

A TIME OF UNCERTAINTY

We had hoped that the Chancellor's Pre-Budget Statement would resolve at least some of the open questions on the tax treatment of small businesses, and on the scope of recent legislation to 'block' inheritance tax planning, which became so important during 2004. But in the event, he said nothing about inheritance tax and created more doubt than ever as to his future plans for taxing small businesses.

Taxing times for small businesses

As part of the pre-Budget 'package', HM Treasury published a 'discussion paper' entitled *Small Companies, the Self-Employed and the Tax System*. This carefully explains what everyone already knew – that the amount of tax payable on profits depends on whether the business is carried on by an individual in his own name or through a limited company, and on whether a company's profits are paid out as directors' salaries or as dividends. The Treasury conclude it is 'unfair' that, in some circumstances, an individual trading through a company pays less tax than one trading in his own name – and, naturally, they assume that fairness can only be attained by increasing the tax payable by the company. To this end, a special tax régime for the owner-managers of small companies is proposed: the paper does not explain exactly what the Treasury has in mind, but it hints at treating dividends paid to owner-managers as earnings liable to National Insurance contributions.

The other side of the coin is that the paper also suggests that Government support for growing businesses might be made available on equal terms to all enterprises, whether trading through a company or not, if it was delivered outside the tax system (presumably in the form of grants or subsidies).

What is particularly disappointing is that, although the Treasury stress the importance of making it easy for existing businesses to incorporate, their paper does not even mention the tax problems which often make it impossible for an incorporated business to revert to sole trader or partnership status.

Confusion over inheritance tax legislation

Turning to inheritance tax, the Finance Act 2004 'blocked' schemes designed to reduce the tax potentially payable on the family home, by imposing an annual income tax charge on the value of occupation where (for example) a scheme allows elderly parents to remain in their home while giving a share in its value to their children. This applies even if the scheme was set up before the Finance Act 2004 was enacted. The legislation is quite complex and its effects depend on the exact circumstances of the case, so anyone who has entered into such a scheme (at any time in the past) now needs individual advice on his or her best course of action.

The legislation allows those affected to 'opt out' of the income tax charge by accepting that an inheritance tax liability will arise on their death. However, 'opting out' will not

unwind the scheme altogether and will not be beneficial in every case, so the importance of individual professional advice cannot be over-emphasised.

Of even greater concern is the fact that the scope of the legislation is uncertain. As presently drafted, it may create unexpected tax charges in situations where tax planning was not part of the parties' original intention – for example, where a mother and daughter simply pool their resources to buy a house because they want to live together. It was thought that the situation might be clarified in the Pre-Budget Statement, but it was not. Hopefully, the problem will be resolved in the Spring 2005 Budget but, meanwhile, anyone planning a joint house or flat purchase (other than with their husband or wife) should take professional advice.

END-OF-YEAR TAX PLANNING

The Government have made it clear that they will not hesitate to use effectively retrospective legislation to block tax mitigation schemes, such as the inheritance tax plans mentioned above. As the action they will take to block a plan cannot be predicted (for example, the income tax charge on occupation, to block an inheritance tax plan, broke entirely new ground), it is difficult to recommend almost any tax scheme, because it is impossible to predict what the final outcome will be. It is, indeed, quite possible that the client will end up paying more tax than if he had let events take their ordinary course.

This makes it more important than ever to consider using all the reliefs and allowances available under the tax legislation and, in this context, the end of the tax year on 5 April 2005 can still be an important deadline.

Inheritance tax Lifetime gifts of up to £3,000 a year are ignored for inheritance tax purposes (the limit is per donor, not per recipient). The allowance can be carried forward for one year only, so that gifts of £6,000 may be made in 2004/05 if the 2003/04 allowance has not yet been used. One way of using the allowance is to pay the premiums on a life assurance policy written in trust for the desired heirs: in this way, both the cash gifts and the investment return build up outside the donor's estate and free of inheritance tax.

Capital gains tax It had been predicted that the Chancellor would use the Pre-Budget Statement to announce an improved taper relief for non-business assets, such as portfolio holdings of quoted shares. In the event, he did not, so it is important to consider managing capital gains liabilities, for example by making sales to utilise the annual exemption or to crystallise losses.

Straightforward 'bed-and-breakfasting' (sale and immediate repurchase) is no longer effective for tax purposes, but alternative arrangements, such as sale by a husband and repurchase by his wife, or sale by an individual and repurchase within his ISA, are still available. In case of legislative changes in the Spring Budget, we would recommend action before Budget Day (which will almost certainly be during March, but the date has not yet been announced).

ISAs (Individual Savings Accounts) The annual investment allowance (£7,000 for adults and £3,000 for 16- and 17-year-olds) will be lost if it is not used by the end of the tax year. One piece of good news from the Pre-Budget Statement is that the £7,000

investment limit will be retained for 2006/07 to 2008/09: it was due to be reduced to £5,000. The Government's present intention is to withdraw the ISA scheme in 2009.

