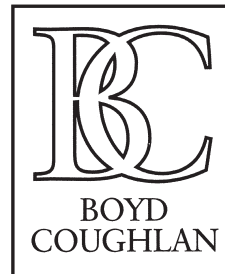


2007

SUMMER NEWS



ACCOUNTANTS

An inspector calls

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What's worse than receiving your tax return to fill in? Answer: receiving a letter saying that the Revenue want to ask you some questions about a past return. They started about 164,000 enquiries into the affairs of individuals in the year to April 2006 – those will range from fairly simple questions about single figures to a full “going over”.

A year later, the Revenue are hoping that they won't have to send out the letters – they are waiting for people to come to them. Another story tells how they have managed to acquire lists of offshore accounts held by UK residents with the five main banks, and they have been matching them up with tax returns to see who hasn't been telling them about their foreign income. They expect to raise up to £2 billion from a mixture of those who own up and those they have to chase.

If your affairs are in order, an enquiry from the Revenue is irritating, and we can help minimise the annoyance. If your affairs are not in order, an enquiry can seriously damage your wealth: you should take professional advice as soon as possible. The number of people reported to be on the Revenue's lists is so huge that they won't actually be able to cope with all the enquiry work – but it would be dangerous to count on it. ●

Losing a bet

An employee stole over £9m from his employers to fund his gambling habit. The spread betting business to which he gave the money knew where it had come from. When all was discovered, the employer successfully sued the betting business for the return of the money, because they received what they knew ought not to have been paid to them.

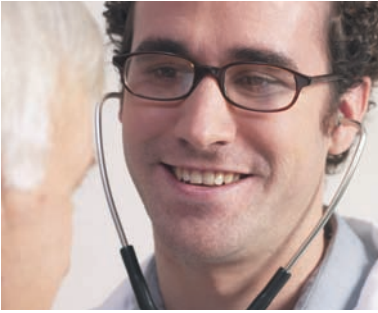
The gambling company then sued the directors and auditors of the employer for a contribution towards their loss because – according to their argument – the employee was only able to steal the money because the directors and auditors were negligent. The judge ruled that there was a correct principle here – if the

employer company had not been able to recover its money from the gambling company, the auditors and directors might have had to make up the loss if they could have been shown to be negligent. However, there was no way that the directors or auditors would be made to contribute to the gambling company when it knew what it was getting and stood to benefit, and they did not know and did not benefit at all.

It's a reminder that directors and auditors have a duty to mind their company's assets – and also that lawyers will always look for someone else to blame! ●



Caring doctors



There's no VAT on healthcare. That's been the case forever. But doctors' practices are having to get used to a change that came in on 1 May to what counts as "healthcare". Up to now Customs have reckoned that medical procedures have been covered by the exemption – if the doctor is wearing a white coat and using a stethoscope, there isn't any VAT. Now it's more complicated (why do these things never seem to get easier?).

The European Court ruled a few years ago that the exemption for "care" should only properly apply if the doctor was trying to do the patient some good – to diagnose or treat their illnesses, or somehow to protect or improve their health. If a doctor is doing a procedure for some other reason, it won't be exempt.

The sort of things that are most clearly affected are medical examinations for legal reasons – such as paternity tests, or to do with medical negligence and other lawsuits. If you are suing your previous doctor, the last thing you want is for your expert witness to cure you. That could cost you your damages claim!

Most of us won't notice the change, but doctors will certainly need to consider it. If they are already registered for VAT, they will need to make sure that they account for the tax on everything that has stopped being exempt; if they aren't registered already, they will need to check to see whether they now have to be.

Unfortunately, Customs have not issued very clear guidance. If this affects you, we will be happy to discuss it with you. ●

TAAR brush

The Budget introduced a "targeted anti-avoidance rule" which says that artificial schemes to create CGT losses will be blocked. The problem is knowing the difference between "standard tax planning to use the losses you have suffered" and "dodgy tax avoidance" – an accountant and a tax inspector might draw the borderline in different places.

At least the Revenue have published some examples of what they think is acceptable and what is not, so we have some idea of where they want to put the line. The problem is that it's a bit of a shock – it brands several routine ideas as unacceptable, including the sale of a lossmaking asset by a husband for it to be bought back

shortly afterwards by his wife.

Tax advisers think that's OK, as it simply crystallises a loss that the husband has actually made – but the Revenue don't like it.

The worst of it is that the new rules applied from 6 December 2006 onwards, but the guidance notes they issued at that time changed before the Budget in March. So people may have already done things thinking they were all right, and now they find that the Revenue are minded to object. If you have capital gains or losses, it's worth discussing the tax treatment well in advance of selling the assets – we'll be happy to advise you, and happier still once the Revenue have stopped changing their guidance. ●

Made to be broken

Newcastle United football club are in the middle of an argument with HM Revenue & Customs about fees that they pay to their players' agents for negotiating contracts. The club is claiming back the VAT charged by the agents, and to justify that it must have instructed the agents to act on its behalf in the negotiations.

Otherwise it's purely the player's bill, and the club can't claim the VAT on someone else's expense.

The problem is that the club isn't supposed to instruct the agent – the agent is meant to be acting for the player. The Football Association rules forbid the club to pay these fees – to avoid embarrassing questions from the FA, Newcastle filed reports saying "we didn't pay them", and then still claimed back the VAT from HMRC.

The VAT Tribunal chairman thought that this was all completely improper, and held that the club couldn't have the VAT back. The High Court judge said that the chairman was confused – he had mixed up what ought to

happen with what did happen.

There was no doubt that the club was not supposed to give instructions to the agents, but that didn't mean for certain that they didn't do so. Rules get broken, and the VAT should depend on what actually went on, not on what should have done.

There are many who think that the club is digging a deeper and deeper hole for itself. There is probably another argument to be had with the PAYE people about paying employees' bills once the VAT team have finished. It's a reminder to think about the tax consequences before picking up an expense for someone else – you could be given the red card. ●



Flat VAT

The VAT flat rate scheme for small businesses has been around for a few years now, and so far it has produced very few disputes in the VAT Tribunals. It can make life simpler – you don't have to worry about getting proper VAT invoices for your expenses because you don't claim input tax – and you can end up with more money, because you are allowed to keep the difference between the 17.5% output tax you charge to your customers and the flat rate percentage of receipts that you have to pay to Customs.

There are possible problems, though. One danger is that people apply the flat rate to the net invoice rather than the gross. If your flat rate is 10% and you charge your customer £100 plus VAT, you are supposed to pay £11.75 to Customs (10% x £117.50 gross), not £10. It's obviously important to get this right, both when operating the scheme and when deciding in the first place that it's right for your business.

Another issue is that you apply to go onto the scheme, but you don't agree the rate with HMRC in advance. You have to look at a list of types of business in the Customs Notice and pick the one that sounds most like you. When they come to visit they can decide that you got it wrong. Last year a publican (5.5%) was held to be mainly a restaurant (12%). Recently an ice-cream vendor won an argument that he was a food retailer (2%) rather than a caterer (12%).

If you are a bit of one thing and a bit of another, you have to go for the rate which applies to the largest part of your turnover – you don't apply different rates, and you don't take an average. You can see that getting it wrong could be very expensive – HMRC wanted 10% of the vendor's gross takings for the last three years. If you want advice about the flat rate scheme, we will be happy to help you. ●

Safe deposit

New rules came into force on 6 April 2007 to protect tenants who have to pay a deposit to their landlord on an assured shorthold tenancy agreement. The landlord will either have to hand the deposit on to a government-established custodian company, or will have to join an insurance scheme to protect the tenant's money. There are new procedures for sorting out disputes with tenants over the return of deposits and amounts deducted to cover the landlord's expenses.

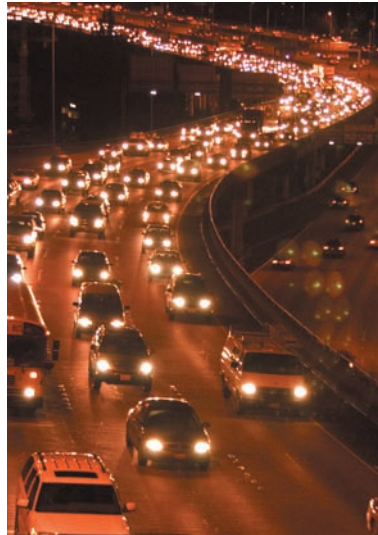
If you are a landlord, you need to be aware of your new responsibilities. It's also a worthwhile reminder that the agreement should make it very clear what the deposit is and what

may lead to it being wholly or partly forfeited. That should make it easier to settle disputes.

