

Tax Angle



Andrew Shaw,
National Tax Managing Partner

Pre-Election Hot Air

Alistair Darling spent 50 minutes today bluffing his way through a Pre-Election Pre-Budget Report, it said very little about the massive Budget deficit issues we face as a country and absolutely nothing about how we are going to get out of the mess we find ourselves in. Instead he concentrated on public enemy number 1, bankers, and introduced a new levy on bank bonuses, bringing the tax rate on bonuses over £25,000 next tax year up to 67%, before National Insurance Contributions. If my preliminary calculations are right this will bring the total deductions to just over 70%.

“Our VAT rate is now the second lowest in the EU and the only one to have decreased in the last year, whilst 6 countries have raised their rates”.

Clearly with an election on the horizon there was never going to be any bad news for the population as a whole, so the much hyped VAT increase to 20%, has been postponed until after the election. A rise of VAT of 2.5% raises £12bn so it is not a question of if, but rather of when. Our VAT rate is now the second lowest in the EU and the only one to have decreased in the last year, whilst 6 countries have raised their rates. So expect a new Government in 2010 to refer to harmonising rates in Europe to cover up the rise in VAT, by chance Darling said the Bank of England expects inflation to be undershooting the 2% target by mid 2010, so what a handy time to raise VAT. When you need to issue so much debt it is great to get some inflation in to the system as it devalues the debt you issue.

As usual there was much to be said about incentives to help people young and old, but much has been said before and is in any case merely the moving of Government expenditure from one pot to another. The only tax reduction mentioned was the new 10% rate for exploitation of UK patents, but when you read the small print it does not come in until 2013 – nearly 4 years away – so plenty of time to reverse it before then. No mention of the now wide disparity between income tax rates of 50% and Capital Gains Tax at 18%, but do not hold your breath too long as there will be an inevitable change post election, the gap is too wide and I cannot see top rates of Income Tax coming down.

Once again Tax Avoidance and Tax Evasion were mentioned in the same sentence and appear in the same Press Release. On the Avoidance side there are yet more targeted rules to allow HMRC to find out how people are avoiding tax quicker, but no General Anti-Avoidance Rule which had been mooted. The Government clearly does not like people reducing their tax bills, especially if they are higher rate taxpayers. On the Evasion front we have seen plenty of news in recent months with the New Disclosure Opportunity (NDO) and the Lichtenstein Disclosure Facility (LDF), and now Darling tells us he knows about 100,000 overseas accounts belonging to people living in the UK. Just in case they do not come forward voluntarily he is proposing a new 200% penalty for tax evaders, so that is, pay the tax and the interest on the tax and then pay a penalty of twice the tax. This would in all events amount to more than 100% of the money in the offshore account. We have had the carrot and now the stick is clearly on the way.

At this season of Goodwill I wish all our readers a Merry Christmas in the knowledge that it is all going to be a lot more expensive next year so we might as well enjoy it while we can.

Andrew Shaw

Tax Status for Subcontractors 'the elephant in the room'

With new inspection rights now in force, fears over Revenue demands to look at PAYE and subcontractor records without prior warning are growing. While the Government continues to struggle with the definition of what an 'employee' actually is, the tax status of subcontractors working through limited companies often remains uncertain.

Over the years, various changes have been made to the Construction Industry Scheme to counter the belief that tax avoidance or evasion is rife within the construction industry. However, one fundamental issue that has not gone away is the identification of subcontractors who, due to their working arrangements, are considered employees for tax purposes. Since this is now the centre of even more Revenue activity, those working in the construction industry must ensure that all contractual and working arrangements truly reflect the tax status of their workers.

The root of the problem is the absence of a definition of what an employee actually is. The closest thing is a remark by Lord Denning, that: "an employee is like an elephant, difficult to describe but you know one when you see one".

So while lawyers, accountants, and HMRC continue debating elephants, contractors on the ground are getting it wrong. Often

this is due to a worker genuinely taken on as a subcontractor initially, but falling into the category of being an employee over the course of time. This is particularly the case where a subcontractor is approached to carry out work on a specific project but is then hired to undertake other tasks, and ends up working exclusively for one contractor under their terms and conditions.

HMRC is currently considering ways of defining an employee and the result is expected shortly. It is likely that, if implemented, this will result in a large proportion of current subcontractors being re-categorised as employees. Whilst some certainty will be welcomed, any mass change from self-employment to PAYE will do little to improve conditions for an industry that is already under enormous financial pressure.

Compliance officers are taking an increasingly aggressive line when reviewing subcontractor payments. Even where a worker has held the usual CIS6 and CIS5 cards in the past and/or is now registered for gross payments, that does not mean he or she is not an employee. If adequate steps have not been taken to ensure that the original arrangement is truly a self-employed one and remains as such, then the contractor or employer will be faced with a bill including interest and penalties.

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The Divid-End?

From 6 April 2010 a new Income Tax rate of 50% will apply to individuals with taxable income exceeding £150,000. The effective dividend tax rate at this level will increase from 25% to 36.11%. Owner-managers who will be affected need to start considering how they can mitigate the effect of these changes now.

Dividends may still be preferred to bonus payments even though for the company they are not relievable for Corporation Tax. Say for example Mr X already has taxable income above £150,000 and X Ltd has £100,000 of surplus profits. If the profits are used to fund a bonus payment, this will leave Mr X with a post tax receipt of £43,440. If instead a dividend is paid, the post tax receipt will be £50,473. This takes into account the Corporation Tax relief on a bonus payment (we are presuming that X Ltd pays the small companies rate of 21%), but also the various employer and employee National Insurance charges on a bonus.

Owner-managers may wish to consider paying substantial dividends in advance of the 36.11% rate being introduced on 6 April. Should the company have distributable reserves but little cash, a dividend can be paid and credited to the owner-manager's loan account. The tax payable on the dividend will need to be settled by 31 January 2011.

In addition, owner-managers could consider introducing their spouse as a shareholder to make full use of their spouse's basic rate income tax band and this may help to keep their individual incomes below £150,000. HMRC's efforts to prevent this form of 'income shifting' were defeated in the Arctic Systems case. We cannot be certain, however, that they will not introduce anti-avoidance legislation to counter this.

The 50% rate of income tax only serves to highlight more starkly the disparity between Income Tax and Capital Gains Tax rates. Whilst CGT rates remain low there is a real incentive to retain profits in a company and ultimately extract them as capital on an exit from the business. This could be in the event of selling the company, passing control to family members or employees, or winding-up the company. In order to secure the most favourable tax treatment on exit, advanced planning is often required and we would be delighted to discuss some of the pertinent issues with you.

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In, Out, Float It All About

Management buy outs, buy ins, flotations, restructuring and subsidiary sales; corporate restructuring is as varied as it is costly. In most cases the VAT incurred on professional fees, such as solicitors and accountants is considerable.

HM Revenue & Customs (HMRC) has historically resisted recovery of this VAT. Until 2005 the issue of shares was treated as VAT exempt providing a good basis for HMRC to make such an argument on any restructuring involving shares. However, in 2005 the ECJ's decision in Kretztechnik (that share issues were not a supply) negated that argument in cases involving a share issue, although not those involving a share sale.

This change led to an influx of claims for VAT including a large number of claims under the Fleming opportunity. The amount of VAT involved is huge, although not publicly reported. Unsurprisingly, perhaps, HMRC has developed a number of arguments to resist both these and contemporary claims for this VAT.

Primary among these is the argument that the services of the professionals are supplied to parties other than that which is attempting to recover the VAT. Engagement letters and other evidence often suggests that services are supplied to banks, investors, other professionals or associated companies. A recent Tax Tribunal ruling, in the case of My Travel, has weakened HMRC's position though. In that case an engagement letter created a tri-partite agreement between the professional adviser, the investor and the claimant company. The Tribunal Judge ruled that the claimant company received the supply and was therefore entitled to recover the VAT.

