Business Matters

News & Information from your Accountants — Autumn 2005

Welcome to the Autumn 2005 issue of our Business Matters newsletter

Setting the right price

One of the most important decisions to be made when launching a product or service is setting the price.

Ideally, you will want to make maximum profit from each sale, with prices set at the highest point possible before demand starts to decline. This can be a delicate decision: for example, last year British Gas raised its prices twice and lost a million customers.

Numerous factors will influence your pricing structure. If your aim is just to maximise profits, you may set a higher price than if your objective is to increase market share or grow sales.

Covering your costs

Perhaps the most obvious way of pricing a product or service is to calculate the costs of producing it and add a percentage profit margin. But it is important to take into account 'indirect' costs (such as rent, utility bills, insurance and depreciation of equipment) as well as the obvious 'direct' costs like materials, sales, employee and management costs and delivery. You may need our advice when analysing your total costs.

In addition, using this 'cost-plus-profit' method alone fails to take into account such factors as competition, market trends and the expectations of the customer. Many successful small businesses cannot compete with large corporations on price, so they focus on areas such as perceived quality, customer service or uniqueness of brand. Indeed, if you are marketing your product or service as high-quality or 'luxury', customers expect to pay more and a lower price could actually harm sales.

Target costing

It can be difficult to compete on price if production costs are relatively fixed. Target costing is a possible solution to this problem. When launching a new product, an optimum selling price is decided from the outset. The desired profit is deducted from this figure and the result is your target cost. All those involved in product design, development and production are tasked with meeting this cost. However, setting the initial optimum selling price does require extensive market research.

Discriminatory pricing

Sometimes, you might want to set different prices for what is essentially the same product. For example, existing customers might get discount prices on new products; or prices can be varied in relation to season or time (off-peak and on-peak). You might be able to charge higher prices for the same product in more affluent areas, or in places where there is less competition, or perhaps with a different packaging and image, the same product might be sold at different prices to different markets.

Pricing is an important weapon in your strategic armoury. Make sure you consider all the different factors in your planning.

OUR SERVICES FOR YOU AND YOUR BUSINESS

Here are just some of the ways that we can help you with your personal and business finances. Why not call us now and we'll arrange a meeting to discuss:

- Raising finance and maximising the value of your business
- Maximising wealth within the family using your annual exemptions and tax breaks
- Retirement planning strategies for you, other family members and your business
- Timing transactions to minimise the tax bill
- Exit strategies and estate planning, for a secure future

For further information on any of our services, please contact us we will be happy to help you

IN THIS ISSUE

- Creating a 'launch pad' for your child
- Conducting staff appraisals
- Minimum wage to increase
- Who should pay your pension contributions?
- Merger of the VAT and tax offices
- The Civil Partnership Act

Creating a 'launch pad' for your child

The launch of the Child Trust Fund (CTF) brings into focus the issue of saving for your child's key life events. For many parents, that may mean university costs (estimated at nearly £30,000 over three years), help with buying a car or the deposit on a first home.

With the cost of raising a child from birth to age 21 estimated at more than £140,000, there might be limited spare funds. But starting even a modest programme of saving now could create the 'nest egg' your child will need.

The Child Trust Fund

The Child Trust Fund is a savings and investment account available for all children living in the UK born on or after 1 September 2002. The Government will start the account with a gift of £250 and will make a further contribution when the child is seven. The child will not be able to access the money until the age of 18. Neither the parents nor the child will pay tax on income and gains in the account. More information is available at: **www.childtrustfund.gov.uk**.

The money provided by the Government for investment in a CTF account could be viewed as a 'launch pad' for your child, as you and other relatives can add up to £1,200 a year for investment tax-free.

You might consider investing some or all of the Child Benefit in your child's CTF account (current rate equivalent to £884 a year for your eldest child).

Gifting money to children

Of course, the CTF is not the only investment vehicle for gifts of money to children – and is not an option at all for children born before 1 September 2002 – so other options should be considered.

There are income tax complications if parental gifts produce income of more than £100 per annum, but these do not apply to gifts from grandparents and other relatives. Consequently parents might invest their gifts in assets which specifically produce tax-free income – such as certain National Savings products, Premium Bonds, or Individual Savings Accounts (ISAs) – while gifts from others can be invested in a wider range of savings products.

Your child is entitled to his or her own tax-free allowances, so income up to £4,895 and capital gains of up to £8,500 would be exempt this year, with the opportunity to recover any tax deducted from savings income (except dividend tax credits).

Reducing inheritance tax liability

With inheritance tax (IHT) standing at 40% on estates over £275,000 it is important to decide how you are going to reduce the potential IHT on your wealth.

