employees or all employees at a particular location.

Registered or approved childcare includes childminders, nurseries and play schemes registered by Ofsted, out of hours clubs run by a school on the school premises or by a local authority and childcare schemes run by approved providers.

Expense payments

Reimbursed expenses

Reimbursed expenses are taxable as a benefit but the employee can claim a deduction for those expenses incurred wholly for business purposes. The two will usually cancel out each other.

Tax Planning

Check if a dispensation is in place. If not, the employee must record reimbursed expenses shown on the P11D as income and then claim a deduction for the business portion of the reimbursed expenses.

If the employee does not receive a tax return they can write to HMRC to claim the deduction.

At the end of each tax year, the employer has to send a summary of all benefits to HMRC on form P11D. As well as the perks listed above, this form will include the reimbursed expenses.

The employee can then make an expense claim either on a self assessment return or by letter.

Because, often, nothing is taxable, employers can ask to be excluded from this process if they write to HMRC. This is known as a dispensation.

Mileage claims

Many employers pay a standard rate of mileage to all employees who use their own cars for business journeys. HMRC set authorised rates for business mileage which are currently 40p for the first 10,000 miles in a tax year and 25p thereafter.

If the employee is paid for business miles at less than the authorised rate, tax relief is available on the difference. If, however, the employee is paid at more than these rates then the excess is taxable.

Example

In 2006/07 Dave travels 14,100 business miles in his own car and is paid 32p per mile by his employer.

Dave can claim tax relief of £513 ((10,000 x 40p) + (4,100 x 25p)) - (14,100 x 32p).

Mileage payments do not have to be shown on the form P11D unless more than the authorised rates are paid.

Tax Planning

If you are paid less than the authorised rates to use your own car for business purposes remember to claim a deduction on your return or write to HMRC to make your claim.

Other transport issues

Vans

Where employees are provided with a van, and the only private use of this is to go backwards and forwards to work (including any incidental private use on the way), then no taxable benefit may arise. If there is private use beyond this, there is a benefit of £500 per annum or £350 if the van is more than 4 years old.

However, from 5 April 2007 the benefit on the private use of vans will rise sharply to £3,000 and there will be an additional benefit of £500 if fuel is provided for private use.

Tax Planning

Most double-cab, pick-up trucks are treated as vans and are a tax efficient way to avoid the car benefit.

Motorcycles

The provision of a motorcycle by an employer for private use will be a benefit in kind. The taxable amount each year will be 20% of its market value when first provided as a benefit.

If an employee uses their own motorcycle for business travel their employer may pay them up to 24p per mile tax free. If the employer pays less than this then the employee may claim tax relief on the difference.

Bicycles

Keen to promote environmentally friendly travel, HMRC will not tax as a benefit the provision of a bicycle for travel to and from work or for incidental private use.

If an employee uses their own bicycle for business travel their employer may pay them up to 20p per mile tax free. If the employer pays less than this then the employee may claim tax relief on the difference.

Employee Checklist

- Check your tax code to avoid substantial underpayment at the year end.
- Don't reject a perk just because it is taxable.
- Company cars don't have to be expensive; choose wisely to minimise the benefit.
- Consider paying for fuel yourself and reclaiming business mileage.

WORKING FOR YOURSELF

Starting up a business of your own is a big step and not one to take lightly. The taxation of your business is only one of many commercial and legal aspects of starting a business that you will need to consider.

Preparation is the key and a proper business plan should be one of the first things you should do. However, tax matters are our concern here.

Choosing a business structure

The alternative business structures are:

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. If the business incurs debts which are unpaid, the creditor can seek repayment from the sole trader personally.

Partnership
A partnership is similar in nature to a sole trader but involves two or more people working together. A written agreement is essential so that all partners are aware of the terms of the partnership. Again the business and personal affairs of the partners are not legally separate.

Sole traders and partnerships are often referred to as unincorporated businesses.

Limited Company
A company is a legal entity in its own right, separate from the personal affairs of the owners and the directors. A company provides specific liability which means that the creditors of the company cannot make a claim against the owners or the directors except in very limited circumstances. Often this advantage is somewhat eroded because a bank, for example, may seek personal guarantees from the directors.

These potential advantages carry the downside of greater legal requirements and regulations that must be complied 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 again gives some protection to the owners from the partnership's creditors.

