to produce accounts and for tax purposes. We would recommend a detailed reading of Notice 733 and a reworking of the last four VAT returns to compare the actual liabilities with what they would have been using the flat rate scheme.

As good as their word?

A VAT consultant has related the circumstances of a client who was denied a VAT repayment after Customs had previously confirmed in writing that she was entitled to it. He compares this to a prize winner on the television show 'Who wants to be a millionaire?' leaving the stage with a large cheque only to be recalled by Chris Tarrant and told that one of the earlier questions had been answered incorrectly and now the cheque must be handed back.

The client had obtained a written ruling from Customs confirming a VAT rebate backdated three years and inviting her to claim the repayment by submitting a voluntary disclosure. The disclosure was submitted but the repayment of around £13,000 was not made. Four months later another letter was received from Customs stating that they had changed their minds and no rebate was due.

This decision was appealed on the basis of a parliamentary statement in 1978 when Robert Sheldon, Financial Secretary, stated 'when an officer with the full facts before him, has given a clear and unequivocal ruling on VAT in writing, the Commissioners would only apply the correct ruling from the date the error was brought to the attention of the registered person concerned'. On the basis of this Customs were entitled to change their mind for supplies made after the second letter but should have been bound in honour to carry out the promise of the first letter. Surely Customs could be relied upon to keep their word?

Appeals through local channels produced nothing and the case was then taken to the Customs adjudicator. Customs argument was that their job was to ensure that the correct VAT law was applied at all times and if they got their decision wrong in the first instance they were perfectly entitled to a second crack of the whip in order to finish with the proper outcome. Furthermore, because the client had not received the money promised there was no financial disadvantage suffered by the revised decision. The adjudicator agreed and the appeal was dismissed. However Customs did offer to pay all costs incurred as a result of their initial poor advice.

(Neil Warren of Keens Shay Keens in Tax Adviser May 2002)

Advice: This story really does put Customs in a bad light and it now seems that written rulings can no longer be relied upon. Presumably we must still obtain written rulings but then cross fingers and hope that there is no retraction until any money due or liability has been settled.

EMPLOYMENT TAX

86.5 per cent tax on PAYE settlement agreements

When PAYE settlement agreements (PSAs) were first introduced they were widely welcomed as a flexible solution to a payroll problem. A PSA assists where benefits cannot accurately be apportioned amongst individual members of staff, payment is deferred until October after the end of the tax year but the employer is not forced to use a PSA if it does not wish to. In practice many employers are using PSAs and the Revenue is accepting them in relation to ever larger items.

However, the employer probably does not realise that because of grossing up and the incidence of employers' NIC a PSA can produce an effective rate of tax of 86.5 per cent. Consider the example of £10,000 of benefits included in a PSA for 2001/02.

	£
Notional tax (40%)	4,000
Grossed up (100/60)	6,667
Class 1B NIC (10,000 + 6,667) @ 11.9%	1,983
Total	**8,650**

Effective rate on £10,000 = 86.5%

If the benefit of £10,000 included VAT which was recoverable in full by the employer, the net benefit cost to the employer would have been £8,510. In that case the PSA total tax and NIC of £8,650 becomes over 100 per cent of the net cost of the benefit. Small wonder that the Revenue is keen to promote PSAs.

(Tolley's Practical NIC March 2002)

BUSINESS TAX

IR35 – Right of substitution

The case of Express and Echo Publications Limited -v- Ernest Tanton [1999] IROR 367 clarified the requirement for a worker to provide personal service. The case demonstrated that if the worker does not have to conduct his task personally but can hire a substitute to carry out the work, the relationship is inconsistent with employment and the worker will be treated as self employed irrespective of any other factors such as control.

However, there are three important caveats:

- the right to supply a substitute must be genuine.
- the client must not have an unreasonable veto over the substitute.
- the worker must hire and pay the substitute.

If the worker simply introduces another worker who the client can take on this does not amount to the true provision of a substitute.

(IBC Conference Point by Patrick Way reported in Taxation 31.1.2002)

Farming and non-farming income

Farming is a unique industry and there are some equally unique tax reliefs exclusively related to the business of agriculture. Examples are farmers averaging, the five year rule for losses (recently temporarily extended), agricultural property relief, reliefs in respect of farmhouses and the treatment of farming as 'one trade'.

However, following the recent problems suffered by the industry due to the foot and mouth epidemic, many farmers are finding that the returns from agriculture are no longer adequate to support living expenses. They are therefore turning to alternative types of farming and other uses of their land and buildings to create income. It now therefore becomes important to ensure that the different types of income are clearly identified in accounts and split between farming and non-farming activities.

Farming is defined as 'the occupation of land wholly or mainly for the purposes of husbandry'. Activities treated as farming

can include 'set aside', grazing income, short rotation coppice and farm shops selling the farm's produce. Excluded from farming activities are letting of land for 365 days or more, horse grazing, crops growing naturally, letting industrial units, quota leasing and share farming with minimum return.

