critchleys
CHARTERED ACCOUNTANTS
& BUSINESS ADVISERS

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Budget 2007

Sector Updates

looking to the future...

Agriculture

Most of our farming clients run their businesses as sole traders or family partnerships. The income tax rate changes coming into affect from April 2008, will be the same for farmers as for other taxpayers.

The change in Capital allowances means that from April 2008, instead of getting 25% allowance on plant and machinery, the amount will be reduced to 20%; over the life of the asset, however, all the depreciation in its value will get tax relief (as now).

Larger capital expenditure on plant, machinery and vehicles etc (but not motor cars) will benefit from a maximum Annual Investment Allowance of £50,000. It looks as though most businesses will probably be better off with this new system, even though the annual writing down allowances will be reduced to 20% from the current 25%. It may mean, if you have lots of large amounts of expenditure, that you will have to judge this timing of expenditure more carefully if you want to maximise your tax reliefs.

Timing the replacement of such items in the early part of 2008 might be critical (depending on the financial accounting year, the amount being spent and what part exchange deal is involved). Choosing which side of 5 April 2008 the transactions are to happen will be the key.

Farmers and rural business enterprises often have 4x4 vehicles and so on which emit more than 226 g/Km CO_2. They will be paying more in Vehicle Excise Duty - £300 in the coming year and £400 after April 2008. Keeping a record of business / personal mileages will help us to fairly allocate the expenses between tax allowance in the accounts and what has to be treated as drawings. Smaller vehicles will pay less Duty.

Where an employee has a van made available from his employer, from 6 April 2007 the taxable benefit is £3,000 plus £500 if fuel is also provided. This will cost the employee extra income tax and the employer additional National Insurance.

Changes to Agricultural Buildings Allowances will also have an impact. The allowances are to be phased out over the next four years but we are as yet unsure how any residue of unrelieved expenditure will be dealt with. It looks though it will be simply lost.

Landfill Tax is to be increased from £21 to £24 per tonne - and this comes on top of the Waste Management Regulations coming into force this Spring.

Land owners with let properties will be pleased to hear that a deduction of up to £1,500 per property can be claimed in connection with loft, floor, wall and hot water system insulation.

Farmers should look at tax free opportunities to produce electricity for their home and business use and for onward sale of any surplus power generated.

Want to know more?
Contact Bill Jestico on 01235 553333 or email bjestico@critchleys.co.uk

Charities

VAT and charities

Two technical changes, one welcome and one unwelcome, but both highly relevant to charities, were announced in the Budget. A further measure, first mentioned last year, comes into force on 1 April 2007 and will also impact on many charities. Billed as a cost saving measure by HMRC, it may in fact increase uncertainty.

The good

Charities that purchase or construct new buildings, or commission certain works to listed buildings, can obtain zero-rating for the purchase/construction cost where the building is used by them for non-business purposes.

By concession, charities have been able to ignore a small amount of non-qualifying use so long as this is less than 10%. However, if the qualifying use of the building falls below 90% within 10 years of the zero-rating the charity will have to repay some of the original VAT saving.

From 21 March 2007, HMRC will not enforce this change of use charge provided that the change of use was genuinely unanticipated at the time zero-rating was claimed. Charities are likely to have to substantiate this from Trustee minutes, etc. (If the Charity knew that a change of use would occur it was probably wrong to claim zero-rating in the first place. It is important to note that there are no changes to the rules on zero-rating.)

Further, any charity that has paid a change of use charge in the last 3 years may be entitled to a refund.

The bad

If a charity has to pay VAT on property then, unless the property is used solely for taxable business activities (e.g. as a charity shop), it is unlikely to be able to recover all of the VAT incurred.

Recovery of VAT on assets used for both business and non-business purposes has long been a contentious area. EU law permits the recovery of VAT on such assets in full* so long as a charity accounts for VAT on the non-business use in each VAT return period. This is calculated by spreading the capital cost of the asset over an "economic life" and multiplying the cost attributed to the VAT return period by the proportion of non-business use in the period. This is known as "Lennartz accounting". (*Assuming the business use is taxable. Partial exemption still applies.)

HMRC dislike Lennartz accounting which leads to a cashflow advantage for the charity. HMRC's suggested alternative is for charities to allocate the asset only partly to business purposes, apportioning the VAT charges, so as to recover up front only the VAT attributable to the (taxable) business use of the goods. Alternatively, HMRC are happy for charities to allocate the asset wholly to non-business purposes and forego recovering any VAT on the acquisition of the asset, in which case no VAT is due if it is subsequently disposed of.

