Spring 2011

Silbury Chartered Accountants

Annual Investment Allowance

The Annual Investment Allowance (AIA) provides 100% tax relief on qualifying expenditure of up to £100,000 on plant and machinery. Despite the limitations of the AIA (especially for group companies where the allowance maximum is shared between group members) the planned reduction of the maximum from April 2012 onwards will be a significant tax cost to all business. From this date not only will the AIA fall to £25,000 but the standard rate of capital allowances (the rate at which tax relief is given for the remainder of qualifying expenditure on plant and machinery will fall from 20% to 18%). We suggest that businesses closely monitor these allowances and tailor expenditure to maximise AIA while they still can.

Dividend Salary Mix

Subject to the budget, from 6 April 2011 basic salaries for company owners should be set at £7,225, a considerable hike from the previous level of £5,715. At this level the employee will qualify for one years contributions towards the state pension, pay no national insurance or tax on the sum received but have corporation tax relief against the sum.

Whilst salaries will rise, dividend payments, for those not wanting to pay higher rate tax will fall from roughly £33,000 (net of the notional tax credit) to £31,000. Other income and losses must also of course be considered.

As ever payments to spouses both in dividend and salary need to be considered, to ensure the most tax efficient mix of dividend and salary (and even pension contributions) is achieved. Even more than ever an annual review of the business dividend and salary strategy is essential.

Leasehold Improvements

Much to the frustration of many business owners, leasehold improvements may often not qualify for any tax relief at all. When faced with a list of works carried out to a building, occupied but not owned by a business, the first route regarding the analysis of the expenditure is to investigate whether it can be classified as repairs and renewals. Whilst even this definition can be difficult, as what is or is not, restoring a building to its original condition (at the time of commencement of lease) can be open to interpretation.

If the expenditure is not a repair or renewal then all is not lost as expenditure which would not immediately appear to be entitled to capital allowances may indeed qualify. Such items that will qualify for capital allowances include:
- Gas and sewerage systems provided mainly to meet the particular requirements of the qualifying activity, for example machine related drains for the connivance of cooling or cleaning fluids.
- Temperature controlled rooms.
- Sound insulation.
- Alteration of land for the installation of plant.

The above is not an exhaustive list, so clearly it is worth taking a second look at buildings related expenditure before consigning it to the non allowable category.

On Audit Fees

For accounting years ending on or after 15 December 2010, the new Clarity ISA's (International Standards on Auditing) apply. Whether or not this should make much difference to the way current auditors act will greatly depend upon the quality to which they have to date been carrying out audits. These changes are clarifications rather than changes aimed at improving the standard of audit work. Auditors who have to date been interpreting exiting guidance in a manner consistent with the standard setters will see little change or addition to the work carried out. The Clarity ISA's are therefore not an excuse to hike up fees.

Budget

The budget is set for 23 March 2011, if following this date, you would like a personal assessment of what the budget means for you and your business, please contact your local Silbury office to arrange a free of charge meeting.

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Pensions

It was good to hear from the government that rules governing the purchase of an annuity on retirement are to be relaxed. Despite this welcome change decisions relating to pension provision remain complex and a range of factors should be considered before making any pension contribution

- Maintaining business and personal liquidity. Once a pension contribution has been made normally it cannot be retrieved for other uses.
- The flexibility of a decision once made, as above.
- Tax cost both now and on draw down.
- Inheritance tax issues regarding pension funds.
- Alternative methods of providing an income, such as taxed personal savings or extending the period over which your company pays you a salary of dividends.

In addition to the above the risk and return of any investments, be it pensions or alternatives, needs to be evaluated. Normally a mix on investments is advisable. Due to the interaction of taxation with pensions and alternative solutions not sold by your Independent Financial Adviser (IFA) it is always worth working with both your accountant and IFA to get the balance right for you.

Basel III

For most of the planet, Basel I, the first international protocol on world banking of the modern era was ushered in with little more than a murmur. The fact that Basel II was launched immediately before the banking crisis of 2008 meant that it received broad coverage. As we are now looking at a third protocol through post crisis spectacles means that it has and will attract even more attention and comment. So what does Basel III have in store as and when implemented? The brief answer is a tightening of the rules imposed by the existing protocols. The major revisions fall into 4 areas.

Existing rules require the banks to hold adequate capital in liquid (or readily realisable) form. The new Protocol will greatly increase the current capital requirements from 2% to 4.5% of assets.These figures are significant as before the onset of the current crisis, all of the world's top 50 banking institutions held, on average, only 4 percent of capital. Surprisingly none of these institutions held more than 8 percent. This increased capital requirement will increase costs for the bank which is inevitably going to increase the cost of money to the customer. The risk weighting system will be given

even greater prominence as it impacts on capital levels and therefore this will push the banks into an even more risk adverse position. The type of capital that can be held will be further restricted. A new leverage ratio is also to be introduced. This is a further measure of capital adequacy which is calculated in absolute terms (without the weighting referred to above).

Although the reserve does not need to be in pure cash it will need to consist of generally recognized and easily realisable investments. These categories are being further restricted.

There will be an additional capital buffer requirement of 2.5% which will be flexed to act counter cyclically to underlying economic trends. Key national financial institutions will need to be identified and even stricter capital rules applied to them. In the UK this will be the clearing banks who now over dominate the market place.

It is recognised the changes proposed are significant and therefore while effective from 2013 the capital provisions will l have a long lead in time of between 5 and 10 years.

While credit in the market as a whole is still tight these provisions are unlikely to assist in increasing liquidity. From the above it is clear that our larger clearing bank dominated system will not only be hit by the standard Basel III increases in capital cover requirements but due to their pre eminent position the clearing banks will be seen as key institutions that will need to further strengthen their balance sheets because of the systemic risks noted in 3 above.

These changes mean that money is unlikely to become more readily available and will certainly become more expensive as these new measures are implemented.