GE

Welcome to the Summer edition of GENIE.

news
information
events
summer 2007

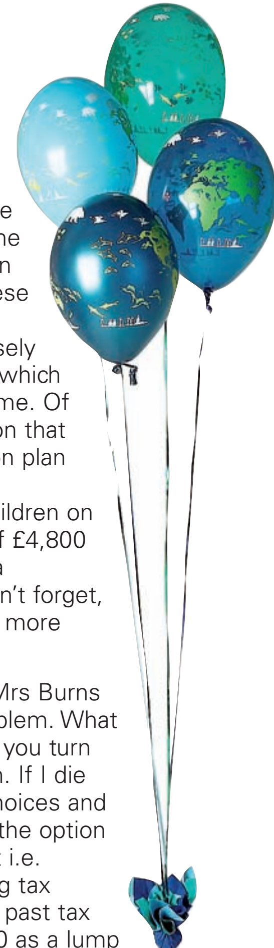
GENIE

Turning 50

Welcome to Genie and during the timespan of this edition I reach this grand old age in July. This got me thinking about the advantages and disadvantages of becoming 50. I will not bother listing the disadvantages as it would take this whole edition but the advantages are few and far between. Perhaps I am older and wise? I can now join Saga and invest in numerous advantageous savings accounts with the likes of Northern Rock and Abbey for the over 50's (I never have understood why a 50 year old's savings are more desirable than a 49 year old's!) However I did come up with a major advantage but this only applies to 5th April 2010 so if you are 50 between now and then read on. If you are 55 in the next 10 years I would carry on reading anyway!

The good news is that the government allows me to 'retire' my pension plans. You do not really have to retire from the day job but you are allowed to take the benefits from your pension plans. This does not necessarily mean you have had to have a plan for many years. Take my situation where I reach 50 on 1st July 2007. Let us assume I have income of £100,000 in the 40% tax bracket. I decide to write a cheque to Pension Co for £78.000. HMRC give basic rate relief worth £22,000 to Pension Co so I now have £100,000 in my pension plan. Let us ignore the tax free growth for a couple of months and assume I am risk averse and put everything in the cash deposit fund. So the box below sets out what happens on 'retirement' on 1st July 2007.

So I am now in the happy position of having £75,000 in a pension plan at a net cost of £35,000. I can now do something called 'Income Drawdown (I do not have to buy that dreaded annuity until I am 75 and I don't intend that much of the pot will be left by then!). At my tender age the government limit the amount I can draw to 6.4% of the £75,000. These percentages rise each year as we age. I therefore invest the pot wisely and draw 6.4% from Pension Co which gives me £4,800 p.a. annual income. Of course I have to pay income tax on that unless I put it into another pension plan but that is another story, and see Graham's fantastic idea for the children on page 4. Now what is the return of £4,800 on a cost of £35,000? – Well it's a **MASSIVE 13.7% p.a. for life.** Don't forget, I plan to increase that by drawing more as I age.



Now having explained all this to Mrs Burns she came up with a potential problem. What if the grim reaper calls soon after you turn 50? Good point but not a problem. If I die before 75 she has a number of choices and the one I have told her to take is the option whereby she takes the whole pot i.e. £75,000 less 35% (a free-standing tax being a claw back of some of the past tax relief.). So she is left with £48,750 as a lump sum to do with as she wishes. Now bearing in mind that pot only cost me £35,000 that wasn't a bad deal for the Burns household.

Why did I mention 5th April 2010 above? Well the government have decided to increase the earliest age we can take retirement benefits to age 55 from that date. The above still works for those younger readers but you just have to wait 5 years longer!

If you are interested in taking advantage of this type of pension planning do let me or my colleague Graham Thomas know.

