income must include the amount that could have been charged. The claimant is also deemed to have received any income that he has deprived himself of for the purposes of obtaining tax credits.

It is vitally important to note that apart from claims made in advance of 6 April 2003, claims cannot be made before the entitlement arises. They must then be made within a tight deadline of three months from entitlement and as claims can only be backdated by three months any failure to claim on time will give rise to a loss of tax credits. For entitlements commencing 6 April 2003 the latest claim date is therefore 6 July 2003 to avoid loss of entitlements. This is to be contrasted with the previous children's tax credit where 2002/03 claims can still be made up to 31 January 2009.

The first claim will be based upon income for 2001/02 and will subsequently be corrected to the actual income for 2003/04 in due course. It will also be possible to claim based upon estimated income for the actual year of a claim with amendment to actual at the end of the year. At the end of each year, renewal claim forms will be sent out asking for details of income for the year just ended and representing the claim for the subsequent year. Accordingly, the 2004/05 claim will be based upon the income of 2003/04. The form will require signature by both claimants and will need to be submitted by 5 July 2004. If income is unknown at that date, as is likely to be the case for self employed persons, an estimate will be required with subsequent correction to actual.

Needless to say there are penalties for fraudulent or negligent claims. These penalties are up to a maximum of £3,000 per offence. For failure to file the initial penalty will be up to £300 but daily penalties of up to £60 per day can be incurred if the failure continues.

(Peter Gravestock in Tax Adviser October 2002)

Advice: ***Practitioners need to be familiarising themselves with the ins and outs of the new claim forms and should be informing their clients of the additional work that will be involved. They will effectively be preparing two tax returns but clients may be unable or unprepared to pay additional fees. For self employed clients to avoid losing benefits it may be necessary to move to, say, a 30 April year end, finalise the accounts rapidly and make a claim by 5 July. Letters of engagement should make very clear whether or not you are to deal with tax credit claims and deadlines for supplying information should be clearly set out. Other potential problems are looming – fines and criminal sanctions for fraudulent or negligent claims are to extend to anyone acting on behalf of someone else, putting tax agents in the firing line.***

Interest relief on loans to companies

Where an individual takes out a loan to fund the trading activities of his unincorporated business tax relief is available by including the interest in the sole trader accounts or, in the case of a partnership, by deduction claimed in the tax return. Where there is excess unrelieved loan interest it can be carried forward against the share of future trading profits from the partnership.

However, in the case of money raised to inject into a limited company there would appear to be no provision for the carry forward of excess interest where perhaps there is little or no taxable income in the year that the interest is paid. This can often be the case in the early years of trading when there may be little or no remuneration or dividends from the company.

The answer would appear to be that the individual should consider charging interest on the loan to the company. In this way, if the interest charge equalled the interest paid there would be no net tax charge created on the individual and the interest charge would effectively roll up within the company where relief should eventually be obtained one way or another under the loan relationship rules.

(Adapted from Readers Forum item in Taxation 5.9.2002)

Pensioners shouldn't rely on the Revenue

The PAYE system often struggles to cope with multiple sources of income and it is particularly important to be aware of this in the case of someone with, say, state retirement pension, an army pension and a pension from former employment. It is extremely unlikely that the total tax deducted will equate to the true liability for the year.

In other cases, there may be just a small pension which is insufficient to utilise all tax allowances and investment income which suffers tax at source. In the past, the Revenue would have issued a tax return and invited a repayment claim. However, it would now appear that returns are not necessarily issued unless the taxpayer writes in to claim a repayment. If full details of the income for the year are given in the letter the Revenue will often make repayment without requiring a formal tax return but, nevertheless, it is up to the individual to ensure that repayments are claimed.

(Item from Small Business Tax and Finance quoted in TaxLine September 2002)

Advice: ***Ensure that clients in these circumstances are flagged up on your database or client index for review each year even if a tax return has not been issued by the Revenue.***

CAPITAL GAINS TAX

Small disposals

Since business asset taper relief came into full effect from April 2002 it is important to consider the interaction of other capital gains tax reliefs and whether these remain beneficial. One relief in particular to consider is the rule for small part disposals of land under s 242 TCGA 1992.

If three conditions are satisfied it can be claimed that the sale proceeds are not treated as a disposal for capital gains tax purposes but are instead deducted from the cost price of the land to be used on a future sale. The conditions to be satisfied are as follows.

1. The proceeds must not exceed £20,000.
2. The total proceeds of all sales of land in the year must not exceed £20,000, and
3. The proceeds must not represent more than 20% of the market value of the total of the land at the date of sale.

