

Tax Factsheet - October 2007

Welcome to the October 2007 edition of our Tax Factsheet.

The issues covered in this Factsheet are aimed at providing outline guidance only, and further specific advice may be needed before decisions are taken.

HMRC's Arctic case freezes.....

This Factsheet had referred in previous editions to an ongoing tax case (Jones v Garnett), with potential ramifications for smaller owner-managed businesses; particularly husband and wife owned limited companies.

After four years of hearings, the taxpayers recently won their case unanimously in the House of Lords, and so owner managed businesses up and down the country were able to breathe a huge sigh of relief. But.....

HMRC's reaction to losing such a high profile case is simply to propose changing the law! - subject hopefully to meaningful consultation.

This case was and is important with regard to the extraction of funds for owner-managed limited companies, and so the facts of the case and potential future developments are worth reviewing in some detail.

The facts

- Mr & Mrs Jones each subscribed for one ordinary £1 share in their new owner managed business called Arctic Systems Ltd
- For the next few years they each drew small salaries but distributed most of their income equally in the form of dividend
- Mr Jones had other income and was a higher rate taxpayer, Mrs Jones was a basic rate taxpayer and undertook only minor duties within the company
- The dividend payments escaped National Insurance, and the dividends Mrs Jones received were subject to a lower rate of tax than those of her husband

HMRC's arguments

- The dividends received by Mrs Jones were caught by settlement legislation as it was effectively a disposition of income received by her husband and therefore should be reallocated to him
- To enforce settlement legislation, HMRC needed to prove that the spousal exemption within this legislation which applies to outright gifts, did not apply
- They argued that because Mrs Jones subscribed for her own £1 share there was effectively no gift of the share
- Their 'back up' argument was that the share was wholly or substantially a right to income which under the legislation meant that the spousal exemption could not apply

The decision in the House of Lords

- All five judges agreed that the outcome should go in the favour of the taxpayer
- This was because whilst the majority of them thought that a settlement did exist, they agreed that the existence of a settlement meant Mr Jones consented to Mrs Jones having her share, and so the issue of the share was a gift

- Therefore the spousal exemption applied and so the dividends should not be reallocated to Mr Jones
- The judges also agreed that an ordinary share in giving a right to vote, participate in the distribution of assets, etc., give rights over and above the right to income. Most of us thought that this was logical because ordinary share dividends are an agreed return on investment, not a right to income

The result

- If taxpayers have filed 2006 Returns as 'provisional' pending the outcome of this case, they may now be finalised
- Meanwhile it is clear HMRC will not easily accept the overwhelming verdict by the highest Court in the land. They still have issues with 'income splitting', and so we await further developments

Please contact Robert Bradley on (01509) 212890 if you want further detail with regard to this landmark tax case. It is important that the facts of any similar case are checked to make sure it is not substantially different to enable HMRC to argue it is not covered by this decision.

Changes to statutory holiday entitlement

From **1 October 2007** all employers are required to provide a minimum of **24 days holiday allowance**. This increases to **28 days from 1 April 2009**.

Part-time workers will be entitled to a pro-rated amount of this annual entitlement.

Although these changes effectively merge statutory and Bank Holiday entitlement, the new rules also state that employers will be able to insist employees take Bank Holidays as part of their overall 28 day holiday entitlement.

Also note that from 1 April 2009 employers cannot pay in lieu of holidays except on termination of employment.

If affected by the new rules, employers whose 2006/07 holiday year runs over 1st October 2007 are required to calculate an increased allowance from 1 October on a pro rata basis to the end of the employers holiday year.

There are several websites (eg www.dti.gov.uk) with further details and pro rata calculators.

Please contact Robert Bradley if you have any queries.

Business fuel reimbursement - yet another change in the rates..!

Having announced new fuel only business mileage reimbursement rates in February, HMRC have revised the rates (in the employees favour) from **1 August 2007**. (The previous rates are as shown in brackets).

These rates can be used by **company car drivers** who:

- are reimbursed by the employer for business mileage paid for by the employee *or*
- reimburse the employer for private mileage to avoid a taxable Benefit in Kind

Engine Size	Petrol	Diesel	LPG
1400cc or less	10p (9p)	10p (9p)	6p (6p)
1401cc to 2000cc	13p (11p)	10p (9p)	8p (7p)
Over 2000cc	18p (16p)	13p (12p)	10p (10p)

Note that this is a different reimbursement system to the tax-free approved mileage rates (AMRs) of 40p per mile 1st 10,000 miles; 25p per mile thereafter, which applies to the reimbursement for the running costs of your **own vehicle** for business journeys.

However, Customs will allow employers to use the fuel only advisory rates to reclaim input VAT on the fuel element of AMR payments to employees.

Remember that these are advisory rates only, and an actual cost method (if higher) can be negotiated with the Tax Office. Contact Robert Bradley for more information.

Reminder - National Minimum Wage Rates from 1 October 2007

New National Minimum Wage Rates come into force on 1 October 2007:

- Aged 22 or over £5.52 per hour
- Aged 18 - 21 £4.60 per hour
- Under 18 £3.30 per hour

For further help with NMW rates, please contact Robert Bradley on (01509) 212890.

Tax Diary - October 2007

30 Sept 2007	Last date to submit paper 2006/07 tax return to have unpaid tax of up to £2,000 collected through the 2008/09 PAYE code
1 Oct 2007	Confirm CT600's for the year ended 30 September 2007 have been submitted to the Inland Revenue.
1 Oct 2007	Confirm abbreviated accounts filed with Companies House for private companies with 30 November 2006 year end.
1 Oct 2007	Corporation Tax due date for year to 31 December 2006.
5 Oct 2007	Deadline for notifying HMRC of taxable income or gains if no Tax Return has been issued for 2006/07
19 Oct 2007	PAYE and NIC deductions due for the month end 5 October 2007 (If you pay electronically, the due date is 22 October).

For further assistance on any of the issues raised, please contact Robert Bradley, Tax Manager at Turner and Smith on 01509 212890 or email robert_bradley@turnerandsmith.co.uk

All due care has been taken in the preparation of this fact-sheet. The authors can accept no responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication.