

# M R Salvage Limited

CHARTERED ACCOUNTANTS AND BUSINESS ADVISERS

7/8 Eghams Court, Boston Drive, Bourne End,  
Buckinghamshire SL8 5YS

Tel: 01628 522773

Fax: 01628 810406

Email: [info@mrsalvage.co.uk](mailto:info@mrsalvage.co.uk)

[www.mrsalvage.co.uk](http://www.mrsalvage.co.uk)

Registered to carry on audit work and regulated for a range of investment business activities by the Institute of Chartered Accountants in England and Wales

# Newsletter

## Allowances Alert!

The reductions in key capital allowances announced last year come into force from April 2012 - that is 1 April 2012 for companies and 6 April 2012 for the self-employed.

One of the key changes concerns the Annual Investment Allowance (AIA). This allowance provides 100% tax relief on most types of plant and machinery (not cars) for all forms of qualifying business.

Since April 2010 the maximum annual limit available has been £100,000 but this is to reduce to £25,000 annually for expenditure incurred from April 2012.

What this effectively means is that if a business delays the replacement of qualifying expenditure until April 2012 then it could significantly delay when it obtains the related tax relief.

At the same time the annual writing down allowances, otherwise available on unrelieved qualifying expenditure, reduce as follows:

- from 20% to 18% for the main qualifying pool
- from 10% to 8% for the special rate pool.

Now is the time to consider the potential impact these changes could have on your business and whether plans should be put into place to advance expenditure to secure tax relief earlier. Please contact us to review the impact of these changes on your business so that any opportunities to maximise allowances are not missed.

## WINTER 2011

## HMRC get tough on overdue taxes

HMRC are adopting a new, targeted approach to the collection of overdue taxes. This started under the previous government and continues to yield rewards. HMRC's purpose is to make sure that money is available to fund the UK's public services and, to do this, they need people to pay taxes in full and on time.

However, HMRC are also keen to emphasise that if businesses find themselves in financial difficulty, they should contact HMRC as soon as possible. It may be that HMRC can arrange time to pay, for example, by an instalment arrangement.

If businesses do not contact HMRC before payment is due, HMRC's strategy is to segment customers according to their previous behaviour, payment history and risk.

HMRC then try to tailor their debt letters and direct interventions according to the characteristics of each of those segments e.g. their letters will be stronger in tone if customers

have a history of non payment and are ignoring their attempts to contact them.

This segmentation will also determine which interventions are appropriate, so debts will be referred to a debt collection agency for a visit or court action on the basis of risk and customer behaviour.

The best way of avoiding a visit or court appearance is for businesses to respond to HMRC letters. Under current procedures, any debt referred to a debt collection agency will have been sent a letter from HMRC giving them a 'final opportunity to pay'.

There is no doubt HMRC are becoming much more aggressive with debt collection. The moral of all of this is contact HMRC before debts arise to explain if there are potential issues regarding future payment.



# All aboard for VAT online

HMRC has now decided that all remaining VAT registered businesses will be required to file VAT returns online and pay any VAT due electronically from 1 April 2012.

Existing VAT businesses with a turnover of £100,000 or more and all new customers that have registered for VAT since 1 April 2010 are already required to file and pay online.

The new measures will have effect from 1 April 2012 in relation to accounting periods starting on or after that date, for those businesses with a VAT exclusive turnover below £100,000. Only two exemptions are proposed:

- where the business is insolvent or
- where run by people who are practising members of a religious group whose beliefs are incompatible with the use of computers.

All businesses affected should be advised by letter, in February 2012, of their new responsibilities and how to meet them. Businesses which believe they fall into either of the two exempt categories above should notify HMRC of the position, once they have received that letter (which will explain the process to follow).

## Electronic payments

The new measures also mean that any VAT due must also be paid electronically from the same date. There are various ways of paying electronically and not all of them involve the use of a computer, for example, phone banking, BACs, CHAPs and payment by Bank Giro Credit (at a participating bank or building society) for cash or cheque payments.

## Will penalties apply?

HMRC has stated that they recognise this will not be straightforward for all businesses and so will not initially penalise businesses which continue to file paper returns instead of online returns in the first year until 31 March 2013.

However, the sooner you get the online habit, the lower the risk of potential penalties. In any case the penalty for failure to file online is distinct from the late payment penalties (default surcharges) which continue to apply when a VAT registered business pays late, or not at all.

Please contact us about how we can assist you in this process including our range of online services available for your business.



# A simple solution?

Given that there are approximately three million unincorporated businesses in the UK that have a turnover of £70,000 or less, including approximately two million with a turnover of £20,000 or less, it is not surprising that a review of small business tax is on the agenda for debate. Following an initial report on small business tax earlier this year, the Office of Tax Simplification (OTS) is now working on the next stage of the process, with a view to preparing a further report with recommendations ahead of Budget 2012. There are currently three strands to this further work.

## The tax administration experience

The first strand of the project is to examine small businesses' experience of tax administration and their contact with HMRC at key stages of the annual tax cycle. It will also look at the tax administration processes involved in starting and growing a new business.

John Whiting, Tax Director for the Office of Tax Simplification said:

'A clear message from the first stage of our small business project was that a big area of difficulty for small businesses was the administration that surrounds the tax system. I'm delighted that the Chancellor has endorsed our report and asked us to take it forward to the next stage.'

'It's clear that many small businesses are struggling under the administrative burdens imposed by the UK tax system. We plan to set up surveys and more roadshows to really home in on what steps cause the most difficulties – and how the system can be improved, making it easier for businesses to get things right with the minimum of fuss.'

## Taxing the small business

The second strand of the project is concerned with looking at alternative methods of taxation for small unincorporated businesses. Options fall into two broad categories:

- the retention of profit as a measure upon which the tax charge is based but allowing a simpler approach to the calculation of those profits, or
- using non-profit measures as the basis for taxation.

## A simpler approach to calculating profit

This option is about exploring the alternatives to generally accepted accounting practice, commonly known as GAAP. GAAP requires accounting adjustments such as prepayments, accruals and work in progress. Such matters are not readily understood by the smallest businesses. Instead these businesses could prepare accounts and tax returns on a cash receipts and payments basis.

Another option suggested is to explore the use of fixed deductions either by way of a rate (%)

or fixed amount (£) for certain expenses which could reduce the amount of work required to produce both the accounts and hence the taxable profits. Such a method could also provide more certainty as to tax allowable expenses.

A further option suggested is to consider allowing small items of capital expenditure, say up to £200 per item, as an allowable revenue expense. Currently, items of capital expenditure, however small, are dealt with under the capital allowances legislation.

## Options for non-profit based measures

A more radical approach to the taxation of the small business could be to use a non-profit related measure. Each of the options to be explored are already used in various other countries. These options include basing the tax charge on:

- Turnover, such as using adjusted turnover for example, by removing employment related expenditure and using a previous year's profit figure updated by a specified amount.
- A flat charge on the business, where there is a single fixed tax charge for being in business.
- Indicator-based measures where, for example, the tax charge is fixed by reference to the number of tables in a restaurant or the number of employees.

Clearly, further research would be needed to understand how these measures work in other countries and how successful they are in simplifying taxation for the smallest businesses before any decisions were made in respect to UK businesses.

## And the third strand... disincorporation

The third strand examines the possibility of introducing a relief for businesses that no longer want, or need, to be carried on in a corporate structure and for which it would be administratively more straightforward if, for instance, they were able to convert to a sole trader or partnership structure.

Reliefs apply to individuals when incorporating their businesses, for example, no charge to capital gains tax need arise on the transfer of assets into the company, but there are currently no similar reliefs on disincorporation.

There are no actual proposals for a disincorporation relief at this stage. The aim of the discussion paper is to present some provisional options in enough detail to help people gauge whether there is a demand for such a relief and whether it would deliver overall simplification for the small business.

We will keep you informed of any future tangible developments in this area but please do contact us if you wish to discuss any of these areas.

# Business angels

The Government's growth plan includes helping SMEs to access the finance they need to grow and invest. Measures announced following the Budget earlier this year included an announcement of reforms to the Enterprise Investment Scheme (EIS) and Venture Capital Trusts (VCTs). This article focuses on the EIS only, a scheme designed to encourage private individuals to invest directly in newly issued shares of smaller high risk unquoted trading companies. The tax breaks available are a key driver to encourage individuals to invest.

