

CLIENT NEWSLETTER – DECEMBER 2008

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“ACTIVE ACCOUNTING AND TAX”

INTRODUCTION

Whilst the first pre-budget report (PBR) given by Alistair Darling was brought forward to early October 2007, with the thought of there being an election at that time (what a long time ago that seems!), the second Darling PBR was deferred to 24 November 2008, owing to the current economic circumstances.

The main headline, on which I have already issued a separate "Client Alert", was the reduction in the standard rate of VAT from 17½% to 15%, from 1 December 2008. This Alert has been sent to all clients whom we are aware are registered for VAT, but if you did not receive one and would like to have a copy, please do not hesitate to contact Andrew Coates in the office and he will be pleased to send you one.

In an effort to be fiscally responsible, in an addition to short-term tax cutting measures the Chancellor also announced a number of tax raising measures, to start from 6 April 2010 and then be extended from 6 April 2011. As these are some distance off and many start after the date of the next election, I will not spend a lot of time on them, but set out some general comments towards the end of this newsletter.

HEADLINES

- ☞ **Decrease in the standard rate of VAT to 15% until 31 December 2009**
- ☞ **Income splitting/shifting legislation to be deferred – or possibly scrapped?**
- ☞ **Small company corporation tax increase of 1% from 1 April 2009 to be deferred**
- ☞ **Some tax losses to be able to be carried back for three years**
- ☞ **New HMRC “business payment support service” to help business facing cash flow difficulties to spread their tax payments on a temporary basis**
- ☞ **Personal allowance for 2009/10 increased by £130 over RPI inflation to continue relief for those disadvantaged by the withdrawal of the 10% tax band**
- ☞ **Income tax bands and rates for 2009/10 announced – this is usually left until the budget, but this year they have been announced at PBR**
- ☞ **Increases in the upper limit for National Insurance contributions to be brought into force from 6 April 2009 as previously announced**
- ☞ **Again only very selective uplifts in working and child tax credits**
- ☞ **More information on HMRC’s new powers**

As always, it is only possible for me to comment on some of the matters contained in the pre-budget report and the other documents that have been issued recently. If you are interested in any other matters, please do not hesitate to get in touch with me to discuss your concerns. To find the information you need in this newsletter, please refer to the following headings:

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| 2. | Income splitting legislation deferred again or scrapped, BUT does this mean IR35 may be "back" and will there be further reform of small business taxation? | 8. | Tax relief for business mileage and travel |
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1. VAT RATE CHANGE – ADDITIONAL POINTS

Since the issue of my Client Alert on changes to the standard rate of VAT – as noted above if you do not have a copy of this and would like one, please do not hesitate to contact Andrew Coates here in the office, a number of clients have contacted us with further questions, some of which are of general interest and I will cover here.

With a 17½% standard rate, the VAT element included in a VAT inclusive price was 14.89% (7/47^{ths}) with the rate dropping to 15%, the equivalent figure is 13.04% (3/23^{ths}). Because of this gross/net issue, the percentage reduction in a VAT inclusive price, to take full account of a 2½% drop in the standard rate, is only 2.12%!

In the alert, I commented that for businesses incurring fuel costs, the increase in fuel duties meant a real increase in costs as these could not be reclaimed whereas, at least in some circumstances, VAT on fuel costs could be. It is also the case, of course, where you collect VAT and hold that as part of your cash flow processes until you are required to pay it over to HMRC at the end of a VAT reporting period, then the amount of cash that you are receiving from your customers will go down and this may have some cash flow consequences.

PAH comment: Following the publication of the PBR, there was some comment in the press that the government had considered announcing that not only would it go back to 17½%, but there would be an increase to 18½% from 2010. Although this has been denied and may now be politically difficult as a result, it is fair of me to point out that the standard rate in the UK, even at 17½%, is somewhat lower than in most other European countries and that a number of these, notably Germany and the Republic of Ireland, have seen quite substantial increases in the standard rate of VAT in the last couple of years – the standard rate in Ireland is now 21%. Accordingly, I think it is at least possible, particularly if the recession is more prolonged than the Government is hoping, and as reported in the press, many economic commentators think that will be the case, that from perhaps 2011 or 2012 there will have to be a rise in the standard rate beyond 17½% to help put the nation's books back into balance by the intended date of 2015/16.

I think most clients are now clear on how to introduce the new lower rate of VAT, but we have received a couple of queries with regard to services supplied more than 14 days before 1 December 2008, that are being invoiced after that date. Whilst I believe the note in the alert is clear on that point, if you do have any questions, please ask. It is likely that VAT inspections over the next two to three years will concentrate on whether the VAT change was dealt with properly and if you are in any doubt, it is much better to ask "now". However, having said that, I think there will only be a problem where the "wrong" VAT has been charged to an "end" customer, who cannot reclaim it. Clearly, if the "wrong" VAT is charged between two registered traders, there is no loss of tax to the Exchequer.