Many accountants are just preparing Schedule D Case I computations based on total profit or loss with no accurate allocation of expenses and income between farming and non-farming activities. Quota leasing and horse grazing fees may well be inflating profits for the purposes of the five year rule. It is also important to think ahead to consider the commerciality of the farm and its business status. Clients will want to preserve agricultural property relief or business property relief and for capital gains tax purposes will want to ensure that business taper relief and rollover relief are preserved.

(Julie Butler of Butler & Co in Taxline March 2002)

Construction industry tax changes

In the past companies suffering deductions from their income as subcontractors had to wait and eventually use the tax deductions to reduce their final corporation tax bill nine months after the end of the financial year. From 6 April 2002 they can instead set these deductions against their monthly or quarterly PAYE/NIC remittances and against any CIS deductions made from payments to their own subcontractors.

It should be stressed that the ability to set off tax deductions in this way applies only to companies and is not available to individual subcontractors or partnerships. The Revenue explains that for the majority of individuals and partnerships operating in the construction industry the 18 per cent CIS deductions approximates to the eventual tax liability for the year. However, for small company subcontractors the tax deducted is in most cases far higher than the eventual corporation tax liability. Companies are therefore being allowed to use their deductions at an earlier stage.

The new system will work on a tax year basis. Any CIS deductions made in any month or quarter can be set off against PAYE/NIC and CIS tax due to be paid over to the Revenue for the same period. If the CIS deductions fully cover any tax due a nil payslip must be submitted to the Accounts Office and any balance of CIS deductions is carried forward to the next pay period. If the CIS deductions are insufficient to fully cover the PAYE etc due then the balance is payable to the Revenue on the normal due date i.e. 19th of the following month. Companies must keep a record of the amounts set off and the Revenue has produced a form CIS 132 which can be used for this purpose.

At the end of the tax year any CIS tax deductions which have not been set off against other liabilities will be repayable by the Revenue. It is important to note that the link with corporation tax has been broken and there will no longer be any automatic set off of surplus CIS deductions against corporation tax bills. The CIS tax will be repaid once forms P35 and CIS36 have been received. Companies can still ask for the repayment due to be set against other liabilities but there will be no formal automatic set off against corporation tax. Any CIS deductions which have been made up until the new arrangements commence will still be set against corporation tax.

(IR Budget 2002 Question and Answer Briefing 26.4.2002)

Losses – Budget confusion

A number of commentators, including ourselves, were confused by the Budget announcement that trading losses set off against capital gains of the same or previous tax year are in future to be set off against gains before taper relief rather than after as at present. In our comments on page 4 of last month's *Small Practitioner* we could not see how this could be heralded as an improvement to loss relief because the new treatment would result in more loss relief being used up to extinguish the gain and less available to be carried forward.

It has now been pointed out that the Revenue is indeed correct and taxpayers will be better off. Under the existing rules the maximum trading loss which can be set against chargeable gains is the amount of gains as reduced by taper relief. Having established that amount it is then converted into an allowable loss but set against the gross gains **before** taper relief as indeed are other allowable losses. The outcome of this process is that the trading loss is not fully used yet some of the gains remain chargeable. It is this strange consequence which is now corrected by the new Budget provision. This indeed benefits the taxpayer.

(Maurice Parry – Wingfield quoted by Malcolm Gunn in Taxation 2.5.2002)

PERSONAL TAX

Earnings Cap

The Pension Schemes Office has updated its guidance following a change in view by the Revenue as to the application of the earnings cap where an individual has nominated a basis year to support higher contributions for a later year. Previously it was the Revenue view that the net relevant earnings of the basis year were subject to the cap which applied in the basis year.

From 23 April 2002 a basis year can be nominated to support contributions in a later tax year and the cap to be applied will be that applicable to the later year. As a result, it will not be necessary to re-nominate the basis year every year purely in order to take advantage of the increased cap each year.

(Pension Schemes Office Press Release 23.4.2002)

Pensions catch up for part timers

It has recently been decided in the courts that part time employees who had been denied access to occupational pension schemes can claim retrospective rights back to 8 April 1976 or to the date that employment started if later.

Employer contributions to fund back service will be deductible for tax purposes in the normal way. Employee contributions to catch up may be made as a single contribution or as ongoing contributions. Both will attract tax relief but subject to the limit of 15 per cent of remuneration in the tax year in which the contribution is made. There are no provisions whereby the Revenue can apply a higher limit in these circumstances. Although scheme rules will normally not allow the payment of contributions in excess of the tax relief limit, the Revenue will not object in these specific circumstances and scheme rules can be amended accordingly. However, tax relief will not be given on the excess over the 15 per cent limit.