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Chartered Accountants

Is it a phone?

Many tax exemptions are either so hampered by conditions or are of little practical benefit that their role as a perk is somewhat limited. This makes the opportunity to provide an employee with something tax free that he or she is actually likely to use several times a day all the more valuable. Mobile phones arguably fit into this all too rare category.

Scope of the exemption

An employer can provide a mobile phone to an employee without triggering a tax charge under the benefit in kind provisions provided that certain conditions are met. The legislation provides that no liability to tax arises in respect of the provision of one mobile phone for an employee without any transfer of property in it.

The first point to note is that the exemption is only relevant where the contract for the phone is between the employer and the employee. If the employee has his or her own mobile phone, the contract for which is in the employee's name, and the employer pays the bills on the employee's behalf, the exemption does not apply. The employer is meeting a pecuniary liability and as such tax is in point. However, in this situation, the employee may be entitled to a deduction for business calls.

In the case of a pay-as-you go phone, similar considerations apply. If the phone belongs to the employer and the employer pays for the top-ups the exemption may apply, provided that the other necessary conditions are met. However, if the phone belongs to the employee and the employer merely reimburses the costs initially incurred by the employee, the exemption is not in point, although the employer may be entitled to a deduction for business calls.

The second condition to note is that the employer must retain ownership of the phone. The exemption only applies where the phone is made available for use by the employee. The exemption cannot be used to provide the employee with a state of the art phone tax-free.

Counting to one

The exemption for mobile phones was revised from 6 April 2007. Since that date it has only been possible to provide one mobile phone to an employee within the scope of the specific exemption for mobile phones. This limit was imposed as an anti-avoidance measure to scupper the development of schemes providing multiple phones to an employee for private use.

Prior to 6 April 2006, there was no limit on the number of phones that could be provided, making it possible to kit out the employee's family and friends tax-free (and probably at a substantial cost to the employer) without any tax liability arising.

It is still possible for an employee to enjoy more than one phone tax-free, provided that the phones were all made available prior to 6 April 2006. The exemption will continue to apply to all pre-April 2006 phones until the phones concerned are replaced by a new phone or upgraded at the employee's request. This may mean that the employee may need to consider whether it is worth forsaking an upgrade in order to continue to benefit from tax-free call charges. Depending on the extent to which the phone in question is used, not having the latest model may be a sacrifice worth making.

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The exemption for multiple phones made available prior to 6 April 2006 is not lost if the phone is replaced under a warranty that formed part of the original agreement.

Where a phone is made available to an employee on or after 6 April 2006, the exemption is limited to one phone per employee. Deciding whether an employee only has one phone may not always be as straightforward as it sounds. For example, if an employee has two SIM cards to the same number, one in a handset and one in a hands-free phone in a car, this will only be regarded as one phone. However, two connections to two different numbers represents two mobile phones. The limit on one is really a limit on connections rather than on handsets.

What is a phone

Most people would think that they would know what a mobile phone is, but the answer to the question 'is it a phone' may not always be clear. The definition of what constitutes a mobile phone for the purposes of the mobile phone exemption was revised from 6 April 2006. From this date, for tax purposes at least, a mobile phone is defined as telephone apparatus that is:

- not physically connected to a land-line;
- is not used only as a wireless extension to a telephone that is physically connected to a land-line;

or anything that may be used in such apparatus for the purpose of gaining access to, or using, a public communications service. For these purposes, telephone apparatus is taken as wireless telegraphy apparatus designed or adapted for the primary purpose of transmitting or receiving spoken messages and used in connection with a public communications system.

As with many definitions contained within the tax legislation, one is left to make practical sense of whether a particular item that most people would refer to as a mobile phone is actually one in the eyes of the taxman. What is not particularly evident from the legislation itself is that the revised definition extends the scope of the exemption to a connection provided independently of a mobile phone, This means that the exemption applies if the employer provides the employee with a SIM card and the employee uses that SIM card in his or her own handset, provided that the employer contracts with the provider, meets the cost of the calls and retains ownership of the SIM card. The answer to the question 'Is a SIM cards a phone' may well be yes.