In my Alert, I set out the processes for changing the VAT rate within Sage and QuickBooks accounting systems; I think most accounting system providers have also sent registered users either some details or web-links to information setting out how this should be done.

QUICKBOOKS 2008

I have become aware that the very latest QuickBooks software requires a slightly more complex process to change the rates than I set out in my Alert – if you have QuickBooks 2008 and have not been able to follow this through, please give me a call.

QUICKBOOKS – COST OF GOODS SOLD ACCOUNTS

There is also a slightly more complex process to be followed if you wish to alter the rate that automatically comes up for postings to QuickBooks cost of goods sold accounts, the normal edit screen for this type of account does not have the facility to alter the VAT rate within it. If you need to do this, again please give me a call and I will talk you through the process.

ANTI-AVOIDANCE LEGISLATION WHEN THE RATE GOES BACK UP

The detailed note on VAT in the PBR advises there will be special anti-avoidance legislation brought in to ensure that when the rate goes back up, from 1 January 2010, payments, etc are not brought forward to avoid the increase in the rate. This is technically known as "forestalling" and I will comment on this again, about this time next year, when the increase will be imminent.

2. INCOME SPLITTING LEGISLATION DEFERRED AGAIN OR SCRAPPED, BUT DOES THIS MEAN IR35 MAY BE "BACK" AND WILL THERE BE FURTHER REFORM OF SMALL BUSINESS TAXATION?

Following a very long tax case – known as "Arctic Systems" or "Jones v Garnett", which HMRC lost in the House of Lords last year, in the 2007 PBR, the Government brought forward some proposals, the intention of which was to prevent one person effectively sharing their income with another person, with the intention of reducing their combined tax liability. Whilst the details of the original case are more complex than this, essentially, Mr and Mrs Jones were husband and wife and between them owned a company called "Arctic Systems". Mr Jones did most if not all of the company's work for its customers, but Mr and Mrs Jones shared the profits through the payment of dividends. In HMRC's view, the reduction in their overall tax payable as a result of Mrs Jones being able to use up the whole of her basic rate "band" for income tax purposes, and the consequent reduction in tax payable at 40% by the "worker", Mr Jones, was unacceptable tax evasion and they attempted to use some legislation that was over 60 years old to prove their point – they lost! However, on the same day as the verdict was given in the House of Lords, HMRC announced they would change the law to their point of view and the proposals on income shifting or splitting – these two terms seeming to be used interchangeably, were set out in the 2007 PBR.

I am very pleased to say that following an outcry on publication of the Government's proposals, which initially caused them to be put off from an intended start date of 6 April 2008 to 6 April 2009, it has now been announced that these proposals are to be "deferred" further. Following the publication of the proposals this time last year, it was pointed out by almost all tax commentators that they were completely unworkable and extremely unfair and it would appear HMRC has not been able to come up with any acceptable alternative.

There is some discussion on tax professional websites, based it would appear on a "slip" by a very senior HMRC official at a meeting, that rather than being deferred, the proposals have been definitively scrapped – but there is no formal announcement to this effect.

PAH Planning point: My "bet" is that these proposals have been scrapped, but will in due course – see immediately below, be overtaken by a more general reform of the taxation of owner-managed companies to bring their tax treatment on to a par with partnerships and sole-traders; there are models of this form of taxation in a number of other countries. However, in the meantime, it is unlikely that a significant change of this sort could be brought in over a period of less than, say, three years, meaning there is substantial room to consider using the "deferral" to reduce overall family tax liabilities. We will be looking at this next time we prepare the accounts and tax returns for any businesses we act for, who are not already using this approach.

We believe we are in the forefront of advisers who look proactively at family remuneration strategies in advance and should be pleased to talk to any of your contacts who may feel they are not receiving this service from their current advisers.

BUT DOES THIS MEAN IR35 WILL BE "BACK"?

To be fair, IR35, the colloquial name for rules that prevent a company being used to avoid tax and NICs, where a person might normally be considered to be employed by the end-user of their services, has never "gone away", but there have certainly been fewer high profile cases in the last couple of years, with the rules apparently being understood by "both sides". However, recently, a new case – "Dragonfly Consulting", has been decided in favour of HMRC, this case concentrating on the practical application of the "substitution" rule that is often relied on to keep a contract outside of IR35.

