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NEWS

AUTUMN 2010 EDITION

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PLUS

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Welcome

Welcome to the second issue of Midgley Snelling LLP News, which brings you updates and practical advice on issues that may affect you financially.

Our bulletin contains a round-up of tax and financial news and developments that we hope will be of interest to both businesses and private individuals.

Following the first few months of the Conservative-Liberal Democrat coalition government, we take a look at the likely impact of their latest policies and proposals.

We consider the opportunities provided by incorporation for doctors and dentists, plans to overhaul the PAYE system, tightened rules for furnished holiday lettings and a new one-in, one-out approach to regulations.

We hope you enjoy reading Midgley Snelling LLP News and that you find it useful. We'd welcome your feedback on the content, or ideas for

topics that you'd like to see featured in future, so if you would like to comment please contact us at email@midsnell.co.uk or call **01932 853393**.

For professional financial advice, tailored to your individual circumstances, on any of the topics covered in Midgley Snelling LLP News, please contact us.

Taxpayers warned over continuing codes error

Following the introduction of a new computer system at HM Revenue and Customs (HMRC), taxpayers were urged to check their tax codes for the 2010-11 financial year carefully to avoid erroneous amounts of tax being deducted.

However, despite HMRC promising to urgently review such cases, around 15 million people still have the wrong tax code, including expats who receive UK pensions but have limited contact with HMRC.

As a result of the PAYE errors in 2009-10,

HMRC collected £238 million too much in tax – an increase of £96 million year-on-year. However, the department also failed to collect £132 million of revenue when mistakes meant taxpayers underpaid.

In fact, up to five million taxpayers receive

a refund or a bill each year because they have been asked to pay the incorrect amount of tax.

Anyone who thinks they may have received the wrong tax code should contact HMRC immediately.

Office established to simplify the tax system

Following its Budget-day pledge to simplify the tax system for individuals and businesses, as well as to increase competitiveness and entrepreneurship, the coalition government has established the Office of Tax Simplification (OTS).

The OTS will review legislation to ascertain where complexities can be removed, beginning with the regulations governing tax reliefs and small business taxation, and report to the Chancellor before next year's Budget.

In terms of simplifying or removing reliefs, the

government is most interested in those that are rarely used or highly complex to administer, with an interim report due in late autumn.

The review of small business taxation will include alternative approaches to the controversial IR35 legislation, introduced in 1999 to tackle the issue of what HM Revenue & Customs (HMRC) refer to as 'disguised' employment.

IR35 was introduced to target those freelancing through their own limited companies (particularly in the knowledge-based sectors), where HMRC believes that the working relationship between

freelancer and client bears all the hallmarks of employment.

However, it has been criticised for the amount of extra uncertainty and expense it creates for small businesses and, based on a Freedom of Information request submitted by the Professional Contractors Group (PCG), it has failed to generate any meaningful additional tax revenues.

Following its preliminary report, the OTS will recommend ways of simplifying the tax system for small businesses.

HMRC proposes overhaul of PAYE system

The processes for collecting PAYE deductions have remained unchanged since their introduction in 1944. However, in those 66 years the labour market has changed significantly, with less people having a single job for life and the move from weekly to monthly payrolls.

As a result of this increased complexity in working patterns, incorrect levels of tax can be deducted from an individual's pay. Because Employer Annual Returns only need to be submitted once a year, checks to ensure deductions are correct can only be carried out after the tax year has ended.

Consequently, HM Revenue & Customs (HMRC) plans to update the PAYE system. The first option is for "Real Time Information", which would require employers to report deductions and payments more frequently. For employers with computerised payroll systems, information regarding an employee's pay and the tax deductions made would automatically be sent to HMRC every time the payroll was run.

The next step would then be to use this information for "Centralised Deductions". As the name suggests, this would mean consolidating the calculation and deduction of tax, with responsibility moving from the employer to HMRC.

Employers would send the gross payment for each employee electronically to HMRC, which would use the individual's payroll information and details of their tax allowances and reliefs to deduct the relevant amount of tax before sending the net payment to the employee's bank account.

However, there are concerns that HMRC will not be able to handle the extra responsibility, and that they could not provide the one-to-one guidance on key issues currently offered by dedicated payroll bureaux, such as the one provided by Midgley Snelling LLP.

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- Convenience - payrolls can normally be returned within two working days of us receiving your information
- Full security arrangements

If HMRC decides to proceed with the collection of real time information, consultations will continue in the autumn with employers, payroll software providers, payroll bureaux and other affected parties.