HMRC has previously introduced legislation to restrict the use of Lennartz accounting on land and buildings. These were "ultra vires" and thus ineffective. This Budget repeals the ineffective legislation and then introduces new measures.

Regardless of the true economic life of an asset, HMRC will introduce rules from 1 September 2007 to specify the period over which the non-business element must be repaid. In effect, this will limit the cash flow benefit to the charity. For land and buildings this will be 10 years.

HMRC also proposes to limit the cashflow advantage for arrangements already in place, which may cause major changes to cashflow forecasts for affected charities. Transitional provisions are promised but no details have been released at the time of writing.

As a related anti-avoidance measure, from 21 March 2007, the surrender of an interest in land for no consideration will become a deemed supply.

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The uncertain

A significant change to the use of partial exemption special methods will take effect from 1 April 2007. Around 20,000 taxpayers have a bespoke special agreement with HMRC as to how much VAT on expenditure the taxpayer can reclaim. This includes quite a few charities, especially in the education sector. HMRC have recently told several of these charities that they wish to re-negotiate existing special methods.

The aim of such agreements is to produce a result that is fair and reasonable to both parties. Almost by definition this can be contentious, as what a taxpayer thinks is fair and reasonable is often very different to what HMRC sees as fair and reasonable. Further, HMRC do not always appreciate that an overly complex method places an unfair and unreasonable burden on a taxpayer's resources. This has led to negotiations in some cases taking months or even years.

From April 2007, any business negotiating a new agreement must declare that 'to the best of its knowledge and belief' the proposals will produce a fair and reasonable recovery of VAT. If the taxpayer knows, or should have known, that the method will not, in fact, produce a fair and reasonable result so that the declaration is incorrect, HMRC can strike down the agreement with retrospective effect.

HMRC claims that having the 'backstop' of the fair and reasonable declaration will significantly speed up the approvals process and reduce administrative costs, to the benefit of both parties. Time will tell if this is indeed the outcome.

Conclusion

Charities need to keep their VAT recovery position under review. The aim should be to obtain a satisfactory VAT recovery on VAT-bearing expenditure (after considering available reliefs from VAT) but the staff resources needed to capture information and carry out calculations should not be disproportionate to the amount of tax at stake.

Any charity using property for non-business purposes should be considering whether they are paying VAT unnecessarily.

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Direct tax and charities: gift aid

The Budget and Finance Bill introduce two issues that impact on gift aid payments:

1) The current rules on gifts say that, if you make a gift to a charity, you can't claim gift aid on the gift if you receive a benefit back from the charity, unless that benefit is too small to worry about. The limit up to 5 April 2007 is quite complicated, but is roughly as follows:

- If the gift is under £100, the benefit must be no more than 25% of the gift.
- If the gift is between £100 and £1,000, the benefit must be no more than £25.
- If the gift is more than £1,000, the benefit must be no more than 2.5% of the gift and, in addition, must not exceed £250.

The Finance Bill proposes to change this from 6 April 2007 so that the last line will now become: If the gift is more than £1,000, the benefit must be no more than 5% of the gift and, in addition, must not exceed £500.

2) Charities recover basic rate tax on gifts made by individuals. In 2007/8, if you make a gift of £100, this is looked at by the charity as a gift of £128.20 on which tax at 22% of £28.20 has been paid and can be recovered. (If you have paid tax at 40%, rather than 22%, remember you can claim back the extra 18% tax yourself — or you can agree to have it paid over to the charity.)

A side-effect of the change of the basic rate of tax to 20% in 2008/9 is that, if you make the same gift of £100 to the charity then, the charity will treat it as a gift of £125, on which tax at 20% of £25 has been paid and can be recovered. The charity will suffer a loss of £3.20 in the amount of tax it can recover.

Want to know more?
Contact Robert Kirtland on 01865 261100 or email rkirtland@critchleys.co.uk

Property

Industrial and Agricultural Buildings Allowances

There has been a scheme of tax allowances since the early 1960s giving allowances for expenditure on industrial and agricultural buildings. (For reasons that are hardly clear, hotels count as industrial buildings.) In short, 4% of the cost of construction can be written off each year for 25 years.
The Chancellor has decided, in what was a surprise move, to abolish these allowances. They will be phased out starting in 2008.

