Tax Insider

HOW TO BEAT THE TAXMAN AND BOOST YOUR INCOME!

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Entrepreneurs Relief from CGT - Good(ish) News for the Few

By James Bailey

Alistair Darling has announced the concession he has been forced to make as a result of the outcry about his "reform" of capital gains tax that takes effect from 6 April 2008.

This "reform" consisted of scrapping various reliefs, notably the indexation allowance and taper relief (see the October and December 2007 Tax Insiders for details of this), and replacing them with a universal flat rate of CGT of 18% for individuals and trustees. Limited companies are not affected by these changes and will continue to be charged to corporation tax on their capital gains exactly as before, with the benefit of indexation allowance.

How does Entrepreneurs Relief Work?

From 6 April, every individual (and trust) will have a "lifetime allowance" of £1million in capital gains on "business assets" that will be charged at an effective rate of 10% - the same rate that applies to business assets under the current rules. Any gains above that, and any gains on other assets, will be charged at 18%.

That is how the Press Release describes it, but the detail is a little different. The 10% rate for Entrepreneurs Relief is achieved by reducing the first £1million of gains by 4/9, so only 5/9 of the gain is charged to CGT - 5/9 x 18% is 10%, so that's OK, isn't it?

Well, not quite. Consider the treatment of a gain on a business asset sold now compared to the same asset sold on or after 6 April:

Roy is the sole shareholder of his trading company and he sells his shares realising a gain of £500,000. He has owned the shares for more than two years, so under the current regime he qualifies for full business asset taper relief, and under the new regime he will qualify for Entrepreneurs Relief:

	2007/8	2008/9
Gain on Shares	500,000	500,000
Taper Relief 75%	(375,000)	Nil
Entrepreneurs Relief 4/9	Nil	(222,222)
Gain after relief	125,000	277,778
Less Annual Exempt Amount	(9,200)	(9,200)
Taxable	115,800	268,578
Tax at 40%/18%	46,320	48,344

Do you see what Alistair has done? Because the annual exempt amount is deducted from the gain after all other reliefs, Roy is about £2,000 worse off under the new regime because his annual exempt amount is only relieved at 18%, not 40% as it now is. In fact, the position will be marginally worse because the Annual Exempt Amount increases every year in line with inflation, so if it is, say, £9,800 for 2008/09 the difference between that at 40% and at 18% will be £2,156.

The winners under the new regime will be those who make gains on assets that did not qualify for Business Asset Taper Relief under the current rules - buy to let landlords of residential property (not commercial property - they will be worse off, in general), investors in the stock market and so on.

The losers will be entrepreneurs like Roy, in a big way if their total gains on business assets exceed £1million over their lifetime, and in the smaller way illustrated above even if their gains are less than £1million.

What are "business assets" for Entrepreneurs Relief?

This is the other nasty piece of news buried in the Press Release. Currently, an asset (say, a factory) qualifies for Business Taper provided it is used by an unlisted trading company or unincorporated business (such as a partnership or sole trader). The owner of the asset does not have to be involved in owning or running the business in order to get business taper relief when he sells it.

For Entrepreneurs Relief, the owner of the asset must be a proprietor of the business, or a shareholder in the company (more on this in a moment) and a director or employee of it.

This is, of course, bad news for landlords of commercial properties, but it will also affect a group you might have thought Alistair would want to encourage - employee shareholders.

Under the current rules, if you are an employee of a company (even one listed on the stock market) you get business asset taper relief on your shares. In order to qualify for Entrepreneurs Relief however, you will have to hold 5% or more of the shares in the company.

The last decade has seen a huge increase in the number of employees benefiting from various "Share Incentive Schemes", and not just the "Fat Cats". Many Plcs have Employee Share Schemes of one kind or another and I am sure many readers will have, or will know someone who has, shares in their employing company. I am equally sure that in the case of the big listed companies, none of those shareholdings will amount to 5% of the total share capital, so all those employees can look forward to paying 18% CGT instead of 10% when they sell their shares.

What can be done?

