

Capital gains miscellany

David King, Tax Consultant, guides us through some of the Budget's new rules on taxing capital gains.

Taper relief: definition of business assets

Under current rules a property owned by an individual and let to a qualifying trading company benefits from the more favourable rate of taper relief, leading to a maximum 10% tax rate on sale after two years. From 6 April 2004 the definition of a business asset for taper relief purposes will be extended to include properties let to any qualifying trading business, irrespective of whether the tenant is a limited company.

This means that once the new rules are introduced it will no longer matter what trading vehicle is used by the tenant, so in tax terms it will no longer be advantageous to seek out a tenant that is a trading company in preference to a sole trader or partnership. However for the rest of this tax year this advantage still applies so for those individuals

owning commercial properties who are seeking new tenants at the moment it would still be beneficial to let to a trading company if possible. If you have property let to an unincorporated business, talk to us as there may be some tax planning that can be done to improve the position.

Carry-back of losses on rights to unascertainable deferred consideration

When an individual sells a business it is quite common for an element of the consideration to depend on the subsequent performance of the business, commonly known as an 'earn-out'. For tax purposes at the date of sale of the business a value has to be attached to the earn-out, even though the actual amount to be received cannot be known at that stage. If the value placed on the earn-out exceeds the amount subsequently received then for tax purposes a loss arises.

Under previous rules this loss could not be set back against the capital gain arising at the time of the original deal, but was set against gains arising in the same year or subsequent years. Under

the new rules, which have immediate effect, a claim may be made for losses arising in such circumstances to be set back against the earlier gains. This change should make it easier to structure deals for the sale of private companies, as it alleviates a tax risk that used to exist for the seller.

Treatment of certain "earn-out" rights as securities

This is another change affecting 'earn-out' rights, and this should also ease the deal-making process. You might sell your company to another company, with part of the price to be decided later and paid in shares or loan notes at a future date. You can defer the tax on the sale of your company until you sell those shares or redeem the loan notes. However, until now you have had to make a claim to do this.

The new rules will mean that a tax deferral is available without the need to lodge a claim. Instead, you will have to make a claim if you want tax deferral not to apply. We expect that it will be quite rare for such a claim to be beneficial.

Manufacturing for Success

So what impact did the Budget have on the UK manufacturing sector?

The Government's Manufacturing Strategy shows, on the face of it, a commitment to improving our manufacturing base and bringing the UK back into direct competition with some of our European neighbours and the US.



Richard Green, Director

They have identified "seven pillars for manufacturing success" including raising skills and innovation. There are, therefore, some small snippets from the Budget that are steps in the right direction.

The extension of 100% first year allowances on computer equipment for another year and reduction in the amount of spending required to qualify for the research and development tax scheme are both helpful for the innovative business looking to reinvest in its future.

However, manufacturing accounts for one in seven of the UK's workforce (an even greater proportion in the Yorkshire region) and accounts for 60% of our exports. To raise productivity, the 'skills gap' that has developed over the last two decades must

be closed and the Government is looking to the private sector to assist with this.

Garbutt & Elliott are working in partnership with Yorkshire Enterprise to help deliver business skills training to South and West Yorkshire manufacturing companies through the Workforce Development Programme. This programme is funded by Yorkshire Forward the Regional Development Agency, therefore grant assistance

is available and covers the following themes:-

- Effective selling and marketing.
- Better financial controls.
- Improving competitiveness and productivity.

The programme is delivered by approved business development specialists and support is available now to give you and your workforce the tools to transform your business. With grant funding available it will cost less than you think.

If you are interested in obtaining details of the Workforce Development Programme please contact Richard Green in our Leeds office (rgreen@garbutt-elliott.co.uk).

Announcement - Christmas Cocktail Winners

The Garbutt & Elliott Christmas Cocktail VII was as popular as ever this year with several answer sheets coming very close to gaining top marks! However, with just a mark separating our winners from their closest rivals, Steve & Lynn Spink from York were awarded the top prize of a £50 Winerack voucher.

