Bulletin

mercer & hole
chartered accountants

Spring 2007

Mercer & Hole news update

This year we have not distributed our usual Budget Newsletter immediately following the Budget announcement. Instead we have decided to produce a slightly different Bulletin which focuses on some key areas of the Budget that we feel will be most interesting to our clients. We hope very much that you find this useful.

Also in this edition we focus on one of the world's fastest growing business communities, China, as two of us prepare to visit Beijing for the next TIAG conference.

One of the firm's main areas of development is technology. We are delighted to be on the verge of launching a brand new website which will include the use of blogs - comment and information that is regularly posted and updated. Many of you will be familiar with blogs through sites like the BBC's, however this is a relatively new area for Chartered Accountants and we hope you will find it interesting and helpful.

In addition, as we move towards a paperless office, we are also hoping to develop our use of email communication and aim to send future editions of the Bulletin via email rather than through the post.

We are intending not to produce any paper copies of our newsletters in the future, so please do make sure we have your email address if you wish to continue to receive our publications.

Budget 2007 - Behind the headlines

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On 21 March Gordon Brown produced his eleventh and - by popular wisdom - last budget. There were some headline grabbing reductions in tax rates but the meat as always was in the 290 pages of press releases and notes issued after he sat down. Despite the green credentials of the budget there were four pages defining the abbreviations used! The words "modernisation" ,"reform" and "simplification" occurred frequently but with the exception of capital allowances there were none of the wholesale changes of previous budgets. Much of the Finance Bill will be taken up with matters announced previously and many of his measures do not take effect until 2008/09 or later. You will have seen the main headlines elsewhere but we want to focus on a few practical issues.

Private Client Matters

After the shock and awe of last year's budget attack on trusts, there are no major changes for individuals or trusts this year beyond some rate changes and technical amendments. The headline cut in the basic rate band is not quite as generous as it seems since it is partially offset by the abolition of the 10% band for some types of income. The precise impact will depend on the type of income you receive but overall it is not the simplification it was held out to be. There are further measures which merit some closer examination.

Foreign Dividends. Anyone in receipt of income of less than £5000 from overseas companies in which they hold less than 10% of the shares will be taxed as if it was a UK dividend. This means that a higher rate tax payer will pay slightly less tax than on a foreign dividend. There may also be implications for the use of foreign tax credits and there is a hint that the rule could be extended more widely in the future. This is all good news but the thresholds set here for a 10% shareholding and £5000 of income seem rather low. The marginal cost of infringing the limits is high since it appears that £5001 income, or income from a 10% holding as opposed to a 9.99% holding, will be taxed in full. It is unclear how this system will interact with the remittance basis for those of you who are not UK domiciled but if, as is likely, the limits apply to funds brought into the UK there may be an opportunity for some planning here and, possibly, splitting of holdings between family members. We will need to see the detailed law before advising further on this.

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Homes Owned Abroad through a company were previously subject to a charge to tax under the benefit in kind rules. This had caused a lot of problems for people with holiday homes particularly on the continent where corporate ownership is very common. In an unexpected and welcome move the Finance Act 2008 will legislate to take away this charge where the company is owned by individuals and its only asset and purpose is the ownership of the property. HMRC has indicated that it will not seek to tax such arrangements in the interim but the past treatment is as yet unclear. Certainly those returns for 2006 which included a charge may need to be amended.

The new rules will not apply to companies owned by trusts nor to companies where the property is in the UK so those with a non UK domicile still need to be careful. Where the property is let the rules on the residence of the company - particularly the place of its central management and control - also remain in place so it should be properly run offshore.

Self Assessment Filing dates and the penalty system are to be changed. As announced in November as a result of the Carter Report, filing online will be encouraged for individual tax returns. The deadline for filing electronically will remain at 31 January but, other than in some exceptional cases, paper returns will need to be filed by 31 October. The due date for tax remains 31 January. Following a consultation process the 12 month period in which HMRC can raise enquiries into a return will begin from the date the return is received by the Revenue again to encourage early filing. This is all expected to change for the returns relating to the year ended 5 April 2008.

We are already filing returns electronically for the majority of our clients and we expect to increase the number dealt with in this way for the 2007 returns. There remain some clients where electronic filing is not possible and we will be working through various consultations to ensure these clients are not prejudiced by the new system.

Where there is an error or under declaration the penalties levied will be assessed in a more objective manner than presently. There will be a sliding scale of seriousness and culpability and regard will be had to whether it was a prompted or voluntary disclosure. The new penalty rules will apply to returns for 2008/09 onwards.