There are nearly two months to go before the new rules take effect and here are some things you may want to consider doing (having taken proper professional advice!) before 5 April:

- If you are in the process of selling a business or a business asset, consider whether you can accelerate this so that it is charged under the old rules rather than the new - this really only applies to gains greater than £1million because the professional fees involved will be greater than the £2,000 you will lose if you make a lesser gain after 5 April. One of my clients is currently selling their business and they have told the prospective purchaser they will walk away from the deal if it is not done before April - but in other cases, purchasers, aware of the advantage of an early sale, are offering a lower price for a deal before 5 April!

- Consider transferring assets into a trust to "bank" the taper relief before it is abolished - again, not something to be done lightly and not without its problems.

- If you own assets that currently qualify for the indexation allowance (broadly, assets owned since before 1998) consider how to bank this as well. This is easy for a married couple or civil partnership (see the December 2007 Tax Insider for details), but in certain circumstances can also be considered by other individuals.

TAX INSIDER TIPS

• Good News for Those with Small Income Tax Bills.

The threshold for making payments on account of your self-assessment tax liability has been raised from £500 to £1,000 - but don't celebrate too soon - it only applies from 2009/10.

James Bailey

• Have You Had a Tax Investigation?

Did it result in no additions to your profits or additions on a technical basis to the year of investigation only, so there was no "fraudulent or negligent conduct"? If so, you can treat the professional fees incurred as an expense of your business - either for the year they were incurred if your business is continuing, or for the last year of trading if the business has ceased - see HMRC's Tax Bulletin No. 37 for details.

James Bailey

• Are all Professional Fees Allowable Expenses?

If you are selling your business, some of the professional fees you pay will be allowable expense and some will not. Check carefully with your advisers to make sure that they allocate the fees they charge you correctly.

James Bailey

• Some Basic VAT Do's and Don'ts

DO keep a 12-month 'rolling' turnover record if not yet VAT registered - late registration can result in a penalty of up to 15% of the net tax

DO retain business records for the last six years - these could be demanded by law

DO obtain and keep all VAT invoices for purchases - these are your authority to claim back the VAT on supplies made to you

DO charge VAT on supplies to your staff (except for food, drink and accommodation provided free to catering & hotel employees)

DO account for VAT on fuel used for private motoring using the appropriate CO2-based fuel scale charge

DON'T claim the VAT on the purchase of a motor car - it will not be recoverable except in some very special circumstances

DON'T claim the VAT on goods or services used for private purposes. Where there is an element of private use (e.g. mobile phone) an appropriate percentage should be claimed.

DON'T claim the VAT on entertaining clients and prospective clients, including that on the staff doing the entertaining (but **DO** claim the VAT paid on entertaining your staff, such as a summer barbecue or Christmas party).

Andrew Needham

Reinventing the Wheel - Tax Credits for Research and Development

By James Bailey

31 March this year is the deadline for making backdated claims for "R&D" Tax Credits. Until now, a company has had six years to make a claim, but after 31 March that time limit will be reduced to two years. Claims for R&D in the period between 31 March 2002 and 31 March 2006 must therefore be in by this 31 March.

R&D Tax Credits were introduced in 2000 and have been modified in various ways since then, but they offer a generous tax relief for companies (but only companies, not individuals or partnerships) who have engaged in scientific research and development, as defined under the rules.

The way the tax credits work depends on the size of the company, but for "Small and Medium Sized Enterprises" (SMEs), they offer a deduction at an enhanced rate of 150% for expenditure on R&D - so for every £1,000 spent on R&D, the company can claim a deduction of £1,500 in its corporation tax computation.

It gets better - if the company makes losses for tax purposes as a result of its R&D relief, it can "sell" those losses to HMRC for 16% of the amount of the loss so created:

Brainstorm Ltd spends £20,000 on R&D during its accounting year, and when its tax computation is done, there is a loss of £30,000 for corporation tax purposes. The company can either carry this loss forward against future profits or (perhaps because it does not anticipate making any profit for a few years, or has other losses brought forward) it can choose to surrender the loss in exchange for a cash payment of £4,800.

What is R&D?

In order to qualify as R&D for tax purposes, the research must conform to guidelines published by the Department of Trade and Industry in 2004.

