

## Mercer & Hole news update



Once again, we seem to have had a very busy and positive last quarter and it is very easy for me to share some of our news with you.

On 1 April 2008 Helen McKie became a partner in the firm. Helen qualified with us, becoming a member of the Chartered Institute of Taxation in July 2006. Not only did she qualify then,

but she also achieved the highest mark in the country in the specialist paper on the taxation of individuals, trusts and estates and was awarded the Institute's prestigious Spofforth Medal for the May 2006 sitting.

Helen was promoted to become a director of Mercer & Hole Trustees Limited in 2007 and we are delighted that she became a partner in the firm on 1 April 2008. Helen is a specialist tax and trust partner and I hope that many of our clients who haven't already met her, get the chance to meet her in the forthcoming months.

Risking everything by finalising such significant issues on April Fool's Day, 1 April was also the day when we acquired the

financial business which had been run by Michael Lockyer. This is such an important expansion of our services, that I have written a short article on this acquisition later in this Bulletin and I very much hope that this will be of interest to a lot of our clients.

We continue to spend a lot of our time talking to clients about the ramifications of this latest Budget announcement and some of the areas of interest also appear later in this bulletin. One of the most difficult issues continues to surround how Non-Doms are taxed and one of our partners in London, Lisa Spearman, is heavily involved in this and has been in discussions with the Treasury and the Tory front bench trying to convince them of some of the issues which the proposals have given rise to.

Finally, myself, Paul Webster and Chris Laughton, at the time of writing this, are due to attend the latest TIAG conference in Berlin and no doubt we will have more to say about that in the next bulletin.

## Entrepreneurs' relief



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Entrepreneurs' relief has been introduced from April 2008 to mitigate the new flat capital gains tax (CGT) rate of 18% for business owners who previously might have expected to pay CGT at an effective rate of 10%.

### How does it work?

The relief provides for the first £1 million of gains on qualifying disposals to be taxed at an effective rate of 10% rather than 18%. The £1 million is a lifetime limit for all relevant gains after 6 April 2008.

A qualifying disposal is the sale of a trading business by a partner or sole trader, or a disposal - at the same time - of an asset used in that business at the date of the business sale. The disposal has to represent a cessation of business and there is a minimum holding period of 1 year. A holding of shares in a trading company will also qualify provided that there is a minimum holding of 5% and the shareholder is an officer or employee of the company. Once again the shares must have been held for at least 1 year.

### Does it deliver?

To start with you have to recognise that the maximum benefit is

£80,000 and the relief will apply to only a limited class of assets. Some key losers who previously would have paid tax at 10% are:

- Small or non-employee shareholders
- Individuals owning property let to a third party business
- Partners making small sales of assets to incoming partners - taper relief generally kept such gains within the annual exemption
- Individuals who have charged rent on business property - relief is restricted where any rent is, or has been, charged. Two problems - history cannot be rewritten and rent may be required to fund borrowings. There is a possible problem on sole traders who own property used by their business - it is by no means certain that relief is due on sales of such property. Hopefully the position will be clarified soon.

*Continue overleaf...*

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# Entrepreneurs' relief... continued

- Individuals who have historically let property to their business but the business has moved on
- Individuals selling their business for deferred consideration - the new position is very complicated, see below.

## Sale for deferred consideration - examples

1. Shares may be sold for a combination of cash and shares in the new company. Relief should be due on the cash element, but possibly not on the new shares unless you become an employee of the new company with a holding of 5% or more. You can elect to pay tax on the total value of cash and shares but the cash-flow is not good, and if the shares fall in value the loss cannot be carried back.
2. Earn-outs will be settled in cash, shares or loan notes. If payable in cash the total anticipated value is subject to CGT in the year of sale. Where payable in the form of loan notes there are two choices with different tax implications:
  - Qualifying Corporate Bonds (QCB's) - loan notes that are "normal commercial loans".

- Non-qualifying corporate bonds (non-QCB's) - broadly loan notes that are not "normal commercial loans" because, for example, they carry the right to be redeemed in a currency other than sterling or have a share subscription right.

Where shares are sold for non-QCB's the loan notes "take over" a proportion of the cost of the original shares. Unless non-QCB's are held in conjunction with a 5% shareholding they can never qualify for relief. However if the new company fails the non-QCB's will generate a capital loss.

Where shares are sold for QCB's the gain is deferred until the loan notes cease. At that date if the original shares would have qualified for relief the deferred gain also qualifies. The problem is that if the new company fails the deferred gain still falls into charge.

