Tax Wire

Marsland Nash Associates

Summer Edition - Issue 22

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Slicing and dicing your income

Your income tax bill is now determined by a complex network of allowances, tax rates and tax bands, which interact in unexpected ways. There are different tax rates for savings, dividends, and for all other income. Certain allowances apply or disappear as your total income crosses particular thresholds.

The result is a mess, and we take no pleasure in saying it is now virtually impossible to predict your personal tax position using only a pencil and paper. However, such complexity can be used to your advantage if you have control over your own income.

Company owners can determine how much income they draw out of their own company, and the form that income takes: salary, dividend, interest, pension contribution, etc. As all those categories of income are subject to different rates of tax and National Insurance Contributions (NIC), it is possible to plan your income mix to minimise your total tax bill and to fit your personal income needs.

If there are two or more family members involved in the business the possibilities to save tax are magnified. For example, a larger slice of income may be covered by available allowances or fall into the lower tax bands. Unincorporated businesses such as partnerships can be used to share income around a family in a more flexible manner than a company.

To achieve the most favourable tax position it is necessary to look ahead and plan when income will arise, and in whose hands. If this is of interest to you, we should talk. Sensible income and tax planning is no longer a back-of-the envelope task – it requires some deep thought and a cool head.

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Dividend Myths

There is a dangerous rumour kicking around that you can backdate a dividend to avoid paying the dividend tax that applies from 6 April 2016. This is total nonsense.

To be clear: a dividend can't be backdated. Under company law the dividend proposal must be voted on by the company's directors. The dividend can be paid out after that approval has been given.

The dividend need not be paid in cash; it can be credited to the shareholder/director's account within the company. However, the dividend is taxed at the date it is paid to the shareholder, or credited to the shareholder's account within the company, not by reference to the date when it was declared and voted on.

If a dividend was declared and approved before 6 April 2016, and paid out after that date, it is taxed in 2016/17 and it will be subject to the dividend tax. The only way that a cash dividend received in 2016/17 can escape the dividend tax is if it was credited to the shareholder/director's account within the company before 6 April 2016, then at a later date the individual drew funds from that account.

The amount of dividend paid per share must be the same for all shareholders who hold the same class of shares. A company may issue different classes of shares to different shareholders, e.g. A-shares, B-shares, so it can pay a different amount of dividend to, say, the A-shareholders.

The company must have the relevant profits available (called distributable reserves) at the time the directors approve the dividend. That decision should be based on the company's accounts, not simply on cash balances in the company's bank account.

!

We can help you determine if the profits are available to pay a dividend.

Construction Industry Scheme (CIS) is easier

If your business operates in the construction industry, tax will be deducted from payments due to you from contractors, unless you obtain CIS gross payment status.

Obtaining and keeping gross payment status has been difficult in the past as a business could lose that status by underpaying tax by a tiny amount, or by sending in a PAYE return a day late. The good news is that the rules for meeting the tax compliance part of the gross payment status test have been relaxed from 6 April 2016.

Continued/.....

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Continued/……..CIS

Now all you need to do is:

⇒ file all the monthly CIS returns due
⇒ file the self-assessment tax return for the business (Income or Corporation Tax)
⇒ pay CIS tax and PAYE due to HMRC
⇒ meet all requests by HMRC for the supply of accounts and other information about the business

All CIS returns must now be filed online by the **19th of each month**. If there are no payments to report there is no need to file a nil return.

You must, however, verify with HMRC the identity of all the subcontractors you pay before you pay them. You can do this through the CIS online service on gov.uk. This now has an improved matching system, so it should cope with minor spelling differences in a subcontractor's name. If the online verification doesn't work, you can call the **CIS helpline: 0300 200 3210.** **But be warned:** HMRC want to withdraw that telephone service in April 2017.

Real Time Information (RTI) late filing

The Full Payment Submission (FPS) report under RTI should be submitted on or before the date the employees are paid. **A concession which allowed employers with fewer than ten employees to submit one FPS per month, even if there were more pay days, ended on 5 April 2016.**

HMRC is currently risk-assessing the issue of every RTI late filing penalty. This means that only employers who persistently file their FPS report late will be issued with a penalty - which can be appealed.

Also, any filing of the FPS within three days after the due date isn't given a penalty. This three-day grace period has been extended to all FPS reports due before 6 April 2017.