Further complications arise as phones evolve and do more than simply make or receive calls. The vast majority of handsets allow the user to text, take photos, send multi-media messages, access the internet, double up as an MP3 player and provide Bluetooth capabilities. As the list of functions increase as new models appear, it becomes increasingly difficult to determine when a device stops being a mobile phone and starts to be something else entirely. This is important as if a device is not a mobile phone it cannot benefit from the exemption for mobile phones.

Particular problems arise in relation to personal digital assistants (PDAs) such as the BlackBerry. Like whether a Jaffa cake is a cake or a biscuit, popular opinion is divided on whether a BlackBerry is a mobile phone or a computer. HM Revenue & Customs' answer to this question would seem to be `it depends'.

Early BlackBerrys were predominantly mobile phones and benefited from the mobile phone exemption. However, as technology has developed, BlackBerrys and PDAs have additional functions more typically associated with a computer and HMRC take the view that these 'can no longer be considered primarily as a mobile phone'. This is a bit of a disaster from a tax perspective. This means that they cannot benefit from the mobile phone exemption and unless provided prior to 6 April 2006 cannot benefit from the old exemption for computer equipment provided for private use. The only tax-free route is to provide one primarily for business use and keep any private use to a minimum so it can be disregarded as incidental.

Thus whilst an exemption exists for mobile phones, all phones are not equal. While the provision of a SIM card alone will qualify, a state of the art Blackberry will not. With demise of the exemption for computer equipment, the mobile phone exemption is extremely valuable. Care must be taken not to stretch the limits and when providing an employee with what at first sight appears to be a mobile phone, one must ask whether the taxman would agree.

Q&A

Q If I am the landlord of a property with a market value of £300,000 and outstanding mortgage of £60,000, is there a tax-free way of transferring the property to someone else for £60,000? In effect they would just pick up the outstanding mortgage. Please assume I haven't lived in the property for some years. This would help out a cousin who has just lost her husband and has 4 young children.

A Because you are not making an 'arms length disposal', you are deemed to be disposing of the property at its present market value, i.e. £300,000, even if in actuality you only receive £60,000 for it, or any other sum. Therefore your capital gain is the difference between £300,000 and the amount you paid for it. I get the impression from the question that you used to live in the property. If so you are eligible for principal private residence relief on its disposal. So you take the aforementioned gain, a) reduce it by indexation relief if you owned the property before April 1998, b) then reduce it by principal private residence relief, i.e. the period you actually occupied it plus the last three years of ownership, which are deemed occupied, c) if the property was let out during the period which you didn't actually occupy it or are deemed to occupy it, then you can reduce the gain attributable to this period by the 'letting exemption', i.e. the smaller of £40,000 or the amount you are claiming PPR relief in b), d) the remaining gain can then be reduced by non business asset taper relief, and e) after that you can knock off annual exemption, currently £9,200, if you haven't used it elsewhere. After all these calculations, it is quite possible that your final gain will be very small.

Q My husband is prepared to loan me money for a buy-to-let property. Can I offset the interest of this loan from the rental income?

A Yes you can offset the interest of this loan from the rental income. However, since the loan is from a connected person I would strongly advise you to draw up proper paperwork before the loan starts showing a legitimate authentic loan agreement. It is essential that the rate of interest can be justified as being a commercial rate. You should also ensure that the interest payments go from a bank account in your own name into a bank account in your husband's name so that you can prove that the payments actually took place should HMRC question you. You should also bear in mind that the interest you pay will be taxable on your husband as income – if, for example, you pay tax at the basic rate and he is a higher rate taxpayer, then paying him interest will cost you more in tax between you.

Associated Companies and Corporation Tax

Companies pay Corporation Tax on their profits, and the rate of tax varies according to the level of those profits. Currently, the rates are:

Profits	Rate of CT
£0 – £300,000	20%
£300,001 – £1,500,000	32.5%
Over £1,500,000	30% (on all profits)

These rates only apply if the company concerned has no "associated companies" during the accounting period in question.

Where a company has an "associated company", then the various bands for the different rates of CT are halved for each company – so, for example, the 20% rate only applies to the first £150,000 of profit for each company.

If there are two "associated companies", then the bands are divided by three (so the 20% rate only applies to the first £100,000 of profit for each company) and so on for each additional "associated company".

What is an "Associated Company"?