The R&D must be undertaken as part of a "project" that is designed to "achieve an advance in science or technology".

The detailed guidelines are a lot more complicated than that, and not everything that seems to be R&D on a commonsense view of the matter will qualify for the 150% allowance, but companies involved in science or technology which do their own research should invest some time in checking whether they qualify or not.

A good rule of thumb is to ask yourself the following questions:

- Did our project confront a genuine problem involving scientific or technological uncertainty? That is, was there a problem which a person skilled in the field would not be able to solve using existing knowledge?
- When we started to work on the problem, was it uncertain if it could be solved and how it could be solved? Again, the test is whether an expert in the field would think in these terms.
- Was the result of our project a genuine advance, such as the creation of a new process or solution, or a real improvement in an existing process? Or, if we failed, was that what we were trying to achieve?

If you can answer "Yes" to all those questions, it is likely that at least part of the project would be R&D qualifying for the 150% allowance.

What expenditure qualifies for R&D Tax Credits?

Even if your project ticked the boxes above, not all the expenditure will qualify. We will look at this in a moment but the categories of expenditure that qualify are:

- Consumable items and stores such as electricity and raw materials used directly as part of the R&D
- Staff costs (wages, employer's NIC and pension contributions) directly related to R&D
- Payments to subcontractors to carry out part of the R&D project (the rules here are more complex still and typically only 65% of the cost will qualify).

There is also a de-minimis limit of £10,000 - if the company spends less than this in the year on R&D, none of it will qualify.

What is and is not R&D?

Assuming the overall project involves R&D, the next step is to consider how much of the above expenses were directly related to it.

It is unlikely that the whole budget for a project will qualify for the enhanced allowances. For example, the following are NOT R&D for this purpose:

- Work on financing and administering the project
- Research and development of non-scientific aspects of the project - so even if the new wonder machine itself involved R&D, designing a nice box to put it in will not!
- Marketing, advertising, distribution, and so on
- Support services - secretarial, the wages of the cleaner who mops the blood off the walls after each test run, and so on

It is important to be clear that the costs of these things are still an allowable expense for tax purposes - it is just that they do not qualify for the additional 50% allowance.

Staff costs

This is usually the trickiest area. HMRC take the view that it is extremely unlikely that any member of staff's entire salary and other costs would qualify for the enhanced allowance.

I recently dealt with a claim where one member of staff did nothing but work on research projects for the company, and we had already agreed with HMRC that the projects in the year in question were R&D that qualified for the 150% rate.

The inspector then made the point that the staff member in question had mentioned that he had been involved in the following activities in addition to the time he spent in the lab:

- He had been involved in sourcing materials for making the main component of one project
- He had travelled abroad to sort out difficulties with some of the prototypes installed at clients' premises
- He had attended meetings with prospective clients to discuss their problems and how the project he was working on would help them

The inspector agreed that actually testing the materials was R&D, but shopping for them on the internet was not.

The work done at clients' premises might or might not be R&D (in this case he agreed it was) but the travelling time was definitely not - and as the clients were all over the world, the travelling time was not inconsiderable.

The meetings with prospective clients were at best preparation for R&D, not R&D itself.

HMRC's attitude

Since 2006, R&D claims have been dealt with at seven regional centres staffed by tax inspectors who specialise in this kind of work. This is a great improvement on the previous situation, where although there was some specialist back-up, one dealt with the local inspector - some of whom had somewhat eccentric views on what constituted R&D.

There is a story of one inspector, based in Scotland, who took the view that in the mechanical engineering sector, the last genuine piece of R&D was the invention of the wheel and everything since had been mere refinements of the original idea. This may be apocryphal, but the last time I spoke to one of the new HMRC specialists and mentioned the story he smiled ruefully and said "You may believe that, but I couldn't possibly comment"!

On my experience of them, the R&D specialists know their stuff, are keen to help ensure that the maximum amount allowable can be claimed and even have a sense of humour - regrettably, none of these characteristics are all that common among other tax inspectors!