In this section we consider the differing tax treatments of the alternatives but you should choose which structure is right for you based on more than just the tax issues alone.

Tax Planning

If you operate as a limited company, there is a legal separation between you as the owner and the company itself. This means you cannot use the company cheque book as if it were your own! This requires a certain discipline without which all kinds of difficulties can occur.

Many will start off as a sole trader, taking advantage of the lack of any formal procedures to establish the business. Some, however, will need the protection of limited liability because they are in a high risk business or they may need the additional stature that is seen as attaching to a limited company. Alternatively, they may need to establish and protect a particular name which only the formation of a limited company will allow them to do.

The tax regime

Unincorporated businesses

A new business must register with HMRC within three months of commencing to trade. Income tax is paid on the profits of the business. The amount that the proprietor, or a partner in a partnership, draws out of the business (referred to as 'drawings') is irrelevant.

Profits are taxed on a current year basis as shown by the example.

Example
If the accounting period (or 'year') end is 31 March then, in the tax year 2006/07, the profits for the year ended 31 March 2007 will be taxed.

If, however, the year end was 31 August then, in the tax year 2006/07, the profits for the year ended 31 August 2006 will be taxed.

Many businesses choose 31 March (or even 5 April) as their accounting period end but this is not compulsory.

If losses arise at the beginning of a new business or if the profits grow appreciably month on month, then the choice of the accounting date can be important. Otherwise, the accounting date chosen will not be significant.

Working out profits
Profits are calculated using accepted accounting practices and crucially this means that profit is not necessarily simply receipts less payments. Instead it is income earned less expenses incurred.

Tax Planning

Try to incur expenditure just before rather than just after the year end, as this will accelerate your tax relief. Examples of the type of expenditure to consider bringing forward include building repairs and redecorating, advertising and marketing campaigns and expenditure on plant and machinery.

Not all of the expenses that a business incurs are allowed to be deducted from income for tax purposes but most are. However, it is important that you keep proper and comprehensive business records so that relief may be claimed.

Capital allowances

When assets are purchased for the business, such as machines, office equipment or motor vehicles, capital allowances are available. As with expenses, they are deducted from income to calculate taxable profit.

Payment of tax

A person who is self employed, either as a sole trader or a partner in a partnership, will usually pay tax twice a year, on 31 January and 31 July. At first this may seem confusing and is best explained by an example.

Capital allowances	
	Writing Down Allowance
Plant and Machinery*	25%# (reducing balance)
Motor Cars**	25% (reducing balance) - £3,000 max.
Industrial and Agricultural Buildings and Hotels	4% (straight line)

***For small businesses:** first year allowances (FYAs) of 50% for 12 months from 6.4.06 (1.4.06 for companies). 40% otherwise.
For medium-sized businesses: FYAs of 40%.
For all businesses: 100% FYAs on expenditure on energy saving plant and machinery.
**100% FYAs on new cars with CO_2 emissions not exceeding 120 gm/km until 31.3.08.
#6% on certain long life assets.

Example

A business starts on 6 April 2006. Profit for the period to 31 March 2007 is £10,000. Tax due in 2006/07 is £1,231.

On 31 January 2008 tax payable is £1,846 being £1,231 balancing payment for 2006/07 and £615 (50% of £1,231) payment on account for 2007/08.

On 31 July 2008 £615 will be payable being the second payment on account for 2007/08.

Tax Planning

The payments on account system can make tax payments very volatile if profits fluctuate widely from year to year. You must plan ahead carefully to avoid nasty shocks.

Profit in the year to 31 March 2008 is £30,000 and the tax on this is £7,200.

On 31 January 2009 the payment is £9,570 made up of £5,970 balancing payment for 2007/08 (£7,200 - (£615 +£615)) plus £3,600 payment on account for 2008/09.

On 31 July 2009 a second payment on account for 2008/09 of £3,600 is due. And so on ….

Companies

Unlike sole traders and partnerships who pay tax on profits only (and drawings are ignored), companies have two layers of tax. The first is tax payable by directors and shareholders on money they take out of the company and the second is corporation tax which is due on the company's profits.

Corporation tax

	Year to 31.3.07	Year to 31.3.06
Starting rate	N/A	0%
Lower marginal rate	N/A	23.75%
Small companies' rate	19%	19%
Upper marginal rate	32.75%	32.75%
Full rate	30%	30%

The starting rate (abolished from 1 April 2006) was normally applied where profits did not exceed £10,000. Where profits were between £10,000 and £50,000 tax was payable on this slice of profit at 23.75%.