Two companies will be "associated" if:

- One company controls the other, or
- Both are controlled by the same person or persons

The commonest test for "control" is the voting power of a shareholder. In a simple case, where each of the company's shares carries one vote, any person or persons who own more than 50% of the shares will "control" the company. There are more sophisticated tests involving rights to the income or capital of the company that need to be considered as well, but the usual test for control is owning the majority of the shares in the company. For example:

Company A owns all the shares in Company B – these two companies are "associated" because A "controls" B.

Mr A owns 51% of the shares in Company C, and 52% of the shares in Company D – these two companies are "associated" because Mr A "controls" them both.

Attributing other person's rights to a participator

This is where it gets complicated – when deciding if a person has "control" of a company, you do not just look at the shares he owns personally. You also have to include any shares owned by his "associates".

In this context, an "associate" means:

- A husband or wife (or civil partner)
- A child "or remoter issue" (e.g., a grandchild)
- A parent "or remoter forebear" (e.g., a grandparent)
- A brother or sister
- A business partner
- In certain cases, the trustees of a trust

So, for example, if Mr A owns 100% of Company X and his brother, Mr B, owns 100% of company Y, those two companies are "associated".

Unexpected Associations

These rules are very broad and can produce unexpected results:

Mr B's wife has her own company which Mr B is not involved in. Mr B goes into partnership with Mr C. Unbeknown to Mr B, Mr C owns a company (not connected with the partnership business – in fact it exists to own Mr C's Spanish holiday cottage). Mrs B's company is now "associated" with Mr C's company.

Escape routes

There are two ways to avoid two companies being treated as associated even if they fail the "control" tests described above:

Extra Statutory Concession C9

This concession allows you to ignore shares owned by relatives (except for spouses or children under 18) when checking for "control" *provided there is no "substantial commercial interdependence"* between the two companies concerned.

Whether or not there is "substantial commercial interdependence" between two companies is determined by looking at such things as:

- The administration of the companies – who are the directors?
- Do they share premises, staff, or plant and machinery?
- Do they use the same suppliers, and if so, do they have joint purchasing arrangements?
- Do they co-operate on joint projects?
- Are there any loans or guarantees between the two companies?

No trade or business

If a company that is associated with another company has not "carried on any trade or business" *at any time during the accounting period concerned*, then it can be ignored for the purpose of calculating the number of associated companies.

Some companies are "dormant" – that is, they simply exist but have no income or assets – and such companies would be ignored. In any other case, it can become a matter of contention with HMRC as to whether a company is "carrying on a business". In some tax cases, companies have successfully argued that merely receiving rent from a property owned by the company or receiving bank deposit interest is not a "business", but beware – these cases were very much decided on their particular facts and HMRC would look very closely at any claim that such a company was not carrying on a business. The one clear case is a holding company which does nothing except hold shares in other companies which it controls, and which has no income except for dividends from those companies which it in turn distributes in full to its shareholders – under Statement of Practice 5/94, HMRC have agreed that such a company may be ignored.

Tax Tips

If you run a business...

If you run a business (in a company or as a sole trader) and you are thinking of significant investment in plant and machinery you need to consider whether to spend the money now (50% first year allowances but only 20% writing down allowance on the balance for 2008/09), or wait until 2008/09 (100% first year allowances on the first £50,000 spent).

Do you have more than one job?

Do you have more than one job? Or are you self employed as well as employed? Check your PAYE codes carefully – it makes sense to have your tax allowances set against the better paid job, and in addition you may be due a refund of NIC if you have paid more than the annual maximum.

Swap shop!

Traders should be careful if they 'barter' – such as if a car dealer and an electrical shop swap a car for a new set of kitchen appliances – both of them are taxable (and VATable, if registered) on the value of the goods, and it's a favourite question from HMRC if you get investigated.

Are you using your Gift Allowance?

Gifts totalling up to £3000 in a tax year are ignored for IHT – and if you did not use the £3000 in the previous tax year it can be added to make £6000 that will never be taxable, even if you die within seven years of making the gift.

Have you made a will?

If not, you should do so at once – if you die without leaving a will, the law on "intestacy" may mean that your estate is distributed in a way you would not have wished – it could even go to the Crown!

Home Sweet Home - what exactly is a “Main Residence”?

Probably the second most frequently asked question is “how do I make this property my main residence?” – the most popular is “should I use a limited company for this venture?”.

