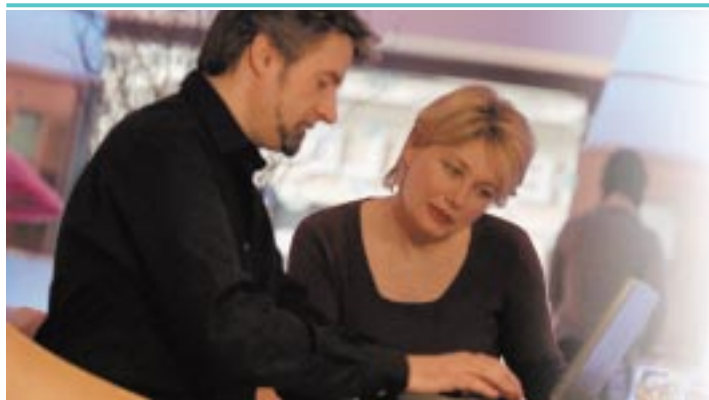


Business Matters

News & Information from **Hammonds** Chartered Accountants and Business Advisers

Summer 2004



Hammonds

Chartered Accountants and Business Advisers

The 'dividend tax' and your business

When the starting 10% rate of corporation tax was reduced to nil from April 2002, there was an added advantage for many small businesses to operate as limited companies.

For example, a sole trader whose only income was the business profit of £10,000 for 2003-04 would be liable to pay £1,484.30 in tax and national insurance. If the same business was a limited company, the entire profit could be taken as dividend, with no tax payable!

Stemming the flow

Although the rate reduction was meant to encourage small businesses to reinvest their profits, the results clearly showed that businesses were incorporating to gain the tax advantages of maximising net profit withdrawals. Consequently, the Government has now introduced measures intended to counter this perceived 'abuse'.

The new measures are designed to ensure that profits distributed to individuals bear at least a 19% corporation tax charge. Lower rates will continue to apply where profits are retained or are distributed to other companies. The tax treatment of dividends themselves is unchanged.

Example

In the year to 31 March 2005, Small Ltd makes profits of £12,000 and distributes £10,000 by way of dividend to the sole shareholder,

Fred Small (with no other income). The normal tax charge would be £475 (£2,000 @ 23.75%), an 'underlying rate' of 3.9583% on total profits. With the new rules on dividends, there is an extra charge of £1,504:

<i>Distributed profit £10,000 @ 19%</i>	<i>£1,900</i>
<i>Undistributed profit £2,000 @ 3.9583%</i>	<i>£79</i>
<i>Total profit £12,000</i>	<i>£1,979</i>

Fred Small, sole trader, would have paid £2,041 in tax and national insurance, an extra cost of £62.

This example also illustrates some anomalies: dividends are paid out of after-tax profits; and any profit which is not distributed has to bear the full tax cost (the retained profit is only £21).

The nearer the profit is to £50,000 and the greater the proportion of the profits retained, the less effect the new rules will have. For profits over £50,000, the advantages of incorporation are undiminished.

Where there is no other personal income, the savings can be increased by paying a salary equal to the personal allowance. This incurs no PAYE or national insurance charges but also has the following benefits:

- It reduces the company's taxable profit
- It saves wasting dividend tax credit which is not repayable
- It secures entitlement to certain state benefits.

So there can still be considerable tax advantages to incorporation. However, each situation depends on individual circumstances, and you should always contact us for a detailed review before acting.

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OUR SERVICES

Here are just some of the ways that we can help you with your personal and business finances. Why not call us now and we'll arrange a meeting to discuss:

- Strategies for minimising your business tax burden
- Raising finance and maximising the value of your business
- Maximising wealth within the family using your annual exemptions and tax breaks
- Retirement planning strategies for you, other family members and your business
- Timing transactions to minimise the tax bill
- Exit strategies and estate planning, for a secure future

Recognising profits: A work in progress?

Since the announcement just before Christmas last year of a change in the rules for recognition of profits in business accounts, there has been much speculation in the professional and general press that this might be a major problem for small and medium-sized businesses.

The proposal

The Government has proposed a change in the rules on the timing of recognition of income. The accounting standards bodies have been concerned that some companies have been 'massaging' their results by anticipating profits not yet earned. They have announced a change to the rules requiring that profits are not recognised until such time as the business is entitled to payment for the goods or services concerned.

What implications does it have?

It must be remembered that this change was originally meant to target companies recognising profits earlier than they should, so that their financial statements gave a better than fair picture of their turnover, and therefore also of their profitability.

The new rules mean that such companies can no longer include in their accounts any income to which they are not yet entitled, but they also stop businesses delaying recognition, for example by leaving completed work in Work-in-Progress (WIP) at the end of the year, to defer the tax.

Is this a problem for me?

It may not be a problem for your business at all, but we would welcome the opportunity to discuss the issues with you. For the majority of businesses, the 1999 changes mean that WIP is included in the results at the year end, so that although you might not have billed your client or customer – and consequently at the year end you had not collected the cash – you still included the income in your profit for accounting and tax purposes.