The small companies rate normally applies where profits do not exceed £300,000. Profits between £300,000 and £1,500,000 are taxed at 32.75%.

The full rate applies to all profits where those profits are greater than £1,500,000.

Before 1 April 2006 companies with profits of less than £50,000 paid a minimum rate of 19% on profits distributed to non-corporate shareholders.

Tax on 'drawings'

The directors of the company will normally be paid a salary and this is taxed under PAYE as for all employees. The cost of this, including the employer's NIC, is generally an allowable expense of the company.

The shareholders of the company may be rewarded by the payment of dividends on their shares. In most small companies the directors and shareholders are one and the same and so they can choose the most tax efficient way to pay themselves. Using dividends can result in savings in NIC. This requires planning. Please talk to us to decide the best options for you.

Tax on profits

The profits of a limited company are calculated in a similar way as for unincorporated businesses and the same rules about expenses and capital allowances apply. Remember though that the salaries paid to directors, but not the dividends paid to shareholders, are deductible from the profits before they are taxed.

Payment of tax

PAYE and NIC on salaries is payable monthly (or quarterly where the amount due is less than £1,500 per month).

Corporation tax is usually payable nine months and one day after the year end, so the choice of year end has no tax consequence.

In recent years companies have become more popular as they can result in less tax being paid overall.

Tax Planning

The tax saved can be a potent argument for incorporation but it should not be the only factor in deciding the best business option for you.

Example

Terry and June own equally the shares in Scott Ltd. They have profits of £100,000 before allowing for their salaries.

They can arrange their salaries and dividends in the most tax efficient way and, assuming they draw all of the profits, the company will pay corporation tax of £17,087 and they will have income tax to pay of £1,613 each. This makes a total of £20,313.

Tom and Barbara are equal partners in Goodlife Associates and they have profits of £100,000. Irrespective of how much they draw and in what proportions, they will each pay income tax on £50,000. The amount due will be £14,179 each, making a total of £28,358.

Terry and June have saved £8,000 by operating as a limited company.

Value added tax (VAT) and your business

VAT is a tax ultimately paid by the final consumer and businesses act as the collectors of the tax. There are heavy fines for failing to operate the system properly.

What does VAT apply to?

VAT is chargeable on the supply of goods and services in the UK when made by a business that is required to register for VAT.

A registered business must charge VAT on its sales. This is known as output tax. However, that business will also pay VAT on the goods and services it buys. This is known as input tax.

If the output tax exceeds the input tax, then a payment of the difference has to be made to HMRC. This calculation is normally done quarterly. If input tax exceeds output tax, a repayment of VAT will be made. This calculation is also done quarterly except that if repayments occur regularly this can be done monthly.

Tax Planning

When you first register for VAT you can reclaim input tax on goods purchased up to three years prior to registration provided they are still held when registration takes place. VAT on services supplied in the six months prior to registration may also be reclaimed.

Supplies

Certain supplies of goods and services are not subject to VAT at all and are known as exempt supplies. A business that makes only exempt supplies cannot register for VAT and will be unable to reclaim any input tax.

Other supplies are called taxable supplies but there are different rates - zero rate (0%), reduced rate (5%) and standard rate (17.5%).

There are two examples of input tax that a business may incur that are not usually reclaimable. These are VAT incurred on entertaining business customers and VAT on the purchase of a car.

Do I need to register?

A business must register if its taxable supplies exceed an annual figure, currently £61,000. If taxable supplies are less than this a business may still register voluntarily. So, for example, if the business makes only zero rated sales, it can still register and reclaim the input tax suffered.

Tax Planning

You should consider carefully whether to register voluntarily. If the VAT at stake is relatively small the responsibilities of registering may outweigh the benefit.

VAT can affect competition. A plumber, for example, who sells only to the general public will be at a disadvantage if they have to register for VAT. They may have to charge up to 17.5% more than a plumber who is not registered to earn the same profit. On the other hand, if the same plumber only works for other VAT registered businesses, such as building companies for example, then it will not matter if they are registered because the customer will be able to recover the VAT that is charged.

Indeed, in general, a business that always sells to other VAT registered businesses will normally register, even if below the annual limit, because then it can reclaim VAT on purchases and expenses. This will improve profit. This can be especially relevant for new businesses because there are often high start up costs that carry VAT.