In this instance, the "contractor" did work for the AA via his personal service company Dragonfly Consulting, but with an agency in the middle. Whilst the contract between Dragonfly and the agency might have been considered IR35 proof and contained a substitution clause, the contract between the agency and the AA, such contracts are often examined by HMRC as part of their review, contained no such clause; both contracts named the consultant as well as his company. In addition, HMRC contacted the AA who, unhelpfully, told them they only wanted Mr Dragonfly himself and would not have accepted a substitution clause in their contract – it is certainly possible this clause may have been taken out by the agency, without them then telling Dragonfly, although that is not clear from the case notes.

This case highlights the importance of making sure that not only your contract with your agency, but also their contract with the end-client contain all the correct clauses and that the end client is "on-side" from an IR35 perspective.

PAH Comment: In the period since the PBR, this case and the "deferral" of the proposed income splitting rules have been talked about incessantly on professional websites; the general view being that Dragonfly is the start of a new campaign on IR35 by HMRC. If you are in any doubt about your current contract, or are not fully aware of the terms of the contract between your agency and the end-client, particularly if you are a named consultant within your contract, this would be a very good time to get your contract AND the contract between your agency and the end-client fully reviewed – as mentioned above, don't forget this second contract is "discoverable" by HMRC in considering your IR35 status and they may also speak to your end-client; don't get caught out!

AND WILL THERE BE FURTHER GENERAL REFORM OF SMALL BUSINESS TAXATION?

From comments in the narrative of the PBR, it appears that the general reform of small business taxation is still "somewhere" on the Government's agenda, but in the last six months this has definitely slipped down that agenda as there are no formal proposals – other than a little bit of tinkering around the edges in very specific cases, in any part of the PBR.

Accordingly, at this stage, we can only keep a watching brief, but with the changes to National Insurance contributions and also the upper rate of tax of 45% and personal allowance changes for those earning over £100,000, these new rules coming into effect in 2010/11 and 2011/12, see section 14 below, it is likely that very many more people will be seeking to set up alternative arrangements to avoid the increases and this may act as a catalyst for reform.

3. SMALL COMPANY CORPORATION TAX RATE

One piece of definitively good news is that the third annual increase in the "small companies" rate of corporation tax from 21% to 22%, due to come into force from 1 April 2009, has been deferred for one year. Until 31 March 2007, the small companies' rate was 19% and Gordon Brown then announced it would go up by 1% in each of three successive years to 22% from 1 April 2009.

PAH Comment: Regrettably, I still think there may be an intention to increase this rate to about 25% and to reduce the rate for larger business to the same figure, to combat major companies moving their head offices to lower tax regimes – such as Eire!

4. CARRY BACK OF TRADING LOSSES

The rules for offsetting trading losses against other income and their carry back and carry forward against profits in earlier or later years have always been tortuous. Generally, the tax rules have always sought to minimise the availability of losses, particularly where a refund of previously paid tax might be obtained and to limit them to carry forward against future profits against the same trade.

However, for company accounting periods ending between 24 November 2008 and 23 November 2009 and in respect of self-employment and partnership losses for 2008/09, it will be possible to carry back up to £50,000 worth of trading losses for up to three years.

Planning point: For companies in particular, if you have made profits in previous accounting periods, but expect a loss for your year-end in 2008 or 2009, this is likely to be of some considerable benefit and it might be possible, with some judicious thinking about year-ends, etc, to increase the benefit of this apparently only one year's worth of relief. If you have previously had profits and expect losses both in the current year and the next one, please will you alert us to this when we are doing your next set of accounts, particularly as far as continuing losses are concerned, in order that we can discuss the possibilities for maximising relief from this relaxation of the loss rules.

5. HMRC BUSINESS PAYMENTS SUPPORT SERVICE

In response to the increasingly desperate conditions facing some businesses as the economic crisis worsens, the Chancellor announced that HMRC will provide a new business payments support service to help businesses facing cash flow difficulties. The details of this are set out on the HMRC website at www.hmrc.gov.uk/pbr2008/business-payment.htm.

If you do not have internet access and would like a copy of this web page, please do not hesitate to contact Andrew Coates in the office and he will be pleased to send you one.

To quote from the website “if you are worried about being able to meet tax, National Insurance, VAT or other payments owed to HM Revenue & Customs, or you anticipate that payments becoming due will cause you problems, you can call our business payment support line on 0845 302 1435. The line will be open Monday to Friday 8 am to 8 pm, Saturday and Sunday 8 am to 4 pm.

This support line is intended for new enquiries only, if you have already been contacted about an overdue payment or if you already have a payment arrangement with HMRC please call the original office that contacted you, who will be ready to discuss payment arrangement options and explain how to avoid legal action being taken”.

If you need to call the helpline, over the years we have normally found that where you are looking to obtain a payment concession from HMRC, it is better for you to call, rather than us to call on your behalf – although of course we should be pleased to do that if you would like us to, you will need to have the following information to hand:-

- ☞ your tax reference number
- ☞ detail of the tax that you are having or will have trouble paying
- ☞ basic details of your business's income and outgoings.