The problem is that, because the phasing out isn't until next year, the Finance Bill doesn't contain any details of exactly how this will work. At the moment all we know is that balancing adjustments on the sale of these properties will stop.

Overseas homes

We have warned for some time that, if you own a property overseas, via a company, you could have a tax problem. You could be classed as a director and taxed on the property as a benefit in kind.
It looks as though this tax problem will be fixed. Again, though, the draft legislation does not appear to be in place yet.

"Green" issues

The Budget and Finance Bill have some environmental proposals:

- If you generate electricity at home and sell it, the income is tax-free, as long as all you are producing is a small surplus to your domestic needs.
- Rules will provide for Stamp Duty Land Tax exemption on certain "zero-carbon" homes.
- Expenditure on certain energy saving items will qualify for 100% allowance, principally of benefit to landlords.

VAT and property

Alterations to housing for elderly people

One Budget Announcement is that the 5% rate of VAT will apply to certain housing alterations for elderly people. This is expected to come into effect on 1 July 2007 "following discussion with representative groups".

Comment- any extension of the reduced rate of VAT is welcome but the Chancellor has again resisted extending the 5% rate to all domestic repair, maintenance and improvement work.

Partial exemption changes

Although not expressly mentioned in the Budget a significant change to the use of partial exemption special methods will take effect from 1 April 2007. Around 20,000 taxpayers have a bespoke special agreement with HMRC including many property businesses.

The aim of such agreements is to produce a result that is fair and reasonable to both parties. Almost by definition this can be contentious, as what a taxpayer thinks is fair and reasonable is often very different to what HMRC sees as fair and reasonable. Further, HMRC do not always appreciate that an overly complex method places an unfair and unreasonable burden on a taxpayer's resources. This has lead to negotiations in some cases taking months or even years.

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Comment-HMRC claims that having the 'backstop' of the fair and reasonable declaration will significantly speed up the approvals process and reduce administrative costs, to the benefit of both parties. Time will tell if this is indeed the outcome.

Charitable property

Charities that purchase or construct new buildings, or commission certain works to listed buildings, can obtain zero-rating for the purchase/construction cost where the building is used by them for non-business purposes. By concession, charities have been able to ignore a small amount of non-qualifying use so long as this is less than 10%. However, if the qualifying use of the building falls below 90% within 10 years of the zero-rating the charity will have to repay some of the original VAT saving.

From 21 March 2007, HMRC will not enforce this change of use charge provided that the change of use was genuinely unanticipated at the time zero-rating was claimed. Charities are likely to have to substantiate this from Trustee minutes, etc. (If the Charity knew that a change of use would occur it was probably wrong to claim zero-rating in the first place. It is important to note that there are no changes to the rules on zero-rating.)

Comment- this is a welcome concession.

Surrenders

From 21 March 2007, the surrender of an interest in land for no consideration will become a deemed supply. This is an anti-avoidance measure.

Want to know more?
Call Steve Chamberlain on 01865 261100 or email schamberlain@critchleys.co.uk

Critchleys run a regular property-focused seminar PlaN. To register for a complimentary invitation please contact marketing@critchleys.co.uk

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Technology

Technology companies have been caught in the conflicting currents of this year's Budget. The alterations to the Corporation Tax rates will benefit larger companies at the expense of smaller ones. One welcome change is the increase in R&D tax credits but that still leaves the UK lagging behind its competitors when looking at the impact of all effective tax rates. The Chancellor is determined to overhaul capital allowances with Industrial Buildings Allowances (IBA), First Year Allowances (FYA) and Annual Writing Down Allowances (WDA) all being tinkered with although the end result could be of some benefit to the sector. The extension of FYAs for small and medium sized enterprises is thought to be only temporary and there is speculation that it will be replaced with an Annual Investment Allowance of 100% on the first £50,000 of qualifying expenditure on plant and equipment. Until the consultation period has ended it will be difficult to chart a future course with any certainty.

Rates of Corporation Tax

The small company rate increases from 19% to 20% in April 2007 and will rise to 21% and 22% in successive years. The large company rate will decrease from 30% to 28% in April 2008.

Capital allowances

Industrial Building Allowances (IBAs) will be phased out between 2008 and 2011. First Year Allowances (FYAs), for small companies, will be retained at 50% in 2007/08 and 40% for medium sized companies.

