



Tax Briefing

Spring'08 Web edition



Opinion

BROWN'S were big boots to fill and few would argue against giving anything less than pass marks to his handling of the economy. But whether or not Alistair Darling fills the boots may well be determined by how the dust finally settles on the proposed changes to CGT – more of this inside and on our website – and how our financial services industry reacts to the proposed reforms at the Bank of England and the Financial Services Authority in light of the collapse of Northern Rock.

The former may well even be challenged in the European Courts due to the amount of time EU law dictates must be given to taxpayers to claim reliefs. But I have a feeling that the potential fallout from these and the other reforms already on the table may well be made more palatable on the 12 March at his first full Budget – just ahead of the local elections south of the border and the politically significant London Mayoral elections in May. We'll just have to wait and see.

Inside, David Boyd reports on the rise of the LLP, Justine Riccomini looks at employee share schemes, Morag Page gives top 10 personal finance tips and Scott Craig brings news of VAT changes to building and renovation projects. You'll also find more on CGT, changes to residence and non-domicile taxes, an examination of the Chancellor's concessions for entrepreneurs and our tax calendar.



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Capital plans

The capital allowances regime is being revamped with effect from April 2008. Investment decisions need to be taken carefully to minimise the tax implications.

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Valuing depreciation

Paul Renz looks at changes to the current capital allowances regime.

THE government is pitching the changes as a 'modernisation' of the current capital allowances regime, so that it reflects the true economic depreciation of assets. The changes will come into effect from 1 April 2008 for incorporated businesses and from 6 April 2008 for the unincorporated.

From then, a new annual investment allowance (AIA) will be introduced to replace the existing first year capital allowances of 40% and 50%. As currently proposed, the AIA will enable businesses to claim £50,000 of expenditure on plant and machinery a year, i.e. full write off in the year of expenditure. However, less attractive proposals include the reduction in the main rate of writing down allowance from 25% to 20%. A new category of expenditure is also being introduced – 'integral fixtures' – which will have a writing down allowance of just 10%. This category will include items such as lifts, air-conditioning and central heating.

Combined with the announced increases to small companies corporation tax rates, tax costs for many small and medium-sized companies will be significantly greater, while large



companies should be considering accelerating capital expenditure to obtain larger allowances and corporation tax relief at 30% not 28%. Therefore, businesses need to think carefully about the timing of any major asset investments.

For example, if you are expecting to spend up to £50,000 on plant and machinery, it may

be worth delaying until the new regime comes into effect, in order to get the 100% AIA.

However, if a much larger investment is being considered, it might be advantageous to act before the regime change.

Revisions are also being made to the capital allowances regime for cars, with the level of Co² emissions becoming the key determinant. High emitters may only get a writing down allowance of 10% after April 2008. The government also plans to phase out the current industrial and agricultural buildings allowances over a four year period – a change which will affect certain sectors particularly. So if you have capital



expenditure plans, be they fitting out new premises with integral fixtures or changing your company cars, the changes do offer planning opportunities for business. ■

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Rise of the LLP

Increasing numbers of businesses are setting themselves up as Limited Liability Partnerships, writes **David Boyd**.

LLPs are more flexible in terms of bringing in new partners or letting old ones go and they avoid all the tax legislation on buying and selling shares that arises with companies and their shareholders. At the same time, an LLP provides the kind of limited liability protection that used to only be available by forming a company.

Although an LLP is treated as a company by law, it is taxed as a partnership. This means a saving on employers' national insurance contributions of around 12%. LLPs therefore enjoy a significant commercial advantage over their corporate rivals. There are some other tax differences, however, which may not always be beneficial. For example, the LLP regime makes no distinction between retained

earnings and those paid out to shareholders – tax is paid on whatever the LLP earns in any year.

However, the government has signalled its keenness to equalise the tax regimes for different types of vehicle. It doesn't want tax to be a deciding factor behind choice of business structure. Thus any tax advantages that currently apply to LLPs may not necessarily continue in the long-term. Even so, indications are that the particular characteristics of the LLP are proving attractive to many entrepreneurs, particularly those running people businesses.

And it isn't just businesses starting up from scratch, or sole traders who might otherwise incorporate, who are opting for the LLP structure. Businesses that have



already incorporated are also taking advantage of the benefits by converting to become an LLP. However, the conversion process is not particularly straightforward – with no specific tax reliefs being available – but it is usually manageable, with appropriate planning and care. ■

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So, everyone has a competitive salary and optional extras like private dental treatment and pet insurance. **Justine Riccomini** asks what next?

Share & share alike



WHEN considering how to remunerate staff these days, there are a number of choices. Hopefully this will assist in recruiting and retaining the best staff, whilst ensuring that everyone stays motivated and has the interests of the business close at heart. After all, a company's future depends largely on what its employees achieve.

Unlike cash and flexible benefits, which are great "hooks", a share scheme can keep the flame of dedication alive in this world of instant gratification and complacency. Employees have the chance to acquire shares in their employer company, help to grow the business and then sell the shares, realising a tax-efficient gain. Also, quite apart from the 'motivational' impact for employees, there are potential corporation tax breaks available to the employing company.

Post the 2007 Pre-Budget Report, there was a slight panic in the share schemes industry due to the new Capital Gains Tax (CGT) regime coming into place from April 2008. Taper relief, a mechanism used to calculate taxable capital gains over period of time, is to be abolished in favour of a standard 18% rate on sale. However, it soon became apparent that the gains to be made using share schemes would outweigh the disadvantages of the new CGT regime.

Share schemes can be adapted to most situations but fall into two broad categories – 'approved' and 'unapproved'. Approved means approved by HMRC. Anything else is, by definition, unapproved. Approved schemes carry certain tax advantages whereas unapproved schemes carry none. Employees can pay the full market value for shares, or less than market value, or they can receive free shares, with differing tax consequences. Shares can be paid in full or be partly-paid (but partly-paid schemes are uncommon and carry specific tax and legal characteristics).

Executive share option schemes allow the opportunity to purchase shares at the market

price as at the date of granting the option. Executives then exercise their right to buy between three and ten years after the date of grant, provided they stay employed by the company. If the executive perceives that the shares have not increased materially in value in the period, he might not exercise his right to buy the shares. He will be no worse off because the options will typically have been granted for nil consideration. Options can carry income tax and National Insurance relief provided they are

granted at market value and the shares are valued at no more than £30,000. Income tax and NIC relief is available on the grant and exercise of the option. However any performance targets must be objective, and require advance clearance from HMRC.

Share Incentive Plans involve three types of share allocation (partnership, free and matching)

and are useful for companies with large numbers of employees but not so good for small companies as the set-up and maintenance costs can outweigh the benefits.

Similarly, Savings-Related Share Option Schemes are popular with larger companies who wish to encourage employees to save up towards their eventual share purchase (they can save up to £250 per month). However these savings schemes can only be offered by banks, building societies and European financial institutions. Options can be granted at a discount of up to 20% of market value at the date of grant. There is no obligation to acquire the shares and the discount on grant, gains on exercise and bonuses are normally tax-free.

Enterprise Management Incentives are by far the most popular scheme for SMEs, providing qualifying conditions can be met. These are

designed to provide tax advantages to employees and executives of high-risk trading companies that have significant growth potential. These shares carry income tax and NICs relief and gains are chargeable to tax under CGT at 18% if sold from April 2008.

Long-Term Incentive plans are another type of scheme for executives and are as popular as discretionary schemes in larger companies. They can be based on: Performance-shares awards (an award of free shares if performance targets are met after three or more years); Deferred shares awards (usually released after three years provided the employee is still employed); Matching shares awards (additional free shares after a certain period); Restricted shares awards (the employee can acquire a beneficial interest which usually contains some sort of risk affecting the market value) and Convertible shares awards (the employee acquires a beneficial interest in shares that are usually capable of being converted into more valuable shares later). These can be flexible and in the right circumstances, very useful, but carry no income tax or NIC reliefs.

Please note: all share schemes are complicated and professional advice should be sought. The recent employment related securities and restricted securities legislation has made the



setting up of a scheme even more of a minefield. The company's Articles of Association may also need to be reviewed. ■

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"A share scheme can keep the flame of dedication alive"

The deals off

HMRC are visibly withdrawing P11D dispensations, and as if this isn't bad enough, they are doing it retrospectively. **Justine Riccomini** considers the risks.

EMPLOYERS obtain P11D dispensations from HMRC on a variety of items. Usually it is business related expenditure such as travelling and subsistence, or entertaining, which, if declared on form P11D, would result in a claim for corresponding tax relief under section 336 of ITEPA 2003, thus negating any taxable benefit on the employee or director.

But employers can also negotiate other items to be included in a dispensation such as the payment of subsistence allowances, telephone bills and mileage rates, as well as agreements that accommodation benefit is exempt (in certain circumstances) and providing work related staff lunches or training events.

The upside of obtaining a P11D dispensation is clear – the P11D boxes do not have to be completed for the areas covered, which can save hours of administration at the tax year end and save on professional fees too.

The burden of proof still remains with the employer however, to show that all the expenditure or benefits in kind within the terms of the dispensation remain exactly as stated when the application was made. It is important therefore that when a P11D application is made to HMRC, that it is as comprehensive as possible and includes all possible outcomes. The Revenue has a habit of undertaking employer compliance reviews and finding that the employer is not in fact providing what he said he was providing in the original dispensation request, simply because policies and procedures have changed over

“The burden of proof still remains with the employer however.”



time but no-one thought to update the dispensation.

Dispensation applications – and therefore, the dispensations that are granted as a result – are often ambiguous and therefore capable of being ‘misunderstood’ by either party. It is best, therefore, to try and be as specific as possible about the nature of the expenditure you would like to dispense with, when first applying.

If HMRC decides that they are withdrawing the dispensation retrospectively, this could mean two things – the amounts have to be declared on P11D for past years (lots of work!) and/or the amounts in question have become taxable and in some cases, NIC’able too (real headache!).