**Does the new relief deliver? - not always and certainly not for everyone.**

## VAT



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The main VAT changes announced in the 2008 Budget are as follows:

### 1. Transitional period for claims

A prospective transitional period will run to 31 March 2009 for businesses wishing to submit VAT refund claims for rights accrued prior to 1996/7 (when the three year capping rules were introduced). Claims for input tax can be made between 1 April 1973 and 1 May 1997. Claims for overpaid output tax can be made between 1 April 1973 and 4 December 1996.

### 2. Withdrawal of staff hire concession

The long awaited withdrawal of the staff hire concession which allows businesses to exclude the salary element from supplies of staff and account for VAT on the margin only. This concession will be withdrawn with effect from 1 April 2009 to allow affected businesses time to deal with the impact of the changes to contracts etc.

### 3. Option to tax

A welcome package of simplification measures has been announced in relation to the option to tax a supply of land/buildings. The changes will take effect from 1 June 2008. Schedule 10 VAT Act 1994 will be rewritten to include:

- Rules for revocation after 20 years
- Treatment by VAT groups

- New option for multiple properties
- Early revocation/cooling off period
- Late application for permission to opt to tax

### 4. Compliance

- With effect from 1 April 2008, the annual VAT registration limit will be increased to £67,000. The de-registration limit will be increased to £65,000.
- The annual registration and deregistration limit for relevant acquisitions from EU member states will also be increased to £67,000.
- Correction of errors on VAT returns - the current limit of £2,000 will be increased to the greater of £10,000 and 1% of turnover subject to an upper limit of £50,000. Errors above £10,000 will be calculated by reference to net VAT turnover (Box 6 of the VAT return). This change will take effect for accounting periods beginning on or after 1 July 2008. This change will also apply to other Indirect Taxes such as IPT/APD etc.
- Revised fuel scale charges will apply to VAT accounting periods beginning on or after 1 May 2008. These changes will reflect fuel price changes and maintain alignment with direct tax charges.
- The current VAT rate of 5% for sales of "over the counter" smoking cessation products will be extended.

### 5. Fund Management services

The current VAT exemption for fund management services will be extended to cover UK-listed investment entities (including investment trust companies and venture capital trusts) and certain overseas funds. This change will have effect for supplies of services made on or after 1 October 2008.

# What's the penalty?



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When a respected tax adviser writes an article entitled: "The Death of Tax Planning", it is probably the right time to take a careful look at how recent changes to how the Revenue polices the tax system

might affect the behaviours of both taxpayers and their advisers.

The backdrop to the article above was the change in the so-called penalty regime, which takes effect for any tax return due after 31 March 2009 (including most companies' corporation tax returns for periods which started this month). Allied to the frequent (and sometimes contradictory) changes to both the relevant legislation and Revenue practice, this new penalty regime will be a worry to many taxpayers, who try to get their tax affairs right whilst (understandably) trying to keep their tax bills to a minimum.

There can barely be a tax adviser who has not told a client that, since there are two alternative, legitimate, interpretations of a given transaction or event, choosing the one that yields the lower tax bill and "seeing how the Revenue respond" is the way to proceed. Until now, this has been almost accepted practice and, even if the Revenue disagreed successfully, it would be rare for them to charge a penalty, on top of the increased tax liability.

But all of this is set to change. The new penalty regime has introduced four new classifications of error - and set a fixed penalty range for each type:

- A mistake, which might be made by a taxpayer taking reasonable care, will not attract any penalty. This is a sensible position and is to be welcomed, though in practice it will probably be difficult to show that any error has arisen without someone failing to take all the care the Revenue thinks is necessary.
- A failure to take reasonable care is punishable by a penalty of between 0% and 30% of the extra tax due. The lower end of the range is confined to situations where the taxpayer finds and corrects the error without any prompting from the Revenue. Historically, correcting such a mistake such as this would rarely have led to a penalty, even if the Revenue had raised the issue (it will now result in a penalty of between 15% and 30% if the correction is "prompted"). A failure to take reasonable care is expected to include the taxpayer not seeking guidance from either a tax adviser or the Revenue on a specific issue, before submitting his tax return.
- A deliberate understatement of tax will attract a penalty of between 20% and 70% of the extra tax due, depending on such points as whether the matter has been brought to the Revenue's attention by the taxpayer (unlikely in these circumstances) and the extent to which the taxpayer then helps the Revenue in resolving the issue. This category would include, for example, a taxi driver keeping some of his cash receipts and not declaring them on his tax return.