Colin Burns

	Pension Pot £	My Personal Bank Account £
Initial contribution	78000	-78000
HMRC basic rate tax relief-22%	22000	
Higher rate tax relief refunded on self assessment	18000	18000
Position on 30th June 2007	**100,000**	**-60000**
Retirement on 1st July 2007		
Tax free lump sum	-25000	25000
Net position	**75000**	**-35000**

in this issue

More on non-residence and domicile
Page 2

Input tax
Page 3

Keep it in the family
Page 4

Investment news
Page 5

Impending changes to UK statutory holiday entitlement
Page 6

GENIE

more on non-residence and domicile

Following on from Colin Burns' article on 'Going non resident' in the Spring edition of GENIE, the Tax Returns for the year ended 5th April 2007 have now been issued by HMRC. Where supplementary non residence pages need to be completed, there are significant differences between the questions that need to be answered on the 2007 Tax Return pages as compared to those of previous years.

It is clear that these changes have come as a result of the Gaines-Cooper case referred to in Colin's article and that it is important that individuals wishing to claim non residence or non domicile in the UK bear these changes in mind.

The most significant changes in the information that is required to be given on the supplementary non residence pages are as follows;

There is now a question asking if you had a full-time employment abroad during the period for which you are claiming to be non-resident.

Despite retaining the question on the amount of days spent in the UK excluding days of arrival and departure, there is a new question asking how many days out of that number you are claiming to have been in the UK for exceptional reasons (and hence not to include in the 91-day test). Previously, these days were simply not included in the amount of days spent in the UK.

A further additional question asks on how many separate occasions were you present in the UK during the year ended 5th April 2007. The answer to this question when added to the answers from the previous questions provides HMRC with the number of nights spent in the UK and more importantly, the pattern of visits to the UK.

On domicile, the new form asks four new key questions;

a) Is this the first year you have claimed to have a domicile outside the UK?

b) If so and you have a domicile of origin within the UK, when did your domicile change?

c) If you have never been domiciled in the UK, were you born here?

d) If you were born outside the UK, when did you come to live here?

The questions added to the form seem to have been designed to identify a range of cases where HMRC's new-found confidence could result in challenges to claims for non-residence and non-domicile and any relevant clients are encouraged to contact us in order to ensure that these new questions are answered carefully.

David Convisser

CONSTRUCTION INDUSTRY SCHEME:
A CATCH FOR RESIDENTIAL PROPERTY INVESTORS

The new CIS which commenced on 6th April 2007 has been well publicised. While there is an exemption for owners having work carried out on their own homes, there is no such exemption for other residential property. A catch to be aware of.

Long-term investors will not need to register unless they are a 'deemed contractor.' This requires expenditure of £1 million a year over three years – in most cases this is unlikely.

However, 'small-time' property developers (e.g. those who buy a property and hire builders to carry out improvements prior to resale) will need to register as contractors and comply with the procedures when paying builders. Registration also appears to extend to 'investors' who change their minds (ie they gain vacant possession and then hire builders to carry out improvements prior to sale).

This is a curious example of a new tax regime having a disproportionate impact on 'ordinary' people. Those needing to register should call HM Revenue & Customs dedicated phone line on 0845 366 7899 or online at www.hmtc.gov.uk/new-cis .

Colin Burns

VAT – Input tax

Property activity often makes businesses partially exempt and therefore they are unable to fully recover Input Tax. Some businesses may also need to consider whether the Capital Goods Scheme ("CGS") is relevant as this often requires Input Tax recoverable on capital expenditure to be adjusted over a certain period.

Partial exemption methods

Most property businesses make both taxable and exempt supplies. They can recover VAT directly attributable to taxable supplies but not exempt supplies. Any VAT that is un-attributable (often referred to as residual VAT) is partly recoverable.

Under the standard partial exemption method, residual recovery is in proportion to taxable turnover divided by total turnover. Incidental property disposals should be excluded when calculating this proportion. A property disposal by an occupier may well be "incidental" but this is far less likely for a property business.

Due to the fact that the standard method does not deal particularly well with properties that have both taxable and exempt lettings, property activity calls for a special method to be agreed with H M Revenue & Customs. This might provide for "sectorisation" i.e. allocating VAT to particular buildings or developments before splitting it and might also deal with empty properties by, for example, recognising anticipated rental values. It is, however, becoming increasingly difficult to agree special methods with H M Revenue & Customs.

