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## Condé Nast, Fleming and the 'Three Year Cap'

**The taxpayers have won in the appeals brought by HM Revenue & Customs (HMRC) against Condé Nast Publications and Fleming (trading as Bodycraft) in the House of Lords.**

Condé Nast's case concerned its attempt to recover VAT on staff entertainment for a period exceeding three years. HMRC refused to repay sums exceeding three years stating that the three-year limit imposed by regulation 29 (1A) of the VAT Regulations 1995 SI 1995/2518 (known as 'the three year cap') meant that this VAT was not recoverable as input tax.

Fleming's case was similar nature in that they attempted to recover VAT of the purchase of motor cars used for its business ten years prior to them making the claim. Again, HMRC refused the claim citing the three year cap, even though this legislation was not on the statute books at the time the cars were purchased back in 1989 and 1990.

Consequently, Condé Nast and Fleming brought a joint case to the House of Lords. The law lords hearing the case ruled (by a majority decision of 4 to 1)

that although the three year cap was legitimate legislation, it had not been implemented correctly due to the fact that the capping legislation contained no transitional period. Consequently, taxpayers were not able to make their claims before they had knowledge of the change in law which is an 'accrued right' of the taxpayer in order that they have legal certainty.

The House of Lords' dismissal of HMRC's appeal means that input tax (VAT incurred on purchases) not recovered for the period from at least 1 May 1997 going back to 1973 can now be recovered. Therefore, all taxpayers who have had previous claims for input tax 'capped' have an opportunity to make a claim. Furthermore, taxpayers that were involved in the following areas could avail themselves to substantial recoveries.

**Share issues:** until the case of Kretztechnik, input tax was not recoverable where it related to share issues.

**Staff entertainment:** until the case taken by Ernst & Young HMRC's view was that input tax could not be recovered on the cost of supplying employees with entertainment, e.g. Christmas party.

**Motor cars:** HMRC deemed that input tax was still blocked on cars used wholly for a business purpose until the European Court of Justice ruled in the case against the Italian Republic. It is also worth noting that clients making claims following this case may also be due compound interest from HMRC following on from another positive decision for the taxpayer in the Semptra Metals case.

The capping case may also mean that overpaid output tax can be recovered where previously subject to the three year cap, although a six year cap will apply as this has always been provided for by VAT Act section 80. However, since the legislation in relation to output tax was not directly at issue in these

cases (merely commented upon by the Law Lords) we cannot yet be sure of the application to overpaid output tax.

In conclusion, although the taxpayers have won the case and secured their own input tax claims, it is still unclear how this decision can be used to the taxpayers benefit, particularly with regard to overpaid output tax. It is expected that HMRC will comment soon on the decision which may give the taxpayer some clarity. However, it is not beyond the realms of possibility that further litigation will be required before this matter is brought to its final conclusion.

***"... all taxpayers who have previous claims for input tax 'capped' have an opportunity to make a claim... taxpayers could avail themselves to substantial recoveries..."***



## Tax news

### Payroll Tax Changes

HMRC has issued a consultation paper on how best to tax benefits in kind and expense payments. The paper envisages the current £8,500 reporting threshold will be abolished and a new statutory system introduced by April 2011 whereby employers account for tax on all benefits and expenses through PAYE.

Reporting procedures will be updated to reflect the new system, with the proposed abolition of Forms P11D and P9D.

### Capital Allowance Reforms

The Chancellor announced significant capital allowance changes in the 2007 Budget, proposed for implementation from 1 April 2008. Main proposals include: a reduction in plant and machinery allowances from 25% to 20%, writing down allowances for long life assets will increase from 6% to 10%, fixtures will be identified separately and only attract a 10% writing down allowance. There will be a phased elimination of industrial and agricultural buildings allowance. The government will introduce a £50,000 Annual Investment Allowance for plant and machinery. Groups of companies will receive one £50,000 limit. Qualifying expenditure up to the threshold will effectively receive a 100% first year allowance.

### Homes Abroad

The 2007 Budget included measures to ensure that individuals who have an overseas home will not face a benefit in kind charge if the property is held through a company. The detailed proposals are due to be included in the 2008 Finance Bill and should have retrospective effect.

### Taxation of foreign profits

There is an ongoing government consultation process on the UK tax treatment of UK companies with overseas shareholdings. Key proposals include that for large groups dividends received would be tax exempt for shareholdings of 10% or more and that the current Controlled Foreign Company regime will be replaced with new Controlled Company rules. It is also proposed that interest deductions claimed in the UK will be restricted to the total external finance cost. It is envisaged changes will take effect during 2009.

# Entrepreneurs' relief

## - partial climbdown by Chancellor in CGT reform

After several months of deferred announcements Chancellor Alastair Darling finally announced on 24 January 2008 his partial climbdown in respect of the proposed reform of capital gains tax, the introduction of a single rate of 18%, and the abolition of taper relief from 6 April 2008. The new relief - entrepreneurs' relief - provides for a reduced rate of 10% on cumulative lifetime disposals up to £1m for qualifying assets and persons.