'It's the Taking Part that Counts' prize went to Ian Bradley, from Ripon, who received a £20 Winerack voucher.

The Colouring Competition was won by Helen Waller (age 4) from York who received a Toys 'R' Us voucher worth £20.

Congratulations to all our winners, and many thanks go to Richard Scott, Richard Stansfield, York Publishing and all those who took part.

The solutions for the quiz can be found on our website www.garbutt-elliott.co.uk or by contacting Karen Muir at the York office.

Please note: To allow space for Budget commentary we are not having a client profile in this issue.



An update for clients and contacts of the firm

News
Issue 1 - 2003

CHARTERED ACCOUNTANTS & BUSINESS ADVISORS

Incorporation - Irresistible?



Duncan Meredith, Tax Consultant

Duncan Meredith reviews the case for incorporating your business after the Budget

6 April saw the 1% increase in National Insurance charges for both employers and employees. However, there was no reversal of last year's generous reduction in corporation tax rates and no measures to penalise the payment of dividends. Whilst it was disappointing that no extra tax reliefs will be forthcoming for unincorporated businesses, the case for running a business through a company is even more persuasive.

The lack of any tax liability on dividends for shareholders who pay only basic rate tax, the zero rate of corporation tax applying to the first £10,000 of company profits, the increased National Insurance charges and the Stakeholder Pension regime that removes the need for annual pensionable earnings, all combine to favour incorporation.

The tables illustrate the tax savings that can arise from incorporation. For modest profits of £15,000, savings of nearly £3,000 arise. Total savings increase with profits and partnerships can benefit as well.

Profit	Self-employed Tax and NIC	Company Tax and NIC*	Saving	% Reduction
£15,000	£2,984	£91	£2,893	97.0%
£20,000	£4,484	£1,279	£3,205	71.5%
£25,000	£5,984	£2,466	£3,518	58.8%
£30,000	£7,484	£3,654	£3,830	51.2%
£40,000	£10,729	£6,506	£4,223	39.4%

	Sole trader £	Company & director* £
Profits	20,000	20,000
NICs (Class 2 & 4)	1,334	0
Income Tax	3,150	0
Corporation Tax	0	1,279
TOTAL TAX	4,484	1,279

* assuming salary of £4,615 drawn by director and remainder as dividends.

Many of our clients have already benefited from incorporating their business. We should be happy to discuss your particular circumstances and talk over the issues.

Inheritance tax - another dog that didn't bark?

Nigel Shaw comments on the inheritance tax position following the Budget.



Nigel Shaw, Director

The inheritance tax nil rate band is to be increased by the statutory indexation for 2003-04 from £250,000 to £255,000. However, there were no other changes in the inheritance tax rules. You might therefore think that there was nothing much to say on inheritance tax following the Budget.

Nevertheless, two main estate-planning lessons are worth repeating. First, on the death of the first of husband and wife to die, it is very expensive in inheritance tax terms to gift everything to the surviving spouse - the new nil rate band means that this would waste £102,000 (=£255,000 x 40 per cent). Better to set up a nil rate band trust from the estate. This can involve planning using the family home in appropriate cases. Secondly, a husband and wife can each use their nil rate bands and £3,000 annual exemptions to make lifetime gifts free of inheritance tax amounting to an aggregate of £1,068,000 over an eight-year cycle (ignoring increases in the nil rate band in that period).

- Incorporating your Business
- Inheritance Tax
- Budget VAT
- Capital Allowances
- R & D Developments
- Company Share Schemes
- Company Fund Raising
- Manufacturing for Success
- Capital Gains Tax
- Pensions: Stop Press
- Tax Non-Compliance
- Exam Successes
- Christmas Cocktail Winners

Directors and staff in the firm are happy to discuss matters arising from this newsletter, as well as any other issues related to your business or personal financial affairs.