In my experience, many employers obtain a

P11D dispensation, file it at the back of a dusty filing cabinet for years on end and forget what is on it. When it comes to P11D reporting, they cannot remember what is included, so they start assuming – a very dangerous habit, especially when the penalty for submitting incorrect P11Ds is stated at up to £3,000 per form. My advice would be to obtain a P11D dispensation for anything you possibly can to save yourself work in future, and then to keep the dispensation handy as opposed to losing it so that you can check it matches your current staff expenses and benefits policy, year on year. If it doesn't, you need to inform the Revenue and update the dispensation as soon as possible. ■

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VAT: Year End

The VAT year end of most businesses takes place in March, April or May (depending on their VAT return periods). Most charities have exempt and/or non-business activities and at the year end the VAT that has been recovered on a provisional basis in earlier VAT returns must be reviewed. This annual review ultimately confirms the amount of input VAT the business is entitled to recover for that year.

Annual adjustments are compulsory for all business that are partially exempt. As well as confirming the VAT recovered for the year they also provide an opportunity to revisit the basis of VAT recovery to ensure it still provides a fair recovery of VAT and reflects the activities undertaken. If activities have changed it may be appropriate to consider a different method of apportionment and take the

necessary steps to agree this with HMRC.

Where a business has purchased, constructed or renovated a property in the last 10 years and incurred costs exceeding £250,000 or has purchased individual items of computer equipment exceeding £50,000 it will be required to carry out a Capital Goods Scheme adjustment at the end of its VAT year. If the taxable use of the asset has changed during the year it will

be required to adjust the amount of VAT claimed and either recover additional VAT or repay an element of the VAT already claimed.

If your charity could benefit from reviewing its partial exemption or non-business calculations, or would like help with year end adjustment calculations, the VAT team at Scott-Moncrieff would be happy to assist you. ■

Get your New Year off to a good start

1 Review your income on retirement and seek independent advice to make sure you match the tax advantage in pension contributions with your long-term needs.

2 If you have children who are likely to start university courses, consider how you will fund the additional cost of top-up fees.

3 If you're a taxpayer and have made charitable donations or are planning to do so, ask the charity for a gift-aid form. This will enable the charity to claim 28p for every £1 you give. If you are a higher rate taxpayer, keep a copy of the form so that you can claim higher rate tax relief too. Gifts made by 31st January can be related back to the previous tax year.

4 If your spouse pays tax at a lower rate than you do, consider transferring income-yielding assets so that the income is taxed at the lower rate, if at all.

5 On the same theme, if you are planning to cash an insurance bond, and your spouse pays tax at a lower rate than you do, assign the bond to your spouse beforehand, so that tax suffered on any gain in value will be reduced or possibly even negated. The same principle applies to investments that are showing a capital gain. Make use of your spouse's annual CGT exemption, by transferring the assets to your spouse before they are sold. Even if you have both used up your annual exemptions, a transfer can still prove worthwhile if your spouse pays tax at a lower rate.

Top 10 personal finance tax tips from **Morag Page**



6 If your spouse or children don't have to pay tax as their income levels are within their personal allowance make sure that you don't have tax deducted on bank and building society interest by completing Inland Revenue form R85. If tax has been deducted, consider making a repayment claim to the Inland Revenue. And if your spouse or children work part-time, check that any tax deducted is correct. Reclaim any overpayment due for example to the use of an 'emergency PAYE code'.

7 If your children have received money from family or friends, which is to be invested, make sure the funds are kept in a bank account that is separate from money you have given them as parents. If you don't and the income exceeds £100, you as parent will be taxed, if you are a taxpayer. But, your children do have their own capital gains tax annual exemption of £9,200 for the 2007/08 tax year, which applies whether the monies came from parental gifts or not.

8 Seek independent advice to make sure your pension contributions yield the best tax advantage.

9 Review your borrowings and your financial commitments. Are they providing best value and organised in the most tax-efficient way?

10 Make sure that you and your family all keep proper organised records of your income and expenses, so that you can complete



your tax returns with the minimum of difficulty. Records must also be maintained in case of a Revenue enquiry into your Tax Return.

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Tax: News briefs

Employment Status and the Construction Industry

Employment status – that is to say – whether a worker is employed or self employed for tax purposes – is a huge issue for employers generally, and a good money spinner for HMRC. Nowadays, since the advent of the new Construction Industry Scheme, it is an even bigger issue, because contractors have to complete a monthly return which contains a declaration to say that they have checked the status of their workers and are satisfied that all is in order. Bearing in mind that Centre 1 has now decided to review all Scottish contractor returns in 2008 and check that all declarations are accurate, now is

no time to be complacent about employment status.

But how is a person who is not familiar with the courts' decision on weighing up employment status supposed to know where to start? The Revenue refers employers to its Employment Status Indicator Tool (ESI). However the questions being asked are far too simplistic and do not take into account individual circumstances and working arrangements. It follows therefore, that the "answer" which is spewed out on completion of the questionnaire cannot be relied on unless the circumstances of that particular case fit exactly with the questions being asked. It is not surprising therefore, that most

of the answers say that the individual should be on the payroll and treated as an employee.