Another argument HMRC is currently advancing relates to engagement letters created before the incorporation of the claimant. How, Customs argues, could such a supply possibly be

made to an entity that didn't exist when the engagement was agreed? This argument would appear to directly contradict HMRC's own guidance on pre-incorporation input VAT.

A similar change in relation to share sales comes from a recent ECJ decision in the case of AB SKF. This decision, whilst thought unusual by commentators, appears to allow the possibility of VAT recovery on costs associated with the sale of shares in a subsidiary if the claimant was earning taxable income from the subsidiary.

Most recently, the European Commission has issued infraction proceedings against the UK for allowing non-trading entities to join VAT groups. If successful this would block a common post-transaction VAT planning structure.

A frequent issue encountered following a Buy Out is that the company that engaged the professionals and received the invoices is a non-trading holding company. Such a company cannot register for or recover VAT. One solution to overcome this is to enter the holding company into a VAT group with the trading company. The VAT group will then be entitled to recover the VAT.

That HMRC appears to be trying to limit the impact of the European Commission's action is welcomed. It was widely expected that they would use this as another tool to prevent recovery of VAT on corporate restructuring.

All of these developments are very recent and the fallout is yet to settle. As always though, if you are about to embark upon or are already undertaking a transaction involving restructuring, share sales or share issues, consult a VAT expert at the earliest opportunity to ensure you maximise the recovery of VAT on the deal costs.

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Non-Residents / Non-Domicile: The Headache of Working with the New Rules

The tax treatment for individuals who are resident but non-domiciled, or not ordinarily resident in the UK for tax purposes, was fundamentally changed with effect from 6 April 2008. The headache of completing the first Tax Returns within the new legislation is taxing many practitioners.

We have written about the remittance basis in previous editions of TaxAngle but we cannot stress the importance of these new rules strongly enough with regard to record keeping on an ongoing basis.

Everyone affected by these new rules needs to:

- Consider whether you are eligible for the remittance basis and, if so, prepare the calculations to determine whether it is beneficial to claim the remittance basis or be taxed on the arising basis.
- Work with your Offshore Bank and Investment Managers to identify capital and income separately.

Do not forget this exercise should be completed each tax year as it will depend on the level of your foreign income and foreign gains as to whether this is beneficial.

A particular area to consider is OVERSEAS CAPITAL LOSSES

Taxpayers who do not make a remittance basis claim, calculate capital losses in the usual way.

However, if you are resident but not domiciled in the UK and claim the remittance basis then you may make a loss election as part of your claim for the remittance basis. Once made, the election cannot be revoked and applies to all future tax years.

If you decide not to make an election for the first year that remittance basis is claimed then, going forwards, in all future years your foreign losses are not allowable losses.

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Welcome to...



Kieron Hughes

In September this year I joined BTG Tax, within the Private Office Team, with the ambition of training to become a Chartered Tax Adviser.

I graduated from the University of Birmingham in 2008 with a First Class BSc (Hons) in Accounting and Finance. Studying tax as part of my degree, alongside an already present interest in the economic environment, was the catalyst for my chosen career path. With ambition and drive, beside a warm company attitude, BTG Tax was an obvious choice for my career plans.

In my spare time I enjoy watching and participating in as much sport as possible, most notably football and cricket. Beside sports, socialising and enjoying music performances are my other main hobbies.



Ruzwan Boota

After graduating from the University of Birmingham with an Upper Second Class BSc (Hons) degree in Accounting and Finance.

I decided to pursue a career in tax and joined the Corporate Tax Team in the Birmingham office in September of this year. I initially became interested in Taxation when I was studying a tax module as part of my degree. It helped instill in me a thirst and passion for the profession which I am now looking to take further and qualify as a Chartered Tax Adviser.

I decided to apply to BTG Tax after attending the National Graduate Recruitment Fair at the NEC where I met Richard Shaw – Operations Director. The conversation with Richard left me with a lasting impression of the firm and convinced me to hand in an application a few days later.

Hobbies: I participate in a number of sports but amongst my favourites are Cricket, Football, and Snooker. I am also a keen artist, completing numerous paintings in my spare time.

SAVING TREES!!

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