Budget 2007 - A budget for business?

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In some ways the Chancellor's Budget this year reminded me of Lewis Carroll - "The rule is, jam tomorrow and jam yesterday - but never jam today". So much of what he announced happens later (apart from the bad news items and they come into effect now!)

Corporation Tax is a good example of this, the Chancellor announced a concern that businesses are incorporating to avoid tax (presumably on this basis he now accepts that national insurance is a tax). Consequently he has decided to increase the rate of corporation tax for companies with profits below £1.5 million over the next three years (from 1 April 2007), while reducing the rate for larger companies (albeit some 12 months hence), a brief summary is below:

Year from	Profit < £300,000	Profits between £300,001 and £1,499,999	Profits > £1,500,000
1 April 2007	20%	32.5%	30%
1 April 2008	21%	29.75%	28%
1 April 2009	22%	29.50%	28%

The problem with his logic is that with national insurance at the marginal end being at a composite rate of 13.8% (12.8% employers and 1% employees) for companies with profits below £300,000 or above £1.5 million, dividends are a much more tax efficient option.

Bearing in mind the reliefs available only to companies on the acquisition of assets such as goodwill and on research & development costs - the pendulum still swings to incorporation for many businesses.

On that note **Research & Development** relief has been given a particularly generous increase with small and medium sized companies being able to claim 175% of qualifying expenditure and large companies 130% from 1 April 2008. However the small and medium sized companies relief requires EU State Aid approval so its start date cannot be guaranteed.

Despite the tax breaks available I still notice reluctance on the part of many companies to regard what they do as innovative - in many instances this is a case of familiarity breeding contempt. The guidelines require the knowledge to be "new to you" i.e. not available in the public domain. The fact that you have spent time designing or even replicating a competitor's process to remain competitive / at the front of the market, could well give you a qualifying spend, as could product improvement resulting in a new patent. The reliefs are generous, the period for which back claims may be made is being reduced so now is the time for a review. We would be happy to talk through with you the issues specific to your business and see if, on further reflection, a claim should be made.

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Budget 2007 - A budget for business?

Anti-avoidance legislation is being introduced (with immediate effect of course) to prevent tax planning on Employee Benefit Trusts, loss buying and capital loss and gain buying. This is likely to be relevant on acquisitions rather than historically for most of our clients. Care will need to be taken on due diligence to make sure that losses etc in target companies remain available for future use or, if not, that the price is adjusted accordingly.

Capital allowances are a key area for a lot of our clients' businesses and a lot of (future) changes are being introduced in this area:

- One piece of good news with immediate effect (!) is that on **First year allowances for small businesses** the temporary rate of 50% has been extended for a further 12 months.
- On the downside however, the rate of allowances has been reduced on fixtures & fittings integral to buildings to 10% and on plant and machinery to 20% from April 2008 (both currently at 25%).
- **Industrial and Agricultural Buildings Allowances** are being phased out over the 4 years ending 2011 and balancing adjustments are being withdrawn - this is good news if you are looking to sell but generally bad news otherwise.
- One final piece of good news is that allowances on long-life assets will attract an increased writing down allowance of 10% in line with that on fixtures from April 2008 (currently 6%).

An annual investment allowance of £50,000 is proposed for expenditure on plant & machinery - the detail on this will be subject to consultation. There are also allowances on property renovation or conservation in designated areas; consultation on a tax credit for "green" technology; consultation on capital allowances on cars, on an annual investment allowance of £50,000 and on reliefs on brownfield development - we will let you know if anything interesting develops.

The changes outlined above mean that proper analysis of capital spend is crucial - the difference between 4% and 6% was not really significant but the difference between 0% and 10% is much more marked. Identifying short-life assets to bring forward tax relief and spend relating to R&D etc will become much more important. More detailed records on spend, use of assets, expected life etc will need to be kept to make sure allowances are maximised.

One further piece of anti-avoidance legislation that may be significant is on **Managed Service Companies**. Whilst few of our clients will be directly affected by the changes there is a sting in the tail. With effect from 6 April 2007 (6 August for NIC) any income received by individuals operating through such companies will be deemed to be employment income. This means that the companies will have to operate PAYE and NIC on payments to the individuals. The real problem is that HMRC will at a future date have the right to recover unpaid PAYE & NIC debts from designated third parties, including directors.