Issues – Developers

If a developer is going to opt to tax, the general point is to ensure prompt recovery of Input Tax either by opting early. A special method is likely to be needed for mixed (taxable and exempt) projects.

There are issues around predevelopment costs and aborted projects. Generally, however, Input Tax can only be attributed against firm intentions and if these change they should only be adjusted if the costs are clearly re-used for something else. VAT related to planning gain agreements and to roads etc dedicated to the local authority are seen as attributable to the related development and recoverable accordingly.

Some financing arrangements can involve exempt supplies. Examples can be equity funding and forward funding, where the land is sold and the developer then acts as a contractor. The creation of a mortgage or charge is not seen as involving a supply by the owner.

VAT cashflow can be a major issue. There are various ways of improving this, the most obvious being the making of monthly VAT Returns during the development phase.

Issues – Housebuilders etc

There are some additional points for residential developments. If a major interest can be zero-rated, then shorter leases should generally be avoided. If necessary, the best answer may be to grant a major interest to an associated company, which then grants shorter occupational leases to third parties. Where the developer does grant a short lease, it may be possible to correct this through a deed of rectification, or to recover some input tax by granting a major interest subsequently.

Following a zero–rated grant, ongoing rent is exempt: the idea is to allow the developer to recover VAT on capital costs but not on ongoing repairs and maintenance. Any subsequent grant is also exempt – this can create a problem under the CGS.

Housebuilders can never recover VAT on certain items incorporated into buildings such as white goods and carpets.

Issues – Commercial Occupiers

For occupiers whose business is fully taxable, the main issues are around VAT cashflow and around the consideration of whether the option to tax on any letting or disposal of surplus property is relevant. The CGS may create a substantial cost with exempt transactions. If the business is a tenant whose landlord has not opted, it may be worth looking at how costs, such as maintenance, are incurred so that VAT can be recovered.

Exempt and partially exempt occupiers have a range of ways of mitigating VAT costs. These include persuading landlords not to opt and optimising partial exemption methods. These business can gain, through the CGS or otherwise, by opting to tax sales and lettings of surplus property. Charities, and operators of care homes can also gain substantially from ensuring Relevant Residential Purposes (RRP) or Relevant Charitable Purposes (RCP) treatment, although this can be complex and challenging.

Tenants will also have an interest in whether the landlords revoke the option. Generally, exempt and partially exempt tenants will benefit from revocation; fully taxable tenants may suffer since any service charge is likely to be increased to cover the landlords irrecoverable VAT.

Capital Goods Scheme (CGS)

The CGS applies where VAT is incurred on capital expenditure of £250,000 or more in a range of circumstances, including the purchase of property or the construction, enlargement, refurbishment or fitting out of a building.

The VAT is normally adjusted, 10% at a time, over nine to ten years according to the use of the property in each year. If it is used in making both taxable and exempt supplies however the impact would be determined mainly in accordance with a partial exemption method rather than an actual split in use.

On a disposal, all remaining years are treated according to the liability of the disposal. So if a taxable business builds a building, occupies it for five years and then sells it exempt, it can expect to have to repay half the VAT on construction to HM Revenue & Customs. Conversely, an exempt business can gain on the sale of a building if it opts to tax. There are further, potentially harsh, rules about disposal but such matters are beyond the scope of this article.

Richard Kleiner

KEEP IT IN THE FAMILY

and avoid up to an 82% tax charge

Gordon Brown has announced his intention to introduce further changes to pensions making it extremely penal to pass any residual pension funds down to children or grandchildren on death after age 75. In this event, combined taxes of up to 82% could be incurred and collected by the Treasury. Graham Thomas, our pensions specialist however demonstrates in this article that there is still a way of legitimately avoiding such taxes providing the appropriate strategy is introduced in good time.

