

31st March 2006

This newsletter will provide a brief comment on certain topics from last week's budget, it does not aim to be comprehensive but highlight a few points that may be of interest to readers.

There was the usual index linked rises in personal allowances, income tax rate bands and other thresholds but little in the way of good news in the budget for businesses or individuals. The rates of income tax and national insurance remain unchanged so that the cost for an owner of extracting cash from a company remain as below:

AFTER-TAX INCOME FOR A HIGHER-RATE TAXPAYER

			←	Dividends	→
	Salary	Interest or rent etc (NIC free)	Small Co (to £300,000 profit)	Large Co (over £1,500,000 profit)	Marginal (£300,000 to £1,500,000 profit)
Marginal corporate tax rate			19.00%	30.00%	32.75%
Cost to company	1,000.00	1,000.00	1,000.00	1,000.00	1,000.00
Net cash position	523.05	600.00	607.50	525.00	504.38
OVERALL TAX RATE	47.70%	40.00%	39.25%	47.50%	49.56%

NB - consideration could also be given to the company making contributions to a pension scheme. These do not attract NI or an immediate income tax charge.

The above table demonstrates the after tax cash received by a shareholder for a payment of £1,000 out of pre-tax profits as salary, interest / rent and dividend. on the assumption that the shareholder is a 40% tax payer and the employee marginal national insurance rate is 1%. It can be seen that payment of dividend is most tax efficient for small companies (profits up to £300,000 assuming no associated companies) with a tax rate of 39.25%. The marginal tax and national insurance rate for self employed individuals is 41% (higher rate tax payer above upper earnings limit) and is slightly higher than the tax rate for dividends for small companies, however the differing treatment of expenses and benefits between employed and self-employed mean a comparison of the overall tax burden between employed and self employed is more complex.

There were a couple of major surprises:

- The acceptance of the recommendations of the Carter report to shorten the deadlines for filing of tax returns in 2008 and continued extension of electronic filing to also include VAT returns will cause concern to business and accountants and it remains to be seen if there will be any changes to the proposals following representations.
- The proposed changes in the rules for certain trusts to potentially impose an inheritance tax charge on lifetime transfers into trust of 20% of the value in excess of the IHT threshold, a periodic charge of 6% of trust value over the IHT threshold every ten years and an "exit" charge on subsequent transfers out mean that the use of trusts in standard family arrangements will be severely restricted, existing arrangements should be reviewed and Wills checked to consider whether changes are required. The ability to make out right gifts as potentially exempt transfers remains, so that individuals will still be able to avoid inheritance tax by giving assets away and surviving 7 years, however it will no longer be possible to retain control over the assets through the use of trusts except in limited circumstances.

As previously announced, the nil rate band for corporation tax together with the non-corporate distribution rate have been abolished which diminishes the incentive to incorporate for smaller businesses. There is an indication that the government is continuing to review the treatment of dividends and remuneration from owner managed companies and in particular arrangements for managed service companies, however for the time being it still generally remains more tax efficient for dividends to be paid rather than salary for many owners and in particular where the small companies rate of corporation tax of 19% applies (for profits up to £1.5m). The reintroduction of a 50% first year allowance for small companies (turnover up to £5.6m plus other conditions) investing in plant and machinery (excluding cars and long life assets) will provide some additional support for businesses and the rate for medium sized companies remains at 40%.

The new pension regime comes in to force on 6 April. To prevent individuals using the new rules to pass on wealth through pension schemes it has been confirmed that there will be an inheritance tax charge on assets left over in a scheme on the death of a member unless they are to be used to provide benefits for a member's spouse, civil partner or financial dependents. There are new rules to restrict the reinvestment of tax free pension lump sums in a pension scheme which mean that members approaching retirement will need to be careful when making additional contributions as potentially a tax charge at rates of up to 55% may apply to a lump sum.

The income tax relief for investment in venture capital trusts will reduce to 30% from 6 April in addition the qualifying holding period will increase to 5 years. Investors wishing to take advantage of the existing 40% tax relief will need to act quickly this week. The good news for Enterprise investment scheme

investors is that the annual limit increases for shares issued on or after 6 April from £200,000 to £400,000. Unfortunately the gross assets limit for both EIS and VCT companies reduces to £7m before investment and £8m afterwards (previously £15m and £16m respectively). This reduction in the size of companies qualifying for the reliefs can be expected to reduce the number of companies qualifying and increase the investment risk.

The tax exemption for employers to provide computers for home use is being withdrawn from 6 April, however it is understood that this will not affect computers first provided prior to 6 April. The exemption for mobile phones is to be restricted to one per employee and this will potentially impact on those who have both a blackberry and mobile phone for private use.

For many there will be no significant impact from the budget immediately, the proposed changes to the filing deadlines and extension of electronic filing do not come in until 2008 or later and the reliefs detailed below with a 5 April deadline continue to be available.

Impending deadlines

31 March, 2006

Private companies with 31 May 2005 year-ends should file their accounts at Companies House.

Corporate tax returns for periods ended 31 March 2005 should be filed by concession no penalty is charged if the return is submitted by 7 March 2006.

1 April 2006 - Employers should no longer pay Working Tax Credit to employees from today.

5 April 2006 - Last day of the 2005/06 tax year and deadline for various tax claims and elections including:

- Using the ISA investment allowance for 2005/06.
- Making disposals to use the 2005/06 CGT exemption.
- Claiming for CGT purposes that an asset became of negligible value or a loan to a trader became irrecoverable in 2003/04.
- Utilising IHT annual exemptions for 2004/05 and 2005/06.
- Reclaiming Class 1 NICs mistakenly paid in 2004/05 on self employed earnings.

- Making an AVC or FSAVC contribution for 2005/06.
- Utilising unused RAP relief from 1999/00 onwards (as it cannot be rolled over into the new post 5 April 2006 pension regime).
- Contracting back into the State Second Pension for 2005/06.

6 April 2006 - "A" day, start of new pensions regime

19 April 2006 - PAYE tax and Class 1 NICs for 2005/06 not paid by today will attract an automatic charge to interest. This includes tax and NICs due under the IR35 rules.

30 April 2006

Private companies with 30 June 2005 year-ends should file their accounts at Companies House.

Corporate tax returns for periods ended 30 April 2005 should be filed by concession no penalty is charged if the return is submitted by 7 April 2006.

For more information or to discuss how the ideas can be applied to your particular situation please contact Simon Bell by phone on 01376 571358 or email simon.bell@sjbtax.co.uk.

This newsletter is written in general terms and therefore cannot be relied on to cover specific situations; applications of the principles set out will depend on the particular circumstances involved and it is recommended that you take professional advice before acting or refraining from acting on any material in the newsletter.