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Hillier Hopkins LLP
Chartered Accountants and Tax Advisers
hillierhopkins.co.uk

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Tax Briefing - Winter 2016

Preparing for digital business records

Lost or forgotten

HMRC believe that a lot of small businesses don't pay the right amount of tax on their profits. This is because they delay writing up their accounting records to the end of the year; in the meantime some receipts are lost and bits of income are forgotten. To resolve this problem, HMRC will require businesses to record their expenses and income digitally, as near to the date of payment or receipt as possible. HMRC think that simple accounting software, such as an app on your smart phone, will make this task easy to do. Free software may be available for very simple businesses.

Quarterly reporting

Most unincorporated businesses and landlords will also have to report a summary of their income and expenses to HMRC, within one month of the end of each quarter. The accounting software may help to do this, but we can check that the correct information is submitted. These changes are collectively called: Making Tax Digital, but we suspect it is going to feel like 'making tax difficult' for many businesses.

Exemptions

The new rules are due to come into force from 6 April 2018. Those with low levels of income (we don't know the threshold yet) won't be required to make quarterly reports to HMRC. Also, some smaller unincorporated businesses who are over the threshold may not need to make quarterly reports until after 5 April 2019.

The current timetable envisages that all companies will be making quarterly reports from April 2020. But HMRC have not specified exactly what will be required to be reported by companies or by complex partnerships, so we expect this timetable to slip.

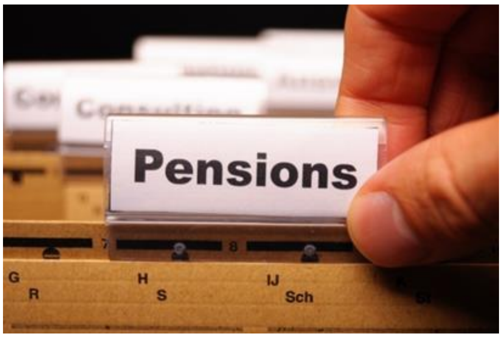
Be prepared

The best way to prepare for this digital revolution is to get into the habit of recording your income and expenses using some form of accounting software. We can help you choose and implement the right software for your business.

Pensions recycling

Anyone aged 55 or over can now access their pension savings built up in a money purchase (defined contribution) scheme. This access can be as a one-off lump sum payment, an annuity purchase or as flexi-access draw-down.

The downside is that, depending on how you draw your pension benefits, you may be subject to the money purchase annual allowance which restricts your contributions to £10,000 per year. This is to prevent people from drawing funds from their pension scheme and replacing the money in the same or another pension scheme, with additional tax relief.



From 6 April 2017, the amount you can contribute into a pension scheme after starting to draw your benefits will be reduced to £4,000 per year. If you don't use that allowance in the year, it can't be carried forward to the next tax year. You can continue to save for retirement in other ways, such as using an Individual Savings Account (ISA). The current annual ISA contribution limit is increasing from £15,240 to £20,000 on 6 April 2017.

VAT flat rate scheme skewered

Many small businesses use the VAT flat rate scheme (FRS) to simplify VAT reporting and some gain a cash advantage from using the scheme.

When using the FRS you simply multiply your gross sales (including VAT charged at nor-mal rates) by the FRS percent-age for your trade sector. You ignore VAT incurred on purchases, except for capital items costing £2,000 or more. The FRS percentage

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is set to take account of the VAT likely to be incurred on business expenses.

A business which incurs few expenses, and operates in a sector with a relatively low FRS percentage, will pay out less VAT to HMRC under the FRS, than outside the scheme. This is the cash advantage.

The Government is set to remove this cash advantage from 1 April 2017 by requiring low-cost traders to use a FRS percentage of 16.5% of gross sales. This is equivalent to 19.8% of net turnover, leaving almost no credit for VAT incurred on purchases.