On the other hand registration comes at the cost of having to meet onerous record-keeping requirements, a need to submit VAT returns on time and a fundamental need to get it right! Failure on any of these points exposes the business to penalties which, in some cases, can be substantial.

Schemes for small businesses

The Flat Rate Scheme

This scheme, designed to make the VAT system simpler, is open to businesses whose annual taxable supplies are less than £150,000. It allows businesses to pay VAT at a fixed percentage of their total turnover and no specific claims to recover input tax need to be made. The fixed percentage depends on the type of business.

The Cash Accounting Scheme

If annual taxable supplies are less than £660,000, a business may calculate its VAT payable by considering only the output tax and input tax on invoices which have been paid, rather than by reference to the invoice date alone. This is advantageous where a business has to wait a long time before it is paid by its customers.

The Annual Accounting Scheme

If taxable supplies are below £1,350,000 a business may choose to make only one annual return instead of quarterly returns. However, interim payments of VAT must be made monthly or quarterly by direct debit based on an estimate of the amount due.

By reputation VAT is a tax full of pitfalls for the unwary but most problems arise from poor record keeping or a lack of understanding of the rules. We can help with both and make your life a lot simpler.

Checklist for starting up in business

- Make a business plan.
- Choose the most appropriate structure.
- Set up a bank account.
- Register for VAT if necessary or if voluntary registration would be advantageous.
- Notify HMRC of the new business or company.
- Set up a PAYE scheme if there are employees (always if using a limited company).

Please talk to us for advice on these essential steps.

TAX AND YOUR INVESTMENTS

Setting aside income in the form of savings is important for us all, to provide for the unexpected or to build up a nest egg that we can enjoy in retirement. Given that the earnings from which our savings come have already been taxed, people often object to the fact that any return they enjoy on their investments will usually be taxed again.

In this section we consider what are the most tax efficient investments to make.

Tax Planning

Interest paid to individuals by banks and building societies will have tax deducted at 20%. If you do not pay tax you can sign a form to have the interest paid gross. If you have suffered tax but are not liable for it, you can make a repayment claim.

Pensions

Pensions are one of the most tax efficient forms of saving. A higher rate taxpayer can contribute £100 to an approved pension fund at a cost of only £60 and investment income and capital gains will accrue within the scheme largely tax free.

An individual is entitled to tax relief on personal contributions in any given tax year up to the higher of 100% of earned income or £3,600. The contributions are paid net of basic rate tax and the pension provider will then recover the tax from HMRC. Higher rate relief, if appropriate, can be claimed from HMRC. Contributions of more than this can be made into a scheme but the excess will not attract tax relief.

An employer may make contributions to a scheme and a deduction from profits may be available to the employer.

Despite these generous reliefs there are controls which serve to limit very high levels of contribution. These are complex but, put simply, they will give rise to a tax charge if annual contributions result in an increase in pension rights for a year of more than £215,000 (for 2006/07) or if the value of the fund when benefits are taken is greater than a lifetime allowance which, for 2006/07, is £1.5 million.

When the pension is taken, the fund must be used to buy a life annuity. However, part of the fund, normally 25%, may be used to take a cash free lump sum.

Tax free savings

Individual Savings Accounts (ISAs)

ISAs are free of income tax and capital gains tax. There are maximum investment limits which apply for each tax year but, over several tax years, large investments can be made. The ISA can be in stocks and shares, cash or life insurance but most ISA providers invest solely in stocks and shares (maxi or mini). Banks and building societies provide mini cash ISAs.

Individual Savings Accounts

	2006/07		**£**
Overall investment limit -	**maxi ISA**		7,000
	mini ISA	- stocks shares and life insurance	4,000
		- cash	3,000

Note that if, say, a cash mini-account is opened, no maxi-account can be opened in the same tax year so that only a mini stocks and shares ISA can be opened. 16 and 17 year olds are able to open mini cash ISAs.

Other tax efficient investments

The following investments work in varying ways. You should consider your needs in detail before entering into any commitments.

National Savings products

There are a number of products, taxed in different ways, but some, such as savings certificates, are tax free.

Premium bonds

Another national savings product, premium bonds are tax free and you could win £1m! By their nature, returns are volatile. However, prizes total 3% of the premium bonds in issue so that, statistically, a large investment (maximum £30,000) should yield something similar to this. 3% is equivalent to a gross return of 5% to a higher rate taxpayer.