Those employers and contractors who wish to minimise risk should always seek professional advice, until something better comes along....as no two situations are the same.

IHT Nil Rates Bands Published

The Pre Budget Report introduced the transfer of nil rate bands between married couples and civil partners with immediate effect.

This means that widows and widowers will benefit from the unused nil rate band in their

partner's estate on their death. Claims will be made on the second death, and the change applies to anyone dying from 9 October 2007, irrespective of the date of their spouse's death. This means that many widows and widowers will need information about the IHT or other estate tax rules on the date of death of their spouse. Her Majesty's Revenue and Customs have therefore published the nil rate band for Inheritance Tax, Capital Transfer Tax and Estate Duty as far back as 1914. Claimants will, of course have to provide evidence about the disposition of the deceased's estate at that time, to show that the nil rate band was not fully utilised.



Are you on track for the end of the tax year?

Justine Riccomini runs through your check list.

As employers amongst you will know, the twelve weeks between 5 April and 6 July, leading up to the end of the tax year are fraught with activity especially when trying to track down all the information needed. Many of the tasks to be completed by the end of the tax year include:

Form P35

This is probably the first thing you need to concentrate on but, at the same time, you should be collecting details for the expenses and benefits paid to employees so you can complete Forms P11D by the 6 July deadline. If we complete your P11Ds for you, we will send you a questionnaire asking for the relevant information.

Other returns

Take care not to forget to also pay attention to other returns – Form 42 for shares and securities and returns of termination payments made in the year that exceed £30k and consist of cash and benefits. If you are a contractor in the construction industry, please remember that monthly returns now have to be submitted and there are penalties for non-submission.

PAYE and CIS

Do not forget that months 12, 1 and 2 of both PAYE and CIS remittances will also be due soon. CIS returns are now due by 19th of each month. There are no longer annual CIS returns.

PSA

You should now be considering whether you require a PAYE Settlement Agreement (PSA). This is a must for all employers needing to bear the cost of benefits provided to their employees of an irregular nature - such as staff entertaining, awards and vouchers. These need to be agreed and set up by 6 July to qualify for exclusion from Form P11D.

Class1A NIC

Just as you thought all tasks had been dealt with, do not forget to make payment of your Class1A NIC by 19 July at the very latest. For further information and advice on this and employer services generally, in the first instance please contact:

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2008 Key dates

19 APRIL

PAYE/NIC/CIS remittances for month 12
CIS returns due by 19th of every month.

19 MAY

P14, P35, P38A and CIS 36 returns due

4 JULY

Taxed Award Scheme returns due

6 JULY

Forms 42 (shares and securities) returns due

Termination payments returns due

P11D returns due (copy to employee)

Agree PSA contract by today

19 JULY

Pay Class 1A NIC by today

19 OCTOBER

Payment of any agreed PSA contract



VAT: Rule changes for building renovations

From 1st January 2008 the VAT rules associated with the renovation of existing residential dwellings changed. Where a dwelling has been unoccupied for 2 years the renovation of the property will now attract VAT at the reduced rate of 5%. Contractors who are

renovating residential properties that have been empty for at least 2 years on 1 January 2008 should only account for VAT at 5% on supplies that take place on or after that date. Contractors should ensure that they are fully aware of the tax point rules when

determining the time of their supplies.

Whilst the onward sale of the renovated property will still be exempt (and as such all associated input tax blocked from recovery) these rules allow VAT on the cost of renovations to be reduced by 12.5%.

If you would like a copy of our VAT building renovations table to help you to calculate your VAT liabilities, send me an e-mail. ■

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HMRC to cough up

Scott Craig examines the landmark ruling in the Condé Nast case.

HMRC face the possibility of having to make large refunds of VAT after losing a landmark tribunal case against publishers Condé Nast. The House of Lords approved an earlier Court of Appeal ruling that stated HMRC could not place a three year cap on reclaims of overpaid output tax.

The three year rule was introduced almost overnight in 1997, and gave traders no opportunity to submit retrospective claims beyond the three year cap.

As a result of this decision HMRC are now obliged to provide all taxpayers with an opportunity to familiarise themselves with the new rules, and enjoy a period of grace to submit claims. It has been estimated that the amount of VAT that HMRC may have to repay as a result could reach a staggering £1 billion.

We understand that until a suitable transition period is confirmed the current 3 year time limit may be disregarded. Affected

clients may submit claims for input tax incurred prior to 1 May 1997 – the date the inadequate new rules were implemented. In addition to this, clients could possibly submit a claim to HMRC for output tax that was overpaid for periods until 4 December 1996.

It is recommended that claims are submitted as soon as possible, given that HMRC will be in process of creating new legislation to deal with the position. This new



legislation could be introduced in as little as six months.

If you have any clients who may be affected please contact me. ■

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Tax: News briefs

R & D Units

Large companies claim research and development tax relief through the Large Business Office structure within HMRC, but smaller companies had experienced problems progressing their claims to relief, so a new regional structure of specialist units was created last year.