### Background

Prior to the Pre-Budget Report (PBR) last year, the rate of capital gains tax suffered by UK individuals was the same as their marginal rate of income tax – for many this meant 40% on capital gains exceeding the annual exempt amount.

However, there were various reliefs to reduce inflation from any gains, to provide incentives for holding assets for longer periods, and to reward individuals for holding risky trading assets. These took the form of rebased costs to market value at March 1982, indexation allowance to eliminate the effects of inflation up to March 1998, and taper relief for assets held for particular periods of time, with varying rates of relief for trading or non-trading assets. For many owners of private trading companies, holders of shares in AIM listed trading companies, and employees participating in certain share schemes, this meant that the shares could be disposed of at an effective rate at or below 10% on the indexed gain to March 1998.

This was because the maximum business asset taper relief was 75% exemption of the gain provided the qualifying assets had been held for at least two years.

At the time of the PBR, the Chancellor announced that he was simplifying capital gains tax and reducing the rate from 40% to a flat rate of 18%. Whilst on face value this sounds attractive, it was immediately clear that the loss of reliefs, particularly business asset taper relief, could lead to an increase in capital gains tax of 80% if there were no transitional or relieving provisions in the Finance Bill 2008. After intense lobbying, the Chancellor has announced a partial climbdown in the form of entrepreneurs' relief.

### The relief

The relief will apply to certain individuals making disposals of businesses, certain shares and securities and associated disposals. For those that qualify 4/9ths of the gain will be exempt, leaving an effective rate of 10% on the gains (5/9ths times 18% = 10%). There will be a single lifetime limit of £1m of gains that qualify for each individual. Any gains over that are taxable at the full 18%.

### Conditions

- The relief will be applicable whenever the relevant conditions have been met for a period of one year;
- The relief applies to the disposal of the whole or part of a trading business that is carried on by the individual either alone or in partnership;
- The relief also applies to the disposal of shares and securities in a trading company (or the holding company of a trading group) provided that the individual making the disposal:
  - has been an officer or employee of the company (or a company in the group)
  - owns at least 5% of the ordinary share capital of the company (including an ability to exercise at least 5% of the voting rights)
- An associated disposal (for example of property used by the business/company sold but owned by the individual) will also qualify for the relief.

### Commentary

Whilst any relaxation of the initial proposals should be welcomed, there are many categories of taxpayer who have not welcomed the new relief. The lifetime limit of £1m of gains does little to ameliorate the position of the private business owner which is worth more than a few million pounds, and the minimum share ownership criteria are likely to exclude many employee share scheme arrangements.

It will be possible to elect to disapply the rollover provisions on share for share exchanges to ensure entrepreneurs' relief applies to the disposal so it is important to discuss with your tax adviser the best options if you are considering an offer for your company's shares.



# Back to the future

The self imposed moratorium on new accounting standards from the International Accounting Standards Board is coming to an end. We already have a couple of amendments out for 2009. When it was first announced, the moratorium on new accounting standards was greeted with a great deal of relief. There had been so many changes to international accounting standards in 2005, a whole raft of new UK standards to converge with International standards, and a new set of International Standards on Auditing to replace the more familiar UK domestic standards; so many changes that accountants were crying out 'Enough!'.

Nothing is ever still for long, however.

This year will see the implementation of the remaining sections of the largest and longest Act of Parliament ever, the Companies Act 2006. After that, we expect a few new international accounting standards and interpretations. Also, IASB unveiled a hitherto secret weapon - regular annual changes. They are supposed to be minor changes but no less than 25 international accounting standards are being amended as a result of an annual review.

After that, the auditing standards will again have been revised, and this time round, redrafted. We expect a wide range of new requirements in the auditing world.

Another significant development in the international community is also likely to have far reaching implications for the UK and Ireland.



We refer to the proposed IFRS for SMEs – or in English, the International Financial Reporting Standard for Small and Medium Sized Entities.

This was badly needed and has been popular with many people (except the President of the EU who didn't seem to think much of it!). The standard is aimed very much at the small and medium range. Medium sized are all businesses except listed companies, banks, insurance companies and similar; in other words very substantial enterprises. One major issue, and not just a British problem, is the concept of the 'micro entity'. The draft IFRS for SMEs is still much too weighty for all those flat management companies, IT consultant companies, name preservation companies, and so on.

The UK and Irish Accounting Standards Board will need to decide on its own future too. They can adopt the IFRS for SMEs and the full range of IFRS for listed etc companies, but could keep the existing Financial Reporting Standard for Smaller Entities (FRSSE) going for 'micro' entities.

Or could ASB perhaps persuade the international community that there is a need for a micro IFRS? Or they could keep the IFRS for listed companies and extend the UK and Irish FRSSSE to all other entities! Whichever way it goes, the future holds some stimulating times.

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**We hope you find this newsletter of interest. If you have any questions about any of the topics covered please email our Tax Director, Alan Curry at [alan.curry@asmhorwath.com](mailto:alan.curry@asmhorwath.com) or telephone 028 9024 9222.**

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