

## Hobsons : Newsletter January 2006

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#### **Introduction**

Happy New Year! As this is the first newsletter of a new year, we have concentrated this month on positive issues, particularly the sections which set out tax planning pointers and opportunities for individuals, the self-employed and property owners prior to 5 April 2006. We have also included a brief report on the recent court case Arctic Systems v Revenue. This is the case involving husband and wife owned companies - the good news is that the Revenue lost!

Don't forget that the 31 January 2006 is the last date for submitting your 2005 Self Assessment Tax Return - penalties will apply for late filing! It is also the date that you will need to settle any self assessment balancing payments for 2005, and if applicable, make the first payment on account for 2005-2006.

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#### **Do you back up your data?**

A recent survey has found that one in three organizations in the UK do not have basic back up procedures. The survey also found that of those firms that actually performed regular backups, a large majority of them stored their media in-house.

Apart from the legal responsibilities of complying with the Data Protection Act, a loss of business data could paralyse your business for days, weeks and even permanently in the worst cases.

How bad can the worst be? We heard of what happened to some of our colleagues in New Orleans. They thought their home was a safe storage area!

We have seen catastrophic data loss and cannot stress the importance of a proper rigorous backup regime combined with some form of offsite storage. Some firms are now backing up their data on the web overnight on secure sites. If you would like to discuss any of these matters further please call us.

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#### **Do your employees purchase road fuel?**

There are new arrangements for recovery of VAT on road fuel purchased by employees. The new rules come into effect from 1 January 2006.

Under the new rules, employers will be able to continue to treat as input tax the VAT incurred by their employees on fuel costs that are subsequently reimbursed by the employer, either on the basis of the actual cost of the fuel or by means of a mileage allowance. Unlike the existing rules, the proposed new Order makes it explicit that employers can recover only that VAT on fuel which is for use in their businesses in making taxable supplies and must hold a VAT invoice in support of their claim.

This means that the current arrangements in practice for businesses to recover VAT on fuel purchased by employees are unchanged, except that businesses must now retain VAT invoices to support their claims. The invoice can be a full VAT invoice or a less detailed VAT invoice, as appropriate.

The guidance in Public Notice 700/64 is being amended to reflect the new arrangements. More information can be found in Business Brief 22/05 or for specific help talk to Monica Szolin-Jones in Newark on 01636 702100.

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## **Arctic Systems - Revenue lose appeal!**

This is the case that the Revenue started which contended that:

- when a husband and wife company was set up, with equal shareholdings,
- the main fee earner took a lower than market value salary, and
- dividends were drawn equally by the spouses

then the dividend income of the non-fee earning spouse, in this case a Mrs Jones, should be assessed as if it were the income of the main fee-earning spouse, Mr Jones. This of course increased the overall tax of the married couple as Mr Jones was taxed on his wife's dividend income at higher rates.

The Court of Appeal have now judged that there was no settlement of income by Mr Jones on his wife, and therefore the Revenue cannot assess the dividend income of Mrs Jones as if it were her husbands.

This is great news for husband and wife run companies that operate similar dividend policies.

However, although the Court of Appeal have denied the Revenue a right to appeal to the House of Lords, they can apply for permission to appeal.

The decision may encourage the Government to re-write this area of the law - we shall have to wait and see.

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## **Tax Planning opportunities for individuals - prior to tax year end 5 April 2006.**

### **Marital/Partner status**

If you are considering a change in your legal status, getting married or formalising a relationship under the new Civil Partnership Act, then consideration of the following matters may be productive.

- Tax treatment of properties held prior to the change in status.
- Effect on claims, or subsequent payback, of tax credits.
- Review and change your wills - for high value estates this is essential to plan for inheritance tax liabilities.
- Effect on company tax payments if both partners manage and control their own, separate, businesses.

### **Pension Planning**

Although the Chancellor reversed his position on the purchase of residential property by pension funds, there are still significant changes approaching when the new pension legislation applies from 6 April 2006.

For contributors to existing pension schemes it may pay to calculate any unused relief that may be available for the current tax year to 5 April 2006.

If you have significant pension funds, or would like to know more about the new arrangements a review before 6 April may be useful.

### **ISA's and other tax effective investments**

Have you utilised your entitlement for the year? For the more adventurous there are also Venture Capital Trusts and Enterprise Investment Schemes.

### **Capital Gains Tax**

Can you utilise your annual exemption of £8,500? Although it is not possible to sell and buy

back your own investments (Bed & Breakfast arrangements) to create a tax free gain up to £8,500, the same effect can be achieved by transferring shares to an ISA or indeed your spouse.

### **Negligible Value Claim.**

The Revenue recognise that:

- shares in quoted companies, and
- subscribed shares in unquoted companies,
- that have no value, can be written off for capital gains tax purposes. This is a further useful way to reduce your taxable gains this year.

In the second category, subscribed shares in unquoted companies, there is also the possibility to claim the loss against income rather than set off against other capital gains.

### **Inheritance Tax.**

If appropriate, make sure that you take advantage of the annual exception, £3000 gifts are exempt from inheritance tax. (£6000 if you made no gifts in the previous tax year to 5 April 2005).

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### **Tax Planning opportunities for the self-employed - prior to tax year end 5 April 2006.**

This section applies particularly to sole traders and partnerships that have a year end date on or before 5 April 2006. These year ends will form the basis of your self assessment for 2005-2006.

#### **Capital Expenditure.**

If your financial year is between now and 5 April 2006 and you are planning the purchase of plant or other equipment in the summer of 2006, consider bringing the purchase forward to a date prior to your year end.

You will then be able to claim a capital allowance based on the cost in the current tax year - leave expenditure until after the business year end and you will have to wait another year to obtain the equivalent deduction.

#### **Revenue Expenditure.**

The same comment as in the previous paragraph applies to revenue expenditure. Whereas capital expenditure may qualify for a 100% tax deduction (certain energy saving/efficient plant and cars), most plant and equipment will only generate a 40% tax write off in the first year for established trades. (From the 6 April 2006 this is increasing to 50%) Revenue expenditure incurred for the benefit of trade will normally qualify for an immediate 100% deduction.

So if you are considering repainting the office, or repairing equipment, bring forward the expenditure prior to your business year end and obtain tax relief a year earlier.

#### **Stock write off's**

If you have significant stocks of trading goods and materials, some of which are slow moving or may never be sold, consider writing down the value in your year end stock calculations. The Revenue will accept the write off as long as you apply the "value stock at the lower of cost or net realisable value" rules.

Any reduction in stock will reduce your taxable profits.

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## **Disposals**

Any property disposal by individuals - other than a principal private residence - before 5 April 2006 will be taxed as a capital gain in the current tax year. Tax will become due in most cases on 31 January 2007.

Delay the disposal until after 5 April 2006 and the relevant tax will not be due until 31 January 2008.

Stamp duty considerations (e.g. will it be increased in the March 2006 budget?), and commercial considerations, (e.g. will you lose the sale if you delay?), must of course be taken into account.

## **Acquisitions**

If you are buying a property that qualifies as a business asset, and therefore the higher rates of taper relief, there is no advantage in delaying purchase until after 5 April 2006. In fact the opposite position probably applies, that the sooner you buy the sooner you will be able to claim the maximum rate of taper relief.

Properties that do qualify for the higher rates include Furnished Holiday Lets and certain commercial property let to trading businesses and unquoted trading companies.

## **Your own home.**

Described by the Revenue as your principal private residence, this will not be taxed when you sell as long as you have used the property for the entire period of ownership as your own home.

But what to do if you either have, or are considering the purchase of, a second home?

If the acquisition will take place, or has taken place, before 5 April 2006 then this may open up the possibility of making an election to determine which property is to be considered your principal private residence for tax purposes. It may also be prudent to plan for a future change in this election that would possibly enable both properties to be sold at a lower tax cost!

## **Repairs**

As all property income is taxed on a fiscal year basis (to 5 April each year) consider dealing with outstanding repairs before 5 April 2006,

## **Rents receivable and costs payable**

Don't forget that property income is calculated for tax purposes on the accruals basis - in jargon free text this means rents must include rents due but not necessarily received, and costs incurred and/or invoiced but not actually paid.

If you have tenants who owe rent but are unlikely to pay, then evidence of the bad debt (copies of solicitors correspondence etc) should be available to justify leaving the income out of your property income on your tax return.

## **Review**

Property is an area of your tax affairs that deserves an annual review. For our clients we need to be aware of your intended acquisitions and disposals, and the uses to which the property(ies) will be applied.

**1 January 2006** - Due date for corporation tax for the year ending 31 March 2005.

**19 January 2006** - PAYE and NIC deductions due for month ending 5 January 2006. (If you pay your tax electronically the due date is 22 January 2006)

**31 January 2006** - Last day to file your tax return for 2005, and to pay any balance of Self Assessment tax for that year, to 5 April 2005. You may also need to make a payment on account for the tax year ending 5 April 2006.

**1 February 2006** - Due date for corporation tax for the year ending 30 April 2005.

**19 February 2006** - PAYE and NIC deductions due for month ending 5 February 2006. (If you pay your tax electronically the due date is 22 February 2006)

**28 February 2006** - Last day to pay your balance of self assessed tax for the year ending 5 April 2005. Payment made after this date will be subject to a 5% surcharge on tax outstanding, and interest will apply from 1 February 2006!

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