Investors can benefit from the following tax breaks:

- For shares issued on or after 6 April 2011 income tax relief at 30% (20% for shares issued prior to 6 April 2011), on investments up to £500,000 a year.
- Capital Gains Tax (CGT) exemption on any gains made on the disposal of EIS shares.
- Relief is allowable if a capital loss is incurred on disposal and allowable amounts can generally be used against income or gains.
- CGT deferral relief for gains that arise on the disposal of any assets against subscriptions for shares in any EIS company.

## The investor and connection

There are a number of detailed rules that can deny or lead to the withdrawal of income tax relief or restriction of the CGT exemption. One key condition is the requirement to hold the shares for three years. Another key condition for the investor is the no connection condition. The presence of connection to the company does not deny the ability to use the CGT deferral relief.

The no connection rules apply throughout the period beginning two years before the issue of the shares and ending three years after that date, or three years from the commencement of trade if later. An individual can be connected with the company in two broad ways:

- by virtue of the size of the shareholding in the company or
- by virtue of a working relationship between the individual and the company.

We can provide further guidance on this area if this is likely to be a concern for you.

## Qualifying companies

Companies must also meet certain conditions for any of the reliefs to be available for the investor.

In summary these include:

- The company must be unquoted when the shares are issued.
- All the shares comprised in the issue must be issued to raise money for the purpose of a qualifying trade.
- The money raised by the share issue must be wholly employed within a specified period (generally two years from issue).
- The company or group must have fewer than 50 full time employees.
- The amount of capital raised in a 12 month period is limited to £2 million.
- The company must not be regarded as an 'enterprise in difficulty' under EC guidance.
- The company must have a permanent establishment in the UK.
- The gross assets of the company must not exceed £7 million before the most recent share issue and is capped at £8 million immediately afterwards.

Certain activities are classed as excluded trades. The main excluded activities include trades of the following types; dealing in land or shares and securities etc, financial, legal, accounting, leasing, property development, farming, market gardening, hotel and care home management and operation.



## Future changes

Proposals are being considered to introduce further changes to the EIS scheme for shares issued on or after 6 April 2012. These are detailed below.

- The annual amount that an individual can invest through EIS is to increase to £1 million.
- The annual amount that can be invested in an individual company is to increase to £10 million.
- The thresholds for the size of the company which may benefit from EIS investment is to be increased from fewer than 50 employees to 250 employees and the gross assets threshold is to increase to £15 million.

As you can see the scheme has a number of detailed rules. If this is an area you would like further advice on, please let us know.

# Penalty delay criticised

In a potentially wide ranging case, HMRC have been criticised for deliberately issuing penalties for late forms P35 and P14 (Payroll end of year forms) several months late, which resulted in more penalties than were necessary.

In the case concerned an appeal was made against a penalty of £400 for late filing of the 2009/10 P35 which was required by 19 May 2010. The penalty was calculated at £100 per month for four months. Once the company had been alerted to its default, it took action and filed the return on 15 October 2010. However, this was too late to avoid the issue of a further penalty of £100.

The company argued that it thought it did not need to file the appropriate returns because its only employee had ceased employment part way through the year. It acknowledged that it was wrong and that HMRC was entitled to levy a penalty. However, the company argued that, if HMRC had promptly notified it of its default, it would have been remedied at a far earlier time, thus avoiding ongoing penalties.

The Tribunal found in favour of the company and their report states:

'...HMRC deliberately waits until four months have gone by and does not issue the first interim penalty notice until, as in this case, September

of the year of default... In our judgement it would be a very simple matter for HMRC to set its computer settings so that a default or penalty notice was sent out immediately after the 19 May in any year, instead of some four months later. That might generate less penalty cash for the State, but it would be fair and conscionable as between the taxpayer and the State (acting by HMRC).'

As a result the penalty was reduced to £100. This case may also apply to other employers who have received penalty notifications in similar circumstances. Please contact us if you think this may be relevant.

# The importance of occupation

The capital gains tax (CGT) exemption for gains made on the sale of your home (known as Principal Private Residence (PPR)) is one of the most valuable reliefs from which many people benefit during their lifetime. Only a property occupied as a residence can qualify for the exemption. An investment property in which you have never lived does not qualify.

## Quality matters

'Occupying' as a residence requires a degree of permanence so that living in a property for say, just two weeks with a view to benefiting from the exemption is unlikely to work.