You will be classed as a low-cost trader if your annual expenditure on goods (not services) is less than 2% of your gross turnover, or if more than 2%, less than £1,000 per year. This will discriminate against businesses who incur VAT on services such as rent, software licenses, IT support, digital journals, subcontractors, and telecoms.

Knowledge-based businesses such as consult-ants, journalists, estate agents and lawyers, may find it uneconomic to use the FRS. If you work in a knowledge-based trade, we should discuss whether you should withdraw from the FRS from April 2017 or even deregister from VAT.

Quarterly reporting for agencies

Employment agencies are required to report to HMRC the payments they make to workers they place with third par-ties, if those workers are not paid under PAYE. This requirement covers any organisation who finds work for an individual, which can include many agencies or intermediaries. One-man companies who only find work for their sole director are, however, exempt.

This reporting requirement has been in place since 6 April 2015, but many businesses are unware that they need to report to HMRC at least four times a year, within one month of the end of each quarter. For the quarter to 5 January 2017 the report must arrive with HMRC by 5 February 2017. If the agency has not supplied any workers in the period it must submit a nil report by the same deadline.

The report must be submitted online using a prescribed spreadsheet. HMRC are starting to issue penalties for late reports. These start at £250 for one late report in twelve months, increasing to £1,000 for three or more late reports, then £600 per day for a continued failure to report on time.

Where your business is involved in finding work for others, we should talk about your reporting requirements. Don't ignore any penalty notice you receive from HMRC.

Working for public sector clients

If you contract through an agency to work for a public sector body, from 6 April 2017 the agency will have to decide whether the contract falls within IR35 or not. If it does, the payment to your personal company will be subject to PAYE and NIC and no 5% deduction for costs will be made. This change only applies to public sector contracts.

How your savings are taxed

For many years banks have deducted tax from interest they paid to savers, un-less the particular account was designated as tax-free, such as an ISA. That default position has changed from 6 April 2016.

Now all bank and building society interest is paid without tax deducted, but the individual saver is taxed on the interest they receive. However, most taxpayers are eligible to be taxed at 0% on all their savings income, which includes interest, so no tax is payable.

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This zero tax rate applies if the savings income falls within the taxpayer's savings rate band (worth up to £5,000 per year) or within their savings allowance (worth up to £1,000 per year). Any savings income which falls outside that rate band or allowance is taxed at the taxpayer's marginal income tax rate (20%, 40% or 45%).

Dividends are not categorised as savings income as they are subject to different tax rates and allowances. How much savings rate band (SRB) you have available depends on the level of your taxable non-savings income for the year. Any salary, pensions, trading profits or rent you receive, which exceeds your personal allowance, eats up your SRB.

Example
Colin receives a pension of £16,000. After deducting his personal allowance of £11,000, he has £5,000 of taxable pension. This entirely eats up his SRB, so he has no SRB band to set against his £1,500 of saving income.

Colin's total taxable income is £6,500 (£5,000 pension + £1,500 interest), which falls within the basic rate band (up to £32,000). As a basic rate taxpayer, Colin is entitled to a savings allowance of £1,000. He deducts this allowance from his savings income of £1,500, leaving £500 taxable at 20%. Colin pays tax of £100 (£500 x 20%) on his savings income.

Marginal taxpayers
Higher rate taxpayers are entitled to a savings allowance of £500 and additional rate taxpayers (income over £150,000) are not entitled to the savings allowance. Taxpayers whose income pushes just over the basic rate band into 40% tax rate, will lose half of their saving allowance. Straying over the £150,000 threshold, will mean all the savings allowance dis-appears.

The boundaries between the tax rates can be expanded by making gift aid donations or personal pension contributions. We can calculate whether an additional pension contribution or donation will reduce your total tax bill.

Topping-up your state pension

To receive the full amount of the new state pension you need to pay national insurance contributions (NIC) for 35 complete tax years. If you were contracted out of the second state pension, or SERPS, for any part for your working life you may receive less pension than you were expecting. You can check how much state pension you are due to receive on gov.uk under 'check state pension' or through your personal digital tax account. We can help you with this.