The report on the first year of operation quotes a total of over 5,000 claims successfully dealt with, and the sum of £150 million paid by way of special tax relief for R & D.

Case studies on small companies obtaining help with their claims from HMRC are to be published shortly, to encourage more companies to claim.

Changes to VAT guidance and procedures - have your say!

HMRC constantly review VAT legislation and procedures and regularly request 3rd party comments on consultation papers. Some of the most recent consultations include:

- HMRCs proposals for modernising and streamlining the way HMRC deals/handles appeals against its decision.

- HMRCs proposals to change the Tax Avoidance Disclosure regime to improve the identification of users of disclosed schemes

All consultations are published at: <http://www.hmrc.gov.uk/consultations/index.htm>

Each consultation document

provides a deadline for submission of comments and details of whom/where comments should be submitted.

HMRC targeting hospitality industry with NMW inspections

HMRC stated at their recent Employer Talk seminars that they are commencing a programme of National Minimum Wage inspections specifically targeted at the hospitality sector for the whole of the UK. Our experience tells us that the NMW is not the only item on their agenda and that these inspections inevitably lead to other lines of enquiry. Any hospitality sector clients with workers whom they consider to be self employed need to be especially careful, as a

status enquiry will be likely to ensue. The Revenue's staff can ask a whole range of questions and an employer compliance review can also be a likely tag-on depending on the responses given by the client.

Green Cars

From April next year, company cars which run on bioethanol, or an 85% mixture of bioethanol and unleaded petrol (known as E85) will attract a discount of 2% when calculating then benefit in kind. On an average price company car, this would reduce the benefit in kind by around £350 – 2% of the list price. Those choosing new company cars should be aware of this, and also the new rate of 10% coming into force next year for cars emitting no more than 120g/km of Co². ■

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Residence and non-domicile: Proposed UK tax changes

Proposed draft legislation was published on 18 January 2008, following October's Pre-Budget Statement, giving considerable detail on the Government's current intentions. The consultation period continues to 28 February, and the draft legislation is likely to be amended, and possibly extended.

There is a window of opportunity for nondomiciled individuals to review how they will be taxed after 5 April 2008, and to consider what action to take before that date. However, in view of the fact that the proposals may be further amended, it is generally suggested that advice be sought and action considered, but not yet necessarily implemented.

The proposed changes to the taxation of non-domiciliaries are wide-ranging and, in some areas, more severe than anticipated, particularly for resident beneficiaries of offshore trusts. There is also a much wider definition of remittance, so, for example, even a remittance to the UK by the donee of a gift from a UK resident donor can give rise to a tax liability for the donor, if the two are connected.

In this context, even a couple living together who are neither married nor in a civil partnership, may be regarded as connected.

Residence

As foreshadowed by the Pre-Budget Statement, for the purposes of counting the days of presence in the UK, the days of arrival in, and departure from, the UK after 5 April 2008 are to be treated as days of presence (but for earlier years are still regarded as days of absence). This is to apply for the purposes of both the 183 day and the 90 day tests. The only exceptions are that a day of transit in the UK can be ignored, provided that the individual remains in a part of an airport or port not accessible to members of the public, unless they are arriving in, or departing from, the UK. An individual in transit who has to move from one airport terminal to another, for example, is likely to be unable to satisfy this requirement.

Retaining the remittance basis of taxation

UK resident non-domiciliaries can currently use the remittance basis of taxation. While this is optional, it is generally favourable. It means that offshore investment income and capital gains (and in some cases offshore earned income) are only taxed if and when remitted to the UK.

From 6 April 2008, UK residents will be taxed

on a worldwide arising basis for income and gains unless they are non-domiciled, and:

- their unremitted income and gains for that year are less than £1,000, in which case the remittance basis is automatic; or
- they make a claim on their Self Assessment Tax Return for the remittance basis to apply. The claim must state the individual is not domiciled in the UK for the tax year. Further provisions apply to those individuals claiming the remittance basis for a tax year, i.e. those in the latter category above:
 - claimants lose their entitlement to certain allowances for that year, primarily personal allowances against income and the capital gains tax annual exemption;
 - for those who have been resident for more than 7 out of the previous 9 tax years there is an additional annual charge of £30,000.

Example

An individual is not domiciled in the UK and has been resident here since 2001/02 with the exception of 2004/05 when he was nonresident. As at 6 April 2008 he will have been resident for 6 out of the last 9 tax years so for 2008/09 he can claim the remittance basis without payment of the £30,000 levy. As at 6 April 2009 he will have been resident in at least 7 of the last 9 tax years and so if he wishes to maintain the remittance basis for 2009/10 (or later years) he must make a claim and pay £30,000. He loses his personal allowance and annual exemption for any year such a claim is made including 2008/09.

Regardless of domicile, individuals who are resident but not ordinarily resident in the UK can make a claim for the remittance basis, although the same provisions apply, (i.e. loss of personal allowances and the annual capital gains exemption, and potentially the payment of the £30,000 levy although this would be an unusual circumstance).

