TaxZone Newthwire

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Editorial Note

A good proportion of every accountant's portfolio consists of small companies, often 'one man' or husband and wife operations. This wire contains a checklist of points, some of which are obvious and others less so, that the accountant should consider when dealing with the tax affairs of each of his small company clients.

Regards

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Disclaimer

Ten Points for Small Companies

Books and records

Persuading the client to keep good books and records is vital. Not only is it a requirement under the Companies Acts, but it is now mandatory under the tax code. The company record-keeping requirements in paragraphs 21-23 of Schedule 18 to the Finance Act 1998 mirror those of section 12B, Taxes Management Act 1970 relating to an unincorporated business (see Newthwire no. 44).

The relevant books and records must be retained for six years from the end of the accounting period, and the maximum penalty for defaults that can be imposed by the Inland Revenue is 3,000 pounds.

In most instances a formal audit will not now be required, so that the function of the accountant is to prepare accounts in accordance with the format laid down by the Companies Acts, and to deal with tax computations etc. A 'carrot' that may interest the client is that, if he or she keeps a good set of books, then this will be reflected in the amount of fee charged.

Accounts and Returns filing

In most instances, and subject to the engagement letter, it will be part of the duties of the accountant to submit the accounts and CTSA return CT600 to the Inland Revenue. In connection with this aspect the following points should be borne in mind:

- Do the accounts comply with the Companies Acts, SSAPs & FRSs?
- Has the CTSA return CT600 been completed correctly, and has it been signed by the company secretary?
- Does the accountant have a reminder system so that it is ensured that the accounts and return are filed on time?
- The same applies to potential claims. Have the appropriate time-limits been observed and noted?
- Has the accountant considered the advisability or not of changing the company year-end?
- Has full consideration been given to the company tax liability and opportunities for tax-mitigation? This can include the first 10,000 pounds of profits, small companies rates and bonuses to directors, dividends and other distributions (see later discussion under tax planning)?
- Have any unusual factors been explained to the Inland Revenue in the 'white space' of the return or accompanying letter? Has the accountant examined the accounts critically to determine whether they are susceptible to Revenue Enquiry? Has there been any failure in accounts disclosure that could be picked up by the Revenue?
- Has the client company been informed of the CTSA penalties that can be imposed for late filing of accounts and returns? Also the penalties for the submission of accounts fraudulently or negligently drawn.

Payment of tax

It will be the duty of the accountant to advise the company client of the amount of corporation tax and the date that it is due. It is essential that the client company is aware of the interest on tax that will be imposed if late payment of corporation tax is made.

Ideally, the client will have been informed at an early date of the corporation tax due 9 months after the end of the accounting period. This aspect is a good reason for both client and accountant to keep up to date with accounts preparation.

Directors Current and Loan Accounts

Part of the education given to the client by the accountant will be to explain that a company is a separate legal entity to the shareholders and directors, even though they believe that the business is 'their company'. It is amazing how difficult this message is to spread, and it seems that even some chief executives of large quoted companies regard company funds as available to them.

The sequel to this to warn the shareholders and directors about the operation of section 419, Taxes Act 1988, and the notification that has to be made to the Revenue on form CT 600A and tax and possibly interest paid if the current or loan accounts go into debit. A common fallacy is that, if the loan account goes into debit, then this can be remedied by voting remuneration or dividends at the end of the accounting period. The client should be disabused quickly about this.

Although this may be idealistic, the best procedure is to try and persuade the client only to draw money from the company personally through:

- Drawings from existing loan account credit balances;
- Net remuneration subject to PAYE, or

- Dividends duly minuted and approved in general meeting.

If the client is unwilling to comply in this area, he or she should be warned that a section 419 default could easily lead to a full CTSA enquiry with all that that means. At the very least personal expenditure should be identified separately in the cash book of the company.

A Payroll Health Check

Although a CTSA enquiry is, hopefully, only a possibility, a certainty is that at some stage the company will receive a PAYE Audit and/or Schedule E Compliance Visit. The results of such operations can be extremely costly to any company.

The best defence is therefore to institute a PAYE Health Check at least once a year, and this can be carried out by the accountant. Not only will it benefit the company, but it will also be a source of additional fees for the accountant.

This is boring and routine work, but actions such as checking the operation of the PAYE system, and ensuring that end of year returns are completed correctly with all relevant information, are important. The client company should also be informed about the importance of prompt payment of PAYE and the filing of the annual PAYE return.

The accompanying forms P11D and P11D(b) are also important, and this may be another area where the practitioner actually performs the work. Now that these forms must be prepared on a fiscal year basis, the complications are obvious where the company accounts year does not correlate. It is important that all the relevant benefits are taken into account, including car benefits and private health insurance.

Once again this is an area that is susceptible to Inland Revenue imposition of interest and penalties. The penalties for late or incorrect forms P11D are particularly savage, and this is an area where many companies need help. The possibility of a dispensation for a small company may be less likely, but should be borne in mind. The company might also like to consider a PAYE Settlement Agreement, although this may be unusual for a small company.