However, HMRC will monitor employers who regularly file late, even within three days of the due date, and they may issue those employers with a penalty warning letter. Note that the three-day grace period doesn't give the employer any legal protection as it is an HMRC concession - it is not written into law.

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TAX RELIEF for successful investors

Investing in unquoted companies is risky, because you can lose everything you put in, as discussed below. If the investment pays off and you make a capital gain, you may want to be rewarded with a nil or low tax rate on that gain.

Entrepreneurs' relief provides a 10% rate of Capital Gains Tax (CGT), but to qualify you need to be closely involved in the company you invest in, as a director or an employee. You also need to hold that position on the day you sell your shares and for at least the previous 12 months.

If you are not going to be involved on a day-to-day basis with the company you invest in, try to acquire your shares under the Enterprise Investment Scheme (EIS) or Seed Enterprise Investment Scheme (SEIS) (for very small companies). The company must apply for approval to run either of those schemes, and certain property-heavy businesses won't qualify.

When HMRC give approval for the scheme you can claim an income tax credit equal to 30% (EIS) or 50% (SEIS) of the amount you invested. You must have a big enough tax bill to soak up this credit. When you dispose of your shares, after three years or more, there will be no CGT to pay on any capital gain, as long as the strict conditions for the scheme have not been broken in the first three years.

If the company doesn't want to jump through the hoops of EIS or SEIS, you may still qualify for the lower 10% rate of CGT when you sell your shares after 5 April 2019, using Investors' relief. The company must be trading, but otherwise there are no restrictions on its activities. You must not be connected with the company as an officer or employee, or be related to anyone connected to the company.

! Let's discuss the conditions necessary **to reduce the tax payable** on a successful investment before you buy those shares.

TAX RELIEF when shares make a loss

There is a very useful tax relief that can convert a capital loss from a failed equity investment in an unquoted trading company into an income tax loss. That loss can then be set against your taxable income and generate a repayment of income tax for you.

If you lend money to the company, and the business fails, you may be able to claim capital loss relief for the uncollectable debt, but the tax relief won't reduce your income tax bill. To achieve an income tax repayment, you need to subscribe for new shares in the company.

You won't get share loss relief on the value of second-hand shares that you have purchased from another shareholder.

Your shares must be part of the company's ordinary share capital, which excludes shares which are only entitled to a dividend at a fixed rate. Preference shares entitled to a fixed rate of dividend won't qualify, but deferred preference shares may, if the amount of dividend potentially payable per share is not fixed.

! *We can advise you on how to structure your investment in order **to protect any tax relief**, just in case the business fails.*

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Protect your lifetime allowance

The Lifetime Allowance (LA) is the maximum total value you are permitted in all tax-advantaged pension schemes, without incurring penal tax charges when accessing benefits. For a 'money purchase' scheme (e.g. a personal pension) the LA is compared to the fund value when first accessing benefits, but for a defined benefit (e.g. final salary) scheme the calculation of effective value is more complicated.

The LA is now set at £1m; for the two years prior to 6 April 2016 it was £1.25m. There is a 55% tax charge on any excess value taken as a lump sum, or a 25% charge if the excess is used to produce income (which itself will be taxable).

Two forms of transitional protection can be claimed by those saving towards the higher limit, but they have different conditions. For example, Fixed Protection 2016 does not allow any further pension inputs, including by an employer.

We can discuss the tax effects of these important issues with you, but advice from a qualified pensions advisor should be taken before making any claim.

State pension changes

If you are due to reach state pension age on or after 6 April 2016, you should receive the new single-tier state pension, rather than the old-style state pension which was made up of lots of elements. However, you are not automatically entitled to a state pension just because you have lived in or worked in the UK.

To receive any of the single-tier state pension, your national insurance record must show that you have paid or been credited with National Insurance Contributions (NIC) for at least ten years. NI credits are added to your NI account when you are paid between £112 and £155 per week (2016/17 rates). You may also receive NI credits in other circumstances, such as when you claim child benefit for a child aged under 12 and you are not working.

It is possible to patch-up your NIC record by paying voluntary Class 3 NIC, or Class 2 NIC in some cases if you are self-employed or live abroad. Before deciding whether to pay voluntary contributions, you should ask the Pensions Service to send you a state pension forecast, so you can assess whether or not such contributions are worthwhile.