Many Happy Returns - Changes to the Filing Dates for 2007/08 Tax Returns

By James Bailey

As usual, my self assessment return went in at the last possible moment this year - posted in time for HMRC to receive it (just) by 31 January - and those of you who file online may well have struggled to cope with the predictable collapse of HMRC's online filing facility on that day.

HMRC would like us all to file online, and the legislation is gradually being amended to force us to do so - all of us except MPs, of course, as the security arrangements for online filing apparently are not quite good enough for their tax returns.

The 2007 Finance Act contained changes to the time limits for filing personal tax returns, which will affect the filing dates for the 2007/08 Self Assessment returns.

The Old Rules

The return for 2006/07 was the last one filed under the old rules. As you are no doubt well aware, the deadline for filing the return was 31 January 2008, but there are two other consequential deadlines that apply:

- The deadline for HMRC to open an "Enquiry" into the return is the anniversary of the filing date, so as regards the 2006/07 return, that closes on 31 January 2009. As far as the 2005/06 return is concerned, if you hadn't heard from HMRC by 31 January 2008, you can relax - it is now too late for them to question it unless they "discover" an error arising from fraud or neglect (this is dealt with in the February 2006 edition of Tax Insider).
- The deadline for amending the 2007/08 return is also 31 January 2009, so if you become aware that you made a mistake in that return, you have until then to correct it - you will pay interest on any unpaid tax, but there should not be a penalty.

The New Rules

Your return for the year ending 5 April 2008 will be sent out shortly after 5 April 2008, but the deadline for filing it will depend on whether you file online or send in a paper return.

- If you file online, you will have the same deadline as now - 31 January 2009, plus however many extra days HMRC have to allow as a result of the almost inevitable failures there will be in the technology!
- If you file a paper return, the new deadline is tighter - for the 2007/08 return, it will be 31 October 2008, just under seven months from the end of the tax year.

Tax Calculation

Currently, HMRC will calculate your tax for you if you file a paper return by 30 September after the end of the tax year (if you file online, the calculation is done for you automatically). This date will be moved back to 31 October as well for the 2007/08 return.

Enquiry and Amendment Deadlines

This is the good news. Whether you file online or by paper, the "Enquiry Window" during which HMRC can open an Enquiry into your return will close on the anniversary of the day you file it, rather than the anniversary of the last possible date for filing, so if you really get your skates on and file your 2007/08 tax return before the end of April 2008, the enquiry window will close on the same date in April 2009, rather than on 31 January 2010.

The deadline for you to amend the return, however, will remain at the anniversary of the latest filing date - whether you file on paper or online, that will be 31 January 2010 for the 2007/08 return.

Implications of the Changes

As a professional, I suppose I should give a guarded welcome to the changes - January is always a miserable month for us, badgering our clients to come up with the information we need for their returns and rushing to beat the 31 January deadline. The introduction of the October deadline for paper returns may have the effect of spreading the load somewhat - though like most firms, we are more probably going to respond by filing more and more returns online, so frantic dashes on 31 January to the local tax office with a bundle of returns will no doubt be replaced by frantic hours spent sitting staring at a "frozen" computer screen.

The changes to the enquiry windows, however, are more interesting. The more switched-on clients will be pressing for their returns to go in as early as possible so as to reduce the period during which they are vulnerable to an Enquiry, and there will be more emphasis placed on exactly when returns were received by HMRC as this will affect the date the Enquiry Window closes. When we send in a client's paper return, we always ask for a receipt to confirm exactly which day it was received, and these will become more important in the future - though when filing online, the receipt is issued automatically.

As the pressure to file online increases, there will also be an issue about "disclosure". In order to take full advantage of the early closing of the Enquiry Window, it is important that any relevant details are disclosed in the return when it is filed. To take one example, if a valuation has been used (say, a 31 March 1982 value for CGT), it is wise to send a copy of the valuation in with the return, and currently this is impossible to do if you file online. This is one of the reasons why my firm currently favours paper filing, but we are going to have to change our ways to adapt to the new rules, and it will be important that we are still able to make appropriate "disclosures" for our clients.