If you need any help in compiling the necessary information, for example putting together a basic cash flow over the next few months showing your business income and outgoings, please do not hesitate to contact us, we should be pleased to help.

On receipt of the necessary information, HMRC will review your circumstances and discuss temporary options tailored to your business needs such as arranging for you to make payments over a longer period. The website states that they will not charge late payment surcharges – for example default surcharge for VAT or the late payment surcharge due on 28 February where payment of self-assessment income tax/capital gains tax due on the previous 31 January is not made before that date, but interest at the HMRC rates, will remain payable.

Many of you will be aware that these rates are traditionally much lower than a small business is typically able to borrow from its bank and therefore we expect that quite a lot of clients may well want to make use of this option, as opposed to obtaining additional bank finance, which may be impossible in the current circumstances of course, to cover HMRC's liabilities.

The website stresses that if you are expecting payment problems the sooner you get in touch the sooner they will be able to see how they can help. If a payment isn't due yet, you can ring the support line once you are clear about whether you will be able to pay or not, but please do get in touch with them in advance, don't wait until the payment is overdue.

In essence, this is no different from the normal action you might take if you were going to exceed your overdraft limit – if you let the bank know in advance – at least in normal times!, they are normally more prepared to help than if you only tell them when you have actually already gone overdrawn.

PAH comment: I think it extremely likely that there will be a huge take-up of this service and you may have to ring several times to ensure that you are able to get through. In addition, we would like to monitor how successful this service is and should be most grateful if all clients could let us know if they have used the service and, in particular, what sort of response was obtained from HMRC to their particular circumstances. Whilst we will, of course, keep individual client circumstances confidential, it would be very interesting to know, particularly when advising others, as to the sort of questions that have been asked and the sorts of deferral of tax liabilities that have been obtained.

I think the service is likely to become heavily over-subscribed as we get towards the end of January 2009 and would recommend that if you think you may have difficulty making payments due at the end of January, you get in touch with HMRC as soon as possible and certainly no later than the middle of the month, in order to make sure that the facility you require can be in place before the due date for payment.

6. OTHER SUPPORT FOR SMALL BUSINESS

In the detail of the PBR, a document that runs to some 232 pages, the Government has set out its intention “in the New Year”, to provide further support for business through a small business finance scheme. There are no details available on this at present, probably meaning that it was a fairly late

addition to the report, but it would appear that the Government will be getting together with the Regional Development Agencies (EEDA in this area) to focus their business support towards smaller businesses. It would appear that the amounts being talked about as allocated to this incentive – well over £1 billion of small business loans, are going to at least partly come from current RDA budgets and how much genuine “new” money will be available for this scheme is unclear.

PAH comment: Whilst any announcement of this sort is welcome, the funds allocated to similar schemes in the past have traditionally been very difficult to access, particularly if you have any other form of equity, including your house, to put on the line for a business venture. In particular, the Government’s previous “flagship” small business support programme, The Small Firms Loan Guarantee scheme (SFLG) was a “lender of last resort”, meaning that you could not access those funds unless you had already put your house on the line, something which most people are much more unwilling to do these days. However, let’s be optimistic and hope that the new scheme will provide a realistic level of support to local businesses and that it will be reasonably straightforward to access.

7. CAPITAL ALLOWANCES FOR BUSINESS CARS

Whilst over the last 10 years or so, generally we have discouraged clients from having company cars, instead suggesting that the use of business mileage at the approved mileage rate is a simpler and usually at least as cost effective a way of obtaining a fair level of tax relief for business mileage, the introduction of low emission vehicles have meant that in recent years, a number of clients, who are prepared to use a lower emissions vehicle, have gone back to having a company car, because the calculations now show this to be a tax efficient way of dealing with things.

As part of a further change towards encouraging lower emission cars, where capital allowances are available for car purchase, for purchases made after 31 March/5 April 2009, the rates of capital allowances available will be based on emissions. Where carbon emissions are below 100 g/km then 100% allowances are currently available – although this limit is expected to reduce in future years, for emissions between 101 and 160 g/km capital allowances will be available at 20%, but in respect of cars with emissions over 160 g/km, then capital allowances will only be available at 10%. These emission based rates replace the maximum amount of £3,000 per annum that was previously claimable.

In addition to the changes to capital allowances, there are also changes to the restrictions for leased cars, again based on the emissions of those cars, where the lease was first taken out after 31 March/5 April 2009.

PAH planning point: The detail of these changes is quite complex and if you are interested, please do not hesitate to contact us for further information, but as cars purchased or leased in the 2008/09 tax year will remain on the current rates until they are disposed of, if you are thinking of reintroducing “company” cars for employees into your business, hiring or leasing these before 31 March 2009 would probably give you a tax advantage. However, if you are a sole-trader or a member of a partnership, conversely, delaying a new car purchase until after 6 April 2009 might be best for you. As always, these are general comments and before you take any action, you should take detailed advice based on your specific circumstances.