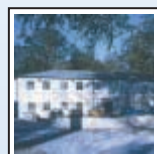
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VAT: Additional anti-avoidance and fraud measures

Our expert David Fiddy, reviews the Budget's mixed news on VAT.

At first glance, there was little to get excited about in the recent Budget with regard to VAT. There were the usual, inflation-linked adjustments to registration, de-registration and fuel scale parameters but seemingly little else. There is, however, a heavy emphasis on measures to prevent fraudulent evasion of VAT and to curb schemes intended to avoid, or delay, payment of VAT by artificial means. The areas specifically targeted are those of transactions in land and property, telephones and computer equipment, fuel and alcohol.

Customs are increasingly concerned about the proliferation of 'carousel' frauds affecting suppliers of mobile telephones and computer equipment. A carousel fraud involves sales and purchases between a number of businesses, in different member states, relying on the reverse charge mechanism but using stolen VAT registration numbers. Input tax is recovered but output tax is avoided by the apparent intra-community movement of goods.

Customs announced in the Budget measures to prevent this type of fraud. They include a new joint and several liability provision and new rules for evidence of input tax deduction.

From 6 April 2003 a business dealing in telephones and computers will become jointly and severally liable for tax that has not been paid where they had reasonable grounds to suspect that VAT on those goods would go unpaid. Furthermore, these businesses will be subject to stricter conditions governing the evidence required to support input



David Fiddy, VAT Consultant

tax recovery claims, where a valid VAT invoice is not available.

New regulations have also been introduced regarding tax points for the supply of new commercial buildings and certain other on-going supplies. The sale of a freehold commercial building is liable for VAT during the first three years after completion. Some businesses have been exploiting a loophole that allows VAT to be paid at the point of payment, not at the time of sale. By delaying payment

beyond three years the sale becomes exempt from VAT. Payments will now become standard-rated when made after the end of the three-year period.

Similarly tax points for certain on-going supplies have also been tightened up so that, for supplies made between connected parties, a tax point will be created after twelve months whether or not payment has been made. This measure will include leasing of property and equipment, electricity, piped gas and water.

A further measure, relating to property, withdraws the opportunity to recover VAT in full on land and buildings to be used for both business and non-business use. In future VAT recovery must be apportioned, in the ratio of business/private use, at the outset. Previously it was possible to recover all of the VAT and pay output tax on private use as it occurred.

The above changes are the subject of consultation exercises by Customs and Excise prior to implementation. These proposals are an indication of Customs' continued determination to clamp down on VAT fraud and avoidance schemes.

Better opportunities on capital allowances

John Guy, Tax Consultant, reflects on the improvements to the capital allowances regime after the Budget.

The Budget contained a number of measures to improve the method by which businesses obtain tax relief for the depreciation of capital assets, in other words the capital allowances rules.

First there was confirmation that 100% allowances on computers and similar equipment would continue for small businesses for a further year, to 31 March 2004. It remains to be seen whether the deadline will be extended again, but for now it is perhaps better to assume that a purchase of such equipment on or before 31 March 2004 will have better tax treatment than one afterwards. This welcome measure was tempered by an anti-avoidance rule stopping 100% allowances for computer software that is not used in a trade, but simply licensed to others. Some taxpayers have used the 100% allowances on software purely as a tax shelter, but the planning is now no longer available.

Next came a proposal to increase the size of businesses that will qualify for these 100% allowances and the 40% allowances for medium-sized businesses investing in general plant and machinery. When these proposals come into force, possibly this summer, a greater number of businesses will receive these enhanced allowances. In the meantime, businesses on the borderline may well choose to defer their capital expenditure plans.

Businesses of all sizes can get 100% allowances on certain energy-efficient equipment, under the "enhanced capital allowances" rules. Full details, together with a facility to check what items of plant qualify for these allowances, can be found on the Government's web site www.eca.gov.uk. This year the list was extended to include water-efficient items. The main point about these technologies is that, in many cases, the enhanced allowances are available only if the particular make and model of equipment is listed, so it is important to check before you buy.

years between option exercises. This meant that the employee had only three chances to exercise options, namely at years three, six and nine.