Many Eastern European countries, including the Baltic States and Russia, have adopted a flat tax system. The theory behind flat taxes contains two main arguments. First, by having a single rate of tax, the system is simple; people understand what they are required to pay. The second says that by setting the flat tax at a reasonable rate, the motive for wealthy people to avoid paying it is blunted.

The latter argument seems to hold water when looking at UK inheritance tax (IHT) statistics. In 2003/04 (the most recent HMRC data available), 55% of estates valued between £300,000 and £500,000 were taxed, yet only 50% of estates between £500,000 and £1,000,000 were caught in the IHT net.

Unfortunately, the politicians running the Treasury don't see the logic, particularly when it comes to bequeathing pension wealth to the next generation. The recent Budget has confirmed the intention to legislate for a 70% rate of tax when any residual ASP funds are passed to other scheme members. IHT is also payable giving an overall tax rate of potentially 82%.

If the second argument of the flat tax theory is correct, the wealthy - those most likely to have ASP funds - will seek to avoid this punitive tax.

ASP allowed parents to bequeath what was left of their pension fund to their kids. It still does, but not in the way originally envisaged.

Instead of drawing no income from their drawdown fund and allowing the funds to accumulate until death, the parents can simply strip the funds out as early as they can get their hands on it - age 50 currently. They can then use this pension income to fund third-party pension contributions for their kids.

The Treasury might argue that at least it is getting income tax on the drawdown instalments taken by mum and dad. However, what it takes with the right hand is given back immediately to the kids with the left hand in the form of tax relief. If parents and children pay the same rate of tax, this process is tax neutral.

If the parents are basic rate taxpayers by the time they begin withdrawals and the children are higher rate taxpayers, then the deal is better than tax neutral because the children receive a further 18% tax relief. If this tax relief is reinvested in their pension, the children also get another 40% tax relief on the tax relief – another 7.2% on top of the 18%. This brings the total boost to over 25% of the gross third party contribution.

Stripping out income and putting it back into your children's pensions can actually produce a better result than accumulating the fund until death in ASP, even if we go back to the days before 70% was ever conceived.

By using such a simple and legitimate mechanism, the 70% unauthorised payment charge is avoided despite the pension fund still being bequeathed to the children i.e. what the 70% charge is supposed to stop.

Even better, IHT can also be legitimately avoided using this method.

What better way of legitimately avoiding an 82% tax loss and perhaps even turn it into a tax gain!

Instead of collecting 40% of the residual ASP fund in tax, where the estate was subject to IHT, the Treasury will now collect next to nothing from ASP. In fact, it could actually end up out of pocket, as highlighted above.

I'm no expert on whether flat taxes are a good thing or a bad thing, but in this particular case, I am convinced that a flat rate of 30% or 40% applied to ASP residues (and no IHT) would have raised a lot more revenue. And all without all the anguish inflicted upon people who simply want to pass some of the results of a lifetime's hard work onto their kids.

Tax and legislation are liable to change. This information is based on Gerald Edelman Financial Solution's current understanding of law and HM Revenue & Custom's practice.

Tax rates and reliefs may be altered. The value of tax reliefs to the investor depends on their financial circumstances. No guarantees are given regarding the effectiveness of any arrangements entered into on the basis of these comments.

G E N I E

Investment **news**

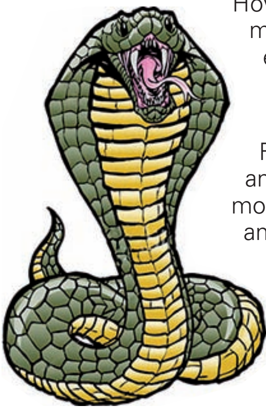
FATAL BITE FOR ASP

Many wealthy individuals having built up large amounts of capital in their pension funds are reluctant to convert those funds into an annuity and thereby submit to the double whammy of currently low annuity income rates and the prospect of losing the capital on death.