It has been reported in the press that the Inland Revenue will be notified about people registering as landlords under the scheme. They will be cross-checking against the records of people who declare rental income on their tax returns – so when they have finished trawling through the records of offshore bank accounts, they will move on to this.

There's plenty of information on the internet at www.direct.gov.uk/en/TenancyDeposit/index.htm, and if you want to discuss your responsibilities as landlord or your rights as tenant, we will be happy to help. ●

Tax on gas



If you buy fuel for business use, you can claim the cost as a business expense. If some of that fuel is then used for private motoring, there are tax consequences. A sole trader or partner has to add back some of the expenses; a company has to declare a benefit in kind for the employees. There's also a charge to VAT on the "deemed supply"

of fuel – that applies in the same way to sole traders, partners and employees.

For several years, the VAT charge has been based on a simple table of figures which depended on engine size, while the benefit in kind for employees depends on the carbon dioxide emissions rating of the car. Now VAT has "gone green" as well – but the figure you use is not exactly the same. You'll have to find out your CO₂ rating for the first time if you are a sole trader or a partner – the income tax rules wouldn't have applied to you before – and then you'll have to look up the new VAT figure in a table.

The different tax consequences for income tax, NIC and VAT – none of which are based on the actual amount of fuel you use – mean that it's hard to say whether it's better for the business to buy the fuel, or for private fuel to be always a private matter. If you're wondering which is best for you, we'll be happy to help. ●

Working late



If your employer pays the cost of your “normal commuting” – going from home to your permanent workplace – that’s taxable as a benefit in kind. There is a useful exception for the extra cost of getting home after occasionally having to work late. There are conditions – the exemption is for a taxi home when the employee has to work after 9pm and it wouldn’t be reasonable to expect them to take public transport. It mustn’t be

their normal finishing time, and it mustn’t happen either regularly or frequently. “Regularly” means every week on the same day; “frequently” means more than 60 times a year.

Recently a bank tried to claim money back from the Revenue – it had paid the tax on late-night taxis for its employees, and decided that it was entitled to the benefit of the exemption on the first 60 taxis for each employee in a year. The Revenue disagreed: if there were more than 60, they were all taxable.

Apparently the Revenue are now looking at other employers to see if other people may be taking the benefit of this misunderstanding – not paying the tax in the first place, rather than claiming it back later. It’s a useful exemption, but you can’t push it.

If you are in doubt about what you can do for your employees without triggering a tax charge, we are here to help. ●

Excuses, excuses

Paying your VAT late can become a very expensive habit. The first time you do it they send you a warning; the second time, they may charge you 2% of the outstanding VAT – in theory, for only being a day late – and after that it goes up to 5%, 10% and 15%. If you are always a week late paying, the 15% surcharges work out at an annual rate of interest of 780%. There are cheaper sources of finance available, even from loan sharks!

If you make a mistake once, it’s not the end of the world – you get the warning, then you file the next four returns and payments on time and you have cleaned up your record. If you are regularly late, it’s worth doing almost anything to get rid of the surcharge liability.

One thing you can do is plead a “reasonable excuse” for your lateness. This means that you acted in the way a “reasonable trader” would and the late payment was somehow beyond your control. The law says that simply “not having enough money” won’t do – but if you can show that there was a good reason for this, such as a bank error or a major customer paying you late, it might be accepted.

Customs are unsurprisingly sceptical when people offer them excuses. There are some things that are generally accepted, but they will want to be sure that they actually happened – and the same excuse will cease to be reasonable if it crops up again.

What is surprising is that the VAT Tribunal is much less sceptical than Customs – they find in favour of the trader about half the time. So a reasonable excuse appeal is not a lost cause just because Customs won’t accept it.