The rule requiring a three-year gap is being abolished. This makes this type of scheme (known as the Company Share Option Plan) more flexible and easier to operate.

Furthermore, if an employee in a Company Share Option Plan exercises the option in the first three years, this can now be tax-free if the reason is that he or she is leaving the company because of injury, disability, redundancy or retirement (known as being a "good leaver").

A number of other changes are being made to the approved schemes (CSOP, SAYE and SIP schemes) to make the administration simpler.

• Reversal of *Mansworth v Jelley*

Share options can be granted either by the company or by an existing shareholder. In the latter situation, the recent tax case of *Mansworth v Jelley* created a position that was very good news for the employee, but potentially disastrous for the grantor of the option. The effect of the case was that, in some circumstances, the whole of the tax liability of the employee on selling the shares was transferred from the employee to the grantor of the option.

This decision has now been reversed. As a result, we can once again consider using existing shareholders' shares in employee share options, which brings back some welcome flexibility in the arrangements.

There is a great deal of detail underlying all the above changes, and specific advice is needed before implementing any scheme involving company shares.

Revenue gets tough on non-compliance



Ray Cadman

Ray Cadman, Tax Investigations Specialist, warns about the Government's latest push to improve tax compliance.

One of the Government's Budget Press releases trumpeted an "investment" of £66 million in launching a new compliance and enforcement package for direct tax and National Insurance. According to the release, the £66 million will be injected over a three year period which, it is claimed, will yield additional revenue of "at least" £1.6 billion over the same period.

The problem is that there is nothing in the release, or the accompanying notes, that gives any breakdown of either the £66 million being spent or where, precisely, the yield is going to come from. It is simply stated that the £66 million will be spent on three areas:

Research & Development Expenditure



Russell Turner, Director

Russell Turner, advisor to knowledge-based businesses, summarises the Budget changes that will be important in the research and technology sectors.

R&D tax credits were introduced in the Finance Act 2000 for small or medium-sized companies, and two years later for large companies. The tax credit gives small or medium-sized companies a further deduction of 50% of their qualifying R&D revenue expenditure. The addition for large companies is limited to 25%. Cash payments are available for loss-making small or medium-sized companies.

Up to now, the company has had to spend at least £25,000 a year on R&D to qualify. The tax

Company fund-raising issues

Richard Feltham, Corporate Finance Director, looks at potential implications in the Budget for companies seeking extra funds.

Companies may find the fund-raising process eased by some changes in tax law following the issue of a consultation paper this year. Because this is only at the consultation stage, we cannot say when the rules will change, or indeed what the exact rule changes will be.

• Incidental costs of equity finance

At present, the incidental costs of raising debt finance (such as professional fees) are tax-deductible, whereas this is not the case for equity finance. The Government is thinking of allowing tax relief for the costs of raising equity, but probably only for small and medium-sized companies facing difficulties in raising equity finance.

• Changes to the Enterprise Investment Scheme

Many smaller companies have raised equity funds via the EIS, which provides tax incentives to investors in the form of income tax relief and capital gains rollover when the investment is made, and capital gains exemption on sale.

The Government is consulting on possible simplification of the EIS rules. Since the possibilities being canvassed include removing the rollover of chargeable gains into EIS investments, and the abolition of the capital gains exemption on the sale of EIS shares, perhaps it is a case of making hay while the sun shines?

- protecting the Exchequer from non-payment of tax and NI debts and from failure to file tax returns;
- tackling fraud involving concealment of undeclared income or profits offshore;
- countering avoidance of corporation tax, and PAYE/NI on employment income.

In many respects the package is reminiscent of the famous "Spend to Save" initiative which was introduced a few years ago. But at least that involved a stated number of additional Inspectors and a pretty good idea of what stones they would be turning over. Sadly, on this occasion, the detail remains tantalisingly, perhaps deliberately, vague.

