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# BUSINESS UPDATE

Winter 2008

## Seasonal gifts

So you want to give your employees a present to reward them for their hard work. Perhaps you were thinking of a bottle of something, some chocolates or even a turkey - but are there any tax implications?

HMRC generally allow you to give minor gifts to employees for example, flowers to an employee who is in hospital, without having to report this as a perk of the employee's job through the benefits in kind system. This may even apply where all employees receive a gift, provided it is trivial and not something which can be turned into or used as money. In circumstances where an employer does need to report gifts, which are not trivial, a form P11D is used.

On form P11D the employees will end up paying tax on the value of the gift. This may not be the best way of dealing with this issue as the tax charge may leave a nasty taste. Would you want to pay tax on a gift?

Alternatively the employer can pay the tax on the gift using a PAYE settlement agreement. Do get in touch if you would like to know more about this area.

## Simplifying corporate life

The ongoing implementation of the Companies Act 2006 (the Act) continues and three key dates (1 October 2007, 6 April 2008 and 1 October 2008) have now passed. Therefore this is an opportune moment to take stock of the changes introduced and to consider how they have benefited private companies.

### Everyday administration

Changes have been made to the rules that dictate formal company meeting and communication procedures. As of 1 October 2007, private companies are no longer required by the Companies Act to:

- Hold annual general meetings (AGMs);
- Lay accounts and reports before the company in general meeting. Instead these documents can simply be circulated to those entitled to receive them before they are due to be filed at Companies House. In a further simplification, where shareholders agree, such documents may be circulated electronically, as can resolutions.
- Re-appoint auditors annually.

Auditors will be deemed to be re-appointed for the following year unless steps are taken to end their appointment, therefore removing the need for an annual re-appointment resolution.

Other changes also took effect from that date. For example, it has become easier to make company decisions by written resolution. Such resolutions no longer need to be signed by all shareholders. Instead where an ordinary resolution is being passed, a simple majority of the voting rights is needed, with a 75% majority needed for special resolutions.

Should a private company wish to convene a general meeting on short notice, it may now do so with the agreement of those holding 90% (previously 95%) of the voting rights.



### Going it alone

As of 6 April 2008 private companies are no longer required by the Act to have a company secretary, although they may continue to have one if they wish. This means that it is now possible for a private company to be owned and formally run by a single individual. Previously all private UK companies were required to have a minimum of two officers, including a director and a company secretary.

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## Simplifying corporate life continued...

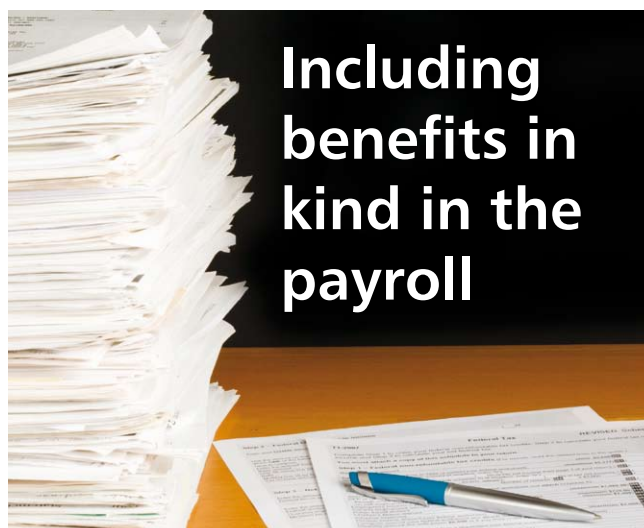
### Capital reductions and financial assistance

As of 1 October 2008 there is a new procedure available to private companies wishing to reduce their share capital. This involves directors' solvency statements rather than a court order. The restrictions under the Companies Act 1985 on financial assistance by private companies for the acquisition of their own shares have also been repealed with effect from this date.

### A word of caution

The changes made are intended to make it easier to run a company. However, some existing companies may find themselves with rules established by their Articles of Association that expressly require them to continue with certain, now potentially out-dated procedures, for example, to hold an AGM. Articles should be reviewed and, if it is considered appropriate, amended to take advantage of the new simplified rules.

If you require further information please contact us.



Late last year HMRC issued a consultation paper on this subject. The stated aims for introducing payroll of benefits in kind are supposedly to:

- reduce administrative burdens and make compliance cost savings for businesses through simplification of the process
- provide a better experience for employees, through improved clarity over the tax treatment of their benefits in kind and expense payments
- increase HMRC processing efficiency
- remove the uncertainty for employees and HMRC arising from current arrangements.

Whilst HMRC would make substantial cost savings from not having to process forms P9D and P11D each year, this would be at the expense of employers, who would effectively have to do this work instead via the payroll.

The proposals raise a myriad of concerns regarding complexity and costs that would be passed to employers. Whilst one of the supposed aims is that of reducing administrative burdens for employers, compulsory payroll seems likely to increase them, especially for small employers.

There have been many objections to these initial proposals but HMRC are keen to press ahead.

We will, of course, keep you informed of further developments.