It would appear that HMRC are taking an interest in this particular area as there have been a number of appeals heard at the First Tier Tribunal (FTT).

## Burden of proof

In one case HMRC held information that suggested that a taxpayer had disposed of a property in addition to receiving rental income from it. No mention was made of this in the taxpayer's tax returns.

HMRC started an enquiry and the taxpayer argued that the property was his PPR but HMRC disputed this. They argued that if the taxpayer had occupied the property, it was only on a temporary basis and was not sufficient to constitute a residence. Unfortunately, HMRC also found that housing benefit was paid to the taxpayer in respect of tenants at the property at the same time as the taxpayer claimed he was living at the property. The Tribunal decided that in the circumstances the taxpayer had not discharged the burden of proof to demonstrate that he occupied the property as his PPR.

## Renovating is not residing

In another case a taxpayer and his partner (now his wife) purchased a property intending to live in it as their home. However, soon after completion they discovered that the neighbours were unruly and the taxpayer's wife changed her mind and refused to contemplate moving there. The property was sold some 4 years later and the taxpayer made a claim for PPR.

HMRC once again argued that the taxpayer had not established the property as his PPR and the Tribunal agreed. They stated that the taxpayer's occupation of the property for a 3 month period was not a period of residence, but a

period in which he was renovating the property for subsequent letting, whilst intending and expecting to continue permanent residence with his wife at her property.

## No degree of permanence

One final case concerned a taxpayer who purchased an apartment and sold it some six months later. The property was furnished although he did not obtain a TV licence as the TV he took to the property had broken. Additionally, he did not install a telephone because he had a mobile phone.

His partner moved into the property but she decided she did not like the area and moved out very quickly. Shortly after this the taxpayer placed the property on the market.

The taxpayer argued that he acquired the property with the intention of living there but when his partner moved out, he changed his mind.

HMRC again disputed whether residence was established. In particular, they drew the Tribunal's attention to the fact that the apartment was heated by electricity and that the bill for the winter period amounted to just £39!

The Tribunal determined that the taxpayer's occupation did not have any degree of permanence. At best he had temporary occupation but the nature, quality, length and circumstances of the occupation did not amount to residence.

## How we can help

The PPR exemption continues to be one of the most valuable CGT reliefs. However, the operation of the relief is not always straightforward nor is its availability a foregone conclusion. Advance planning can help enormously in identifying potential issues and maximising the available relief. We can help with this. Please contact us if you have any questions arising from this article or would like specific advice relevant to your personal circumstances.

# Internet Trading - do you have anything to declare?



In a bid to target those who are not paying the correct taxes HMRC have recently announced further specific target areas, one of which is internet trading.

Selling on eBay and other similar websites is by no means new. However, HMRC are now more able to target these types of operations. Those who regularly buy with a view to selling need to be aware of the rules and the factors HMRC use to determine whether someone has a business.

Certain indicators known as 'badges of trade' are used to decide whether or not someone is in business and equally apply to those selling at car boot sales or through the small 'ads' in the paper.

These indicators have developed over the years in the courts and nine such indicators or badges are included below. These are used to decide whether a trading business exists or not.

Profit seeking motive	An intention to make a profit - supports trading.
The number of transactions involved	Systematic and repeated transactions - supports trading.
The nature of the goods sold	Are the goods only capable of being turned to advantage by being sold? Or do they yield income, or give enjoyment through pride of ownership?
Existence of similar trading transactions	Was this a one off transaction or part of a pattern that suggests trading?
Changes to the goods	Were the goods repaired, modified or improved to sell them more easily?
The way the sale was carried out	Were the goods sold in a way that indicates trading, or to raise cash in an emergency?
The source of finance	Was money borrowed to buy the goods? Were any profits to be used to repay the loan?
Interval between purchase and sale	Goods being traded are usually bought then sold quickly.
Method of acquisition of the goods	Goods acquired by an inheritance, or as a gift, are less likely to be the subject of trade.

HMRC confirm that you are not trading if you:

- sell occasional, unwanted personal items through internet auctions or classified advertisements
- attend a car boot sale once a year to sell unwanted household items.

As a decision can only generally be made by considering a combination of these factors, please do contact us to review whether your activities do constitute trading and how we can assist you.