Such "disclosures" are becoming more important to protect our clients' interests - the new rules on "income shifting", for example, will mean that family company shareholders will need to include quite extensive "disclosures" about the company's salary and dividend policies in their personal tax returns.

Lord Justice Sedgley famously and contemptuously described the VAT legislation as a "fiscal Theme Park, in which relatively uncomplicated solutions are a snare and a diversion". Let us hope HMRCs enthusiasm for online solutions does not prove to be another such snare.

Capital Tax Planning

By Amanda Fisher

Most people, property owners especially, will have heard about the capital gains tax changes that will come into effect from 6 April 2008.

Quite whether it will affect us individually can be an enigma, especially as the changes are so extensive. So, how can we be sure how it will affect us and our investments?

Business property

Since 6 April 2004, a landlord has been entitled to the business asset taper relief in respect of property occupied by an unincorporated or incorporated trading business that is not listed on a stock exchange.

This means that, currently, any capital gains on this type of property would be tapered by business asset taper relief of 75% after two years of qualifying ownership for this purpose, and the effective rate of tax for a higher rate taxpayer would be 10% of the gain.

From 6 April 2008, these gains will no longer be indexed or tapered and the gain will be chargeable at 18%, whatever tax bracket one happens to be in.

Even the introduction of the new Entrepreneur's Relief may not help these landlords, since the letting of property to a business is not necessarily a qualifying purpose for this new relief, as there will be stricter criteria.

There is a possibility therefore for owners of this type of property to be worse off by the new rules that will come into effect on 6 April 2008.

There is still time however...

Although it may be too late to secure a buyer for property in time for the change, especially with existing tenancies in place, some tax planning may be done to make maximum use of the business asset taper relief to date.

One option may be for owners to gift the property into a trust.

Many different types of trust are available, and all options can still give the current owner 'control' (ie, management) of the property if this is preferred.

The gift of the property into trust would trigger the following tax events:

Capital gains tax - this gift would be a chargeable event at the market value of the property on the day of the transfer. Business asset taper relief would be claimed and a smaller tax liability could be payable.

Stamp Duty - no stamp duty would be payable on a gift into the trust as no consideration has passed. If any consideration is paid for the property however, stamp duty would need to be considered.

Inheritance Tax - The gift into a trust would also be a chargeable occasion for inheritance tax. This would be treated as a chargeable lifetime transfer (CLT).

Everyone has a Nil Band of £300,000 (currently for 2007/08) that could be used to cover against a CLT. Of course in the case of jointly owned property, perhaps with a spouse, the amount of the Nil bands available to set against a CLT would be £600,000 provided this had not been previously used in the last seven years.

In addition to this, property that is used by a trading partnership or a trading company of which the owner has control will usually qualify for Business Property Relief (BPR) of 50% of the value. There are a few criteria, such as the minimum time period of two years, but it is certainly worth considering if any balance in value is also covered by Nil Rate Bands, as detailed above.

If the current owner was also prepared to no longer benefit from the property, an additional advantage of gifting the property into trust at this point in an owner's life is that the property could then be removed from their estate for inheritance tax purposes. And, provided the owner lives for seven years, there is unlikely to be any additional inheritance tax due. This plan may be beneficial in comparison to the 40% inheritance tax charge on death if the property was still owned individually.

There would be periodic charges of up to 6% max each 10 years and 'exit charges for any transfers of property out of trust, however depending on the numbers going into the trust, this is sometimes as little as 0%.

VAT - There are no VAT issues unless the property has been 'opted to tax'

Agricultural property

Owners of agricultural property or farms could also be largely affected by the introduction of the new capital gains tax rules, especially where these properties qualify fully or partially for business asset taper relief.
In addition, where this type of property has been in the family for a very long time, the current indexation allowance for the inflation over the years could be substantial, which could make the new regime less beneficial.
As far as Inheritance tax is concerned, Agricultural Property Relief (APR) and Business Property Relief (BPR) may provide exemption for these transfers.

Shares of companies owning property

The new Entrepreneurs Relief that will also come into effect on 6 April 2008 will not apply to shares in companies where the activities are less than 80% trading. Therefore, for those companies for which property is a large activity, this relief will not apply, which makes a comparison of the potential capital gains tax due, before and after the changes, all the more important.