BUT, even if you do introduce the provision of a “company” car for employees, the additional taxable benefit in kind from providing car fuel for private motoring is unlikely to be worthwhile – instead a claim for business mileage at the same rates used for VAT reimbursement should be made. If you need any more advice on this, again please do not hesitate to get in touch with us.

8. TAX RELIEF FOR BUSINESS MILEAGE AND TRAVEL

The Government has been considering whether the current rules on tax relief for travelling expenses on business are fair. In general terms, it has decided that the rules are fair, including the current levels of mileage payments for business mileage, but is concerned that they may not be being applied properly.

PAH comment: A number of you will be aware, particularly if you are new clients, that we have had to ask you some more detailed questions about various types of expenses and we may have had to ask you to accept that a higher proportion than

hitherto are disallowable for tax purposes. It is clear from this announcement that HMRC is going to mount a considerable crackdown on travelling expenses and that a lot more questions may be asked about these sorts of items. Accordingly, I make no apology for the more robust approach to this area that we have taken this year.

Reviewing expenses is an important part of our taking “reasonable care” with your tax affairs. As noted in section 13 below, this is about to become much more important than it was previously, owing to changes in HMRC's powers.

9. TAX AND NIC ALLOWANCES, BANDS AND RATES FOR 2009/10

In the period from about 2001 to this year, the Government has been introducing a policy of aligning chargeable bands for both income tax and NICs. However, the furore over the withdrawal of 10% income tax rate, the effect of which, although noted by ourselves and most other accountants and commentators immediately when it was first announced in Budget 2007, was apparently not picked up by either the Treasury or other MPs until the change had actually come into force from April 2008!, has caused a divergence in these figures.

In particular, the changes to income tax allowances and the band at which the basic rate of income tax is available that were introduced from September this year to counteract the effect of the withdrawal of the 10% band, do not apply to National Insurance, meaning that there are now differences in all of the various thresholds, both upper and lower!

For 2009/10, the Chancellor has increased the basic personal allowance by £440 over the level at September 2008 of £6,035. This represents indexation of £310 plus a further £130 compensation for removal of the 10% band. Following these increases, the basic personal allowance will be £6,475 in 2009/10.

The 2009/10 age related personal allowance for those aged 65 to 74 will be £9,490 and those aged 75 or over £9,640. The income limit for age related allowances, before these begin to decrease towards the “standard” allowances will increase in 2009/10 to £22,900. There are also increases in the married couples allowance for those where one partner was born before 6 April 1935 and in respect of the blind person's allowance.

The basic rates of income tax at 20% and 40% remain unchanged. The basic rate tax band is increased by indexation plus an additional £800 to £37,400 (2008/09 £34,800).

As a result of the increase in the basic rate tax band the 40% rate will not be paid by any taxpayer earning less than £43,875 in 2009/10.

I comment on the proposed changes for 2010/11 and 2011/12 in section 14 at the end of this newsletter.

As far as National Insurance contributions are concerned employee Class 1 contributions for 2009/10 will be based on the following thresholds:-

- ☞ The lower earnings limit will be £95 a week (£412 a month). This is the earnings limit above which you need to record the amount of pay paid to an individual, this being returnable on the end of year PAYE forms, although contributions are not payable until the primary earnings threshold, see below, is reached.
- ☞ The primary earnings threshold will be £110 per week (£477 per month). Both employee and employer contributions at the respective rates are payable on earnings above these thresholds.
- ☞ The upper earnings limit for employees will be £844 per week (£3,657 per month). The annual equivalent – although the maths doesn't work exactly, will be £43,875 – the same as the total income above which 40% income tax is payable. The increase in the upper limit to this figure was pre-announced some years ago, but is quite a substantial increase of £74 per week, £320 per month or £3,848 per year – an increase of £385 in the amount of National Insurance payable by a taxpayer having NICable earnings of more than £43,875!

It has also been announced, which as far as I can see is a new development, that a completely new limit called the “upper accruals point” will be introduced. This is being set at £770, the 2008/09 upper limit for employee contributions. It appears that the Government has decided that this upper accruals point will be the maximum figure that gives access to any form of benefits.

PAH comment: Whilst, in practice, the introduction of this "upper accruals point" might be considered to be of limited immediate relevance, in fact it is of huge significance in Parliamentary terms as this severs, probably once and for all, the link between employee National Insurance contributions and state benefits. This link, which is known as the "contributory principle", has been fundamental over the entire 60 years since National Insurance was introduced in 1948, but is now simply being scrapped as a footnote!

