client briefing

september 2008

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A clearer view on tax penalties

A new way of charging penalties for incorrect tax returns is designed to encourage taxpayers to take care with their tax affairs and comply with all their obligations.

HM Revenue & Customs (HMRC) can impose a financial penalty if an error in a tax return or other tax document results in you paying less tax than you should or means you pay the tax in a later period. What is new is that taxpayers will no longer be liable to a financial penalty if they have taken 'reasonable care' to get their tax right, but have nevertheless made a mistake.

The penalties apply to errors in income tax, capital gains tax, corporation tax, VAT, PAYE, national insurance contributions and construction industry returns. The new rules cover periods starting after 31 March 2008, where the return is due to be filed after 31 March 2009.

HMRC calculates the level of penalty as a percentage of the potential lost revenue and this will be based on taxpayer behaviour: up to 30% for failing to take reasonable care; 20–70% for a deliberate error where no active steps have been taken to conceal it; and 30–100% for a deliberate and concealed error. Disclosing errors early, completely and voluntarily will place the penalty at the lower end of the range.

What counts as 'reasonable care' depends largely on the circumstances and the

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taxpayer's abilities. HMRC expects a higher degree of care to be taken over complex matters, including finding out about the correct tax treatment. No penalty will be charged if a taxpayer takes an arguable view of a situation that is eventually not upheld. HMRC would also not impose a penalty if good accounting systems are in place but processing errors occur, provided the errors are relatively small compared with the overall tax liability.

Simply leaving everything to your adviser is not enough. Taxpayers taking reasonable care must make sure they give their adviser all the necessary information, implement any professional advice received and check the adviser's work to the best of their ability. While an ordinary person cannot be expected to challenge specialist professional advice on a complex legal point, they ought, for example, to recognise the complete absence of a major transaction.

Taxpayers also have a duty to choose an adviser who is competent for the task. Please get in touch for advice on how you can ensure you give us all the required information.

Coming clean on VAT errors

You will soon be able to correct errors of up to £10,000 in your VAT returns, and in some cases more, without making a specific disclosure. It is tempting to sweep up mistakes without drawing attention to them, but doing so could increase any subsequent penalties and interest charged for the error.

For VAT periods that started before 1 July 2008, errors do not have to be disclosed if their total value is not more than £2,000. This limit goes up to £10,000 for periods starting on or after 1 July 2008, except for businesses with a turnover of more than £1 million. For these larger businesses, the limit is 1% of turnover up to a maximum of £50,000.

A potential difficulty arises under the new penalty regime that applies to returns for periods starting after 31 March 2008, where the return is due after 31 March 2009. If the error arose because the taxpayer did not take reasonable care, or made a deliberate misdeclaration, a voluntary disclosure can significantly reduce the penalty.

However, for a disclosure to reduce a penalty, you have to write specifically to HM Revenue & Customs (HMRC) describing how the error happened, give HMRC reasonable help in quantifying it and allow HMRC access to records necessary to verify that you have fully corrected the error.

In future, if you find you have made errors on a past VAT return, as well as quantifying them, you will need to find out how they occurred. There will be no penalty if you took reasonable care but made a genuine mistake. If you are confident of this, you can safely include errors below the limit on a subsequent return, but you should keep evidence of the processes you followed. But if you conclude that the error occurred because you did not take reasonable care, you should make a separate disclosure to HMRC even if the error is under £10,000. From September 2008, any errors separately disclosed to HMRC will also attract an interest charge where that error resulted in an underpayment of VAT.

Clearly it is far better not to make mistakes in the first place. If you need advice on accounting for VAT, completing your VAT returns or correcting or disclosing errors, do ask us.

briefing covers important changes and developments. Please contact us for advice on how they apply to your personal circumstances. Although care is taken in the production of this newsletter,

"… *Integral features cannot be classified as short-life assets to obtain faster relief* …"

New allowances on integral features

The new capital allowances rules for equipment installed in buildings make it more important than ever to classify correctly all expenditure on construction, refurbishment and repair of buildings.

This year's reform of capital allowances introduced a new 10% annual rate of writing down allowance for specified equipment that forms an integral feature of a building. Some of the items previously qualified for the 25% writing down allowance. Other items, such as ordinary lighting and cold water systems, did not qualify at all because they were considered part of a building.