It is also important to note that each individual (husband, wife and children) are separate taxpayers for these purposes.

Furthermore, it is possible to claim the

remittance basis for one year but not another. However, unremitted foreign income and gains of a year of claim will still be taxed if remitted in a year in which no claim is made.

The £30,000 additional charge

The £30,000 additional charge will be non-refundable and be treated as income tax for the purposes of payment, accounting, collection and recovery. However, HMRC has made it clear that it is not income tax and whether another country will give double tax relief in respect of it will be up to each individual country, though this is understood to be unlikely.

Example of payment

A non-domiciled individual has been resident in the UK for 10 years at 6 April 2008 and intends to pay the additional charge going forward. The additional charge for 2008/09 will be due on 31 January 2010. However, the 2008/09 liability also sets the payments on account for 2009/10 due in two equal installments on 31 January and 31 July 2010. Therefore, £45,000 will be due on 31 January 2010, with payments of £15,000 on each 31 July and 31 January thereafter.

Remittances

Currently, foreign-source income or gains of UK-resident individuals who are not domiciled in the UK or not ordinarily resident in the UK are chargeable to UK tax to the extent that such income or gains are 'remitted' to the UK.

The term 'remitted' means, broadly, 'received in' the UK, but includes some instances of constructive remittances where income or gains are not physically received in the UK.

The draft legislation introduces a new wide meaning of 'remitted to the UK' which will apply to all foreign employment income, foreign investment income and foreign capital gains, including those arising in offshore structures where the remittance basis applies.

The main areas affected are:

- **Chattels:** Currently, foreign investment income would not be remitted unless you received or remitted it to the UK as 'money'. You could use foreign investment income to purchase, say, a car or a painting outside the UK, and bringing the car or the painting into

“Even a couple living together who are neither married nor in a civil partnership, may be regarded as connected.”

The proposed changes to the taxation of non-domiciliaries are wide-ranging and, in some areas, more severe than anticipated.

the UK would not be a remittance, unless you sold it and had the money in the UK. If you used foreign employment income or foreign capital gains, it would be a remittance if you brought it to the UK and 'enjoyed' it here. Under the proposed legislation, bringing the car or painting into the UK will be a remittance of foreign income or gains used to purchase it.

- **'Source-ceasing'** will no longer avoid UK tax on foreign investment income remitted to the UK. Source-ceasing relied on the principle that investment income could only be subject to UK tax when remitted if the source was in existence in the year that the remittance took place. Hence, if a bank account was closed one year, the accumulated interest earned on the funds deposited could be remitted in a subsequent tax year, without being subject to tax. Income remitted from 2008/09 onwards will be taxable, even, it seems, if the source ceased to exist many years ago. Hence, where offshore income is still retained outside the UK, which arose from sources which ceased in 2006/07 or earlier, consideration should be given to remitting such funds prior to 5 April 2008.
- **'Mixed funds'**: Where a foreign account or fund comprises capital and/or income and/or gains, the income will be treated as remitted to the UK first (earned income before investment income), then the capital gains, then the non-taxable capital. This constitutes a potentially significant change. Currently, there is no statutory order of identification, although it is normal practice to regard income as being expended in priority to capital. However, it has also been normal practice that where a mixed fund contains income which has already been subject to UK tax, a remittance can be regarded as first coming from that taxed income, so that no further liability arises. The proposed legislation makes no mention of such practice being followed in future. Furthermore, it has been a long-established principle that on the disposal of an asset, the gain and the original capital cannot be separated, so that if part of the proceeds were remitted to the UK the proportion of the gain that was regarded as remitted was calculated pro rata. For example, ➤

Residence and non-domicile: Proposed UK tax changes

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if an asset which cost £9,000 was sold for £10,000, and £2,000 was remitted to the UK, 10% of the remittance, £200, was regarded as the amount of the gain that was remitted/taxable. In future, it seems that, in the same situation, the full £1,000 gain would be regarded as having been remitted.

● **'Alienation'**: Where a UK-resident or temporarily non-resident individual (see below) makes a gift outside the UK to a 'related' person, any income or capital gain element will no longer escape UK tax where remitted to the UK directly or indirectly by the recipient of the gift. In this context 'related' includes not only the individual himself, brothers, sisters, lineal descendants or ancestors and his and their spouses or civil partners but also someone who is living with the individual as husband or wife or civil partner. Hence, an individual who buys a present for his partner (whatever sex) whilst on holiday abroad is potentially liable to UK tax if the recipient of the gift brings it into the UK. Similarly, a father who gives his son some money outside the UK could be subject to UK tax if his son brings that money into the UK perhaps ten years later. This principle may be particularly relevant when considering offshore trusts, as an individual is 'related' to the trustees of a trust of which he is settlor or beneficiary.

● **Debts**: The settlement of offshore debts or loans, the proceeds of which have been remitted to or enjoyed in the UK, can be regarded as the remittance of such offshore funds to the UK. The servicing of such offshore debts using offshore funds could similarly be regarded as a remittance of the latter to the UK. Up until now, the payment of interest using offshore funds on a properly arranged offshore mortgage for the purchase of a UK property has not been regarded as a remittance to the UK. In future, however, payment of such interest using offshore funds could be regarded as a remittance to the UK.

