

Inland Revenue

Malcolm Birkett is an Inspector of Taxes who has worked for the Inland Revenue for many years. He specialises in Business Tax (not Corporation Tax) i.e. the self employed and Capital Gains Tax. He is authorised to answer the following questions "on behalf of the crown".

Q. When should a client who is on our programme i.e. test-trading, register his / her business with the Inland Revenue?

A. The client should register within 3 months of them starting to trade otherwise they may incur a penalty.

Q. When does the Inland Revenue consider that trading has begun?

A. As soon as money changes hands.

Q. How can clients be self employed and unemployed at the same time?

A. They are self employed as soon as they start to trade. The fact that they are receiving benefits from the JCP is irrelevant as far as the Inland Revenue is concerned and because they are on a Government 'Training Programme' the fact that they are registered with the Inland Revenue as self employed whilst on that programme is irrelevant to JCP.

Q. How should our clients register with the Inland Revenue?

A. They should complete form CWF1 fully and 'tick' the box on side 2 which states 'Please tick if you are on the New Deal 25+ scheme'. This box should be ticked for any test-trading programme i.e. WBLA, NDYP and ND25+.

Clients MUST NOT complete the NI Class 2 Direct debit mandate. (A copy of the CWF1 should be retained in the clients file together with the 'blank' NI Direct Debit mandate)

Q. Once registered will our client be liable to pay Class 2 NI contributions even though they are receiving NI credits from JCP?

A. No. By ticking the box as per the Q&A above, they will automatically receive exemption to Class 2 NI Contributions whilst they are on the 'test trading' programme.

Q. What happens when the finish 'test trading'?

A. InBiz should ensure that the client informs the Inland Revenue of their current status. This is best achieved by using specific stencil letters.

These would state the client is either:-

1. Continuing in self employment and is now trading independently and wishes to pay his/her own Class 2 NI Contributions. The Direct debit mandate may be completed at this stage and enclosed with this letter

2. The client has ceased trading.

Q. Once registered will the client receive a Self Assessment tax return?

A. Yes

Q. How long a period can the 'first years' trading be over?

A. Up to One year and 364 days.

Q. Is it advisable to complete a Self assessment tax return in the first April after trading commenced even if that period is only a few weeks?

A. Yes. The advice is to always complete a Tax Return in the first April after trading commences as full year allowances can be claimed. If the first year is extended to say 18 months, then only one years allowances can be claimed. The 'first years' allowance is then held on 'account' and will only be claimable when the business ceases trading. However, it will be held at current not future value and therefore inflation will gradually erode its value.

Q. Is it always advisable to make the 5th April the business's year end date?

A. Yes – always.

Q. If a client is claiming against a Mortgage Protection policy because of their 'unemployment', surely by registering as self employed they will be deemed by the insurance company to be 'working' and therefore their claim will be dismissed.

A. The Inland Revenue will never divulge any information about any individual to a third party without specific authority from the individual themselves. Therefore unless the client advises the Insurance company themselves – the insurance company will never know. In addition, as long as they are on an approved government 'training scheme' and the relevant insurance forms can be stamped as such by JCP there should not be any problems.

Q. If a client suffers a 'Net Loss' during the test trading period and/or first years trading, can this be offset against previous income?

A. Yes. Such a loss can be used to offset income earned over the previous three tax years starting with the most historic year. Such Income is any earned/unearned income. However, net losses cannot be carried forward.

Q. Can clients (or anyone who is self employed) claim expenses if they are running their business from home?

A. Yes. They can claim for a proportion of council tax, gas, electric etc. – but NOT mortgage Interest.

Q. How should this proportion be calculated?

A. Take the number of rooms in the house – excluding Kitchen and Bathroom(s). Divide the total costs (as above) by this number (assuming that they are using one room in the house for business). Decide if the business has exclusive use of the room or is it partly used privately i.e. 50/50. Multiply the above figure by this proportion.

e.g.

The number of rooms in a house is 7. One room is used for business but not exclusively as it is also used privately. Therefore business use is only say 50%.

Total annual costs are as follows-

Council tax	-	£1000
Gas	-	£500
Electric	-	£300
Total	-	£1800

£1800 divided by 7 = £257 x 50% = £128.

Therefore £128 is the amount that can be claimed as expenses for the business.

Q. If someone uses their home for business and claims expenses as above, will they become liable for Capital Gains Tax when the house is sold?

A. Yes (see below)

Q. How is Capital Gains Tax calculated?

A. A capital gain arises whenever an asset is sold at a higher value than its original cost. The capital gain is the difference between the sale price and the original purchase price. At present there is a 100% allowance on privately owned property which is used as an individual's main residence. However, there is no such allowance against the 'Business Use' of that property. The capital gain however, only takes the proportion of the house that was used for business use and for the time period that the business operated from that property.

A house was purchased in 1995 for £85,000. It was sold in 2004 for £250,000.

It had 7 rooms (excluding kitchen and bathroom(s)).

A business was started in 1998 and one of the rooms was used as an office for 50% of the time (the other 50% being private use)

Total gain = £250,000 - £85,000 = £165,000

£165,000 divided by 7 = £23571

The house was held for 9 years but the business only operated for 7 i.e. 78% of the occupancy.

Therefore £23,571 x 78% = £18385

The business use was only 50% therefore

£18,385 x 50% = £9,192

The total gain is therefore £9192 but this can be offset by the individual's annual allowance currently £8,200 (2004/05)

Tax is therefore payable on £9,192 - £8,200 = £992.

This figure is added to the individual's income and taxed accordingly.

If they were in the basic rate band, then tax would be levied at savings rates of 20%.

Therefore the total Capital Gains Tax bill would be £992 x 20% = £198.

Q. Given the above is it advisable for clients to claim expenses for use of their home?

A. Yes

Q. Can clients apply for Tax Credits as soon as they have registered as self employed even though they are still in receipt of JCP benefits?

A. Yes. However, their benefit income will be taken into account.

Q. On what information will their tax credit award be made?

A. On the financial projections that they provide.

Q. When should these projections be updated?

A. As with anyone who is self employed they should be updated regularly to advise the Inland Revenue of current/projected income. This will ensure that the correct level of Tax Credit is being paid. Any under/overpayment of Tax Credits will be rectified following receipt/confirmation of the individuals tax return.

Malcolm stressed that tax offices may be contacted at any time by telephone to answer questions and that he and his colleagues are there to help and not to 'investigate'.