One suspects that the biggest yield will come from the first category, via the Collector – now called the Debt Recovery Office – simply chasing tax arrears. We can also probably expect an even bigger push than that already seen recently on PAYE/NI inspections and on employment status.

If you would like to talk to us about carrying out a PAYE/NI Healthcheck, or discuss any other tax compliance issues, please call us and ask for Ray Cadman, the firm's employment taxes and investigations consultant.

credits will now be enhanced by reducing the minimum expenditure to £10,000 a year, and the calculations of qualifying expenditure will be simplified. Tax credits will be available for grant-assisted projects (previously excluded), albeit only at the large company rate.

The Government will undertake consultation to expand the definition of R&D. This will include design, software development and the cost of specialised software that is required to undertake R&D.

These welcome extensions to the system of R&D tax credits could have a significant effect, as many smaller companies will now qualify for relief, including grant-funded projects. Depending on the outcome of the consultation, software developers should be able to make claims. Significant beneficiaries will include technology companies, such as those set up by universities to exploit new technologies.

If you would like to know more about the availability of R&D tax credits for your business, we should be happy to discuss the subject with you.



Richard Feltham, Director

STOP PRESS ACT NOW BEFORE IT'S TOO LATE?

Shortly before Christmas, the Government issued two consultation papers which proposed radical changes to the way in which you can fund for and receive pensions. The changes will benefit many but could have a detrimental impact upon you if

- you are able and would like to pay more than £200,000 a year into your pension fund
- you have an accumulated pension fund in excess of £1m
- you already make use of your pension fund monies within your business or are considering doing so
- you were planning on using your pension fund to acquire new business premises

The Government is hoping to implement the proposed changes with effect from 6th April 2004 (A Day) although A Day may be postponed until 2005. In any event it may make sense for you to review your existing arrangements now before it is too late.

Exam Successes Another Step towards Qualification:

Jackie Fowler passed her professional stage Chartered exams earlier this year, coming 10th in West Yorkshire. She is sitting her final exams in July.

Both Helena Hamer and Ian Kent have also completed their professional stage Chartered exams, and will be taking their finals in November.

Kelly Temple, Jill Taylor and Clare Blair have all completed the latest stage of their Certified exams. Kelly Temple is now part-qualified and due to sit her finals in December.

Chris Chambers passed another stage of his Accounting Technician (AAT) exams, with just one more stage to go. Chris must then decide whether to continue studying towards either the Chartered or Certified Accountant qualification.

Steve Garbett is also working towards the Accounting Technician qualification (AAT), after successfully completing his Intermediate exams.

Chris Blackburn and Phil Wileman have now reached the half-way point after passing another stage of their Intermediate AAT exams.

Congratulations to all!

Congratulations of a different kind...

...to Kay and Paul on the birth of their daughter Caitlin Maya who was born on 14 January. Kay is part of our Trusts team in the Leeds office.

Company share schemes for employees

Adrian Widdowson reviews the Budget's improvements to employee share schemes.

The Budget and Finance Bill have made a number of changes to the taxation of employee share schemes, designed to increase take-up of this type of remuneration planning. Although share schemes are often seen as relevant mainly to quoted companies, they have a role to play also in the context of small and medium-sized private companies.

Enhancements this year include:

- Giving companies tax relief on the cost of providing employee shares

Take the example of a company giving an employee an option to subscribe for 1,000 shares at £5 each. After a number of years the employee exercises the option and subscribes a total of £5,000, by which time the market value of the shares has gone up to £12 per share. The company receives £5,000 from the employee for his shares, but is also able to deduct £7,000 from its taxable profits, being the difference between the subscription price and the market value of £12,000. This provides the company with a further £2,100 in tax savings assuming a tax rate of 30%.

- Simplification of approved share option schemes

Some Inland Revenue approved share option schemes currently require that options can only be exercised between three and ten years after they are granted, and there used to be a second rule that there had to be a gap of three



Adrian Widdowson, Director