Single premium insurance bonds

These 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 £400,000 in 2006/07. Capital gains tax exemption may be given on sales

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.

of EIS shares held for at least three years. If the proceeds realised on the sale of any chargeable asset (eg quoted shares, second homes, etc) are reinvested in EIS shares, the gain on the disposal can be deferred.

Venture Capital Trusts (VCT)
These bodies 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 30% is available on subscriptions for VCT shares, up to £200,000 per tax year, so long as the shares are held for at least five years (three years for shares issued before 6 April 2006).

Capital gains tax (CGT)

Introduction

Making the most of your investments requires some understanding of CGT. CGT arises on the sale of most assets and, subject to various reliefs and exemptions, is payable on the difference between the sale proceeds and the original cost. The first £8,800 of gains, for 2006/07, are tax free. The rate of tax will be 10%, 20% or 40% depending on your income chargeable to income tax in the year of sale.

Tax Planning

Consider spreading the sales of assets such as shares or valuable antiques over several tax years. Shares giving rise to a gain of, say, £24,000 would result in no tax if sold over three years compared to more than £6,000 if sold in one year by a higher rate taxpayer.

Taper Relief

Number of complete years asset held after 5.4.98 (including 'bonus' where relevant)	Taper for non-business assets %	Taper for business assets %
1	0	50
2	0	75
3	5	75
4	10	75
5	15	75
6	20	75
7	25	75
8	30	75
9	35	75
10 or more	40	75

Some assets are exempt from CGT such as motor cars (including classic cars), personal goods such as jewellery or antiques sold for less than £6,000, UK government bonds and, crucially, your only or main home.

Taper relief

Until April 1998 the gain on a disposal was reduced by an allowance for inflation called indexation allowance. Assets sold now, and bought before this date, will still attract some indexation allowance up to April 1998. After this date a taper relief was introduced.

Taper relief is a percentage reduction in the capital gain and depends on the number of complete years of ownership of the asset after 5 April 1998. A bonus year can be added for non business assets where the asset was acquired before 17 March 1998. The rates of taper relief are shown in the table.

Example

Fred bought a Nevinson painting in 1990 for £10,000. He sold this in December 2006 for £91,000.

The gain is £81,000 (ignoring indexation allowance). The taper relief will be £28,350 (35%). He has owned it for eight complete years since 5 April 1998 but because he owned it on 17 March 1998 a bonus year is added to make nine.

The gain is £52,650 before the annual exemption.

Business assets

Business assets, which qualify for the higher rate of taper relief, currently include:

- an asset 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.

Example

John started his own computer software company in 2001 subscribing for 1000 £1 shares. In October 2006 he sold his shares to a large plc for £1.9m.

The gain is £1,900,000 - £1,000 = £1,899,000. Taper relief is 75% because John has owned the shares for more than two years in an unquoted trading company. This reduces the chargeable gain to £474,750. If John is a higher rate taxpayer he will pay CGT at 40% on the taxable gain. The tax is £189,900 ignoring the annual exemption.

As can be seen this equates to 10% of the gain.

However, the definition of what constitutes a business asset has changed since 1998 and this can mean that the full 75% is not available. Please talk to us if you are contemplating the sale of any business asset..

Main residence

An individual's or married couple's only or main residence is exempt from CGT. The exemption extends to grounds of up to half a hectare. Larger grounds may also be exempt.

The sale of a part of the garden or grounds for development may also be covered by the exemption.

Subject to exceptions, periods of absence are chargeable but, if the main residence was let during absences, as a result of which a charge arises, a 'letting relief' may apply to reduce the chargeable gain.

Tax Planning

If you have two or more homes you can elect which one is to be your main residence. Your decision can be crucial. Contact us for advice if this affects you.

Relief is given on only one residence at any one time. However, once it is established that a particular home is the main residence, the last three years of ownership will always be exempt, even if another home has become the principal home during this time.

Example

Joe has a house in Kingston which is his principal private residence and which he has owned for eight years. Fed up with commuting he buys a flat in central London and elects for this to be his main residence. Exactly five years later he sells his home in Kingston.

The Kingston home is exempt for the first eight years whilst he was living in it and for the last three years because, even though he had another home which was his main residence during this time, the last three years is always exempt provided the home in question qualified as the main residence at some point.