If you have problems paying your VAT or filing your return on time, we will be happy to discuss ways of avoiding the surcharge regime. ●

Composite companies

The rules known as “IR35” have been around for several years to catch people who – to use the Revenue’s phrase – “disguise employment” by operating through a limited company. Instead of paying the lower rates of corporation tax and avoiding NIC by paying out dividends, IR35 will drag you back within PAYE and Class I NIC – if, taking away the personal service company, you would be an employee of the client, and a number of other conditions are met.

One attempt to get around IR35 has been the establishment of “managed service companies”. Someone running a composite company which acted as an “umbrella” for a large number of individual workers could get

around the rules – up to the March Budget. New rules will effectively apply IR35 to MSCs from 6 April 2007.

Some people have suggested that a new way around the rules is for an “accountant” to run the MSC – the new rules don’t apply to accountants who provide services to clients. Some of those people who have been running MSCs up to now reckon that they can use this as a loophole. However, it seems likely that the Revenue will clamp down on that as well – they really aren’t keen on this sort of tax planning.

If you have been working through this sort of arrangement in the past, we will be happy to discuss with you the changes to the rules. ●

Reverse charges

After years of losing huge amounts of money to “carousel fraud”, which involves trading between EU countries generally in mobile phones or computer chips, the government has taken steps to stop the criminals getting away with our money. If this works, the savings to the Exchequer will be huge – if it doesn’t, more of everyone else’s taxes will be poured into the hands of conmen.

The way a carousel fraud works (don’t try this at home) is that Mr Dodgy sells a lot of phones or chips (small, high value items) to someone else and charges VAT. Mr Innocent then sells them to a customer in another EU state – that’s a VAT-free despatch, so Mr Innocent claims the VAT charged by Mr Dodgy from Customs. Meanwhile Mr Dodgy has disappeared with all the money Mr Innocent paid. As long as Mr Innocent truly had no way of knowing what Mr Dodgy was up to, and there really were some goods changing hands, Customs have to pay.

From 1 June, transactions in phones and chips for more than £5,000 on a single invoice will not be charged to VAT in the normal way. In this example, Mr Dodgy could only charge the net amount on a UK sale to Mr Innocent; Mr Innocent would “reverse charge” the VAT by putting it in Box 1 of the VAT return (as if he was selling the phones to Mr Dodgy instead of buying them) and also in Box 4. Innocent doesn’t claim anything back from Customs, and Dodgy has no means of conning people into paying over VAT that he can disappear with.

It may work and it may not – the Dodgies of the world have made so much money over the last few years that they are surely able to employ clever people to think of ways round it. Whether it does or not, if you are involved in these areas of business you will need to be ready for the change. We will be happy to help. ●

Beyond the grave

There used to be a rule that the Inland Revenue could collect tax and penalties from the personal representatives of a deceased person where the deceased had understated tax liabilities during his lifetime. They have now decided that this is contrary to the Human Rights Act – in effect, they are penalising the living (those who would otherwise benefit from the estate) for the offences of someone else (the deceased). The Revenue will therefore not now try to collect a “tax-geared” penalty from personal representatives on account of the deceased’s conduct.

They will still pursue the executors for their own defaults, of course, and they will be trying

to get as much inheritance tax out of them as possible. Meanwhile, the sins of the deceased may be subject to punishment in the Afterlife... ●



Director's two hats

A director is an “office holder” in a company who has rights and duties set out in company law and in the company’s articles of association. Directors are appointed by the shareholders in general meeting, and they can generally only be removed by the same people. If you belong to a board of directors which wants to get rid of one of your colleagues, you only have the right to vote them off if the articles of association say that – otherwise you have to get the shareholders to do it.

A director may also be an employee. It’s possible to be one without the other, and it’s possible to be both – it depends on the circumstances and the nature of the duties. Someone who turns up only for board meetings is likely not to be an employee as well; someone who works every day in the company and is a fundamental part of the operation is probably an employee. In between there are grey areas.

If a director is also an employee, all the rules of employment

protection apply to them. You are supposed to issue an employee with a contract of employment or written terms within two months of the employment starting. The Companies Act says that a director’s contract that will last more than five years has to be approved by the shareholders in general meeting, and one that will last more than 12 months has to be available for inspection by the members.