Where you have missed paying NIC, those contributions can often be replaced using voluntary NIC payments; Class 3 NIC for employees or Class 2 NIC for the self-employed. This top-up facility is particularly useful for those who have retired before state pension age or have missed making contributions because they lived overseas.

Spouses and civil partners of members of the armed forces, who accompanied their partners when posted overseas, can apply for NI credits toward their state pension for tax years back to 1975-76.

If you reached pension age before 6 April 2016 you can also top-up your state pension by up to £25 per week, by making lump sum payment before 6 April 2017. The amount due will depend on your age at the time you make the payment. This is a useful way of increasing the income of women who have a small state pension because they spent some years out of the workforce.

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Trivial benefits

A trivial benefit is a non-cash gift to an employee, not ex-changeable for cash and worth no more than £50. Employers can give as many trivial benefits to their employees as they wish. Each gift is tax-free and exempt from NIC, as long as it is not a reward for services, and not connected to the recipient's employment contract. The employer could provide a £50 gift card to each employee on every working day of the year, but that is likely to be seen as a reward for services, in which case the gifts would be taxable.

A company's directors are only permitted to receive up to £300 of trivial benefits each tax year. That total includes the value of trivial benefits provided to a director's family members. This cap for directors permits the company to buy six £50 gift cards to give to each director at intervals (they must be separate gifts). The director is then free to spend or distribute those gift cards as they wish. Many other forms of gift will qualify as a tax-free trivial benefit.

Salary sacrifice

Many employers allow employees to pick and choose from a range of benefits such as extra holiday, company car or health insurance. Each employee may be able to sacrifice a part of their salary to receive the benefit, which often results in NIC savings for both parties and a tax reduction for the employee.

From 6 April 2017, most benefits provided by way of salary sacrifice will be taxable on the greater of:

- the amount of salary sacrificed
- the value of the benefit for tax purposes.

The employee will face an increased tax charge on the grossed-up value of the benefit, i.e. the gross salary needed to buy the benefit after tax deductions.

There will be transitional arrangements for cars, school fees and living accommodation, which can stay in place until April 2021 without additional tax charges. Also, the tax treatment of these four benefits won't be affected:

- pension contributions and associated advice
- childcare vouchers
- cycling to work scheme
- ultra-low emissions cars.

In all other cases, the salary sacrifice arrangements should be reviewed without delay.

Marriage allowance

If you are married or in a civil partnership, you may be able to claim the 'marriage allowance'. This is not a separate allowance, but a reallocation of 10% of the personal allowance from the partner with lower income to the other partner.

The marriage allowance can't be claimed if the higher earner pays tax at 40% or more or if either was born before 6 April 1935. The person who surrenders the allowance has their personal allowance reduced by £1,060 for 2015-16 (£1,100 for 2016-17). This should have no effect on their tax position if they have 'spare' allowance of at least £1,060 to surrender. However, if the taxpayer's income is greater than the personal allowance due to dividend income, an unexpected tax charge may occur. The HMRC computer applies the marriage allowance by reducing the tax due of the recipient by £212 (20% x £1,060), but in some cases the computer has in creased the tax bill by £212. HMRC say this fault has been fixed, but the tax calculations may still be showing the wrong amount.

If you have made a claim for the marriage allowance for 2015-16, your tax payments for 2016-17 should not be affected, but that is not how some tax soft-ware has been programmed. If you have some odd figures in your personal tax account after claiming the marriage allowance, talk to us and we'll help you get to the bottom of it.

For a free initial consultation please contact:

Debbie Wilson
Associate
+44(0)207 004 7139
debbie.wilson@hhllp.co.uk

Ian Abrey
Principal
+44(0)207 004 7140
ian.abrey@hhllp.co.uk

Offices

Aylesbury
Milton Keynes
London
Watford