

Newsletter October 2006

During late November early December we are due the Chancellors Pre-Budget Report. We can expect announcements that will no doubt change elements of the UK tax system and whilst we do not intend to speculate on what might happen, we will of course keep you informed.

This month we have included information on VAT for owners of Holiday Let Property, the tax consequences of loans to directors, the green agenda for cars and vans, and finally a couple of tax pointers for owners of commercial property who let to a trading business.

Our next monthly tax update will be sent out on Tuesday 6th November - be sure to check your inbox.

VAT and Holiday Let Property

There are a number of well known tax advantages for the owners of UK furnished and let property that has been classified as a "Holiday Lets Property" by the Revenue. A major tax advantage is the treatment of rents received as trading income.

For example this would ensure that losses sustained in letting the property can be set off against other income, and that surplus rents count towards earnings for pension purposes.

There are, however, VAT considerations which should not be overlooked.

The letting of holiday accommodation is generally a standard rated supply. If the property owner is already registered for VAT as a sole trader, then such letting income will be subject to VAT.

If the property is owned jointly by a married couple or other partnership that is already VAT registered, then again relevant letting income will be subject to VAT.

If the property owners are not already registered for VAT, these gross rents received from all properties owned by the same person or partnership count toward the VAT registration limit - currently an annual turnover of £61,000.

If such rents, together with any taxable turnover from other business interests, exceed the threshold, the owner(s) will need to register for VAT and charge VAT at 17.5%.

It would be difficult to argue that the takings were not business income for VAT purposes, as this would involve claiming that this was not a business activity. Such a claim would certainly undermine the favourable tax treatment.

Loans to Directors of small companies

Small company accounts often show an overdrawn position on directors loan accounts. Technically a company cannot loan funds to a director, this is a breach of the Companies Act. Fortunately, for private companies, this apparent breach of the law is not subject to criminal sanctions.

Where the amount of the loan exceeds £5,000 it is good practice to get the written permission of the shareholders to the granting of the loan - unless the director is also the sole shareholder.

The loan will have a number of tax consequences. Two are highlighted below.

S419 Corporation Tax

If a small company had loaned say £10,000 to a director and this amount was unpaid at the year end, 31 December 2006, then an additional corporation tax charge could be created. Whether the tax would fall due depends on when the loan is repaid.

If the loan is unpaid 9 months after the year end, 30 September 2007 in the above example, the Revenue would issue an assessment based on 25% of the loan, £2,500, which would be payable on the 1 October 2007. This is not a permanent loss of revenue for the company as a claim can be made to have this £2,500 refunded when the loan is paid back to the company. Unfortunately the refund of tax will be delayed until the due date for corporation tax in the trading period in which the directors loan was repaid.

In our example above if the loan is paid back in full on the 30 November 2007, and as this is after the 9 month cut off (30 September 2007), the additional tax would have to be paid on the 1 October 2007. As the directors loan was cleared in the trading year to 31 December 2007 the refund of £2,500 would not be forthcoming until the 1 October 2008.

This provision applies to all loans outstanding at the accounting year end, even those under £5000.

As you can see from this example the timing of repayments of the loan is critical.

Directors' personal tax

The grant of a loan by the company to a director is deemed to benefit the director and not surprisingly the Revenue will want their pound of flesh.

There are two possible outcomes.

1. If the company charges the director interest for the term of the loan the Revenue will not seek to assess the director for any additional benefit. The rate of interest charged must be at least the official rate of 5%. This will increase the company's taxable profits by the amount of the interest and will of course increase the amount that the director has to pay back overall.
2. If the company does not charge interest or charges at less than the 5% official rate, the Revenue will assess the deemed shortfall in interest, which they consider should have been charged, as a benefit in kind. This will need to be returned on the form P11D at the tax year end. The current rate of interest applied is 5%.

Please note loans to individual directors that do not exceed £5000 at any time during the relevant year will not attract a benefit in kind charge.

Cars and Vans – the Green Agenda

As you will see from the comments made below, there are currently a number of incentives to buy and use low emission cars. There are also a number of disincentives to discourage private use of company vehicles.

100% Capital allowances for very low emission cars

This 100% first year allowance was introduced in the 2002 Budget, and lasts until 31 March 2008. The allowance is 100% on the cost of new cars which emit at no more than 120 g/km of CO₂, or are electrically propelled.

Benefits in kind on very low emissions cars

In the 2006 Budget, the Chancellor announced that from 2008/09 very low emission cars, those with emissions of no more than 120g/km would attract only a 10% of list price benefit in kind charge, rather than the rate currently applying, which would be 15% for petrol models, and 18% for diesels.

Capital allowances on expensive cars

The Government is likely to announce a change in the way capital allowances are given to businesses that buy expensive cars. The changes will probably include:

- linking the rate of allowance given to the CO₂ rating of the car – expensive cars tend to have higher CO₂ ratings.
- expensive cars will be "pooled". In this way tax advantageous balancing allowances when the vehicles are sold will no longer be available.

For both these reasons it is likely that the new system will act as a disincentive for businesses to buy and run expensive cars. Please note that "expensive" for these purposes means costing over £12,000!

Company Vans - from 6 April 2007

Don't forget that from the 6 April 2007 company van drivers who are allowed private use will see a swingeing increase in the benefit in kind tax charge.

Presently van drivers (vehicles under 4 years old) will only suffer a benefit charge of £500 per year to cover private use. From next year this will increase to a benefit charge of £3,000, plus £500 for free private fuel.

We may be coming to a watershed in the way in which relief is given and tax is charged for the use of company vehicles. Now would be an opportune time to review this area and create a new strategy - please call if you would like to discuss this.

Personally owned properties used in someone else's trade

The notes that follow point to some of the tax consequences if you personally own a commercial property that is used by a trading business.

1. Capital Gains Tax on sale.

As long as the property is let to an unlisted trading company, (could also be a sole trader or partnership if let after the 5 April 2004) it will be classified as a business asset for taper relief purposes. Potentially higher rate tax payers may only pay 10% tax on sale if the property is owned for more than 2 years. Don't forget that if you let the property to a sole trader or partnership before the 6 April 2004 this earlier period up to the 5 April 2004 will complicate the calculation of the final capital gains tax bill - owners in these circumstances can expect to pay more than 10% tax on a subsequent sale of the property.

There are no restrictions on this favourable tax treatment if the owner charges rent for the use of the property.

2. Owner's income tax status.

Any rents charged by the owners, less allowable costs, interest charges and in some cases Industrial Buildings Allowances, will be subject to tax.

If the property is provided rent free this may result in the loss of tax relief for costs met by the owner.

Tax Diary October/November 2006

1 October 2006 - Due date for corporation tax due for the year ending 31 December 2005.

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

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