Another factor that will affect the level of your state pension is whether you were contracted out of the second state pension prior to 6 April 2016, and paid into a private pension instead. Contracting out is not possible after 6 April 2016.

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Tax on inherited pension pots

The taxation of pensions has changed significantly in the last two years. In particular, the facility to pass on a pension entitlement, known as a 'death benefit', has been reformed.

For deaths before 6 April 2015, the situation was quite complicated. Now the tax treatment depends how old the deceased was when they died.

Essentially, if the deceased was aged 75 or over, the person who is entitled to receive the pension fund after death (the beneficiary), is taxed on the amount they receive as if it was part of their income. If the deceased was under 75, a lump sum or pension income paid to the beneficiary is paid free of income tax.

This is straightforward, but HMRC's computer has not caught up with the new rules. **Sometimes tax is deducted from a pension payment to a beneficiary when no tax is due.**

If this happens to you, please talk to us so we can help you get a refund.

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Tax paid by deceased estates

When an individual dies it can take months or even years to wind up the estate and pay out the funds to all beneficiaries. In the meantime, those funds may earn bank interest.

Since 6 April 2016, interest from banks, building societies and NS&I is paid without tax deducted, but it is taxable. Most people have a £1,000 or £500 annual savings allowance to cover that interest, but executors of deceased estates don't qualify for a savings allowance.

The executors should inform HMRC of all the income the estate receives, so that they can complete a tax return and pay the tax due. This would impose an increased administrative burden on small estates where the only income to report is a small amount of bank interest.

To prevent this paper chase, HMRC has said it won't require executors or trustees to notify them of taxable interest received, where the tax due on that interest is less than £100 for the year. This gives the estate or trust an effective savings allowance of £500.

Inheritance Tax (IHT) planning for untimely death

In early 2016, almost every week brought news of the death of another well-known star of stage, screen or music. This is partly because the baby boomer generation, born in the years 1945 to 1960, are now reaching the end of their lives.

It also serves as a reminder that we each have a finite time on this earth, and without some careful planning, your relatives can be left with a nasty IHT bill to pay on your estate.

One way to reduce IHT is to make gifts of capital while alive, as David Cameron's mother made to him. The IHT is only avoided if the donor survives for seven years after the date of the gift, but it's worth thinking about if one person has been left with more capital than they can reasonably spend.

Many older people are afraid of giving away money that may be needed to fund care in their last years. This is understandable, but we can help with this calculation by working through cash-flow forecasts using various estimates of future expenses and life expectancies.

There is a new IHT exemption for the family home which will apply to deaths on or after 6 April 2017. The property must pass on death to a direct descendent of the owner for the exemption to apply, so the donor's Will must be clear about who is to receive specific properties in their estate. Step children and adopted children are treated as direct descendants for this purpose, but nieces and nephews are not.

Let's have that conversation about planning for tax due after a death before it's too late.

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When Stamp Duty Land Tax (SDLT) supplement is due

When you buy a residential property you may have to pay a 3% Stamp Duty Land Tax (SDLT) supplement on the value of the property. The supplement is due if you own, or partly own, two or more homes at the end of the transaction. It doesn't matter where those homes are situated. A property may be treated as two homes if it comprises a main building and an annex that can be occupied independently, such as a 'granny flat'.

The SDLT supplement can apply when you buy such a property, even if there is a single set of deeds, and the annex can't be sold separately from the main building. This problem is being addressed by the Government – the SDLT supplement won't apply to properties where the annex is worth less than one third of the main property, and it can't be sold separately. The draft law will be changed as it passes through Parliament this summer.

In the meantime, if you have paid the SDLT supplement on a property which is to replace your main home, you can apply for a refund of SDLT from HMRC.

Properties in Scotland are subject to Land and Buildings Transaction Tax (LBTT), which also has a 3% supplement for second homes, but the LBTT rules are different to the rules for the SDLT supplement.

P11D or not to P11D

This year may be the last time you have to submit lots of P11D forms for your employees. Any valid business expenses reimbursed to employees from 6 April 2016 won't have to be reported on a P11D form for 2016/17.

Benefits such as company cars and health insurance will still have to be reported. Although this report can be avoided if you have elected to 'payroll' those benefits – i.e., to include the value of the benefit as part of the amount taxed through the payroll each month. It's now too late to elect to payroll benefits for 2016/17, but you can do so for 2017/18.
Let's talk about what this could save for you.

