

Newsletter May 2006

Now that the new tax year has started, we need to apply ourselves to the completion and filing of self-assessment tax returns for the year ended 5 April 2006.

During the next few months we will be including articles in the newsletter which highlight opportunities and pitfalls when gathering the information required.

This month we have included a section for property investors, reported on the recent success of a taxpayer against a Revenue claim, a section on intestacy (what happens if you have no will?), and a short note regarding directors' loans and inheritance tax.

Payroll reminder - forms P35 and P14 must be submitted by the 19 May for the tax year ending 5 April 2006. See Tax Diary below. Please call us in good time if you are experiencing problems in reconciling or otherwise preparing these returns.

Property investors - a few tax return pointers.

Redeeming a mortgage.

The interest charges on your mortgage account are an allowable expense which you can set off against your rental income. Repayments of the capital owed are not. Also if you redeem your mortgage early, and pay redemption penalties, these costs are not allowable.

10% wear and tear allowance

If you own property which is let substantially furnished, you can make a decision to claim a wear and tear allowance each year to cover the costs of renewing furnishings, rather than claim the actual costs of the renewals.

The allowance is based on 10% of the rents received (less council tax or water rates etc. paid by the landlord).

Once you make a choice to claim the 10% allowance you cannot go back to claiming actual renewals costs.

Capital gains tax - indexation and taper relief

If you bought your property before 1998 you will be able to claim indexation relief. This relief basically inflation-proofs your cost of purchase. You will be able to reduce any gain on disposal, by adding an indexed amount to your cost for the period from date of purchase to the 5 April 1998.

From the 6 April 1998 you can also claim taper relief.

Most rented property is classed as a non-business asset. This means that you will not be eligible for this relief until you have owned the property for 2 years. The relief then increases by 5% for each following, complete year of ownership, up to 10 years, when effectively only 60% of the gain is taxable.

Accommodation for holiday lets is an exception to this rule.

Holiday let accommodation is treated as a trade by the taxman, and as a business asset for taper relief purposes. After one complete year of ownership 50% of the gain on sale is taxable. After two complete years of ownership only 25% of any gain is taxable.

So if you still own property purchased prior to 5 April 1998 both indexation and taper relief are available to you when you sell. For property purchased after the 5 April 1998 you can only claim taper relief.

Rent-a-room scheme.

If you rent out part of your own house you can receive up to £4,250 in rents, in a tax year, and pay no tax at all.

If the rents received exceed £4,250 you can elect to either:

- pay tax on the excess rents received over £4,250 - and make no claim for expenses, or
- pay tax on the total rents received, less allowable expenses.

Holiday Let Accommodation.

As mentioned in the notes on taper relief above, holiday let accommodation is treated as a trade for tax purposes. The benefits in capital gains taper relief are set out above. Other tax benefits include:

- Losses can be set off against other income, in the same year.
- Capital Allowances can be claimed for furniture, fixtures and fittings. (But not the 10% wear and tear allowance).
- Rental income qualifies as earnings for pension purposes

Holiday let accommodation need not be a conventional holiday resort property. As long as the required letting criteria are observed, city centre properties could qualify.

Revenue lose Tax Status Case

It is always a pleasure to report another significant win by a taxpayer against the Revenue.

The case involved a challenge by the Revenue that 29 subcontract scaffolders and labourers, engaged by a Mr Lewis trading as MAL Scaffolding, were in fact employees due to the nature of their contract with Mr Lewis.

The stakes were high for Mr Lewis who is self-employed himself and stood to lose not only his business but also his personal assets should the case have gone against him.

All of the subcontractors had CIS 4 certificates, and maintained a "fierce" degree of independence when performing their daily tasks.

An appeal was made to the Special Commissioners who ruled that all the subcontractors were to be properly considered as self-employed - the Revenue's case was dismissed.

So yet again a well thought out defence has triumphed over the Revenue's campaign to treat genuinely self-employed persons as employed. In the case of Mr Lewis the Revenue had issued assessments for back taxes and national insurance approaching £300,000, none of this is now payable!

Intestacy - What happens if there is no will!

Intestacy is a legal term that describes an estate left without direction for distribution in a will.

The legal position is different in England and Scotland but the following general comments apply to both jurisdictions:

If you are married or in a formalised civil partnership.

Your spouse is entitled to a fixed distribution from your estate, (£125,000 England, property valued up to £130,000 plus £22,000 furniture etc. in Scotland).

Remainder may go to children, or other relatives depending on your circumstances.

If you are single

If you have no children - estate shared equally by surviving parents and brothers and sisters.

If you have children - estate shared equally by children.

As you can see from these notes surviving spouses and partners could be left with inadequate funds after your death, and this may be completely against your present wishes.

If you jointly own a business.

Your business partner may suddenly find a member or members of your family in complete or partial control.

Call to action!

The notes set out above simplify the effects of a complex subject - you should seek advice now if you have no will! Certainly we can advise how you can minimise inheritance tax payable when you die, and this strategic tax planning should be done before a formal will is drawn up.

Please call now if you would like us to create an inheritance tax strategy for your estate, especially if you have no current valid will. Even if you do have a will, the Revenue are currently seeking to attack trusts set up under wills (or indeed during lifetime). If the Finance Act 2006 is passed with these provisions, then a review of any existing will, will be vital.

Directors' loans and inheritance tax.

You are probably aware that shares in your family trading company qualify for business property relief, this is presently a 100% relief, providing the correct criteria apply.

Accordingly, when you transfer the shares, no inheritance tax should be payable.

However a problem can arise if you die with a substantial amount owing to you on a directors' loan account.

The amount of such loans will form part of your estate for inheritance tax purposes. If your estate exceeds the nil-rate band (presently £285,000) the directors' loan will create a tax charge of 40% of the loan balance.

Potentially, the company may have to provide funds to cover this liability.

A solution may be to look at loans of a semi-permanent nature, and consider issuing shares to cover them - this may remove the inheritance tax liability, as you should be able to claim additional business property relief.

As always individual circumstances vary but do consider any outstanding directors' loans when you review your estate planning options.

1 May 2006 - Due date for corporation tax due for the year ending 31 July 2005.

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

19 May 2006 - The payroll form P35 and P14's must be filed by this date - employers late in filing may receive a penalty.

31 May 2006 - Ensure all employees have been given their P60's.

1 June 2006 - Due date for corporation tax due for the year ending 31 August 2005.

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

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