It has been possible for more than 10 years to opt instead for income drawdown (now re-named Unsecured Income), which enables the retiree to retain their pension investments intact and to draw an income from them. The 2006 Budget held out the prospect that drawdown could be continued after the age of 75, when it would become known as Alternatively Secured Pension ('ASP') - one of the great advantages being that it would have been possible on death to pass the value of the pension fund to dependants' pension scheme through a 'family SIPPs' (self-invested pensions).

However, the Treasury began to get cold feet when it saw how popular this was likely to be, and the Chancellor has now confirmed a complete about-turn and proposes to tax ASP out of existence. The withdrawal of this financial planning option has sparked considerable activity among product developers, who are now rising to the challenge of creating vehicles for secure investment-based retirement income, with death benefits. More on this anon.

Although ASP is effectively dead, there is some good news in that the very attractive death benefits available under drawdown up to age 75 are very much intact. However, careful planning is required to maximise these benefits which can often be enhanced by arrangements which direct the benefits to a trust rather than a surviving spouse.



For the fortunate few who commit to annuity purchase and find that this produces more income than they require, there may be another opportunity for estate planning. Gifts made from surplus pension income would normally qualify for the 'normal expenditure out of income' exemption from Inheritance Tax; and this would be additional to the other annual exemptions for gifts.

A good budget for the investor

While the Chancellor is often accused of giving with one hand and taking away even more enthusiastically with the other, one group that should see a benefit from the Budget are wealthier pensioners.

From April 2008 the 22% tax band will reduce to 20%. For most high earners the benefit of this will be largely cancelled out by the increase in the National Insurance threshold. However as pensioners do not pay NI, those who are able to utilise the full basic rate tax band will receive maximum benefit from the tax cut. Furthermore all though there was wide publicity regarding the scrapping of the 10% tax band it was retained for investment income. So for 2007/08 the first £2,230 of taxable investment income will still be chargeable to 10%.

Higher rate taxpayers who have not yet retired could also gain from the reduction in the basic tax rate. They will continue to receive tax relief at 40% on any pension contributions they make, but when they come to retire some or all of their pension income will be taxed at only 20% rather than 22%. This is a welcome additional incentive to save via a pension.

From April 2009 the ceiling for employee National Insurance Contributions (NIC) will come into line with the threshold for higher rate income tax at approximately £43,000. This could make salary sacrifice attractive for individuals earning around this level and face paying NIC on a larger slice of their income.

Salary sacrifice is a formal arrangement whereby employees agree to sacrifice part of their salary in return for their employer making a corresponding contribution to their pension. Generous employers will top-up the contribution with a payment equal to the amount they save in employer's and employee's NIC.

The Revenue will usually accept these schemes as long as they are set up correctly and the payments are regular and not one-off.

Inheritance Tax Planning

Business Property Relief ('BPR') is one of the main tax breaks available to business owners. It provides relief from Inheritance Tax for qualifying business assets which could reduce the taxable value of a business to nil.

For a transfer of property to attract 100% BPR it must relate to a business or an interest in a business or to unquoted shares in a trading company (which expression includes shares which are traded on the Alternative Investment Market). A business is defined as a trade or profession carried on for gain, so 'hobby' businesses would be excluded. Certain other types of business are also excluded, notably those whose principal activity is dealing in securities or land and buildings.

Complications can arise over mixed businesses. In the case of Farmer v IRC (1999) the issue was whether a landed estate which conducted both farming and letting activities should be eligible for BPR. The Tax Commissioner took account of the capital employed in the two parts of the business, the allocation of turnover and profit, and the time spent by directors and employees, and held that the letting of properties was subsidiary to the main farming activity and that BPR should therefore be available for the whole business.

If a business holds cash, stocks or shares, land or buildings for personal use or investment purposes, these will be left out of account for the purposes of BPR. It may sometimes be difficult to tell whether cash, in particular, is earmarked for a specific business purpose or is simply being accumulated as a financial reserve. Clearly it is vital to keep accurate records of management decisions.

Impending changes to UK statutory holiday entitlement

In April the Government completed consultation with various interested parties on its proposed new holiday provisions and is shortly due to publish its final plan for changes to employees' holiday entitlement.

