

Preparing for a storm

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Many businesses are finding current trading conditions difficult. Logically the focus of attention will be on those areas of business that are within the control of owners and managers, such as revenue growth and cost control.

However, in doing so there is a risk that matters of compliance could be overlooked. These are normally routine functions but you need to stay in control of them despite the current challenges.

This article examines three areas which a business is well advised to review. Firstly, we will consider how a business would fare under an Inland Revenue compliance review. Secondly consideration should be given to whether or not the proprietors have adequate protection in place and finally whether the proprietors have a plan in place to mitigate an increasing tax burden.

COMPLIANCE REVIEW

How would the business fare under an Inland Revenue compliance review?

No one should be in any doubt about the scale of the budget deficit and that collection of underpaid tax will be a priority in addressing this. The announcement of a second, and final, non-disclosure opportunity (for off-shore investment) and disclosure agreement with Lichtenstein is evidence of this. Compliance review will continue to be used by Her Majesty's Revenue and Customs ("HMRC") to track down unpaid tax since it has had a high degree of success in this area recently.

The hospitality industry has traditionally involved a high level of cash transactions. HMRC have always focused on businesses of this nature, so traders in the industry should expect to receive a review targeted at both PAYE and VAT.

Typical compliance errors in the operation of PAYE include:

- not applying the correct PAYE coding arising from Form P45 or Form P46 errors;
- not applying PAYE to cash wages; providing employees with benefits such as medical cover, a taxi home and free laundry which in certain circumstances should be reported on a Form P11d. This will also have Class 1A national insurance implications;
- incorrectly treating a car as a pool car rather than a company car when the evidence does not support it;
- not applying PAYE to tips when a tronc scheme is not in place;
- reimbursing employees for business mileage at a rate that should be taxed;
- making round sum allowance payments to employees for business travel and omitting to apply PAYE correctly; and
- breaching the conditions under which a dispensation has been granted or even allowing the dispensation to expire without replacement.

AND VAT TOO!

It is increasingly common that a VAT officer attends a PAYE compliance review. The following aspects of VAT compliance are typically found wanting:

- output VAT accounted for incorrectly on the provision of conference room facilities or the hire of function rooms. This may require an option to tax for VAT to be made;
- output VAT accounted for incorrectly in respect of cancellation charges;
- VAT on room hire involving catering not correctly accounted for;
- proper VAT invoices not being available to substantiate input VAT claims;
- VAT not being accounted for on sales of equipment following a refurbishment;
- the VAT being incorrect when vehicles are purchased;
- the incorrect rate of VAT being applied when the VAT rate changed; and
- VAT being accounted for when accommodation is provided to an individual for over four weeks.

DON'T IGNORE THE LIABILITY

The need to consider whether or not an option to tax for VAT should be made seems to be omitted by many businesses, not least those in the hospitality sector. With development projects often involving a combination of hotel facilities, office accommodation and even retail outlets, the proprietor cannot afford to ignore this. If HMRC is successful in identifying an underpayment of tax they will extend their enquiry to earlier years. Combined with

interest and penalties, the total liability may be substantial.

A review by your tax advisor should identify PAYE and VAT compliance concerns or errors, make recommendations on system changes. Advise how any identified underpayments should be managed to mitigate any tax cost and also make suggestions on how your tax strategy can mitigate your tax burden.

IS YOUR BUSINESS PROTECTED?

Consider what you might do if your business partner died or if a key member of staff were to become critically ill.

If you are in business with other individuals, either as a shareholder or partner, and one of that number dies you may have to reach a settlement with the surviving spouse. One solution is to arrange back finance which would allow you to buy out the spouse. However, with loan finance being more difficult to obtain, such an arrangement may not be easily secured as was the case say two years ago. This could put the future of the business at risk.

A combination of a well structured shareholder or partnership agreement together with life assurance can provide the means to allow the parties to exchange at a fair value for all concerned. There is a number of options to choose from to provide this protection. For example insurance can be written into trust for the company to enable it to buy back shares from the spouse, and partners can enter into cross life policies.



The health of key staff members can be equally important to the business. A study by Legal and General found that 44% of those surveyed feared that they would struggle to continue the business without the input of a vital employee, yet only 4% had protection in place. A key man policy can provide the funds necessary to recruit and employ a replacement staff member.

MITIGATING THE BURDEN

The Finance Act 2009 introduced measures to increase the tax take from April 2010. Indeed some businesses with an accounting year end after 5 April are already generating profits that will be taxed under the new legislation.

There will be three main aspects to the changes that will impact on higher earners:

- for those with income in excess of £100,000, the personal allowance will be reduced;

those with income in excess of £150,000 will have the excess above £100,000 taxed at 50% rather than at 40% as is the case at present; and

- those with income in excess of £150,000 will have annual pension contributions capped at £20,000 unless they can avail of certain reliefs.

For some the above measures will result in a rate of tax that is effectively 60% of earnings. It is not surprising that individuals are planning to mitigate the burden.

Any of the following may prove to be suitable:

- changing your business structure to defer income. For example incorporating the business or introducing a corporate member. There are a wide range of tax benefits to be secured using these arrangements;
- income with your spouse to make full use of allowances and income tax rate bands.

In future this could be worth £20,000 per annum;

- focusing on capital returns rather than income returns as the top rate of capital gain tax is 18%
- accelerating income to be taxed in 2009/10 at 40% if it must be taken;
- in certain circumstances borrowing funds from the company or an employment benefit trust may have tax and cash flow advantages;
- taking capital sums from single premium bonds;
- maximising pension contributions whilst you can; and
- receiving rewards through tax-favoured benefits in kind or share option schemes.

Again your financial and tax advisors can guide you on how best to manage this.

Despite the economic climate and the effort required to mitigate its impact, it is important that what would appear to be mundane matters are not ignored.