Currently, the annual "writing down allowance" (i.e. the tax allowance depreciation is set at 25%). From 2008 this will reduce to 20%, but there will be an additional benefit of an Annual Investment Allowance (AIA) of £50,000 which it appears, can be written off in full. So smaller businesses should get allowances quicker, big ones slower and those with large capital expenditures may need to judge the timing of expenditure right in order to maximise tax reliefs.

Research & Development Relief

Research & Development tax relief will, from 2008/09, increase from 150% to 175% for small and medium sized businesses, whilst larger businesses will see their rates increase from 125% to 130%.

As far as we can tell (because the legislation that will bring in these changes will only be released in the 2008 Finance Bill), the increase for small and medium sized businesses is less generous than it first appears. A lot of businesses that claim R&D tax relief make losses, and use the losses to claim back tax credits. Although the amount of relief is going up, the amount of tax credits looks like staying the same. So the higher levels of relief are only useful to companies that make profits — probably the ones that need the benefit least.

Enterprise Investment Scheme and Venture Capital Trusts

New rules will restrict reliefs from the Enterprise Investment Scheme and from Venture Capital Trusts from 2007/08. In order to qualify in the future companies must not exceed 50 employees and be limited to raising £2m in a 12 month period.

VAT Carousel fraud

Recent anti-fraud measures mean that businesses selling mobile phones and computer chips should be considering the systems implications as a matter of urgency.

Businesses trading in electronic goods, mobile phones, computers and related parts and accessories need to be aware that the provisions whereby HMRC can hold businesses jointly and severally liable for VAT if they had reasonable grounds to suspect that VAT would go unpaid elsewhere in the supply chain, are being extended.

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Background

VAT fraud, involving high-value but easily transported goods (often, but not exclusively, mobile phones and computer chips) repeatedly moving between EU member states (hence "carousel",) has been costing the UK billions in stolen tax revenue. One party in the chain of supply charges VAT but then goes missing without paying over the VAT to the Exchequer. The amount of fraudulent trade has apparently been large enough to affect trade figures and figures for economic growth.

Mobile Phones and Computer Chips

The UK has finally obtained the necessary EU permission to change the rules on accounting for VAT transactions in mobile phones and computer chips.

The proposal is that from 1 June 2007 suppliers will not charge VAT on sales of these goods to business customers, instead the customer would account for VAT under the reverse charge. Thus it should not be possible for suppliers to charge VAT then go missing without paying it over to HMRC.

There will be a "de minimis" of £5000. Transactions below this value, or sales to non-business customers, will be liable to VAT in the normal way. Where the reverse charge applies, the supplier must annotate its VAT invoice with wording along the lines of "customer to pay output tax of £X to HMRC". The supplier will also be to submit web-based Reverse Charge Sales Lists giving information on their sales, in addition to their normal VAT returns

It is important to note that the details finally agreed by the EU are slightly different to the UK's original proposals. The de minimis was originally expected to be £1000, and the goods affected are less extensive than originally intended. The goods affected are:-

1) Mobile telephones; and

2) Integrated circuit devices, such as microprocessors and central processing units, in a state prior to integration into end user products.

HMRC has confirmed that communication devices such as Blackberrys will come within the scope of the reverse charge. Mobile phones supplied with an airtime contract are excluded but 'pay as but you go' ('prepay') phones will come within the scope.

Electronic Goods, Mobile Phones, Computers and Related Parts and Accessories

The Budget announced that the rules on joint and several liability for traders involved in fraudulent supply chains have been extended.

The first measure appears to contemplate that the above reverse charge mechanism may cause fraudsters to target other goods. At present traders in telephones, computers and certain related goods who know, or should have suspected, that VAT might go unpaid somewhere in its supply chain could be made jointly and severally liable for the unpaid VAT. This provision will be extended from 1 May 2007 to cover further types of personal electronic entertainment equipment.

At present, the law permits HMRC to presume that a business had reasonable grounds to suspect that VAT would go unpaid if they purchased specified goods for less than the open market value or less than the price payable for them by any previous supplier. That presumption is rebuttable on proof that the low price payable for the goods was due to circumstances unconnected with a failure to pay VAT.

From Royal Assent, HMRC will be able to add other circumstances in which the trader can be presumed to have known that a supply chain was fraudulent.

Want to know more?
Contact Peter Kemp on 01235 553333 or email pkemp@critchleys.co.uk

Critchleys provide a range of resources for the Technology sector: newsletters, seminars etc.
If you wish to be kept up-to-date, please contact marketing@critchleys.co.uk