Before claiming small part disposals treatment it should also be checked whether annual exemptions can be used, especially if a piece of land is being sold by a partnership. The business taper relief calculation should be looked at carefully and there could be significant advantages by not claiming the small disposals relief if a higher base cost is required for future use.

There are no hard and fast rules. Matters to take into account will include whether the base cost might be used in future and that there is a tax free uplift on death. If the land is to be held until death the effect on future base costs may be irrelevant. On the other hand, clients who expect to make a further disposal will need to consider how they could use the base cost and how this would interact with future taper relief.

(Contribution by Julie Butler in TaxLine September 2002)

BUSINESS TAX

Revenue attacks barristers' slush funds

A leading legal professional journal believes that barristers are leaving themselves open to investigation by the Revenue by not declaring cash reserves. The problem arises because barristers have been claiming tax relief in full on their contributions towards their chambers' running costs. These contributions are often calculated as a percentage of their earnings. However, a significant element of these charges may not yet have been expended by the chambers and may be held in reserve. In other cases, tax relief has been claimed in full without a proper analysis having been done to attribute the disallowable expenditure incurred by chambers on entertaining or capital expenditure.

Those who have been properly advised will have set their chambers up as either a limited company or a trade protection association but apparently these only comprise a small minority. Contributions to the company or TPA are fully allowable and any surpluses are taxed at corporation tax rates within the company or TPA.

(Accountingweb 1.8.2002)

Advice: ***If you act for barristers whose chambers have unexpended reserves they should consider forming a limited company or*** TPA. ***It may be possible to transfer any unspent reserves into the company or*** TPA ***and agree with the Revenue for these to be treated as additional contributions in the first accounting period.***

IR35 change – VAT on expenses

A review of the Revenue's Employment Status Manual reveals various updated paragraphs in relation to status. However, there is also an important change to the IR35 section at paragraph ESM3000.

The Revenue had previously confirmed that the expense figures to be deducted in the deemed payment calculation should be inclusive of VAT. However, this is no longer the Revenue view. Paragraph ESM3162 now states "where the intermediary is registered for VAT, use the net expenditure exclusive of any VAT".

This is a change of practice which ought to have been widely publicised. No doubt the Revenue will seek interest and penalties if it finds that computations have been prepared on the old basis. Nevertheless, it should be noted that the legislation does not cover this point and ESM3162 is simply the Revenue's opinion.

(Mark Morton of Mercia Group Limited in Taxation 12.9.2002)

Mind the GAAP

Four years ago the Finance Act 1998 s.42 introduced a new requirement that in computing the profits of trades and professions accounts must be drawn up on a basis which gives a true and fair view.

Section 103 FA2002 now replaces this with a requirement to draw up accounts in accordance with generally accepted accounting practice (GAAP). GAAP is defined to mean generally accepted accounting practice with respect to accounts of UK companies that are intended to give a true and fair view and this meaning as it applies to UK companies is to be applied in the same way to individuals, entities other than companies and companies that are not UK companies.

Care should therefore be taken to ensure that accounts on which tax computations are based have been drawn up to comply with applicable accounting standards and will stand detailed scrutiny on this basis.

(TaxLine October 2002)

Capital allowances on incorporation

Although capital allowances on incorporation are often relegated to minor peripheral status, they can often be a source of significant tax savings if the adviser has a thorough grasp of the principles.

With the notable exceptions of expensive cars and short life assets, most plant and machinery is pooled with writing down allowances of 25% on the reducing balance. On cessation there is no writing down allowance in the final period. Instead, a balancing charge or allowance is computed. Similarly, there are no first year allowances available in the cessation period of account. It is, however, possible to avoid the balancing allowance or charge if a joint election is made to transfer tax written down values. The following examples show how many people get the calculation wrong and how to do it correctly.

Assume a sole trader with accounts prepared to 31 March each year who decides to incorporate on 31 December 2001. The written down value of plant at 31 March 2001 was £8,000. In November 2001 a new piece of plant was bought for £2,000 and in March 2002 the new company sold plant for £200 and bought new machinery costing £3,000.

Incorrect calculation

Sole trader		£
WDV 31.3.01		8,000
Addition		2,000
		10,000
WDA 25% x 9/12		(1,875)
WDV 31.12.01		8,125

Newco		£
WDV brought forward		8,125
Proceeds		(200)
		7,925
WDA 25% x 3/12		(495)
		7,430
Addition	3,000	
FYA 40%	(1,200)	1,800
WDV 31.3.02		9,230
Total allowances		£3,570

Correct calculation

Sole trader	£
WDV 31.3.01	8,000
Addition	2,000
WDV 31.12.01	10,000

Newco	£
WDV brought forward	10,000
Proceeds	(200)
	9,800
WDA 25% x 3/12	(613)
	9,187