- A deliberate understatement with concealment is the final category and will be punishable with penalties of between 30% and 100%, depending on the circumstances. This might include a company that kept two sets of books and operated bank accounts that were concealed from the Revenue, so that the reported income was markedly less than that actually earned.

Many people will not have much sympathy for the two later groups. Someone who sets out systematically to declare profits of less than he has earned is probably only making the rest of us pay more (on the assumption that the Chancellor will not alter his spending plans if some taxpayers do not pay their 'fair share').

But what about someone who is, for example, selling their business and the property from which they have traded?

If the business was a partnership, they will potentially be entitled to claim entrepreneurs' relief - and a 10% tax rate - on gains up to £1 million, provided that the necessary criteria were met. This is confirmed by the draft legislation, issued since last month's Budget.



If, however, the business was that of a sole trader, the position is less clear. The legislation does not mention the 'associated disposal' of property in those circumstances and the taxpayer is left to make up his own mind. Should he claim the lower tax rate and save up to £80,000, or play safe and pay the higher rate of tax? There is no Revenue guidance and, in this era of self-assessment, it is highly likely that the Revenue will simply tell the taxpayer to calculate his tax bill and await any queries. Under the new penalty regime, taking the more aggressive stance will cost an extra 15% to 30% of the difference if the Revenue challenges it successfully. Even full disclosure of the treatment on the tax return will not be regarded as an unprompted 'correction'.

This is only one - very current and real - example of the difficulties facing all of us and one can only conclude that, if taxpayers decide to play safe on this and other contentious areas where the Revenue has not clarified its stance, Messrs Darling and Brown will count the extra cash and not lose any sleep over the matter.

# Budget at a glance

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The Budget 2008, delivered by Alastair Darling and, accompanied by 212 pages of the Budget Red Book and 270 pages of Revenue & Customs Budget Notes offered some welcome relief for a number of private clients and their advisers.

The Budget confirmed that the residence and domicile rules were to be favourably altered compared with the initial proposed changes in the pre-Budget report and even the capital gains tax changes had been delivered with a sweetener in the form of entrepreneurs' relief. Furthermore, it was announced that proposals to tackle 'income shifting' were to be deferred by a year to allow time to follow further consultation.

The highlights for private clients are below:

## Income tax rate

From 6 April 2008 the 10% starting rate band has been abolished and a new 10% rate solely for savings income has been introduced. The basic rate of income tax has reduced from 22% to 20%. Gordon Brown, at the time of going to press, has promised a compensation deal which will be unveiled in the autumn, and back dated to April, for those on lower incomes who have been adversely affected by these changes.

## Residence & non-domiciliaries

The Budget confirmed that only days where the individual is present in the UK at midnight will be counted as a day of presence in the UK for residence tax purposes. That is days of arrival but not departure. Initial proposals were to include both days of arrival and departure.

From 6 April 2008 non-domiciliaries have to pay £30,000 to enable them to treat their foreign income and gains as only being taxed on the remittance basis. Opting for this treatment will mean they can no longer benefit from a personal allowance nor the capital gains tax annual exemption. There are also new rules on how the remittance basis works for mixed funds brought to the UK.

The new rules apply to non-domiciled adults (18 or over) who have been resident for the last seven out of nine years and also only apply to those who have foreign income and gains of more than £2,000 (uplifted from previous £1,000 de-minimis). We saw confirmation that the £30,000 will now be a tax charge on unremitted foreign income and gains, and will be treated as such for the purpose of double taxation agreements and Gift Aid donations.

Welcome relaxations to the initial proposals of the capital gains tax regime for non-resident trusts were also delivered. Going forward non-domiciled beneficiaries will be taxable on a remittance basis on all UK and offshore assets. However, trustees are able to make an irrevocable election to re-base assets held in trust, as at 6 April 2008, to enable them to exclude accrued gains relating to the period before 6 April 2008 from being taxable at a future date on a non-domiciled beneficiary. This has helped to tackle the calls of unfair retrospection of the initial proposals.

## Capital gains tax (CGT): new 18% rate and Entrepreneurs' relief

Alastair Darling confirmed that 18% will be the new CGT rate from 6 April 2008, and that indexation allowance and taper relief have been abolished, both for individuals and trustees. Concession, in the form of entrepreneurs' relief, was announced allowing the old effective 10% CGT rate to be accessed for the first £1,000,000 of gains realised, both by individuals and trustees, on or after 6 April 2008 for the owners of small businesses as well as employees and directors who, very broadly, hold at least 5% of the shares in a trading company.