Integral features are defined as electrical and lighting systems, water, heating, ventilation and air conditioning systems. This includes the floors and ceilings comprised in such systems, as well as lifts, escalators and external solar shading. The new 10% allowance will also be available for thermal insulation, except where it is used for a residential property business.

Integral features qualify for the annual investment allowance that gives 100% tax relief for the first £50,000 a year of expenditure on equipment. For smaller businesses, timing the expenditure to minimise the excess over £50,000 in any year will accelerate tax relief. Integral features cannot be classified as short-life assets to obtain faster relief. Other plant and machinery in buildings, including toilet and kitchen facilities, qualify for the 20% rate of writing down allowances.

The cost of repairs is normally allowable in full. However, if in any 12-month period the cost of repairing an integral feature is more than 50% of the cost of replacing it in full, the expenditure will only qualify for the 10% relief.

We can help you maximise tax relief on all your expenditure on buildings and equipment.

Buy or lease to equip your business?

Should you buy or lease the major items of equipment and vehicles you will need for your business? Both have advantages and disadvantages. This year's reform of capital allowances, which give tax relief for equipment purchases, may affect your decision.

From April 2008, you can claim immediate tax relief on up to £50,000 a year that your business spends on buying any type of plant and machinery, including many fixtures in buildings and vans, though not motor cars. The £50,000 annual investment allowance (AIA) is proportionately reduced if your accounting period started before April 2008. For example, a company with an accounting year starting on 1 January can claim the AIA on up to £37,500 in 2008 (9/12 x £50,000). Purchases in the two years before April 2008 qualify for the old first-year allowances of 50% for a small business and 40% if your business is medium-sized.

Of course, tax is not the only consideration. If you buy outright, you will usually pay less overall than on a leasing agreement, but you might have to borrow the money to make the purchase, which could be costly. Leasing could tie you into long-term agreements that might be difficult to terminate, but buying could leave you with equipment that you might not need in the future.

There are pros and cons to both. If you are planning to buy or lease major equipment, please come and talk to us, and let us help you understand the costs.

it is a summary only of the topics discussed. In these circumstances, we cannot be responsible for persons acting or failing to act as a consequence of information contained in

“... you could increase the tax saving by paying some salary as well ...”

Income shifting rules on hold

The government has postponed new laws that would prevent people reducing their tax liability by shifting business income to another person such as a non-working spouse or civil partner. This may provide some valuable tax planning opportunities. Although proposals were announced last December, aimed at an April 2008 start, the government decided further consultation was needed.

The delay gives businesses an extended opportunity to save tax by paying dividends up to 5 April 2009. Since losing the Arctic Systems tax case in the House of Lords last year, HM Revenue & Customs (HMRC) has confirmed that where a non-working spouse or partner holds ordinary shares with rights to the company’s capital, dividends can only be taxed as the income of the spouse to whom they are paid.

You can therefore save tax by paying dividends in the current tax year up to the limit of a non-working spouse’s basic rate income tax threshold, ie up to £40,835. Remember though that you have to count as income the 10% tax credit as well as the cash dividend itself. You should also deduct any other income your spouse might have, such as bank interest. You can even give your spouse or partner shares shortly before paying the dividend, provided the gift is unconditional and is of ordinary shares with full voting rights.

Because the 10% tax credit is not repayable, all or part of the personal allowance of £6,035 is wasted if other income is less than this amount. If your spouse or partner does some work for the business, you could increase the tax saving by paying some salary as well. The salary will be deductible from business profits provided it is reasonable for the work done.

We can advise you on how to make best use of the current rules. There are some restrictions on paying dividends but we can check whether they affect your company.

More tax relief on research and development

Companies that carry out research and development (R&D) may be entitled to enhanced tax relief. Small and medium-sized companies (SMEs) can deduct 175% of qualifying expenditure incurred on R&D projects from 1 August 2008 when calculating their trading profits. Large companies can deduct 130% of qualifying costs from 1 April 2008.

To obtain payment of tax credits, the company must make a claim in its corporation tax return.

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