Employment income

The new provisions will also affect the taxation of overseas earnings for UK residents who are either non-domiciled or not ordinarily resident.

Generally taxable earnings are assessed on the arising basis (e.g. when paid) except for:

- earnings for duties performed abroad by an individual who is resident but not ordinarily resident in the UK, or
- earnings of a non-domiciled resident individual from an employment, the duties of which are performed wholly abroad, with a non-resident employer.

In both these cases, the remuneration is only taxable on the remittance basis.



It is proposed that, from 6 April 2008, individuals in either category would only continue to be taxable on the remittance basis in respect of such offshore income if they claim the remittance basis (thereby losing the benefit of their personal allowances etc and, if they have been resident for at least seven out of the last nine years, paying the £30,000 levy). The taxation of non-resident individuals, who are only subject to UK tax on remuneration for duties performed in the UK, is unchanged.

Temporary non-residence

Currently, where an individual has been resident for more than 4 out of the preceding 7 tax years, there are anti-avoidance provisions that in certain circumstances can tax capital gains made in a period of temporary (less than 5 complete tax years) of non-residence. This is now extended to include the remitted income and capital gains of a temporarily non-resident non-domiciliary so that such amounts are taxed in the year residence is resumed.

Offshore structures: capital gains anti-avoidance

The Pre-Budget Statement in October announced significant changes to capital gains tax. Draft legislation is still awaited but is likely to impact on the tax rates applicable to gains of offshore structures.

Trusts

Trusts with non-resident trustees ('offshore trusts') are outside the scope of capital gains tax even in respect of UK assets, because they are non-resident. Currently, these gains can be taxed on resident domiciled settlors and beneficiaries in certain circumstances but not on resident non-domiciled settlors or beneficiaries. With careful planning this meant that offshore trusts could be a source of tax-free capital for nondomiciliaries. From 6 April 2008 this will no longer be the case as the intention is for a resident non-domiciled settlor of an offshore trust to be taxed as follows:

- gains on the disposal of UK situs assets in the trust structure on an arising basis;
- gains on the disposal of non-UK situs assets

('foreign deemed chargeable gains') in the trust structure on an arising basis unless the settlor makes a claim for the remittance basis to apply.

If the foreign deemed chargeable gains are not charged to UK tax on the settlor they are potentially charged to beneficiaries.

From 6 April 2008, UK resident non-domiciled beneficiaries are charged to tax on trust gains if they receive a capital payment or benefit from the trust inside or outside the UK. The remittance basis does not apply to this provision. A payment matches to historic gains on a £:£ basis and if there are no, or insufficient, historic gains the payment is matched to future gains at the time these gains arise.

There will be many different circumstances but trustees may need to consider whether to divest themselves of UK assets before 6 April 2008. Non-domiciled settlors and beneficiaries may need to consider whether to request from trustees a capital distribution (and possibly remit this) before 6 April 2008. Particular consideration will need to be given to trust-company-house structures.

Companies

A non-domiciled resident individual who is a 10% or more shareholder in an offshore 'close' company is now chargeable on gains on UK assets made by the company on an arising basis, with gains on non-UK situs assets also on an arising basis subject to the shareholder claiming the remittance basis of taxation for the latter.

Offshore trusts: notification

The legislation seeks to ensure that an individual creating an offshore trust makes the relevant notification (date of settlement, settlor, trustees) to HMRC within 3 months of the date of settlement. A settlor becoming resident in the UK after 6 April 2008 with such a trust in existence has 12 months from arrival to make the notification.

HMRC has stated that these amendments take effect from 6 April 2008 but do not apply the reporting requirements to non-domiciled settlors who became resident in the UK before 6 April 2008 for periods before that date.

Summary

The full impact of these complex proposals will take some time to be fully appreciated and you should bear in mind that the proposals may well change.

We will be making representations to HMRC on the proposals. If you have comments on the draft legislation, please e-mail or write to your usual Scott-Moncrieff contact by 15 February 2008. This factsheet is a summary of the draft legislation only and you should seek professional advice before taking action. ■

Relief for entrepreneurs'

More changes to capital gains tax

On 24 January 2008, the Chancellor announced significant concessions to the changes to the UK capital gains tax (CGT) regime, which were proposed in his Pre-Budget Statement last October. The original proposals would have seen the effective rate of CGT nearly double from 10% to 18% for many taxpayers from 5 April 2008. A new relief – entrepreneurs' relief – is to be introduced. It will reduce or remove the impact of this increase in tax for those smaller businesses that were particularly affected by the Pre-Budget Statement.



Original changes

The changes proposed in the Pre-Budget Statement were:

- all capital gains made on or after 6 April 2008 will be taxed at a flat rate of 18%. This is irrespective of the marginal income tax rate of the taxpayer concerned. This rate will apply to individuals and trusts;
 - the current system of taper relief will be abolished;
 - the system of indexation allowance, which was in place before the introduction of the taper relief rules, will also be abolished. In addition, certain other rules will be amended or abolished including:
 - compulsory use of market value at 31 March 1982 for assets held at that date;
 - abolition of 'halving relief'; and
 - simplification of share identification rules.
- The annual exemption for capital gains tax, i.e. the amount that can be earned before paying capital gains tax, will remain in place.