Not only can a programme of regular gifts out of income be a great help in building a nest egg for your children or grandchildren, it can also help reduce the value of your estate for IHT. Normally gifts within seven years of your death are added back into your estate for the purpose of calculating the tax due on your death, but regular gifts out of income are not. To qualify, gifts must demonstrably be:

- **fundable from income** – your executor will be required to complete a form on your death to show that gifts for which exemption is claimed did not result in you drawing on your capital for other expenses, and
- **regular** – a letter saying your gift is the first in a series could suffice, as would payment of the first premium of a savings policy taken out in favour of your grandchildren.

In addition, consider gifts from capital within the IHT exemptions – including:

- the £3,000 annual exemption
- gifts of up to £250 per annum, per recipient
- gifts in consideration of marriage (limits vary).

Trusts

A structured programme of regular lifetime gifts out of income removes gifts from the inheritance tax net, and careful planning can also avoid capital gains tax where assets are gifted, either directly or into a trust for the benefit of your child.

Most of these forms of gift will result in capital being under your control until your child reaches 18, as accounts will be held in your name as nominee. But once your child reaches 18 he or she will normally become entitled to the capital and any re-invested income. If, for whatever reason, you are wary of giving your 18-year old access to the money, a trust could be created to ring-fence substantial sums.

How we can help

We can help you with advice on:

- tax-efficient savings for you and your child
- setting up a trust to manage your child's capital
- tax-efficient gifts from parents, grandparents and others
- looking after your own retirement
- lifetime gift strategies, to help your family during your lifetime, and minimise the tax take on your death.

We welcome the challenge of helping you to create the launch pad for a bright financial future for you and your children.

BUSINESS BRIEF

Minimum wage to increase

The National Minimum Wage increases from 1 October 2005, with the main adult rate rising from £4.85 to **£5.05**.

The rate for 18-21 year olds will increase by 15p to **£4.25**.

The rate for 16 and 17 year olds is set to remain unchanged at **£3.00**.

Subject to confirmation by the Low Pay Commission, there will be further increases in October 2006, with the main adult rate set to rise to **£5.35**, and the age 18-21 rate to **£4.45**.

Who should pay your pension contributions?

When you run your own company you can choose whether you pay your pension contributions personally or whether your company should pay an employer's contribution directly into the pension scheme.

Your personal pension contributions are paid net of basic rate tax, so for every £100 of gross pension contribution, you pay £78 and the pension company reclaims £22 from the Government. If you are a higher rate taxpayer you can reclaim an additional £18 through your self-assessment tax return or PAYE code to give you the full 40% tax relief.

However to provide £78 to fund your pension you and your company must first pay national insurance contributions (NICs) totalling £27.70 (see table), when you take this income as a wage rather than as dividend.

Gross additional pay to fund pension		£116.41
Employers' NI at 12.8% x £116.41	£14.90	
Employee's NI at 11% x £116.41	£12.80	£12.80
Total NI payable	**£27.70**	
Tax at 22% (basic rate)		£25.61
Net pay to fund your pension		**£78.00**
Total cost to company pay + employers' NI	£131.31	

If your company pays an employer's contribution to the pension fund it will pay £100 gross with no additional liability for national insurance. So to invest £100 into your pension scheme, your company can pay out £100 directly or £131.31 (see table) via your remuneration. It might therefore be significantly more cost-effective to have your company contribute directly to your pension fund.

For the 2005/06 tax year, your company's contributions into your pension scheme are limited by the permitted level of pension contributions, which is set as a percentage of your gross earnings. For example if you have gross earnings of £20,000 at age 40, the maximum you and your company can pay in total into your personal pension scheme is £4,000 gross (20% x £20,000).

From 6 April 2006, this formula is set to change. You may be able to pay 100% of your earnings into your pension scheme, subject to an annual cap of £215,000. But your company might be able to pay any amount into your pension fund that it can justify as a valid business expense. The employer's contribution will not be linked to your salary at all, so when these proposed new rules come into effect, there might be even less reason for you to make a pension contribution personally.

Conducting staff appraisals

Staff appraisals can provide a valuable opportunity for you and your employees to work together to achieve future growth – for the employees' personal careers and for the business as a whole.

They can help you to assess the role of individual members of staff within the company, and to identify who you should or possibly should not continue to employ. They also allow all parties to air any grievances before they become serious issues.