If you dismiss them, you are supposed to go through all the normal dismissal procedures, and they will be entitled to compensation for unfair dismissal in the normal way. There’s a basic problem here – a director can be dismissed by a vote of the shareholders in general meeting, and there’s nothing that can take away that right of the members of a company. The vote will almost certainly entitle a director-employee to compensation, because the company won’t have followed the correct procedure. ●

IHT plan fails

It's unusual to see tax cases in the national press, but Phizackerley made it because it hit a number of raw nerve-endings – an inheritance charge falling on a widow's estate because she had not done enough to earn her share of the marital home. IHT is unpopular in the press right now, and this seemed particularly harsh.

The couple had entered into a standard plan: they had put their house into "tenancy in common", which means that each owns half but the survivor doesn't automatically get the other half when one dies. The first to die – Mrs P – left her half to a trust. Mr P bought it back with an IOU for £150,000, payable when Mr P died. This sort of thing has been regarded as standard planning to take advantage of two nil rate bands for IHT – as IHT currently starts at £300,000, you can pass on £600,000 of house to your children with no tax as long as you can divide it in two in this way.

The problem was that, when Mr P died, the Revenue said that his executors couldn't treat the IOU as a "real" liability of his estate. It wasn't taken off the value of the whole house when working out his IHT. Why not? Because he had originally paid for the house –

he was the one with the job, so he must have generated the cash which bought the house for the two of them. There are rules to stop you deducting a debt for IHT if the debt arises on buying back something you gave away – even if the gift, the repurchase and the debt are spread out over nearly 20 years.

If Mrs P had been able to contribute cash to the purchase of the house – rather than just the effort of home-making that allowed Mr P to go out to work and earn money – there would not have been a problem. There are variants of this "two nil rate band" plan that still work, but some must now be called into question.

If you read about the case and were worried – or you are worried now! – we will be happy to advise you about what works and doesn't work in IHT planning. ●



VAT and cash

The cash accounting scheme is supposed to help small VAT-registered businesses with their cash flow. If you are using the "normal" rules of VAT, you are supposed to pay Customs the VAT included in your sales for the quarter – even if your debtors haven't paid you by the time you have to put the VAT return in. Under cash accounting, you only have to give the money to Customs after your own customers have paid you.

There is a downside – you can only claim back the VAT on your expenses once you have actually paid them, instead of just when you are invoiced. So if you pay your suppliers

more slowly than you collect on your sales, you are better off not using cash accounting. A retailer normally does this.

From 1 April 2007, the maximum turnover for entering the scheme has more than doubled from £660,000 to £1.35m. The government reckon that another 50,000 businesses will qualify for the scheme as a result. If cash accounting sounds like a good idea to you – whether you now qualify for the first time or you did before – we will be happy to help you with the rules. ●

Amnesty international

If you are UK resident and not "foreign domiciled" (usually meaning your parents were not born here), any income earned abroad is taxable. Last year, the Revenue persuaded a court that one of the high street banks had more customers with foreign accounts than the total number of UK taxpayers who declare foreign income. The court issued orders to all the major banks requiring them to give lists of names to the Revenue so they can check who's not been telling.

On 17 April, HMRC announced that they would allow people and companies who had not previously fully declared offshore income or gains to come clean and settle up. The "carrot" is the chance to only suffer a 10% penalty (plus tax and interest); the "stick" is that the Revenue reckon they have a long list of people who should disclose, and they will be opening enquiries the day after the disclosure deadline (22 June 2007). Barclays have written to all their affected customers to warn them, and the other banks are likely to follow suit.

A similar "carrot" is being offered to people with other undeclared tax liabilities, but the Revenue do not have the same clear source of information on those who fail to use it. This is an important opportunity. Some people will have failed to declare their offshore money because they don't know it's taxable. Some may suspect that it's taxable but hope that no-one will ever know. If anyone with tax to pay fails to take advantage of the Revenue's offer and is discovered later, they will suffer much higher penalties.

If you think this may be relevant to you, you should discuss the matter with us urgently. There's a set procedure to follow and a tight timetable. Bear in mind that a partial disclosure will be the worst of all possible worlds: the Revenue will want to know not just about the interest on the foreign account, but where the capital came from. Anyone making a disclosure will have to be ready to tell all and put themselves completely straight. ●