Everyone is aware that when you sell your “Only or Main Residence” (“OMR”), you are, generally speaking, exempt from capital gains tax on the gain you make so it is most important to understand what is, and is not, an OMR.

In many cases, the answer is obvious – if you only own one house and you live in it as your home then it is your OMR. This article looks at some of the more tricky situations, typically where someone has more than one residence.

If you own two properties and use both of them as a residence, then you have a choice:

- You can write to the inspector of taxes within two years of acquiring the second residence and nominate which of the two will be treated as your OMR
- You can do nothing, and then the question of which is your OMR will be decided based on the facts.

What criteria do HMRC use to determine which is your OMR?

To quote from their Capital Gains Manual:

“The following list of criteria, although not exhaustive, may be useful.

- What address is shown on declarations made on return forms.
- What address is shown on third party correspondence in the file such as dividend warrant counterfoils.
- If a mortgage has been used to acquire one or more residences, on which mortgage is mortgage interest relief due. (This one is no longer relevant, as the law on mortgage relief has changed)
- What security of tenure did the individual have in respect of each residence.
- How is each residence furnished.
- If the individual is married or is in a civil partnership where does the family spend its time.
- At which residence is the individual registered to vote.
- Where is the individual's place of work.”

Obviously, it is better to nominate your main residence yourself as this brings with it a number of planning opportunities – see for example my article “Where do you live” in the June 2006 edition of the Tax Insider.

Making a property your OMR

If a property has been your OMR at any time during your ownership, then it is deemed to be your OMR for the last three years of your ownership of it, even if you had another OMR at that time. There is also a relief of up to £40,000 against a gain on a property that has been your OMR at any time if you have also let it as residential accommodation at another time during your ownership of it.

As a result of these reliefs, I am often asked by property investors planning to sell a buy to let property how they can make that property their OMR so that they can take advantage of these reliefs.

The other question is “how long do I have to live there?”.

They say of those magnificent yachts at the Boat Show: “If you want to know the price, you can’t afford it” and I am tempted sometimes to answer questions about OMRs with: “if you need to know how to make it your OMR, it probably isn’t your OMR”.

I have heard of property owners being advised to get the utility bills put into their names and to inform HMRC of their change of address, as if this was enough. It is not. Unless you actually live in the property and make it your home, it will not be your OMR.

If you want to move into a buy to let property so that it becomes your OMR, then you need to bear all the following in mind:

- You (and your spouse or civil partner) can only have one OMR at any one time, so if you have another property you must make the nomination described above – note that if the BTL property has been let, the two year time limit for the nomination starts when the tenants leave and it becomes available for you to occupy.
- You should make sure you satisfy all the criteria from HMRC’s instructions quoted above
- You must actually move into the property and use it as your home – just camping out in it for a few weeks with the bare minimum of furniture is not enough.

How long must I live there?

There really is no answer to this question. Take these two examples:

1. Joe, who has no other properties, gets a job in Liverpool and buys a flat there. He moves in, but after he has lived there for a week he wins the jackpot on the Lottery. He lets the flat and goes on a world cruise for six months. When he returns, he buys a large detached house and moves into it. He sells the flat a couple of years later. The gain on the flat should be exempt because for that one week before he won the lottery, it was clearly his OMR and only the lottery win meant that he did not continue to live there. Because it was his OMR for that one week, the final three years of his ownership (in this case, the whole period of ownership) are exempt from CGT.
2. Jill, who owns a house and a flat in another part of town, lets the flat and lives in the house. She decides to sell the flat, so she evicts the tenant and moves in. She informs HMRC and her bank, etc., of her change of address. She leaves most of her furniture at the house which she lets her sister use while she is living in the ex-rented flat. She does not like the neighbourhood of the ex-rental flat and so she spends most weekends with her sister in her old house. After eighteen months of this, she sells the ex-rental flat. I suppose it is possible she will get away with this but if HMRC were to start an Enquiry into her return and find out what had actually been going on, they are very likely to argue that her occupation of the flat was a sham designed to get tax relief on it as her OMR, and deny her that relief.

These are of course two extreme examples but they illustrate the basic principle – if it really is your home – or one of your homes, in the case, say, of a weekend cottage, then it can be your OMR. If you are just living there with one eye on the calendar waiting until you can sell up and claim the relief, then it is probably not your OMR.

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