Ownership of property through a company will not qualify for Business Property Relief for inheritance tax, unless the business is 'wholly or mainly' trading. This is open to interpretation and every case is assessed on its own merits.

However, it is still worth carrying out a comparison under the old and new rules.

It is possible to gift shares into a trust in the same manner as the property above, if this is appropriate.

Investment property and second homes

nvestments in residential properties are non-business assets for taper relief up to 5 April 2008 and therefore the new rate of 18% on chargeable gains may be more beneficial despite losing the indexation allowance and taper relief. However, it is still worth doing the numbers to check the position.

If the smaller amount of capital gains tax would be chargeable before 6 April 2008, then the trust route could be an option for the owners. Inheritance tax reliefs may not be available, but using a single, or two Nil Rate Bands of £300,000 could be useful and the overall effect could remove property from one's estate in the process.

Conclusion

So despite the changes, there is still time to minimise your tax liabilities as much as possible...

Consider the options before the capital gains tax changes come into effect from 6 April 2008.

How will HMRC's proposed new penalty regime be applied to VAT?

By Andrew Needham

You may have heard by now that HMRC are proposing to introduce a new penalty regime covering both direct taxes and VAT. In this article, we provide an overview of how the proposed regime will work from a VAT perspective.

First of all, not every error will incur a penalty. If a person takes reasonable steps to complete a document correctly, even if it later turns out to be wrong, a penalty would not be due.

A penalty is chargeable where any person gives HMRC an inaccurate document that satisfies two specific conditions as follows:

The **first** condition is that the inaccurate document either amounts or leads to:

- an understatement of the person's liability to tax, or
- a false or inflated statement of a loss by the person, or
- a false or inflated claim to repayment of tax

The **second** condition is that the inaccuracy was careless or deliberate.

An inaccuracy made by a person in a document may be:

- a mistake made despite the person taking reasonable care, or
- careless, or
- deliberate but not concealed, or
- deliberate and concealed.

HMRC say that error penalties are designed to address the behaviour that led to the inaccuracy. Penalties for deliberate inaccuracies are, therefore, higher than those for careless inaccuracies. Within the deliberate category there will be varying degrees of seriousness, and the law reflects this by providing for higher penalties in those cases where the person has taken steps to conceal the deliberate inaccuracy.

Reason for penalty	Type of inaccuracy	Maximum penalty payable
Giving an inaccurate document	Careless	30% of Potential Loss of Revenue ('PLR')
Giving an inaccurate document	Deliberate not concealed	70% of PLR
Giving an inaccurate document	Deliberate and concealed	100% of PLR
Understated assessment not notified	N/A	30% of PLR
Inaccuracy discovered later but no reasonable steps taken to inform HMRC	Treated as careless	30% of PLR

Where a person makes a mistake despite taking reasonable care to get things right, HMRC will not charge a penalty. Examples might include:

- a reasonable view of the law that proves to be wrong
- an arithmetical or transposition error that is not so large (relative to overall liability) as to produce an odd result or be picked up by a quality check
- following advice from HMRC
- advice from a competent professional is followed but proves to be wrong despite the fact that the advisor was given a full set of accurate facts

Whether a person intended to make an error does not in itself prevent a penalty. If an inaccuracy in a document is due to carelessness, a deliberate act, or failure to act, the person will be liable to a penalty.

HMRC acknowledge that people's ability and experience will vary, and the steps that a person takes to ensure a document is correct will depend upon the nature, size and complexity of their transactions. When an error is found in a document, the person should have the opportunity to put forward their explanation of how the error arose, and the steps they took in completing the document. HMRC will then consider whether it was reasonable for them to act as they did in light of their circumstances at the time they completed the document.

A deliberate inaccuracy occurs when a person intentionally makes an error in a document sent to HMRC. It can also be a failure to act, where this is done deliberately to avoid paying what is due.

For behaviour to be seen as deliberate, HMRC must have grounds to believe that the person intended to submit a document that they know is inaccurate.