The consultation set out the Government's more detailed proposals on increasing the holiday entitlement, which include:

- to phase in the additional holiday entitlement, introducing 0.8 weeks (taking an employee's holiday entitlement from 20 days to 24 days if they work 5 days a week) from 1 October 2007, and the remaining 0.8 weeks from 1 April 2009;
- to enable payment in lieu of the additional holiday entitlement (the additional 0.8 weeks) to continue until 1 April 2009. This is a temporary measure to help employers with transitional arrangements, such as recruiting and training any additional staff to cover the increased holiday entitlement
- any time off for bank and public holidays is included in the additional entitlement (e.g. if the employee already gets 4 weeks' leave plus time off for bank holidays, their holiday entitlement will not increase);
- that the holiday will be calculated on a pro-rata basis for part-time employees (4.8 then 5.6 times their usual working week), regardless of whether or not they usually work on bank holidays;
- that the increases from October 2007 and 2008 will be awarded proportionally depending on when the employee's leave year starts e.g. if their leave year starts in January, and they work a 5 day week and currently receive 20 days including bank and public holidays, they will be entitled to an additional day from October to December 2007;
- to cap the maximum statutory holiday entitlement at 28 days, although employers may give more contractual holiday than that;
- that some or all of the additional holiday may be carried over to the following leave year with the agreement of both the employer and the member of staff;
- to provide an incentive for early compliance with the regulations, whereby employers that already meet the full requirements of the regulations as at 1 October 2007 (giving the equivalent of 28 days' holiday, without payment in lieu and any carryover for no more than one year) will be taken outside of the regulations, as long as they continue to meet those requirements.
- that payment in lieu of taking holiday, apart from the transitional measure referred to above, will not be permitted except on termination of employment.

Employers currently providing their full time employees with less than 20 days holiday and 8 days of public holidays per annum will be affected when the new entitlements come into force.

For advice on the implementation of these new holiday entitlements please contact Sean Lamb at our Whetstone office.

This newsletter is for guidance only, and professional advice should be obtained before acting on any information it contains. Gerald Edelman accept no responsibility for loss suffered by any person as a result of action taken or not taken as a result of the contents of this publication.

Gerald Edelman is registered to carry on audit work by the Institute of Chartered Accountants in England and Wales and is authorised and regulated by the Financial Services Authority. Gerald Edelman Financial Solutions Ltd is an appointed representative of Genesis Financial Solutions Ltd who are authorised and regulated by the Financial Services Authority. The value of investments can go down as well as up and you may not get back the full amount you invested. The past is not necessarily a guide to future performance. If you withdraw from an investment in the early years you may not get the full amount invested. The FSA do not regulate taxation advice, inheritance tax planning, trust advice, private medical insurance, national savings and bank and building society deposits.

GERALD EDELMAN
Chartered Accountants

Partners

Michael Harris
Colin Burns
Richard Kleiner
Neil Summer
Bernard Hoffman
Howard Wallis
David Convisser
David Atkinson
Stuart Rosenberg
Stephen Coleman
Ajay Shah

Associate

Deval Patel

Consultants

Julian Fellerman
Michael Fialko

GERALD EDELMAN
Business Recovery Professionals

Partners

Ian Yerrill
Dave Murphy
(Other partners as above)

Consultant

Leslie Crowther

GERALD EDELMAN FINANCIAL SOLUTIONS LTD
Independent Financial Advisers

Directors

Graham Thomas
Michael Harris
Colin Burns
Richard Kleiner

Office Locations

25 Harley Street,
London W1G 9BR
+44 (0)20 7299 1400

Edelman House
1238 High Road,
London N20 0LH
+44 (0)20 8492 5600

Gateway House
High Point Business Village
Henwood, Ashford
Kent TN24 8DH
+44 (0)1233 666280

Unit 1, Warners Mill
Silks Way
Braintree, Essex
CM7 3GB
+44 (0)1376 569333

gemail@geraldedelman.com
www.geraldedelman.com

oakdene design & print