Accordingly, from 2009/10 any NICs paid by employees earning than more £770 per week, will be simply a straightforward "levy", as indeed Class 4 National Insurance paid by the self-employed has always been. It remains to be seen whether any Government has the guts to admit that NIC is no longer the contributory scheme that it used to be and to change income tax rates and bands such that it can clearly be seen that National Insurance provides benefits, but any anything else is simply a tax charge. Unless they do this and this applies to a Government of any persuasion, the UK tax system will remain opaque and Government will always be accused of treating National Insurance as a stealth tax. It will be very interesting, when the next election is being fought, to see how, or if, the various parties deal with this matter.

Class 2 weekly National Insurance contributions for the self-employed will be increased from £2.30 to £2.40 per week and in an attempt to reduce burdens?, the collection of Class 2 NICs will be simplified, initially by aligning payment dates with those for self assessment liabilities.

PAH comment: I have absolutely no idea why the collection of Class 2 NICs is seen to be difficult, most people pay it monthly by direct debit and the direct debit rolls on from year to year with no particular difficulty. Whilst there may be an issue where the contributions are based on quarterly invoices, the suggestion that payments be changed to twice a year would appear to disadvantage those on direct debits. It is unclear whether monthly direct debit arrangement will now be scrapped in favour of a twice year direct debit on 31 July and 31 January – no doubt HMRC will let us know when they come to advise on the level of payments for 2009/10 – notices regarding this are usually issued a few weeks before the beginning of the new tax year.

10. WILL YOU GET A FULL STATE PENSION? - 50% INCREASE IN VOLUNTARY NIC CONTRIBUTIONS!

You may be wondering why on earth anybody would pay voluntary NIC contributions, but there is one special time when many people do have to consider paying these "Class 3" NICs.

When you are approaching retirement, it is possible to obtain a state pension forecast from the Government; this is a sensible thing to do if for any reason you feel you may not have enough "contribution years" to be eligible for a "full" pension.

Planning point: If you would like to know how to obtain a state pension forecast, please do not hesitate to contact Linda Harrison in our St Ives office on 01480 468931 – this is something that you have to do, we are not permitted to do it on your behalf, although we would be pleased to assist you with the information you need to obtain the forecast and to comment on the forecast that you obtain, when you have it.

If your National Insurance contributions record is not up to date, you can then make a decision whether, by paying additional voluntary Class 3 National Insurance contributions, you want to increase the amount of your state pension. However, any voluntary contributions that you pay usually have to be paid at the rate that is currently in force. For 2008/09 the rate is £8.10 per week (£421.20 per missing year), but from 2009/10 that will rise to £12.05 a week (£626.60 per year). I think the reason for this substantial increase is that the Government is reducing the number of years NIC that are required for a full pension and expects a lot more people to think about topping up their contributions to gain an increased pension in future years!

Planning point: In view of this increase, we recommend very strongly that if you have any breaks in your employment record or are otherwise concerned about the level of state pension that you may be entitled to, as noted above there has been a reduction in the number of years that you need to have worked to qualify for a full state pension,

that you obtain a state pension forecast immediately and if necessary make payment of any additional contributions before 5 April 2009, such that these can be made at the lower rate of £8.10 per week.

11. TAX CREDITS - READ PLANNING POINT 2 EVEN IF YOU THINK YOU DON'T QUALIFY!

As for the last few years, for 2009/10 there will be only be very selective increases in the tax credits "elements". In particular, as far as most clients are concerned there is no change in the family element of £545 and no change in the income threshold of £50,000 above which this begins to be withdrawn – see my comments in previous newsletters about "fiscal drag"! There is also no change in the "income disregard" of £25,000, this being the amount by which income can increase from one year to the next before the tax credits based on the income of the preceding year are considered to have been overpaid.

If you are interested in the detailed increases in some of the other benefits and thresholds, please do not hesitate to give Linda Harrison a call in our St Ives office, she will be pleased let you have details.

As in previous years, renewals for tax credits will need to be dealt with by 31 July 2009 in respect of the year ended 5 April 2009.

Planning point 1: Whilst we only get involved with tax credits for a minority of clients, if you are in any doubt whatsoever about your tax credits renewal or a possible new application, please do not hesitate to give Linda Harrison a call. In particular, if you feel you need to provide TCO with advice that would significantly reduce your tax credits, please check with Linda that this is correct – we have had one instance in the last year where a client advised TCO of a substantial increase in their income, whereas in fact the amount they were receiving was a capital repayment and did not need to be taken into account for tax credits. Whilst this was a relatively unusual set of circumstances, there are other factors with regard to tax credits claims that are slightly out of the ordinary and different from the way in which income tax is dealt with. As I say, if you are in any doubt, and would like advice, please do not hesitate to give Linda Harrison a call.