Any error that is not apparent on the face of a document could be seen as hidden, but HMRC will only apply 'deliberate and concealed' to cases of the most serious conduct. In these cases there will be more than an attempt to deliberately record an error in a document, there will be additional signs that active steps have been taken to cover it up, either before or after the document is submitted.

There are two steps to consider for a penalty to be based on a deliberate and concealed inaccuracy.

- the error or omission was deliberate, and
- steps were taken to conceal the inaccuracy

HMRC will also charge a penalty where:

- an assessment issued by HMRC understates a person's liability to VAT **and**
- the person fails to take reasonable steps within 30 days of the date of the assessment to tell HMRC that it is an under-assessment

In considering whether a penalty is appropriate in cases of under-assessment, HMRC must consider:

- whether the person knew or should have known, about the under-assessment; and
- what steps (if any) would have been reasonable for that person to take to tell HMRC about the under-assessment.

The Tax Insider Gurus Answer Your Questions

Q.1 If I sell a rented out property and am charged early repayment penalties from my mortgage supplier, can I put this down as Expenses on Finance charges when submitting my Tax form?

A.1 Unfortunately not - section 58 (4) (c) ITTOIA 2005 specifically denies relief for the cost of repaying loans "repayable at a premium". This prohibition does not apply to companies as the corporation tax rules are different and the cost is allowable as part of the cost of a "loan relationship".

Q.2 My parents own a property valued at around 300k and have a mortgage on it for 36k. They would like me to buy the house for 60k paying off their debts and they are to live there until they die. I work and rent up in London. Is there a way of doing this without falling foul of the tax man?

A.2 There are two problems here. Because this is a sale "not at arm's length" your parents will be deemed to have disposed of the property at its market value, though if it has been their "only or main residence" throughout their ownership this will not matter as the resulting gain will be exempt from CGT. The other problem arises if they continue to live there without paying you a full market rent for the property. They will be deemed to have "reserved a benefit" and the property will continue to be regarded as part of their estates for inheritance tax - though again, this may not matter if the value of each parent's total estate when they die is less than the nil rate band for inheritance tax (currently £300K, due to rise to £350K by April 2010). This is a complex matter and you need to talk to a tax adviser before going ahead.

Q.3 On which event does the Revenue take as the date of sale of a property for CGT purposes. Is it on exchange of contracts or on the completion date?

A.3 Generally, it is on exchange of contracts. The exception is a "conditional contract" - for example, one where completion is dependent on the purchaser getting planning permission. In these cases, the date of disposal is the date the condition is fulfilled.

Q.4 My wife and I are purchasing a flat from a developer for £135,000. Upon completion, he is giving us back 10 % of the purchase price.

How is this 10% (£13,500) treated for tax purposes? Does it now make our purchase price £121,500, or is treated as £13,500 income and therefore subject to income tax.

A.4 This is a very complicated and difficult issue, and one where the tax treatment is not clear. Unless you are buying the flat in order to sell it on, it is probably the case that the cashback reduces your base cost for CGT as you suggest, but if you are trading in property then I think it forms part of your trading income. As for Stamp Duty Land Tax, I simply do not know the answer, and neither did HMRC when I asked them for a formal opinion on this! Most seriously, though, there are also possible legal problems if your lender has not been told about the cashback - I have heard it argued by lawyers that this is a fraud on the lender, as the cashback is a "material fact" that should be disclosed to the bank or building society when applying for the loan.

Q.5 What happens after April when taper relief is abolished? How is the net value of the property calculated?

A.5 After 5 April 2008, both taper relief and the indexation allowance will be abolished for gains made by individuals and trustees (no change has been proposed to the rules for taxing companies' gains). On a sale of an asset, you will simply deduct the acquisition costs (and any capital expenditure on improvements still evident in the property) and the costs of sale from the sale proceeds, deduct your annual exempt amount (currently £9,200), and charge the gain at 18%. In the case of certain business assets, there will be a relief known as "entrepreneurs' relief" - there is an article on this in this month's issue.

Send your questions to: questions@taxinsider.co.uk for consideration in future editions.

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