BUSINESS UPDATE

Winter 2012

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Dividend or bonus?

Right now is a good time for companies with a year-end of 31 December to decide if any further company profits should be withdrawn, and, if so, whether it should be done by way of dividend or a bonus.

If your aim is just to minimise tax, taking a dividend is now always more tax-efficient – especially if your company pays corporation tax at only the 20% small profits rate. The recent reductions to the rates of corporation tax have reinforced the tax-efficiency of taking dividends, although the main saving comes from avoiding National Insurance Contributions (NICs) – a combined employee/employer minimum of 15.8% when a bonus is paid.

With that in mind, let's crunch some numbers: the table shows how much cash you would take home from withdrawing an additional £10,000 of profit given different levels of personal income (assumed to be entirely director's remuneration), and a 31 December year-end.

Personal income	Corporation tax at 20% rate		Corporation tax at marginal rate (25%)	
	Bonus	Dividend	Bonus	Dividend
£25,000	£5,976	£8,000	£5,976	£7,438
£50,000	£5,096	£6,000	£5,096	£5,579
£200,000	£4,218	£5,111	£4,218	£4,752

The difference is most marked where personal income is just £25,000, since at this level employee NICs at 12% also come into the mix. Dividends also come out on top when the timing of tax liabilities is considered. For a bonus paid in December, the related PAYE/NICs will be due on 22 January 2013.

There will be a reduction in the company's corporation tax liability, but the benefit will not be felt until 1 October 2013. A dividend will fall into the 2012/13 tax year, so any additional liability is not due until 31 January 2014. However, if dividends are taken on a regular basis the payment on account rules will accelerate tax payments.

So is the case for dividends cut and dried? Not quite, as paying a bonus can have advantages. Firstly, dividends must be paid in proportion to shareholdings – fine if you own 100% of the company, but it could cause problems where this is not the case. Then there is the problem that dividends do not count as pensionable earnings – not an issue if you already have sufficient earnings for your pension requirements, or if the company is making contributions on your behalf. Please contact us for advice.

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This newsletter is for general information only and is not intended to be advice to any specific person. You are recommended to seek competent professional advice before taking or refraining from taking any action on the basis of the contents of this publication. The newsletter represents our understanding of law and HM Revenue & Customs practice as at October 2012.

The many layers of VAT

VAT can easily give even the most seasoned of tax experts a headache, and the fact that European Union VAT rules take precedence over UK law just adds to the complexity.

Take the 'simple' matter of buying a sandwich. When you buy a sandwich from a sandwich shop or other fast food retailer you will be charged VAT if you want to eat it on the premises. The European Court of Justice (ECJ) has recently ruled that where the level of service involved is minimal, then VAT should not be charged on cold food sold for immediate consumption even if it is 'eaten in'. Sandwich chain Subway has filed a test case against HMRC, and many other retailers are expected to follow suit.

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The outcome of another conflict between UK and EU law means that businesses may now be able to claim VAT refunds on bad debts going back nearly 40 years.

VAT bad debt relief can generally be claimed once a debt is more than six months overdue but the conditions were once much stricter – the customer had to be insolvent, and a retention of title clause precluded any relief.

In a case brought by BT and General Motors' finance arm, the Tribunal ruled that the conditions previously imposed were not compatible with EU law. This means that refunds can be claimed for the period between 1973 (the year VAT was introduced) and 1997 (when VAT bad debt relief rules were rewritten).

Given the amounts involved HMRC is likely to appeal, possibly to the ECJ. We can help with a submission of a historic bad debt relief claim if your business is due a refund, although one practical difficulty could be finding the documentation after all this time.

As if all that isn't enough, there's one more conflict that could well end up in the ECJ. As part of its drive to reduce carbon emissions, the Government introduced a reduced rate of VAT of 5% for energy-efficient products such as draught insulation and solar panels.

The European Commission has said that such a supply is beyond the range of items for which the reduced rate is permitted, and therefore the standard rate of 20% should be charged instead. The Government disagrees with the Commission's findings, but will study the arguments before deciding on how to proceed.