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VAT Spotlight.....

VAT flat rate scheme

This VAT scheme can save small businesses a great deal of hassle. You may even make money by using the scheme, if you are permitted to use a relatively low flat rate, as determined by your business category.

Choosing which category best fits your own business should be straightforward. Describe your business in ordinary language, then check out the list of business categories and their related flat rates online on gov.uk. There is more detail about each category of business in HMRC's flat rate scheme manual at paragraph FRS7300.

However, there are anomalies in the trade category descriptions. For example, 'publishing' covers books, journals, newspapers and sound recordings, and has a flat rate of 11%, but software publishing falls under computer and IT consultancy (flat rate 14.5%). If your business publishes information online as well as software programmes, you need to judge which products generate the majority of your sales, and use the flat rate applicable to the business category that fits the majority of your sales.

Example:

Publishing
Flat Rate 11%

⇩

Books / Journals / Newspapers / Sound Recordings

Software Publishing
Flat Rate 14.5%

⇩

Computer & IT Consultancy

You should review your choice of business category on the anniversary of the date on which you started to use the flat rate scheme. At that time you should estimate which products will make up the largest part of your sales in the following year. The new flat rate should be used from the beginning of that year.

You should inform HMRC in writing if you have changed the flat rate you use, the date it changed, and why. This letter should be sent to HMRC within 30 days of the date a different flat rate is used.

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Don't hesitate to ask us for help with the flat rate scheme!

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VAT Spotlight.....

Zero-rated sales must be counted

ZER% VAT

If your business is not VAT registered, you should keep an eye on the value of your cumulative sales, to check that total doesn't creep over the VAT registration threshold. That threshold is now £83,000 for 12-months' worth of turnover, but what categories of sales should be counted towards it? The simple answer is: all business sales could be subject to VAT. The confusing thing is that some items carry VAT at zero (0%) and other goods and services are exempt from VAT. The exempt items should not be counted as part of the turnover when testing whether the registration threshold has been reached, but the zero-rated items must be included.

Food and books are two of the most common categories of products which are subject to VAT at 0%, but there are always exceptions that may catch you out. For example, food purchased to be consumed in a café is subject to VAT at 20%, and e-books generally carry VAT at 20%. You can see that the VAT rules quickly become complicated. This is especially true for retail businesses which supply hot and cold food to eat in and take out.

We can help you check that your business stays within the VAT tram-lines and does not become derailed by zero-rated or exempt VAT items.

Keep copies of your VAT returns

It's a basic check that needs to be done every year – reconciling the sales reported on your VAT returns to those in your annual accounts. HMRC will do this, so if there are differences, the tax inspector is likely to ask questions.

There are several reasons why the sales reported in your accounts may be higher than the total from your quarterly or monthly VAT returns. Some of your turnover may be exempt from VAT, or outside the scope of VAT if you sell to businesses in other countries. We can help you explain any differences to HMRC should they ask. However, it is essential that you retain copies of your VAT returns.

Although HMRC insists that all VAT returns are submitted online, you can only access copies of VAT returns which were submitted in the last 15 months, no more.

Don't forget to print out VAT returns once they have been submitted!

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VAT Spotlight.....

VAT trap when changing business

Businesses evolve and grow. What starts with one man in a garage can grow into a multi-national enterprise. Along the way the business will operate through different legal structures; from sole trader to partnership, single company to a group of companies.

At each of those transitions HMRC should be informed, as different tax rules will apply to the new entity. This is particularly important for VAT, as the VAT registration number doesn't automatically transfer, and the new business structure may receive a penalty for not applying for a new VAT registration.

This can be a problem when an individual takes their son, daughter or spouse in to the business, and the sole trader suddenly becomes a partnership. HMRC will see the new partnership as a completely separate entity, although in reality the business has been transferred as a going concern from the hands of the sole trader into the partnership.

The new partnership needs to register for VAT immediately, and it can apply to have the VAT number transferred from the sole-trader business. HMRC will also have to be informed of the details of all the partners.

The transfer of the VAT number is not always a good idea, but it can make life easier where there are on-going contracts which are taken on by the new partnership.

! **We can help you avoid those little VAT-traps, if you let us know what has changed in your business.**

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