## Income shifting proposals deferred by a year

As a response to a favourable court ruling for the taxpayer last year, the Chancellor announced in his pre-Budget report to undertake a period of consultation to tackle the practice of 'income shifting'. The government are particularly concerned that many taxpayers (companies/individuals/partners) arrange their affairs to gain a tax advantage by passing income to another person who is subject to lower tax rates. Any changes have been deferred by a year so watch this space!

## Inheritance tax

As outlined in the Pre-Budget report last October, from 6 April 2008, the nil rate band increases to £312,000. What is more exciting is that the proportion of any unused nil rate band on the death of one spouse can be transferred to the estate of the surviving spouse, or civil partner, who dies after 9 October 2007 no matter when the first spouse died. Given the retrospective nature, this provides a real opportunity for families where the nil rate band had not been fully used on the first death of the first spouse.

## Trusts - Transitional Serial Interests (TSIs) extended

The inheritance tax rules for life interest trusts, created before 22 March 2006, were changed by the FA2006. This included a transitional period from 22 March 2006 to 5 April 2008 to enable existing life tenants to pass down their life interest (right to income) in favour of other beneficiaries. The transitional period has been extended by a further six months to 5 October 2008.

## Investments - ISAs and Enterprise Investment Scheme (EIS)

ISA allowances will increase from £7,000 to £7,200 as from 6 April 2008. The cash element within this will increase to £3,600. For EIS investments the tax amount, upon which investors can claim 20% tax relief, will increase from £400,000 to £500,000 from 6 April 2008.

# Financial Services expansion



We were all delighted when Michael Lockyer and his team joined us on 1 April 2008, considerably strengthening our financial services team.

## Michael Lockyer

Michael has for many years run his own financial services business trading as Nightingale Associates. On 1 April we acquired that business, transferring our own financial services' work and Michael's business into a separate entity, M & H LLP trading as Nightingale Associates. As the name implies, this is a Mercer & Hole owned business and with the increase in expertise which Michael and his team will bring, we hope that clients will see this part of our business strengthened even further.

We already offer many of our clients detailed advice particularly on pensions, both personal and corporate, as well as detailed advice on investments within those various schemes. However, with Michael and his team joining us our financial advisers and para planners will increase from two to seven in number, allowing us not only to strengthen what we do at the moment, but also add many areas that we are now able to help our clients with.

For example, reviewing or setting up staff or group pension schemes will now be much easier. Reviewing or arranging certain employee benefits, not only to include pensions, but also other areas such as medical insurance, income protection, key man insurance and many others, is also much easier.

None of this will interfere with our clients' relationship with Mercer & Hole, where the normal relationship partner will continue to act for their clients in the normal way. What it does bring are opportunities for us to offer an even better and more comprehensive service than in the past.

In acquiring Michael's business, we have also acquired a company called Nightingale Mortgage Services Limited. This company has become a subsidiary of Mercer & Hole Group Limited and although several of us are directors of it, on a day-to-day basis it is run by Liz Hopkin. Essentially Liz has specialised for many years primarily in arranging mortgages (often very large mortgages) for both personal and corporate clients. As far as residential mortgages are concerned, she will arrange the mortgage for a modest fee agreed in advance and I am pleased to say that the credit crunch has seen her services even more in demand than they were before.

However, I am also pleased that she is able to arrange mortgages on commercial property as well, once again for a fee agreed in advance. We obviously see this as being a service which will be particularly helpful to our clients, particularly in the current economic climate.

Our clients for whom we currently do financial services work are all in the process of being contacted either by their normal contact partner, or by Gordon Bowden or Jeremy Goodwin, our existing financial advisers. As far as our clients are concerned, it would be very much "business as usual", but with some added resource to help them if they need it. I am also particularly pleased that Michael Lockyer himself has joined us and become the managing partner of the LLP. We have been trying to strengthen our financial services team for a long time, but it has been a particularly difficult area to find people who share our vision.

Clients of Mercer & Hole will know that we have always strived to achieve the highest level of technical expertise, but couple this with a personal, partner-led service. We have always believed that clients should develop a close working relationship with their partner, who in turn will understand their needs fully. Very clearly, this has also been Michael Lockyer's philosophy in developing his own business and I am very excited that we have persuaded him and his team to join us.

I very much hope that clients not only continue to receive excellent service in this area, but also get the chance to meet Michael over the forthcoming months and I can only encourage them to talk either to their current contact partner or to Gordon Bowden or Jeremy Goodwin.

## Howard Wilkinson

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