The client should be advised about procedures if a PAYE audit is notified to him. Ideally the accountant should be present (although this will cost). In any case the PAYE Auditor should only have access to those books and records that are directly concerned with his or her audit. If possible, the auditor should be housed in a room away from the accounts department, and only those questions directly relevant to the audit should be answered. It is particularly important that no member of management or staff becomes involved in a general and informal discussion about the business. The auditors are on official duty!

The National Minimum Wage

Businesses are accountable to substantial government regulation. Health and Safety is beyond the scope of this wire, but one area that is also 'policed' by the Inland Revenue is The National Minimum Wage.

Practitioners may be surprised to learn that the Department has the power to carry out a NMW investigation, and to impose penalties etc. Companies should therefore make sure that they are complying with the law in order to avoid problems.

Pension arrangements

Private pensions, currently and deservedly, have a bad press, but nevertheless are still tax-efficient in many circumstances. There may also be hope of a recovery in the equity stock market.

The directors of a small company have the opportunity to investigate the formation of an executive pension scheme for themselves. This could also incorporate a death-in-service benefit. More sophisticated arrangements are available, and could involve a small self-administered scheme. Whatever is decided, the company should obtain the appropriate advice from an independent financial adviser.

In some instances, where the company has employees who have served for a period, the directors may consider the formation of an employees' pension scheme. These days this is likely to be a money purchase scheme.

The alternative to the above suggestions is the personal pension scheme, equally applicable to employees and directors. Once again the appropriate advice from an IFA is vital.

Motor vehicles

A current enigma is the business motor car. In an attempt to curb the number of vehicles on the road, the Chancellor has attempted to impose draconian legislation in the form of the current benefits-in-kind regime.

This is another area where the professional adviser is involved in terms of advice. Should the business motor vehicle(s) be owned by the company, with all that that means in terms of benefits-in-kind, or should the directors own vehicles personally and charge the company for mileage under the relevant FPCS rates?

Such a decision also involves capital expenditure and cash flow, and is not solely a tax decision. Another possibility is the leased vehicle.

There are also national insurance and VAT implications that need to be addressed when decisions are made about the business vehicle(s), The accountant needs to be 'up to speed' in this respect, and if the vehicle is owned by the company, this will involve record-keeping, VAT records and NIC.

Share ownership

The ownership of the shares in a small company has become very important in recent years. The old procedure of issuing one share to the director and his spouse may have seen its day. The procedure by which shareholders gift shares gratuitously to the next generation also produces complications in terms of CGT, Stamp Duty and perhaps IHT.

Two other events have affected this area. The first was the case decisions in cases such as *Butler v Wildin* [1989] STC 22 and *Young v Pearce: Young v Scrutton* [1996] STC 743. The second is the 'attack' by the Inland Revenue on small company shareholdings under the 'settlements' legislation (see Newthwire No. 36 on this subject).
http://www.accountingweb.co.uk/item/118222/786/784/785

This particular obstacle may be clarified by the 2004 Spring Budget, but for the time being there is an implied threat that the Revenue will attack share arrangements where there is 'bounty' and the income and profits are earned largely by the efforts of one shareholder. There is a pending appeal on this subject, so that the Revenue view is by no means clear-cut, but nevertheless it needs to be acknowledged and taken into account.

Tax Planning

I have left the most important issue to last and this is tax planning for the small company. Hopefully, this where the accountant will earn his or her fees and gain the (grudging) respect of the client. The following are some of the issues that should be investigated:

- Mitigating the company tax bill. A small company will have the first 10,000 pounds of taxable profits tax-free, followed by the imposition of CT at the small companies rate of 19%. The accountant needs to gauge the impact of marginal rates, and the balance between retained profits and amounts distributed in one way or another.

- The extraction of funds. How this is achieved in important, and every case is different. National insurance, the NMW and pension fund requirements need to be taken into account. Among the possibilities are:

    1. Directors' remuneration, fees and bonuses.
    2. Dividends.
    3. Capital distributions
    4. Drawings on directors' loan or current accounts that are in credit.

An effective accountant will advise the small company on the best solution for each year towards the end of the accounting period.

- The potential CGT liability of both the company and the shareholders should be reviewed. It must be remembered that a company cannot claim business assets taper relief, but individual shareholders may be able to do so.

There may also be the opportunity to take advantage of the rollover relief and holdover relief provisions.

- After the Spring 2004 Budget, the question must be asked 'is incorporation worthwhile?' If not, the method and cost of disincorporation should be investigated.

- Capital expenditure, and the appropriate tax relief attaching to it should be reviewed regularly. If appropriate, the 100% first year allowance for expenditure on computers, e-commerce and information technology incurred before 31 March 2004 should be taken advantage of. Would it be better for the company to lease rather than purchase capital items?

- Succession of shareholdings, and the impact of inheritance tax and business property relief should be reviewed regularly. At least some idea of the current market value of the ordinary shares should be obtained.

- A check should be made to ensure that all tax time limits have been observed, and valid tax claims made.

Ask a question

Readers with a current case should post their query in Any Answers.

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