Changes to the qualification provisions for the **Enterprise Investment Scheme, Corporate Venturing Scheme** and by **Venture Capital Trusts** were also announced from 6 April 2007 that may make it more difficult to raise equity. Essentially the changes further reduce the availability of the reliefs to many businesses by restricting the number of employees immediately after the share issue to less than 50 and placing a limit on funds raised on £2 million in any 12 month period. One plus point is that the 90% subsidiary test has been relaxed to permit indirect subsidiaries.

In the pensions area again the current reliefs have been curtailed - it will no longer be possible to obtain tax relief on **pension term assurance policies,** although existing policies will continue to enjoy tax relief unless the terms are changed.

The provisions on Inheritance Tax on Alternatively Secured Pensions have been confirmed. If this is likely to affect you please contact a pensions adviser as soon as possible - the tax treatment of transferred ASP funds on death remains penal with a potential tax charge of up to 82%.

EMAIL ADDRESSES

We are aiming to distribute all our newsletters via email in the future. If you have not already confirmed your email address and would like to continue to receive our publications, please contact **Lynne Christiansen on 01727 869 141 or via email: lynnechristiansen@mercerhole.co.uk**

Beijing Beckons!

One of the most exciting and necessary developments within Mercer & Hole in recent years is the development of TIAG (The International Accounting Network) of which Mercer & Hole is a founder member.

Our clients have often been able to use it directly and we find ourselves either by phone or e-mail asking for advice very frequently, often several times a week, on specific issues. We have also been able to work for clients who have a global and not just a national need.

Throughout our time in TIAG and albeit with very different cultures, the challenge has been to build the network on a series of like-minded firms. Part of that is achieved by regularly attending the two conferences which are held in May and October each year. Apart from the technical benefits obtained from attending the conferences, it is at these events that you begin to build relationships.

The conference this May is being held in Beijing and myself and Paul Webster will be attending from Mercer & Hole. I can't pretend that I am not looking forward to walking on the Great Wall of China; to exploring the Forbidden City; and to eating in the Great Hall of the People, but from all points of view this conference will be a conference with a difference.

China has the largest population in the world; has incredible annual growth rates; and a clear intention to trade with the West which has not always been the case in the past. Many of our clients are already getting involved with business in China and many more are trying to think how they can go about it. TIAG already has a very active member in China with 6 offices including one in Beijing and one in Shanghai and more recently TIAG has added an additional member in Hong Kong.

Although there has been a one-day overlap with TAGLaw (a sister international network of lawyers) in the past, this conference will see TIAG and TAGLaw as a joint event for the whole of the conference. The last conference held in Dublin in October was attended by 144 lawyers and 58 accountants and although it is unlikely that the numbers will be quite as many in Beijing, I would still expect there to be in excess of 150 attendees.

I can't deny that the social side of these conferences is enjoyable. It is an opportunity for us to get to know other members and some of the cultural trips surrounding the conference in Beijing should be particularly interesting.

However, the aim of this particular conference is entirely different from those which have gone before. Normally we have a wide ranging series of technical subjects which are presented or discussed, drawn from many countries around the world. On this occasion the entire conference is focused on doing business in and doing business with China.

There will be several presentations by leading Chinese figures explaining China's role in world commerce; opportunities and challenges for China's trading partners; and anecdotal stories on both commercial success and commercial failure. There will be site visits to several Chinese manufacturing companies and several Chinese high tech businesses. There will also be sessions on how to form a company in China, the most important tax issues which affect companies doing business in or with China and the most important audit considerations for Chinese companies.

A growing number of clients now deal with China and we are determined that we will continue to be at the forefront of helping them in this. We will obviously be delighted to help any clients or contacts now or after we are back from Beijing with any questions they may have about China.

Finally, it is probably worth saying how pleased we are with TIAG. It was extremely difficult to find an international accounting network for us to join, particularly as they are dominated by the very large firms. For all the obvious reasons, they do not want to allow other firms to join their networks and equally we did not want to join a network which is dominated by one huge firm. Becoming a founder member of TIAG had the advantage of being able to influence the type of firm which has been admitted, while at the same time helping to guide the growth of the network.

The other advantage of course is that TAGLaw, a sister network of lawyers around the world, was already established and has now grown to become the third largest international network of lawyers in the world. In the early days of TIAG, it was easy to contact the local TAGLaw member and in talking to them, be put in touch with a local accountant.

However, TIAG has developed in a very short space of time to become an exciting, growing network in its own right. It now has 86 member firms around the world in 51 countries. Members admitted in the last six months have included a large firm based in Moscow, with offices all over Russia, as well as a firm based in Jordan, with offices all over the Middle East.

These remain exciting and challenging times for us.

Howard Wilkinson

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