

A Professional Practice update following the Pre-Budget Report

December 2009

With the 50% income tax rate looming and VAT increasing to 17.5% on 1 January 2010 we were interested to see what else the Chancellor had to say to last Wednesday given all the rumours circulating in the market place. We summarise below the main announcements in last week's Pre-Budget Report (PBR) and the current key tax considerations for professional practices.

The Chancellor presented the PBR last week highlighting changes to national insurance contributions (NICs) and pension relief, and confirming that VAT will revert back to 17.5% on 1 January 2010. Usually the devil is in the detail, but on closer review, other than a raise in NIC rates and the lowering of the amount at which pension contributions for partners will be restricted, as expected the PBR did not contain anything of great impact to professional practices. The main points for firms and their partners from both the PBR and on-going tax planning advice areas follows:

Although the low rates of corporation tax for smaller companies mean that tax savings can be made at low profit levels, it is unlikely that the tax savings will outweigh the additional compliance costs unless profits exceed £45,000. This is only a rule of thumb as there are several factors to take into account, including the amount of retained, as opposed to distributed profits.

For the firm

NICs - further increases

The Government announced in March 2009 its intention to increase Class 1 and 4 NICs from 6 April 2011 by ½%, within both the main and the additional rates. Last week's PBR saw a further increase to these proposals meaning that Class 4 NICs payable by partners will increase to 9% within the main rate and 2% at the additional rate. The new rates are proposed from 6 April 2011. As a further blow, employer's NICs have also been increased to a rate of 13.8%. This rate will also be applicable to Class 1A NICs (payable on benefits in kind) and Class 1B NICs (payable under PAYE Settlement Agreements).

VAT - increase to 17.5% as of 1 January confirmed

The Government confirmed that the rate of VAT will increase to 17.5% from 1 January 2010 despite requests to delay the increase. Rumours have also circulated in recent weeks that a further hike in rates may be announced by the Chancellor. In the PBR he stated that he has no further plans to change VAT in 2010.

The continuation of tax payment spreading

The Government introduced the ability to spread tax payments at the end of last year; a move that was welcomed and utilised by a number of taxpayers. Last week's PBR saw the extension of these rules "for as long as they are needed".

Electric cars for employees

The Government's main focus in their statement is towards a greener economy announcing a 0% benefit in kind charge and no Class 1A NICs on electric cars for a 5 year period from 6 April 2010.

For the individual

Lowering of threshold for restrictions on pension relief

The Government announced in March 2009 its intention to restrict tax relief on pensions savings with effect from 6 April 2011 for people with incomes of £150,000 or over. In last week's PBR the Government announced that the income definition will include the value of any employer contributions and that the income limit will be reduced **with immediate effect** to £130,000 (before counting employer contributions). This means that more partners and senior employees will now fall into this anti-avoidance and suffer from the limited tax relief.

The Government also announced anti-avoidance provisions that may affect any partners who have participated in an employer funded retirement benefit scheme (EFRBS).

The withdrawal of the furnished holiday let rules

A number of partners have second properties which qualify as furnished holiday lets under the tax legislation. Such properties qualify for beneficial income and capital gains tax treatment (such as flexible loss relief and additional capital allowances). The PBR confirmed that these rules will be withdrawn as from 6 April 2010 with such properties thereafter being taxed under the normal property rules. However, the special capital allowance rules do continue for expenditure prior to 6 April 2010 so it is worth considering advancing expenditure where appropriate.

Gift Aid donations - under review

Although tax relief cannot be obtained by a partnership for gift aid donations, historically such donations were made by one partner and tax relief was claimed by that individual at his/her highest rate of tax. The Government have confirmed that the results of their research into the effectiveness of tax incentives of gift aid donations will be published on 15 December 2009 and have hinted that revisions may occur.

So where does this leave professional practices?

The PBR has not really changed the focus of planning for professional practice firms. In our view there continue to be **three main areas that professional practice firms should be focusing on at present:**

VAT changes

1 January 2010 sees the introduction of two main changes for professional practice firms:

- the new cross border VAT changes that come into effect on 1 January 2010. These changes will impact on the VAT accounting treatment of certain services, both supplied to and by the firm. They also bring further administration in the form of Reverse Charge Sales Lists, which must be submitted if certain cross border services are supplied. There is also a welcome simplification to the process of reclaiming VAT from other EU member states.
- the transition from the standard rate of VAT changes from 15% to 17.5%. In general, supplies that are completed before 31 December 2009 should be billed at 15% VAT, and those completed after at 17.5% VAT. There are special provisions to allow apportionment for supplies that span the rate change, and opportunities to issue VAT invoices or receive payments pre-31 December to secure the 15% rate but there are anti-forestalling provisions that seek to counter certain attempts to benefit from the 15% rate when goods or services are actually supplied post 1 January. In essence each firm should be considering billing for work undertaken in 2009 prior to 1 January 2010 to ensure that clients who cannot recover VAT suffer at the lowest rate, and the firms computer systems can deal with the 15% VAT rate. Where work spans 31 December 2009 a clear policy needs to be determined re allocating the two rates to work in progress when it is eventually invoiced.

The 50% tax rate

With the 50% tax rate due to come in next April firms should be reviewing the tax planning opportunities available to them. Current ideas that we are discussing with clients include:

- partnerships with non 31 March year ends should consider the tax saving of changing their year end to 31 March to maximise profits being taxed at 40%. This requires a detailed analysis in order to assess any consequent tax cashflow and overlap relief implications.
- tax efficient ways to remunerate both staff and partners/directors aligning reward to the commercial objectives of the business. Current ideas include aligning reward to the growth in value of the business on which the individual is subject to capital gains tax, currently at a maximum rate of 18%, rather than income tax at a rate of up to 50% (after 6 April 2010). When compared to employment income of £100,000 this would give additional net

income to the participant of £33,000 and result in pre-tax savings to the firm of £12,800 (where the participant is an employee).

- retention of working capital in a tax efficient environment to maximise the funds available to the firm.
- retirement of partners pre 6 April 2010 so that they do not fall within the new 50% regime.
- maximising the tax relief available under the UK to UK (and overseas) transfer pricing regulations when using a service company for the provision of employee services. Tax savings typically work out to be approximately £15k per £1m of payroll costs.

The 1% (previously ½%) increase in NICs

The effect of the increase in 2011/12 will be to add almost 1% to your cost of employment so why not consider alternative forms of remuneration? The good news is that, apart from the PBR targeting staff canteens, salary sacrifices in return for tax efficient benefits have not been affected. In addition to saving employer's NICs, salary sacrifice arrangements can increase employees' net pay, and this saving will only increase with the proposed increase in NIC rates in 2010/12.

Tax efficient ways of remunerating staff and partners/directors (as mentioned above) may also not be subject to employee or employer NICs and thus the combined tax and NIC savings on such alternatives can be significant.

Grant Thornton would be pleased to discuss the above tax issues with you. If you would like to meet one of our tax specialists from within our Professional Practices Group please do not hesitate to call:

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