Planning point 2: If you do not have a tax credits claim in place, but consider you may be at any risk whatsoever of a substantially reduced income, albeit hopefully only on a temporary basis, over the next year or so, it will pay to make an immediate "protective" claim for tax credits. This is because any tax credits claim can only be backdated for three months, whereas if you lose your job or suffer trading losses, it may not be until later on in a tax year the full position of your income for that tax year can be seen; in this case, failure to have a protective claim in place could lead to loss of tax credit payments. When tax credits were first introduced, there was a lot of talk that absolutely everyone should make a protective claim – effectively a claim for which, owing to your level of income, there would be a £Nil award, but this has somewhat "gone off the radar" in recent years – now is the time to reconsider! If you would like any further advice on tax credits, please call Linda Harrison in St Ives on 01480 468931.

Whilst child benefit is not in fact part of the tax credits regime, the increase for 2009/10 will be brought forward by three months and the payments will now be £20 per week for the first child and £13.20 for other children, with effect from January 2009.

Finally on "benefits", all pensioners will receive a £60 payment in January, equivalent to bringing forward the April increase in the basic state pension for a single pensioner.

12. PAYE ARRANGEMENTS FOR WORKING STUDENTS

When PAYE was introduced as an emergency measure in 1944, most people only worked for one employer and stayed with that employer for many years; in addition, they were only ever paid in cash! The PAYE system was never designed to cope with people working for more than one employer, other than occasional changes of employment and in particular was never designed for people working for more than one employer at once. Whilst the adaptations that have been made to the system over the years to fit changing circumstances have, in general, enabled the correct position to be obtained in the long term, tax deductions from individual payments by employers in multiple employment situations are

often badly wrong and the situation can only be worked out after the end of the tax year; this is particularly the case for students having a considerable number of different employments in a tax year. Over the past couple of years, a major Government computer project has been trying to improve the way in which the records of people having tax deducted under PAYE are held by HMRC. In the past, a different record for each person working for each employer has been held by a tax office relevant to the employer and it has been quite difficult to get different tax offices to "get together", such that the overall tax and NIC affairs of somebody with multiple employments – this also applies to those having employment and pension income at the same time, can be clearly seen.

Unfortunately, the planned implementation date for this new system has been delayed – it was supposed to be in place by October of this year and there has been no formal announcement of when the system will be available. However, perhaps there is an inkling that it is expected to be available before 2010/11, because it is from that date that simplified systems are intended to be brought in to ensure that working students do not have tax over-deducted as they go through the tax year.

13. ARE YOU TAKING REASONABLE CARE? – CHANGES TO HMRC POWERS

When the old Inland Revenue and HM Customs and Excise were merged a few years ago to form HMRC, it quickly became apparent to those charged with making the merger "work" that the powers of the two ancestor departments were radically different. For various reasons, probably historically to do with their responsibilities regarding smuggling, Customs and Excise's powers were generally at a higher level than those of the Inland Revenue. After an exercise taking almost four years, HMRC are poised to introduce a completely new set of powers from 6 April 2009 and I am sure it will not surprise you to hear these are much more closely aligned to the old Customs' powers than those of the Inland Revenue.

In future, and this will could apply to earlier years in some circumstances, if HMRC find an error in a tax return they will consider how the error arose. If they determine the error was:

- as a result of a failure by the taxpayer to take reasonable care with their tax affairs, or
- is deliberate, or
- is deliberate and concealed,

automatic and increasing tax geared penalties will be imposed (a tax geared penalty being a % of the tax lost as a result of the error).

The big debate is what will constitute "reasonable care"; the penalty for not taking such care being a whacking 30% of the tax lost. This has to be compared with the current situation where in most cases, if there is good cooperation with an HMRC enquiry, although tax lost and interest have to be paid if an error is found or HMRC are unable to agree to allow a specific deduction, there is often no actual penalty.

PAH comment: From papers issued with the PBR and other recent announcements and "consultations", it is becoming clear that what HMRC consider reasonable care to be is, essentially, getting it right! It is funny how an ordinary word like "reasonable", can take on such a specific meaning in tax law – as anybody who has ever tried to claim they had a "reasonable" excuse for not submitting a VAT return or paying VAT on time will most probably have already found out.

To help taxpayers, HMRC have advised that if a taxpayer employs an agent then they could personally have been deemed to have taken reasonable care, but if the agent does not then take reasonable care on their behalf – the taxpayer will still be liable for the same penalty! In such circumstances, you would quite reasonably look to us to make good the penalty and, for this reason, as work being done now could well be subject to enquiry under the new rules, we may be asking you to keep additional records and answer some questions you have not been asked before; and then being more circumspect about the allowability of certain expenses. If you have any queries on these changes, of course please do not hesitate to give me a call.