11/13 of the gain on Kingston will be exempt from capital gains tax. If, two years later, he sells the flat and moves elsewhere, the whole of this gain will be exempt.

The main residence exemption can be complex and often causes a good deal of misunderstanding. Please contact us for further advice before making transactions in property.

PRESERVING THE INHERITANCE

Inheritance tax (IHT) has some unique features. It is easy to collect because the authorities meet with least resistance but, conversely, it is relatively easy for wealthy taxpayers to at least minimise it, if not avoid it altogether, and consequently IHT is sometimes referred to as a voluntary tax.

Nonetheless planning to minimise IHT is something that many put off until it is too late and early attention to this tax is almost always worthwhile.

Currently the threshold for IHT is £285,000 (this is sometimes called the nil rate band) and even if your assets are worth less than this you should consider making a Will so that you choose who gets your assets after your death.

The current regime

The key points of the current regime are as follows:

- 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 £285,000 is not chargeable
- some lifetime gifts are treated as 'potentially exempt transfers' or PETs. So long as the donor lives for at least seven years after making the PET there will be no possibility of an IHT charge whatever the size of the gift
- there are numerous exemptions and reliefs.

So what's the problem?

IHT is still a problem because:

- many are simply not in a position to make substantial lifetime gifts because it will leave them with insufficient capital to live on. As a consequence there is likely to be significant value retained in estates on death
- at the time of writing the threshold for IHT, £285,000, is roughly the same as the average price of a detached house in England and Wales. In such a case the house alone will use up the nil rate band and any remaining assets, such as investments and cash reserves, will be charged to IHT at 40%.

It is important therefore to consider ways of reducing any potential IHT liability.

Mitigating the liability

Don't waste your exemptions

Regularly using IHT exemptions will build up funds outside of the estate without incurring an IHT liability. A husband and wife can each take advantage of the exemptions, the main ones being:

- an annual allowance of £3,000 per donor per year. It can be carried forward for one year only if unused
- small gifts not exceeding £250 in total per donee per tax year
- gifts made out of income that are typical and habitual
- gifts made in consideration of marriage up to £5,000 if made by a parent, £2,500 by grandparents and £1,000 by others
- gifts to charities whether made during lifetime or on death
- gifts between spouses and same sex couples in a civil partnership, whether made during lifetime or on death.

Tax Planning

Remember that marriage invalidates any existing Will so make sure you write a new Will. This can be done before the wedding but in anticipation of it.

Tax Planning

Husbands and wives or partners in a civil partnership can each take advantage of the IHT nil rate band. Furthermore gifts between them are exempt. Therefore it pays to use this exemption to broadly equalise estates so that both partners can make full use of exemptions and the nil rate band.

Use the nil rate band

In lifetime

The nil rate band of £285,000 can be used to make 'tax free' gifts in lifetime. Such gifts will be a PET and if the donor survives for seven years they will then be able to make another gift of £285,000 knowing that this too will be covered by the nil rate band.

For wealthy individuals in a position to make substantial lifetime gifts of capital this can be very significant. For example, an individual in their early fifties who lives to age eighty could make gifts in excess of £1 million over the remainder of their life.

On death

On death, assuming the nil rate band has not already been utilised in the last seven years, it pays to ensure that it is not wasted.

Example:
Tom dies leaving the whole of his estate of £800,000 to his wife Pru. A few years later Pru dies leaving her whole estate of £900,000 to her children.

On Tom's death there is no IHT, as transfers between husband and wife are exempt, but on Pru's death the IHT payable is on £900,000 less any available nil rate band.

Had Tom instead left £285,000 to his children and £515,000 to Pru then on Tom's death there is still no IHT. On Pru's death, her estate will now be worth £615,000 and IHT will be payable on this less the available nil rate band. At current rates this saves £114,000 (40% @ £285,000).

Discretionary Will trust

Couples with modest estates find it hard to leave the nil rate band to children in their Will since that may leave the surviving partner short of funds. This can be overcome by the use of Discretionary Will trusts.

Tax Planning

Using trusts can provide an effective means of removing assets from an estate but still allow flexibility in their ultimate destination and allow the donor to retain some control. Some trusts are quite tax efficient but recent changes have somewhat limited this effectiveness. Contact us for more advice on this area.