Incorporations for doctors and dentists

In addition to the new 50 percent top rate of Income Tax for earnings over £150,000 – which came into effect on 6th April this year – those earning over £100,000 face the progressive withdrawal of their personal allowances, rises in National Insurance Contributions and an increased Capital Gains Tax rate of 28 percent.



As a result, many high earners in the medical industry are already considering their options and may have chosen to defer income and make the most of tax-efficient investments.

However, the last Budget also generated a reduction in Corporation Tax from 1st April 2011, with the rate set to drop to 20 percent for a small company with profits below £300,000 and 27 percent for larger companies. For the latter, the rate of corporation will be 24 percent from 1st April 2014.

Consequently, doctors and dentists should consider the structure of their business to see whether it would be beneficial to incorporate as a Limited Company. Individuals who are self-employed are liable for Income Tax on profits as they arise, but companies are a separate legal entity and it is the company which pays the tax on its profits.

Incorporation of a sole trader or trading partnership can generally be achieved without immediate tax charges. However, it is important to consider how profits will be extracted from

the company – whether that will be by salary or dividend or a mixture of both – to see if a company structure is the best option.

As well as the tax savings, incorporation also provides Limited Liability, which ensures that individuals are not personally liable for all debts should the business hit trouble in the future.

Professional advice should always be sought before taking any steps to incorporate. If you are interested in discussing this further, please contact us.

Review of automatic enrolment into workplace pensions

From 2012, employers will be required to automatically enrol all eligible employees between the ages of 22 and state pension age into a qualifying workplace pension scheme, and make minimum contributions.

With 85 percent of a typical UK employer's expenses being staff-related, any increase in staff costs is likely to have a marked effect on a company's profits. Other factors have

also come into play since the initial report was published, including the challenging economic climate, proposed changes to the state pension age and increases in life expectancy predictions.

As a result, the coalition government announced a review of the current arrangements for automatic enrolment to see if they matched the costs and benefits to

both employers and individuals.

The review covered the earnings threshold for automatic enrolment – which currently stands at £5,035 in 2006-7 terms – as well as the age group and size of firm which qualify, and whether an employee should be enrolled when they start work for the firm. It also considered introducing a *de minimis* contribution level, which is small enough for automatic enrolment not to apply.

Treasury to tighten rules for furnished holiday lettings

The letting community breathed a collective sigh of relief in June when the coalition's first Budget confirmed they would not introduce the previous government's new rules to abolish the favourable treatment of furnished holiday lettings (FHL).

As a result, owners are still eligible to claim for business expenses, loss relief, capital allowances and Landlords Energy Saving Allowance (LESA), as well as Capital Gains Tax relief (including business asset roll-over relief and entrepreneurs' relief).

However, the government also promised further proposals on changing the eligibility criteria and reducing the use of loss relief for such properties. In its consultation document, the Treasury has stated that it wants to focus the tax advantages on commercial businesses rather than those run for personal use.

To achieve this aim, they are proposing that owners let their homes for longer.

Properties would need to be available for the public to rent for 210 days in every 12 month period – up from the current 140 days. Homes would also need to actually be let for at least 105 days each year, compared with 70 days at present.

In addition, owners would no longer be able to offset their mortgage against personal income. Any losses the business makes can only be set against future profits from the same FHL. This means the cost of repairs or mortgage payments not covered by rental income cannot be offset against investments such as shares or savings.

By making it tougher for businesses to qualify for these tax breaks, the Treasury estimates that a quarter of Britain's 65,000 FHL will no longer be eligible from 2011-12.

Anyone wishing to comment on the proposals will need to submit their comments by 22nd October 2010. The changes will then be implemented in the 2011 Finance Act.



Beware the drop in corporate insolvencies

While the level of firms failing has continued to fall, experts warn that companies should not breathe a sigh of relief just yet.



Company liquidations in the second quarter of 2010 plummeted by 19.1 percent year-on-year, despite a slight increase (0.5 percent) compared to the previous quarter. Although the levels of receiverships and administrations also dropped, company voluntary agreements (CVA) proved increasingly popular – up 47.8 percent year-on-year.

The number of businesses facing financial distress also dived 31 percent year-on-year to 127,503 – a drop of 21 percent from the first quarter 2010. However, the levels still remain

high compared to 2008 (up 15 percent).

Despite the positive year-on-year results, the average debts of troubled businesses have jumped by 60 percent, implying that larger businesses are now facing problems, which could lead to increased unemployment and impact negatively on the already fragile recovery.