However, without diligent preparation these meetings can be treated as a matter of routine, and not managed in such a way as to attain the maximum benefits. To help get the most out of the appraisal process, try the following procedures:

1. **A formal structure.** Prepare standard forms on which you and the employee can set out an overview of their role and performance ahead of the meeting. This should include a statement of their main responsibilities and achievements, as well as constructive suggestions for future development. You can use the form as the basis of the appraisal meeting.
2. **Put staff at ease.** While the interview should have a formal setting, make it clear that the objective is not simply to judge past performance. Highlight the employee's positive attributes, and make it clear that you are keen to help them to develop their skills further.
3. **Invite feedback.** Giving staff the chance to share their views and ideas may help to uncover any issues which might not be addressed in general staff meetings, and can enable you to identify potential problems in the early stages.
4. **Offer training opportunities.** Your staff are among your business's most valuable assets, and by investing in them you will also be investing in your business. Offering training, a salary review, or other benefits will also make staff feel valued, thereby increasing loyalty and improving performance.
5. **Completing the appraisal.** Once you have agreed on the way forward, compile a document to be signed by employer and employee. Keep a record on file and give a copy to the employee. Make sure the comments are accurate and fair, in case of any future disputes.
6. **Follow up the points raised.** Having agreed on an appropriate plan of action, you should schedule a series of follow-up meetings, perhaps bi-monthly, to assess whether the actions and targets set in previous appraisals have been achieved.

Merger of the VAT and tax offices

In April, the Inland Revenue and Customs & Excise merged into one department: HM Revenue & Customs (HMRC). But how will this merger affect you?

In the long term the Government has promised a 'one-stop shop' for all tax matters concerning small businesses, and hopes that the merger will lead to savings on both sides.

To identify exactly where the efforts of the newly merged department should be concentrated (for example in communications, payment systems, or inspections), HMRC has issued a consultation paper (available at **www.hmrc.gov.uk/consult_new/small-business.pdf**). This paper contains 18 questions, which give users an opportunity to tell the tax officials exactly what they dislike about the systems, and what could be done to improve them.

In the short term the two former departments are operating as before, although there may be more information flowing between former VAT officers and former Inland Revenue Inspectors. Investigations will continue to be handled along tax lines, so a corporation tax inspector will not start to ask questions about VAT, although if he identifies a potential VAT problem he may call in his VAT colleague. Any HMRC officer who contacts you will state clearly which tax, duty or tax credit the enquiry is about.

The contact points for the new HMRC are as before, but there is a new website: **www.hmrc.gov.uk**.

Only time will tell how the merger will affect you, but it is to be hoped that if and when the enquiry and collection functions become merged, the HMRC will adopt the more considered approach which was once common in the old Inland Revenue, rather than the more 'aggressive' stance that was sometimes associated with Customs & Excise. As your accountants, we will continue to monitor developments with your best interests in mind.

WEB WATCH

ESSENTIAL SITES FOR BUSINESS OWNERS

Minimise Waste Maximise Profit **www.maximiseprofit.org.uk**
Free advice and information for businesses on cutting costs by reducing office waste.

Pension Protection Fund **www.pensionprotectionfund.gov.uk**
Information and guidance on the new Pension Protection Fund.

IT Safe **www.itsafe.gov.uk**
Advice on protecting computers and other devices from malicious attacks.

'Stop that Noise' **www.ew2005.osha.eu.int**
Europe-wide campaign targeting excessive noise in the workplace.

REMINDERS FOR YOUR DIARY

September 2005

30 Deadline for submission of the 2005 Tax Return if you wish HMRC to calculate the tax or, if you are an employee, you wish to have a 2004/05 balancing payment of less than £2,000 collected through your 2006/07 PAYE code.

End of CT61 quarterly period

October

1 Due date for payment of Corporation Tax for period ended 31 December 2004

5 Individuals/trustees must notify HMRC of new sources of income/chargeability in 2004/05 if a Tax Return has not been received

14 Due date for income tax for the CT61 quarter to 30 September 2005

19/21 Quarter 2 2005/06 PAYE remittance due

November

1 Please ensure you are retaining your documents for the 2006 Tax Return

2 Last day for notifying car changes in quarter to 5 October 2005 – P46 (Car)

Business and personal planning need not be left until the end of the tax year – talk to us now about tax and financial strategies for you and your business.

The Civil Partnership Act

The Civil Partnership Act comes into force on 5 December 2005. The legislation will create a new legal status of 'civil partner', for same-sex couples who choose to register their partnership.

In the 2005 Budget it was announced that the Government would legislate to ensure that civil partners are treated the same as married couples for tax purposes. From 5 December, the married couples' allowance, tax charges and reliefs and anti-avoidance rules, will all apply equally to married couples and civil partners.

Affected areas include inheritance tax (IHT) – where lifetime transfers and transfers on death between civil partners will be IHT-exempt – and the Child Tax Credit, where individual claims will need to be cancelled and new claims made.

Civil partners will obtain many of the tax advantages of married couples but will also be caught by many of the rules attacking tax avoidance, including the transfer of assets abroad. They will also be 'connected persons' for the purposes of capital gains tax, and 'associates' for the company control tests.

We are sometimes asked if we are able to help additional clients. We are a growing firm and do appreciate your referrals. We consider it a compliment when you recommend us to your friends and business contacts.

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