Entrepreneurs' relief – the basics

The new entrepreneurs' relief will apply for gains that arise on or after 6 April 2008 on:

- disposals of all or part of a trading business; and
- certain disposals of shares in trading companies.

The first £1 million of gains that qualify for the relief will be subject to CGT at a reduced rate of 10%. The £1 million limit will be a lifetime limit. Any gains that do not qualify or that exceed the limit will be charged at the new rate of 18%.

HMRC has indicated that the new relief will be relatively simple. The main condition announced so far is a minimum ownership period of one year.

The detail

The relief will apply to gains arising on disposals of the whole or part of a trading business (including professions and vocations, but not including a property letting business other than furnished holiday lettings) that is carried on by the individual, either alone or in partnership or on gains on assets formerly used in the business and disposed of within 3 years of its cessation.



Relief for entrepreneurs'

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The relief will also apply to gains on disposals of shares (and securities) in a trading company (or the holding company of a trading group) provided that the individual making the disposal:

- has been an officer or employee of the company, or of a company in the same group of companies; and
- owns at least 5% of the ordinary share capital of the company and that holding enables the individual to exercise at least 5% of the voting rights in that company.

Rules will also be introduced to include disposals associated with qualifying share sales of assets used for the purposes of the company's business. A

similar rule will apply for partners who own assets used by the partnership of which he or she is a member.

The relief will also be available for trustees where a beneficiary of the trust is either carrying on a business in which he or she has

an interest in possession (either as a sole trader or as a partner) or where the beneficiary is a qualifying officer or employee of the company whose shares are held by the trustees. In the case of trusts, the £1 million limit will be applied to the trustees and beneficiary jointly to remove opportunities for using trusts to avoid tax in this area.

Draft legislation on the new entrepreneurs' relief is yet to be published.

Companies liable to corporation tax are not affected by any of the proposed changes.

Comments

This concession is extremely welcome but comes as no great surprise. The level of adverse

comment and publicity that followed the changes in the 2007 Pre-Budget Statement made it almost inevitable that some form of relief would be introduced.

One area that does not appear to have been addressed is the position of employees who

own shares in their employer. Most employees will not meet the minimum shareholding requirements outlined above and so will bear 18% tax on any gains arising after 5 April 2008.

The proposals will also impose additional compliance burdens in keeping track of lifetime gains. It is unfortunate that what was purported to be a change designed to simplify the UK tax rules has resulted in some degree of additional complexity. This was to some extent a result of the manner in which the autumn changes were introduced with no opportunity for consultation with business in advance. We hope that in future the Government will attempt to avoid repeating this approach but it remains to be seen.

At the same time as announcing the introduction of the entrepreneurs' relief, the Treasury has also published the draft legislation to effect the changes announced at the Pre-Budget Statement. These will be subject to further commentary once they have been fully analysed.

If you would like further information on the proposals, please contact your usual Scott-Moncrieff tax adviser. ■

"The first £1m of gains that qualify for the relief will be subject to CGT at a reduced rate of 10%."

Key Taxation Dates: February to May

For the full year in tax deadlines visit our website: www.scott-moncrieff.com

February

2 February

P46 (CAR)

Quarterly filing date for notification of change of car.

28 February

Self assessment 5% surcharge.

Surcharge on tax due 31 Jan but still not paid by 28 Feb.

March

Approach of the end of the financial year

Time to get financial affairs in order and put those important dates in your diary.

ISA, EIS, VCT

Although VCT's and EIS's are not April dependent in all circumstances, a number of providers often close schemes on a tax year basis as with Film Partnerships.

April

5 April

End of tax year.

Last day to make retirement annuity payments to carry back to previous tax year. Last day to maximise ISA contributions.

6 April

Electronic filing of end of year returns.

Employer now able to voluntarily file end of year returns and tax payments online.

14 April

Income tax for companies and CT61 due for quarter to 31 March

19 April

PAYE/NIC for 4th quarter due.

CIS monthly return due.

May

3 May

P46 (CAR) due for quarter to 5 April. Quarterly filing date for notification of change of car.

19 May

Deadline for PAYE forms P35/P14/P38/P38A returns.

CIS monthly return due.

31 May

Deadline for giving P60s to employees. Details pay and tax to the year ended the 5 April. The employer must include detail of any employee working for them on the 5 April by the deadline or face penalties.

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We're more than just
number crunchers

➤ Of course, it's much more than a number to us. Every client is different and needs practical advice that is relevant to them. We ensure that each of our clients are made aware of the frequently challenged and amended VAT rules and procedures to ensure that they do not pay a penny more in VAT than they need to. How do we do this? Well, because they are more than a number to us we know them well and understand their business and the issues that matter to them. **THAT'S HOW**