CHARTERED ACCOUNTANTS, TAX CONSULTANTS & FINANCIAL PLANNERS

ALBERT GOODMAN

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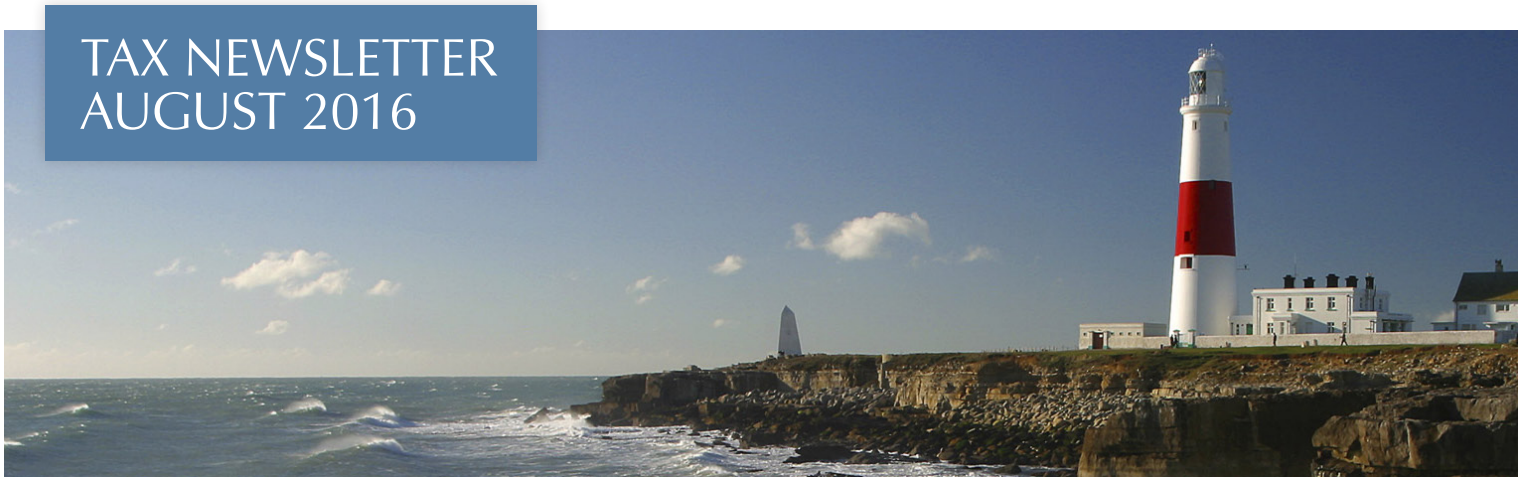

Welcome to this month's eNews. The summer is well and truly upon us now with much deserved family holidays, the start of the Olympics and even some sunshine!

We also have a new Prime Minister who vowed to rule out new tax rises for the rest of this decade by dropping Government plans to achieve a budget surplus by the end of the Parliament. Theresa May has also said that she would not order an emergency budget in response to the Brexit vote but we will have to wait and see how the vote to leave the EU affects the country's finances going forwards. Interest rates have already been dropped to a new low of 0.25% and the Bank of England Deputy has said that they could be cut again before the year is out.

This month we take a closer look at the fine line between when a 'business' is a trade and when it is a hobby. We also consider some further guidance issued by the Government on how the forthcoming restrictions to interest relief on residential property will work in practice. Finally, if you are feeling inspired by the Olympics, see the article below on gaining tax relief whilst supporting local sportspeople.

As usual, please do get in touch if you would like further guidance on any of the areas covered.

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IT'S YOUR BUSINESS, BUT IS IT A HOBBY OR A TRADE?

You may think that HMRC considering your business to be a hobby is a good thing. However, this does not mean that the income you receive will always be tax free and you may also lose out on a number of valuable tax advantages.

For example, you cannot claim losses arising in your business against other income for tax purposes unless you are carrying out a trade on a commercial basis. Nor can you claim capital allowances on plant and machinery purchased for your business. In addition to this, claims for relief for inheritance tax and capital gains tax purposes will not be available unless a trade exists.

As it is so important to determine whether or not you are carrying on a trade, you should be aware of some of the indicators ('badges') of whether your business is a trade or if it is simply a hobby.