Put very simply, the Will leaves an amount equal to the nil rate band into a discretionary trust and the remainder can pass to the surviving spouse. There will be no IHT. The trustees will be given powers to pay income or capital to the surviving partner from the trust in the event that funds are needed.

On the death of the surviving partner this discretionary trust is outside of their estate and any assets owned in the surviving parties own right will attract the nil rate band.

Use the 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.

Leaving business assets to the spouse will waste the relief since transfers to a spouse are exempt anyway. Therefore consider using business or agricultural property to make gifts to the children or others.

Make a Will

If you die without a Will, the intestacy provisions will apply and may result in your estate being distributed in a way you would not have chosen.

Use 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 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.

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?

DATES FOR YOUR DIARY

JANUARY

31st Deadline for tax return submissions. Balance of tax due under self assessment for previous year. First payment on account due under self assessment for the current year.

Tax Tip - *Before making any payments on account under self assessment let us know if your income has gone down in the current tax year - you may be able to reduce your payments.*

FEBRUARY

1st £100 penalty imposed where tax return has not been submitted.

28th Last day to pay any balance of income tax and capital gains tax due under self assessment for the previous tax year or 5% surcharge will be due.

MARCH

31st End of financial year for corporation tax.

Tax Tip - *It is time to consider using your capital gains tax exemption before the end of the year if you haven't already. Need advice on how best to do this? Give us a call.*

APRIL

5th End of tax year.

5th Last day to maximise ISA contributions.

Tax Tip - *Consider opening an ISA for the new tax year.*

MAY

19th Deadline for PAYE and construction industry end of year forms (forms P35 etc).

31st Deadline for giving P60s to employees.

JUNE

Tax Tip - *Not sure if you qualify for Child Tax Credit? If you have not claimed tax credits for the previous tax year then claims can only be backdated three months. The earlier you make the claim the better.*

JULY

6th Deadline for P11Ds, P11D(b)s and P9Ds. Application deadline for PAYE Settlement Agreements.

19th Class 1A NIC due for previous year.

31st Second payment on account due under self assessment. Second £100 penalty imposed where the tax return due on the previous 31 January has not been submitted. Last day to pay any balance of self assessment tax due for the previous tax year or further 5% surcharge will be charged.

Tax Tip - *Get your tax return information ready now. As a result you may also be able to reduce your second payment on account.*

AUGUST

Tax Tip - Concerned about inheritance tax (IHT)? Make the most of your £3,000 annual allowance by making regular gifts. Annual gifts of £3,000 could result in significant IHT savings over time. In addition you could consider making regular gifts out of income which are not chargeable to IHT. There are several other exemptions to think about - talk to us and don't miss out.

SEPTEMBER

30th Paper self assessment return due in if you want HMRC to calculate the tax.

Tax Tip - *Are you an employee or director and think that you have underpaid less than £2,000 tax in the previous tax year? Submission of your return before the end of September will give you the option of paying it through next year's tax code - effectively an interest-free loan! The deadline is extended for returns submitted electronically or on the internet to 29 December 2006.*

OCTOBER

5th Deadline for notifying HMRC of new sources of income if no tax return has been issued for previous tax year.

19th Tax and NIC (Class 1B) due on PAYE Settlement Agreements for previous year.

Tax Tip - *Not had a tax return but have a new source of income on which you will have to pay tax for the previous tax year? HMRC need to be advised so that a return can be issued and interest and penalties avoided.*

NOVEMBER

Tax Tip - *Review your pension contributions - you still have time to make an additional contribution and potentially reduce any payment on account due next January. We can review this for you.*

DECEMBER

Tax Tip - *If you're feeling charitable at this time of year, consider making a contribution to charity under the Gift Aid scheme and benefit from tax relief. Higher rate taxpayers may be able to claim the benefit of their higher rate tax relief sooner by carrying back the donation to the previous year.*

THINGS TO REMEMBER

This booklet is published for the information of clients. It provides only an overview of the regulations in force at the date of publication, and no action should be taken without seeking professional advice. Therefore no responsibility for loss occasioned by any person acting or refraining from action as a result of the material contained in this booklet can be accepted by the authors or the firm.

Hendersons

Chartered Accountants
& Business Advisors

Sterling House, Brunswick Industrial Estate,
Wideopen, Newcastle upon Tyne, NE13 7BA

T: 0191 217 0052
F: 0191 217 0053

E: enquiries@hendersonsca.co.uk
www.hendersonsca.co.uk