14. PROPOSED FUTURE TAX AND NIC CHANGES AND EXTENSIONS TO E-FILING REQUIREMENTS

As mentioned at the beginning of this newsletter, in order to demonstrate fiscal responsibility, as well as "giving away" quite a lot in tax reductions at present, the Chancellor also set out how he expected to pay for the giveaway during the period from 2010/11, when he expects the recession to have ended.

It is proposed that for 2010/11 and subsequent years, where an individual's income is above £100,000, the personal allowance will be reduced by £1 for every £2 above this amount until it is reduced to one-half of the basic personal allowance.

PAH comment: What this measure achieves is a reduction in the personal allowance until it is only worth 20%, effectively the same as the value obtained from the personal allowance by a basic rate taxpayer. There is precedent for this sort of action with the old married couples allowance, although this has now been abolished for all those born after 6 April 1935 and I believe it likely, whether or not there is a change of Government, that this sort of restriction in the personal allowance will probably stand.

In addition, for taxpayers with incomes over £140,000, the amount of the allowance will be further reduced by £1 for every £2 above that limit, until it has been withdrawn altogether.

PAH Comment: This is a very different matter, placing a high earner at a disadvantage to others and to my mind would be better dealt with by changing the figure at which the 45% rate of tax becomes payable.

For 2010/11, far more fundamental changes are planned and I think it is likely that these will be reviewed when the result of the next General Election is known. However, having said that, it is clear that there do need to be some either fairly substantial tax rises, or cuts in Government expenditure of course, to eliminate the current budget deficit and even if these tax rises, in this form, do not go ahead, I believe it likely that other tax rises will have to be put in place – see my comments on VAT rates in section 1 above.

The Chancellor also announced that with effect from 2011/12, taxable income above £150,000 will be liable to income tax at a new rate of 45%; adjustment will be made to the rate at which dividends are taxed to ensure the same amount of tax is paid on that source of income.

From the same date, the main rates of Class 1 and Class 4 National Insurance contributions will be increased by 0.5% to 11.5% and 8.5% respectively. The Class 1 employer rate of National Insurance will also be increased by 0.5% to 13.3% and the increased rate will also apply to employer's contributions based on benefits in kind.

The "additional" rate of Class 1 and 4 National Insurance contributions, currently 1% on income over the "upper earnings limit", will be increased to 1.5%.

The trust rate of tax will also increase to 45%.

PAH comment: As I mentioned earlier in this newsletter I expect that the initial effect of these changes will be to encourage those who may be affected to try very hard to arrange their affairs such that they are "not affected"! I believe this is likely to trigger a further considerable bout of imaginative schemes for tax avoidance; there is recent precedent for this actually reducing the tax take. It is possible, of course, that before then we will also see at least some proposals for a substantial revision to the current rules for "small business" taxation that might make avoidance much more difficult, but there is nothing as imaginative as the tax avoidance specialist facing a challenge!

With there still being well over two years before the beginning of the first tax year to which these new rates might apply and as Harold Wilson said, a week is a long time in politics, I don't think any further consideration of these issues is sensible at this time, however we will be keeping a watching brief on how all of this develops and keep you informed.

EXTENSIONS TO E-FILING REQUIREMENTS

Looking forward, 2010 and 2011 will also bring further compulsory online filing of documents and returns with HMRC. Whilst some of these, e.g. we are already filing most corporation tax returns, as well as personal and partnership tax returns online, we will deal with on your behalf, if you currently do your own PAYE end of year forms, these will all have to be submitted on line from either 2010 or 2011, dependent on the size of your business.

However, the biggest change will be for VAT, where online filing is currently due to become compulsory from a date in 2010 – although this is to be fully confirmed. As always, we will keep you up to date with the Government's proposals and should be pleased to help you meet your statutory obligations.

15. CHRISTMAS OFFICE CLOSURE

This year, both our offices will be closed from 5 pm on Wednesday 24 December 2008, and re-open at 9 am on Monday 5 January 2009. If you have an urgent query during the Christmas period, please do not hesitate to telephone me on 01480 462713, where, if I am not at home, there is an answering machine. I will endeavour to deal with the matter as soon as possible after I return.

16. PREVIOUS NEWSLETTERS

In some of these articles, I have referred to comments made in previous newsletters – e.g., if you are interested, a much more detailed explanation of the Arctic Systems tax case is given in my Summer 2007 newsletter. If you do not have these, copies of previous newsletters, for the last couple of years or so, are available on our website at www.paulahill.co.uk.

Our business grows mainly by referrals and we are always looking for new clients. I should appreciate it if you could let me know of any colleagues, customers or associates who may be interested in the way we do business. Thank you.

PAUL HILL

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