## Change for Charities!

Already we have seen that the statutory audit thresholds in England and Wales were increased for accounting periods commencing on or after 27th February 2007 (effectively 31st March 2008 year ends). Also the 6th Commencement Order to the Companies Act replaces the Accountants Report regime with the Independent Examination regime for accounting periods commencing on or after 1st April 2008 (effectively 31st March 2009 year ends).

Now, after proposals from the Charity Commission and a period of consultation, the Government has announced their response and plan to change the following thresholds for accounting periods commencing 1st April 2009 (effectively 31st March 2010 year ends):

- Submitting annual accounts and Trustees' Report to the Charity Commission
  - Increase from £10,000 to £25,000.
- Preparation of accruals accounts for non-company charities
  - Increase from £100,000 to £250,000.
- Requirement for audited accounts
  - £500,000 income threshold retained (despite proposal to increase to £1,000,000);
  - Asset threshold increased from £2,800,000 to £3,260,000.

These changes apply for all charities registered in England and Wales.

## That service company question...

Some of you may have noticed the rather strange question which appeared on this year's tax return for individuals relating to service companies. HMRC have now amended their guidance on this question.

HMRC acknowledge that, with hindsight, the question on the tax return and original guidance was unclear. The updated guidance for 2007/08 onwards reads:

'Complete this box if you provided your services through a service company. You provided your services through a service company if:

- you performed services (intellectual, manual or a mixture of the two) for a client (or clients); and
- the services were provided under a contract between the client(s) and a company of which you were, at any time during the tax year, a shareholder; and
- the company's income was, at any time during the

tax year, derived wholly or mainly (that is, more than half of it) from services performed by the shareholders personally.

Do not complete this box if all the income you derived from the company was employment income.

If the 2007/08 tax return has already been submitted, there will be no adverse consequences simply because the taxpayer completed (or left blank) the question in a return filed prior to 5 September.'

Whilst the reason for the question is still not entirely clear, at least the guidance is. It remains to be seen what HMRC do with the information they glean from this!

# Dragon-flies away

Some of you may remember that the service company rules, commonly known as IR35, were introduced in April 2000 amidst much fanfare from the government and HMRC.

HMRC was concerned that individuals were able to avoid becoming an employee of a business by working for that other business via their own company or partnership. This meant that they could avoid going 'on the books' of that organisation and both parties were able to save tax and national insurance into the bargain!

The IR35 rules were designed to look through all intermediaries, such as the worker's own company or agencies, that might find work for their company. The rules ignore these intermediaries and look at the relationship between the worker and the payer. If this relationship would otherwise be an employment relationship, then the IR35 rules effectively impose PAYE rules on the worker's business. This essentially means that any tax and national insurance advantages for the worker are substantially reduced.

So it is essential that any relationship between the worker and the ultimate payer is one of self employment, not employment. There are many factors to consider but some of the important ones are:

- How much control does the payer have over how, when and where the work is carried out?
- Is there a genuine right for the worker to send a substitute in their place?
- Is there an ongoing understanding that the payer will continue to offer work and the worker will continue to accept it?

## A milestone case

HMRC took a long time to get out of the blocks but the last 12 – 18 months has seen a glut of IR35 cases in the courts. A recent case which has caused much concern is that of Dragonfly Consulting. Mr Bessell, an IT consultant, provided his services through his company (Dragonfly), via an agency, to the AA.

The contract between the AA and the agency specified the general terms which would apply, including invoicing and payment arrangements. Two of these schedules also named Mr Bessell as the person who would perform the work.

The courts held that there was nothing to indicate that Mr Bessell would have been in business on his own account. The AA had a sufficient right of control to have had an implied contract of service with him.



One major problem was the inability of Mr Bessell to show that he had a genuine substitution clause in the contract. Although the agency could have provided a substitute, Mr Bessell's company could only do this with the agency's prior written consent. Such a limited right of substitution was not compatible with a self employment relationship.

Although none of the parties had intended for the contract to be one of employment, their intentions could not alter the true legal effect of the relationship.

If you believe that this decision may affect you, please do get in touch to discuss what action can be taken.



# Enhancing Expenditure... rich in relief

Enhanced capital allowances of 100% are allowable for expenditure on certain designated energy saving plant and machinery. These have been available for a number of years but the eligible products list continues to expand as technology advances and government continues to encourage green innovation.

## What is energy saving equipment?

Qualifying equipment includes:

- combined heat and power plant
- boilers
- motors and drives
- lighting systems
- refrigeration equipment
- water efficient taps and toilets.

Further additions are updated regularly and details of all of the qualifying technologies can be found at [www.eca.gov.uk](http://www.eca.gov.uk)

Businesses purchasing relevant equipment can establish whether the equipment qualifies by obtaining a certificate from the manufacturer or via the website.

## Why it is important?

Expenditure which qualifies for an enhanced capital allowance obtains a complete write off reducing profit for tax so providing a tax cash flow saving. Such allowances are available in addition to the general Annual Investment Allowance (AIA) of £50,000 introduced for businesses from April 2008. As the AIA itself allows a 100% write off on all types of plant expenditure (excluding cars), the combined value of the AIA and 100% enhanced allowances is attractive to businesses of all sizes.