Did you know that, following the European Court of Justice's ruling that insurers cannot charge different premiums based on gender, from 21 December 2012 pension providers must use the same rates for women as for men when determining the maximum pension that can be taken as drawdown? The change will not initially affect men, but women can take a higher drawdown pension than before. For example, HMRC calculates that annual drawdown for a 60-year-old woman with £100,000 invested could rise from £5,000 to £5,300. But in the longer term, the ruling is likely to result in an overall reduction in annuity rates.

A bit more certainty on residence

The Government plans to introduce its new statutory residence test (SRT) from April 2013. This should make it much easier for you to establish whether or not you are a UK resident if your residence status is currently unclear.

HMRC will provide an interactive online tool so individuals can self-assess their residence status, and a prototype is already available. The aim of the SRT is to ensure that an individual cannot become non-resident without reducing their UK connections, but it recognises that people should not be treated as resident where they have little connection with the UK.

There will be some situations where a person is always treated as UK resident – if they stay here for 183 days or more during a tax year, if their only home is in the UK, or if they work here full-time. In other situations, a person will be automatically treated as being not resident in the UK, for example, staying here for fewer than 16 days in a tax year or leaving for full-time work overseas. The 16-day condition increases to 46 days if a person has not been resident for any of the three previous years.

If your status is not definite, then residence will be determined by a trade-off between connection factors and 'days of presence'. It will be harder for someone leaving the UK to relinquish residence than for a new arrival to acquire it. Connection factors are:

- Having immediate family here;
- Having UK accommodation (made use of during the year);
- Doing substantive work here (40 or more days a year);
- A UK presence in either of the two previous tax years (more than 90 days); and
- Spending more time here than in another country (only relevant for leavers).

The SRT will therefore be particularly welcomed by people who leave the UK without making a clean break, for example where they retain a home here.

Days in the UK	Coming to the UK	Leaving the UK
16 to 45	Not resident	Resident if 4 factors apply
46 to 90	Resident if 4 factors apply	Resident if 3 factors apply
91 to 120	Resident if 3 factors apply	Resident if 2 factors apply
121 to 182	Resident if 2 factors apply	Resident if 1 factor applies

Did you know that the Government is consulting on introducing tax reliefs for the animation, high-end television and video games industries from April 2013? There will be separate reliefs for each industry, but they are all based on the existing film tax relief. Therefore an additional deduction will be given for certain core production costs, and if there is an overall loss then this can be surrendered for a payable tax credit. The Government wants to make the UK a more attractive location for creative industries, but rather than subsidising existing production activity, it aims to attract investment that otherwise would not have taken place.

Income tax reliefs: will the cap fit?

The Government recently launched its consultation on capping unlimited income tax reliefs.

As announced in the March 2012 Budget, an individual will only be able to claim reliefs up to the higher of £50,000 or 25% of their income.

The cap will only apply to those reliefs that are offset against a person's general income and which are not currently capped, but it will not apply to reliefs related to charitable giving. It mainly affects certain loss reliefs and relief for qualifying loan interest, although the ability to carry forward trading losses against future trade profits is not affected. The most important losses that could be restricted are:

Trade loss relief – claimed against income (and potentially chargeable gains) for the loss making year and/or the preceding year. Any restricted loss can still be carried forward.

Early trade losses relief – a loss made in the first four years of trading can be set against income for the preceding three years. Any restricted loss can still be carried forward.

Share loss relief – available for what would otherwise be a capital loss on the disposal of shares in unquoted trading companies. Relief is available against income for the year of the disposal and/or the preceding year. Any restricted loss can still be used as a capital loss and set against chargeable gains.

The first tax year to be affected will be 2013/14, but the cap could apply to earlier years if a loss made after 5 April 2013 is carried back. When calculating the 25% limit, the income figure used will be adjusted so that individuals making pension contributions and/or charitable donations are all treated the same regardless of how these deductions are given. The cap itself will apply to each year relief is claimed.

The other relief most affected will be qualifying loan interest, including where money is borrowed personally for use in the borrower's company. Relief is only available against income for the year that interest is paid, and will be lost if the cap applies. This might mean having to reorganise how a business is financed, with the company borrowing money rather than the individual.

The proposals may yet change, but if you think you might be affected, please get in touch to discuss what can be done to minimise the impact.

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UK Border Agency gets tough on employers

Employers have been put on notice that the UK Border Agency (UKBA) is cracking down on illegal workers in the UK and is holding employers accountable for any failure to check their employees' visa status.