Pension contributions Anyone wishing to make an additional voluntary contribution (AVC) to his employer's pension scheme must do so by 5 April 2005, if the payment is to qualify for tax relief in 2004/05. This is most likely to be an important deadline if the individual is a higher-rate taxpayer for 2004/05, but will probably not be for 2005/06.

Capital allowances The Spring 2004 Budget allowed small businesses to claim 50% First Year Allowances for their purchases of plant and machinery in 2004/05. To qualify, the purchase must be made no later than 5 April 2005 (31 March 2005 in the case of a purchase by a company). A business qualifies as 'small' if it satisfies at least two of the following tests: annual turnover not exceeding £5.6 million; balance sheet not exceeding £2.8 million; payroll not exceeding 50 employees.

BABIES AND CHILDCARE

As part of his Pre-Budget Statement the Chancellor announced that, from April 2007, new mothers will be entitled to Statutory Maternity Pay (or, if they are self-employed, Maternity Allowance) for a maximum of 39 weeks, instead of the current 26. As now, Statutory Maternity Pay will be paid at 90% of average earnings for the first six weeks and at a flat rate (currently £102.80 but uprated annually) for the remaining weeks, while Maternity Allowance will be paid at the flat rate throughout.

The maximum maternity leave to which a new mother will be entitled will remain 52 weeks. By April 2009 the Government plans to pay Statutory Maternity Pay (or Maternity Allowance) for the whole of this 52-week period and to allow an (as yet unspecified) proportion of both the maternity leave and the Statutory Maternity Pay to be transferred to the baby's father.

Working Tax Credit and childcare costs

There are to be increases in the childcare costs which qualify for reimbursement as part of a Working Tax Credit claim. At present, depending on the claimant's income, up to 70% of eligible costs may be reimbursed, to a ceiling of £94.50 a week (70% of £135) for one child and £140 a week (70% of £200) for two or more children. From April 2005, these figures will increase to £122.50 a week (70% of £175) for one child and £210 a week (70% of £300) for two or more children. Then from April 2006 the percentage reimbursed will rise to 80%, making the maximum claim for one child £140 and for two or more children £240.

There will also be changes to make it easier for working parents to claim the Working Tax Credit childcare allowance for childcare in their own home – for example, for the cost of employing a nanny. It is already possible to claim for a nanny, but only if the person employed is a registered childminder or an approved carer, which most nannies are not. A simplified approval process is being introduced and, from 6 April 2005, the wages paid to nannies approved under the scheme will qualify for reimbursement as part of a Working Tax Credit claim.

However, the rule will remain, that where a relative provides childcare in the child's own home, support under the Working Tax Credit scheme will not be available, even if the

relative has a relevant childcare qualification. A 'relative', for this purpose, is the child's grandparent, uncle, aunt, brother or sister.

Employer support for childcare

From 6 April 2005 no benefit-in-kind charge or National Insurance contribution liability will arise where an employer gives an employee vouchers exchangeable for childcare, worth up to £50 a week. This limit applies per employee (so that if mother and father are both employed, both may be given vouchers), but not per child. It is a condition of the exemption that the vouchers must be available to all employees, or at least to all those employed at a particular location.

An employee eligible for Working Tax Credit should note that childcare costs met by vouchers will not count as childcare costs paid by the parents – this effectively dilutes the benefit of the tax and National Insurance exemption.

Different rules apply where the employer makes a payment direct to a childcare provider, or himself operates a crèche, either on his own premises or in conjunction with other local employers. Please contact us for further details if this is relevant to you.

EMPLOYERS AND EMPLOYEES

In the Spring 2004 Budget the Chancellor promised that payment of Working Tax Credit would be transferred from employers to the Inland Revenue. This is, apparently, still on the agenda, but the Government is currently consulting 'on the detail of implementation' and no target date for the changeover has yet been announced. Certainly, it appears that employers will still have to pay Working Tax Credit through their payrolls in 2005/06.

In the December 2004 Pre-Budget Statement the Chancellor made two announcements relating to company cars. First, the 3% surcharge on the benefit-in-kind charge for diesel cars, which is currently waived for cars which meet Euro IV emission standards, will be charged on all diesel cars registered on or after 1 January 2006. Second, from a date to be announced, the VAT charge on fuel provided by an employer, for a director's or employee's private motoring, will be based on the income tax benefit-in-kind charge.

Finally, the Home Office is about to launch a new campaign to encourage more employers to set up Payroll Giving Schemes. Under such a scheme, employees receive tax relief for charitable donations they authorise to be deducted from their salaries or wages. As an additional incentive, the Home Office will be offering grants to offset an employer's costs in setting up a scheme, and will double an employee's first six months' donations (to a maximum of £10 a month). Final details will be available early in 2005.

This newsletter deals with a number of topics which, it is hoped, will be of general interest to clients. However, in the space available it is impossible to mention all the points which may be relevant in individual cases, so please contact us for personal advice on your own affairs.