## Turning tax relief into cash

For companies that invest in qualifying energy saving equipment, a new provision will enable them to convert the tax relief into a cash refund. This will be available where enhanced capital allowances create a tax trading loss. There are certain conditions which apply but the essence is that a company will have the option to convert the loss at a rate of 19% into a cash refund. Whilst this is not as tax effective as carrying the loss forward against a future profit where the likelihood is that tax will be saved at a higher rate, the availability of an earlier cash boost may be welcome.



# Investing in Customer Relationships

Whatever the economic climate the need to focus on providing exceptional customer service should always be high on your business agenda, even if your business is doing well.

## Why is Customer Relationship Management (CRM) so important?

- Research suggests that it costs between three and ten times as much to replace lost customers than to keep them.
- The average business loses 10% of its customers each year.
- A 2% increase in customer retention has the same effect on profits as cutting costs by 10%. Research conducted in 2003 showed that a 5% improvement in customer retention can increase business profits by 25% – 125%.
- There is a 60 – 70% probability that existing customers will buy more products/services from you. This drops to 5 – 20% when attracting new customers.
- Profitability rates are likely to increase over the life of a retained customer.

## Six steps to help improve your CRM

### Keep in touch with your clients

If they have recently placed an order or you have provided a service, ask for feedback. Caring about satisfaction levels speaks volumes about your business. If you haven't heard from them for a while, check to see how you can help them.

### Apply the 80:20 rule

Concentrate on your top 20% of customers, as they may account for up to 80% of your income. Regularly review the products/services that provide 80% of your income. Look through the eyes of your customers to consider how they can be improved and developed.

### Prompt service

A prompt response to an order or enquiry shows your commitment to provide a high level of service. Even if the news isn't good (ie an out of stock item or delayed service) keep the customer informed. The delivery date may not be as important as the service they expect from a provider. They will often be willing to plan around you, as a trusted provider, rather than go elsewhere.

# Employees who work from home

Government changes to encourage flexible working and developments in modern technology have allowed increasing numbers of employees to carry out some or all of their duties from home.

However, as always, HMRC are not quite so generous in allowing tax relief on the costs of working from home. There are generally two ways of attempting to obtain some relief for these home-working costs:

- payments from employers to employees may be made tax free under certain circumstances
- tax relief may be claimed by the employee on certain costs they incur under certain circumstances.

## Tax free payments from employers

This exemption only applies to payments made by the employer. Where the employee works at home regularly under an agreed home-working arrangement then payments may be made tax free. The arrangements need not be in writing and do not need to apply to all employees. However, this exemption does not apply where an employee works at home informally; for example, where an

employee takes work home in the evenings.

Exempt payments can be made to meet or reimburse reasonable additional household expenses that an employee incurs in carrying out their duties at home, such as the additional costs of heating and lighting the work area or the metered cost of increased water use. There might also be increased charges for internet access, home contents insurance or business telephone calls.

Of course, it can be difficult to calculate the exact amount of those additional costs, so from 6 April 2008 HMRC will allow payments of £3/week to an employee without the employer having to justify the amount paid. If the £3 guideline rate is paid the employee does not have to keep any records to demonstrate the additional expenditure. More can be paid if detailed records of costs are kept.

## Tax relief on costs

In order for an employee to obtain a deduction for a household expense it must be demonstrated that the expense has been incurred wholly, exclusively and necessarily in the performance of the duties. HMRC will only accept that those conditions are met where:

- the duties that the employee performs at home are substantive duties ie the central duties of the job; and
- those duties cannot be performed without the use of appropriate facilities; and
- no such facilities are available to the employee on the employer's premises (or the job requires the employee to live so far from the employer's premises that it is unreasonable to expect them to travel to those premises on a daily basis); and
- at no time either before or after the employment contract is drawn up is the employee able to choose between working at the employer's premises or elsewhere.

As these tests are very strict, few employees will be able to satisfy them. If all of the tests are met, then tax relief may be claimed as follows:

- on actual additional costs where records are maintained or
- by claiming the £3/week flat rate as an expense deduction.

## The moral

HMRC are not keen to allow employees to work from home and cover some of their costs tax free. The rules can be complex and care should be taken to make sure all the relevant conditions are met. Please do get in touch if you would like to discuss this area further.

## Pick up the phone

If most of your communication is by email, pick up the phone. Personal interaction is important in building relationships and through conversation you might find out how you can help them further.

## Welcome complaints

If something is wrong you need to know. What if a number of your customers feel the same but instead of complaining simply take their business elsewhere? Look at how you can resolve issues and act promptly. Consider what action you need to take to stop a problem being repeated. This should result in improved service and customer retention. So make a bad situation a positive one.

## Listen, listen and listen

Listen to your clients' needs. The more you get to know them, the more you will be able to provide them with. If you can't help them, can you recommend anyone? They will remember you and make you their first point of contact. Listen to what they say. If they mention they are going on holiday or have an important event in their diary, make a note to ask them about it next time.