The UKBA has just published new information and guidance for employers and expects full compliance. Whether your organisation employs highly paid executives or part-time students, it is important to be fully aware of these employer responsibilities. Even top companies such as Tesco are not immune, and the resulting bad publicity may be more damaging than the penalties that are imposed.

During a recent UKBA investigation, around 20 foreign students of 11 different nationalities were found working between 50 and 70 hours a week at one of Tesco's warehouses. The current UK visa regulations allow foreign students to work only 20 hours a week during term time.

The operation was part of an ongoing campaign to tackle visa abuse, which has resulted in over 2,000 offenders being deported in just five months. The potential fine for the employer is £10,000 for each illegal worker, with criminal prosecution also a possibility.

So it is important to ensure that all of your employees have the right to work in the UK and that you comply with any restrictions.

A potential employee's documents should be checked before they are employed. If a person has a time limit on their right to work, then the document check should be repeated at least every 12 months. Where there are restrictions as to the type of work that a person can do or the number of hours they can work, these work conditions must not be breached.

The UKBA website provides detailed guidance for employers. As Tesco has found out, students can be a particular problem. The rules have changed several times in recent years, and will vary according to when a visa was issued.

EU pushes quota for women on boards

At the opposite end of the pay scale, listed companies could face fines and other sanctions under EU plans to ensure that 40% of non-executive board seats are occupied by women – compared to less than 14% at present.

The proposal has yet to be formally introduced, and is being strongly opposed by the UK along with several other countries. It would apply to employers with more than 250 employees or £40 million of turnover, and be operative by 2020.

Did you know that most self-employed people whose income is below the VAT registration threshold will have the option of calculating profits on a simplified cash basis from April 2013 if Government proposals go ahead? Profits will be on a tax-year basis, and calculated as receipts less allowable business payments and simplified expenses. The cost of equipment will be allowed as an expense, so capital allowance computations will not be necessary, but no deduction will be given for loan interest. Motor expenses will be based on a standard mileage rate, and flat rate expenses allowed where the home is used for business purposes.

Audit exemption for SMEs and LLPs

Some 36,000 additional companies and limited liability partnerships will soon be in a position to choose not to have an audit.

This is as a result of changes to the auditing requirements that take effect for accounting periods ending on or after 1 October 2012. Previously, to qualify for audit exemption, a business had to have an annual turnover of no more than £6.5 million and a balance sheet total of no more than £3.26 million.

The new regulations mean that only two out of three criteria need be met – turnover, balance sheet total, and number of staff (no more than 50). Most subsidiary companies will also qualify for exemption, provided their liabilities are guaranteed by their parent company.

But the choice to dispense with an audit is not necessarily straightforward, because an audit is far more than just a legal requirement:

- Banks may require audited financial statements as a condition of lending, as might suppliers when assessing credit worthiness.
- An audit acts as a deterrent against fraud, and will highlight any potential weaknesses in financial controls.
- Audited financial statements will be more credible, which will be particularly important if the business is to be sold within the next few years.

Dispensing with an audit is not a decision to be taken lightly, and doing so could have serious consequences for your business. Please call us to discuss any questions you may have.

UK fuel rules versus EU law

European Union (EU) law may make more changes for UK businesses.

When a business provides fuel to employees for private mileage, output VAT can be accounted for on the basis of scale charges. However, if the cost of such fuel is fully reimbursed, the output VAT is instead based on the amount received by the employer.

HMRC previously imposed scale charges where reimbursement was at less than cost, but this approach is not compliant with EU law as a deemed supply cannot replace an actual supply. Until the defect is corrected, output VAT can be based on the amount of reimbursement, and a repayment claim made for previous overpayment. The proposed correction will require output VAT to be accounted for using the market value of the private fuel provided, but scale charges will still apply if accurate mileage records are not kept. It is currently not known from when the correction will take effect.

In a similar vein, HMRC's advisory fuel rates where an employee uses a company car for business travel have been updated from 1 September 2012:

Engine size	Petrol	LPG
1,400cc or less	15p	10p
1,401cc to 2,000cc	18p	12p
Over 2,000cc	26p	17p
Engine size	**Diesel**	
1,600cc or less	12p	
1,601cc to 2,000cc	15p	
Over 2,000cc	18p	

The next review is on 1 December 2012.

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