While creditors adopting a more easy-going approach and assistance from government support measures has helped some businesses that would otherwise have struggled, as the recovery takes hold, banks and other creditors

may be more inclined to remove funding from less viable businesses.

Coupled with the impact of the forthcoming increase in VAT and other government fiscal tightening measures, some experts believe that the number of corporate insolvencies will rise again in the fourth quarter of 2010 and into 2011.

Personal insolvencies also fell three percent compared with the previous quarter, but remained at the highest second quarter level – up five percent year-on-year and substantially above those a decade ago.

One-in, one-out approach to cut red tape and bureaucracy

The Conservative-Liberal Democrat coalition has confirmed its commitment to reducing the impact of red tape on business with a comprehensive package of measures.

From 1st September 2010, a one-in, one-out system has applied to domestic legislation impacting on businesses and third sector organisations. As a result, ministers have to determine existing rules of equal value which can be removed before new ones can be introduced. This approach will be extended to other legislation in due course.

An independent panel of experts, the Regulatory Policy Committee, will also examine proposed new regulations at an early stage and advise ministers before policy decisions are made.

In addition, sunset clauses will be applied to new regulations, so they cease to be law after seven years unless Parliament confirms they are

still required, or were originally set to last for a longer timeframe.

This will be welcome news for many businesses, as the British Chambers of Commerce's (BCC) Burdens Barometer showed that the costs for businesses of red tape and new directives rose by £11 billion in the last year.

According to further research compiled by the London and Manchester Business Schools, the cumulative regulatory expense for British businesses since 1998 has reached £88.3 billion, with the business sector being hit by 40 new rules since 2009.

While 21 of the 40 new rules resulted in a

recurring annual benefit for UK businesses, the net result is still a yearly cost of more than £1 billion.

Businesses in London and the South-East have taken the biggest hit, with outlays of £14.78 billion and £14.2 billion respectively.

As a third of last year's additional regulatory burden came from EU directives, the government has also vowed to take a rigorous approach to ending the 'gold plating' of EU rules, which disadvantages British businesses compared with their European rivals.

The BCC, which previously called on the government to repeal regulations which cost more than they achieved, has welcomed the measures.

Avoiding common tax errors

HM Revenue & Customs has issued a reminder regarding the various 'toolkits' it offers to help with preparing returns. Although they are aimed at tax professionals, the toolkits highlight some common errors and the steps that can be taken to reduce them.

The first series of toolkits covers:

- Marginal small companies' relief
- Capital allowances for plant and machinery
- Personal and private expenditure
- Capital Gains Tax for land and buildings
- Capital Gains Tax for trusts and estates

While the main area of risk in all of these cases is failing to keep proper records, other issues can cause further difficulties.

In terms of capital allowances for plant and machinery, problems can arise from:

- Record keeping, such as different proportions of non-business use during the period of ownership and detailed records of all acquisitions and disposals
- Acquisitions and disposals, including whether the asset qualifies for capital allowances
- Non-business use of assets, particularly cars

For private and personal expenditure, areas to watch include:

- Record keeping, such as non-business expenses being incorrectly recorded and claimed in error as allowable expenses
- Personal bills being paid by the business
- Travel and subsistence
- Entertaining, gifts, subscriptions and sponsorship
- Drawings and capital account

If you would like to discuss any of these areas in more detail, please contact us.



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Avoiding the potential costs of unpaid interns

Private companies are leaving themselves open to costly employment tribunals if they employ unpaid interns, according to a report by the Institute for Public Policy Research and Internocracy.

While surveys have found that only half the organisations using interns pay them at least the minimum wage, anyone working for a private company must receive no less than this amount.

Should a current or former intern make a claim against a company, the employer could be deemed liable for up to six years' back pay. In addition, businesses in sectors that rely on employing unpaid interns could see their reputation tarnished, narrowing the pool of candidates that they can hire from.

The National Minimum Wage (NMW) rates are currently £5.93 for adults aged 21 and over, £4.92 for those aged 18 to 20, and £3.64 for 16 and 17-year-olds.

October also saw the introduction of a new minimum wage of £2.50 per hour for apprentices who are under 19 or in the first year of their apprenticeship. The Chartered Institute for Personnel and Development

has proposed that interns should also receive this special rate.

However, there is a major difference between apprentices and interns. While many interns are already eligible for NMW, most apprentices have not previously been entitled to this. In addition, those in trainee positions receive at least the minimum wage, and internships operate in a similar role.



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