This change is likely to bring a closer check by the Inland Revenue on the treatment of work in progress in your accounts,

to be sure that the profit declared for tax includes all sums to which you were entitled at the year end, and that nothing has been deferred.

How can I avoid a problem?

We may be able to offer specific advice for your business after our discussions with you, but generally our advice would be to keep your billing up-to-date.

If your bills are up to date, then not only will your accounts fully recognise the value of work completed in the year, but your cash flow should also receive a boost!



Working, spending and saving: bridging the '38 week gap'

The warning signs have been clear for some time: the state pension is increasingly inadequate; too many people are borrowing just to finance everyday spending; and too few are saving money for the future. Of course, during our working years we need sufficient spending resources to live, acquire a home and repay debts. But we also need to look ahead to retirement.

How much will you need?

A man who finishes his working life at sixty can expect to live for an average of 15 years in retirement, and a woman for 20 years. When calculating how much income you will need in that time there are many factors to take into account, but typically, it will be in the region of 60-70% of your current living expenses.

The '38 week gap'

The retirement pension for a married couple, before pension credit, is just over £6,600. If your gross income expectation or requirement in retirement was in the region of £25,000, then the state pension would provide this level of income for only 14 weeks of the year, leaving you to fund your living commitments for the remaining 38 weeks.

Only half of all pensioners will be paying no tax at all this year, which means that their income is less than £7,000. Many are people who retired during the late 1980s and 1990s. If they had saved, they would have benefited from the growth of markets and higher levels of returns from their investments. Yet today an increasing number are falling back on releasing the equity from their homes to access much needed capital.

The 'spending and borrowing culture'

The UK population now has total debt, including mortgages, approaching £1 trillion. Credit cards and personal loans are constantly advertised on television and by mail marketing. No reference at all was made to savings in Gordon Brown's Spring Budget, and the usual pre-5 April ISA investment surge failed to materialise. It has become normal to borrow and spend for today, deferring saving plans for tomorrow. Many convince themselves that retirement is too far away to worry about, or that the challenge of saving is too great.

How can we help?

Is it time to commit to a retirement investment plan? Are the mortgage and other borrowings so high, that saving seems impossible? Whatever your situation we think it is worthwhile discussing your options for addressing the '38 week gap'.

Legislation Update:

The Privacy and Electronic Communications (EC Directive) Regulations 2003

What are they?

A new set of legal restrictions, which implement the EC Directive on Privacy and Electronic Communications in the UK. The rules became effective from 11 December 2003 and will be enforced by the Office of the Information Commissioner.

What do they outlaw?

Sending unsolicited commercial emails or text messages to individuals without their prior permission, and using personal information without an individual's consent.

How do they apply?

- Companies or individuals wishing to carry out direct marketing to individuals via commercial emails and text messages must secure the advance permission of the addressee, via an opt-in procedure.
- While corporate subscribers are exempt from this rule, all direct marketing emails must now include proper sender and contact details.

- Visitors to a company website must be informed of the use of any internet 'cookies' or similar web tracking devices, and must be given the option to opt out.
- When marketing to existing customers, companies will only be able to e-market goods or services that are similar to those of which the customer is already aware, and must again provide an opt-out facility.
- Mobile network operators wishing to provide advertising and subscription services based on location and traffic data must give subscribers information about data processing, and obtain their consent.
- Directory providers must give subscribers full information about data usage, and an opportunity to have their details removed from directories.

Businesses failing to adhere to the regulations will be committing a criminal offence, and will face a fine of up to £5,000, or an unlimited fine should a case go before a jury. In certain circumstances, individuals on the receiving end of unwanted messages will have the right to sue for compensation.

Action to take

You must adapt your e-marketing procedures to ensure that you only contact recipients who have given their prior consent, and you should update your database on a regular basis. Always provide the required opt-out facilities. You should also make sure that any use of tracking devices on your website is made transparent, and that your privacy policy is up-to-date.

Only two Red Tape days?

The seemingly never-ending changes to UK employment law that affect small and medium-sized businesses will in future be introduced on only two days of each year: 6 April and 1 October.

Given that it has become increasingly difficult for business owners to keep up with new legislation, this new initiative is intended to provide greater clarity and awareness about when changes will be made. The Government will also say at the beginning of each year what those changes are expected to be, through an annual statement of forthcoming employment regulations.

Don't give up on giving

The basic rule for inheritance tax planners is that you should give away as much as you can, as soon as you can.

However, that simple rule can be incredibly hard to implement. There is an old joke about the person being asked in the street for 'any spare change', and responding 'I don't know if I have any spare – I haven't finished with it yet'. That captures the difficulty, and the art, of inheritance tax (IHT) planning: how much is spare, and how can you give away just enough to leave you with a taxable estate as close as possible to the IHT exempt

amount (£263,000 for 2004/05) at your death?

Your gifts strategy

A good lifelong gifts strategy can enable those whose estates will otherwise be caught in the IHT net to enjoy helping younger family members in their lifetimes, and to minimise tax liability at the end.

Key ingredients of the strategy are the use of the annual and regular gifts from income exemptions. These can create considerable amounts of wealth outside your own estate. Trusts, meanwhile, allow valuable assets to be passed out of your taxable estate, but have the

advantage of giving you the option of retaining control (as trustee) over the funds – should younger family members need to be 'saved from themselves'.

Your home

An increasing number of people who would not consider themselves particularly 'wealthy' are finding that the value of their home has taken their estate into the IHT net.

But even they can use the exemption for annual gifts out of income to fund insurance (written into trust for their heirs) to release tax-free cash on their deaths, to meet the final tax bill.

Your Will

You should also consider Will planning, as well as planning to save IHT. A carefully drafted Will can ensure that the wealth you have built up in your lifetime benefits the people who need it most on your death – and it can also save tax.

Your charitable giving

Charitable gifts – through Gift Aid, payroll giving or bequests to charity in your Will – are another way to help those you wish to help in your lifetime. As a general rule, it costs someone paying tax at 40% only £60 to give £100 to charity.

Inheritance tax has become a major issue for more and more people. If you would like to discuss ways of minimising your tax liability, contact us.

Olympic thinking for your business

This August, all eyes will be on Athens and the 2004 Olympic Games, but what can business-owners learn from the world's top athletes? Here are four tips for success:

1. Respond to change and challenge

With five gold medals in five consecutive Games – a span of twenty years – rower Sir Steven Redgrave can claim to be the greatest Olympian of all. He met the challenges of injury, ever-younger competition and even diabetes, and emerged victorious.

Olympic tip: Be prepared to embrace change, and see challenges as opportunities to improve your business.

2. Be ready to take calculated risks

At the 1988 Olympics in Seoul, reigning 3m springboard diving champion Greg Louganis violently hit his head on the board. The accident looked set to rule him out of the competition, but soon after, with head stitched and bandaged, he executed his best dive and went on to win gold. He later said, "You don't win gold medals by playing it safe."

Olympic tip: Winning businesses are prepared to take calculated risks, refusing to let the fear of possible failure overshadow the prospect of success.

Changes to the National Minimum Wage

Following recent changes to the National Minimum Wage regulations, the following rates will apply from 1 October 2004:

- The main rate for adult workers will rise by 35p an hour, to £4.85
- The development rate will rise by 30p an hour, to £4.10
- 16 and 17-year old workers will be entitled to a minimum wage of £3 an hour
- The earnings of home and piece workers will be linked to the minimum wage.

3. Success breeds success

For the 1992 Olympics in Barcelona, the United States put together the famous 'Dream Team' basketball squad, composed entirely of living legends of the game. Their matches began with opponents taking photographs of their idols, and ended in huge margins of victory. The USA were able to assemble such a squad because the players were attracted to the prestige of being part of a great, invincible team.

Olympic tip: In business, high-quality people like working for high-quality companies. Ask yourself: Why would a highly qualified person come to work for us?

4. Seek feedback

Even the best Olympians employ coaches to provide constructive criticism and to help them adapt, improve and correct errors. Seek feedback from people who will tell you the truth, not just make you feel good.

Olympic tip: Seek feedback from all the key people involved in your business: staff, customers, shareholders and suppliers – and act upon it.

We can't all be as famous as Sir Steven Redgrave, but perhaps we can all be inspired to succeed in our own business lives. Enjoy the Games...

WEB WATCH ESSENTIAL SITES FOR BUSINESS OWNERS

Directgov www.direct.gov.uk

New resource offering access to a wide range of UK Government information and services.

European Centre for Customer Strategies www.eccs.uk.com

Free, membership-based web community focusing on customer relationship management in Europe.

British Association of Women Entrepreneurs www.bawe-uk.org

Non-profit organisation for women business owners based in the UK.

Biz/ed www.bized.ac.uk

Information for students and tutors on subjects related to business and economics.

REMINDERS FOR YOUR DIARY

June 2004

30 End of CT61 quarterly period

Last day for UK businesses to reclaim EC VAT chargeable in 2003

Annual adjustment for VAT partial exemption calculations (March VAT year end)

July

6 Last day to file Taxed Award Scheme Returns. File P11Ds, P11DBs and P9Ds. Issue copies of P11Ds or P9Ds to employees

Deadline for relevant third parties to give non-employees information on benefits or expenses they have provided to them in 2003/04

14 Due date for income tax for the CT61 period to 30 June 2004

19/22 Quarter 1 2004/05 PAYE remittance due

Final date for payment of 2003/04 Class 1A NICs on relevant benefits provided to employees

31 Second self assessment payment on account for 2003/04

Annual adjustment for VAT partial exemption calculations (April VAT year end)

Liability to 2nd £100 penalty arises for 2003 Tax Return still not filed

5% surcharge on any tax unpaid for 2002/03

August

2 Last day for notifying car changes in quarter to 5 July – P46 (car)

31 Annual adjustment for VAT partial exemption calculations (May VAT year end)

September

30 Deadline for submission of the 2004 tax return if you wish the Inland Revenue to calculate the tax, or, if you are an employee, you wish to have a 2003/04 balancing payment of less than £2,000 collected through your 2005/06 PAYE code
End of CT61 quarterly period