Motive

Your intentions will be a factor in deciding whether or not a trade exists although this alone will not be conclusive. If you are intending to sell an asset at a profit, even if a profit is not actually realised, this may indicate that a trade exists. Similarly, if you intend to hold an asset as an investment, even if this is then sold, this could support a claim that a trade was not being carried on.

It can be difficult to provide evidence to support your motive but you should try to keep records of your intention, particularly if this changes due to unforeseen circumstances.

Nature and quantity of the asset

How many items you purchase, and the nature of these items, will also be taken into consideration when determining whether a trade is being carried on. Purchasing, and consequently selling, many of the same items may indicate a trade exists, particularly if this is not an item you are likely to use personally.

An instance which actually happened in the 1900s involved an individual who purchased, and quickly sold, one million toilet rolls. As it is unusual for an individual to require so many toilet rolls, the courts felt that the individual must have purchased the toilet rolls with the intention to sell these and that they were therefore carrying on a trade.

Improving the asset before sale

By making improvements to your asset before selling it, you may indicate that you are carrying on a trade. This is because it is felt that you are making the asset more attractive to potential buyers as well as increasing its value so you may sell it at a profit. The changes to the asset do not need to be drastic, for example, simply repackaging the items into more attractive packaging could indicate you are carrying out a trade.

Number of transactions

If you repeatedly enter into the same or similar transactions, this will be an indication that you are carrying on a trade. These transactions do not necessarily have to occur within a short space of time but could occur over a number of years.

For example, purchasing a home which you live in and then selling it at a profit is not likely to indicate that you are carrying out a trade. If, however, you purchase and sell three homes within the same number of years, this could indicate that you are involved in a property business with the aim of making profits on the sale of these properties.

Looking at the whole picture

These 'badges', amongst others, will be looked at together in order to identify whether or not a trade exists and it is unlikely that just one of these points would produce a foregone conclusion.

In recent years, HMRC has been taking a hard approach on whether or not a trade exist, in particular HMRC has been targeting individuals making profits by selling goods online or at car boots. However, the proposed introduction of the micro entity allowance, a £1,000 allowance for individuals trading at home, suggests a reduction in pressure on these individuals.

Until the micro entity allowance is introduced next year, and the final details confirmed, all traders will still be required to report their profit or loss to HMRC through their annual tax return. If you are concerned that your hobby may be more than just a pastime, we would be pleased to discuss this with you and assist with any reporting requirements which may be necessary.

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RESIDENTIAL PROPERTY INCOME AND INTEREST RELIEF

The Government has issued guidance and examples on the restriction of income tax relief for interest costs incurred by landlords of residential properties. The new rules, which are phased in from April 2017, only apply to residential properties and do not apply to companies or furnished holiday lettings.

From April 2017 income tax relief will start to be restricted to the basic rate of tax. The restriction will be phased in over four years and therefore be fully in place by 2020/21. In the first year the restriction will apply to 25% of the interest, then 50% the year after and 75% in the third.

The restriction may result in additional amounts of tax being due but will depend on the marginal rate of tax for the taxpayer. Despite the headlines, the new rules will affect both basic rate and higher rate taxpayers and the calculation method may mean that more taxpayers will move into the higher rate tax brackets as the following example illustrates:

Consider the 2020/21 tax year when the transitional period is over. Assume that the personal allowance is £11,000, the basic rate band £32,000 and the higher rate band starts at £43,000.

Assume Ellisha has a salary of £28,000, rental income before interest of £23,000 and interest on the property mortgage of £8,000. Under the current tax rules, taxable rental income is £15,000. She will not pay higher rate tax as her total income is £43,000 - the point from which higher rate tax is payable.

With the new rules, taxable rental income is £23,000. So £8,000 is taxable at 40% - £3,200. Interest relief is given after having computed the tax liability on her income. The relief is £8,000 at 20% - £1,600. So an extra £1,600 tax is payable.

Other complications

It should be noted that the tax reduction cannot be used to create a tax refund. So the amount of interest relief is restricted where either total property income or total taxable income (excluding savings and dividend income) of the landlord is lower than the finance costs incurred. The unrelieved interest is carried forward and may get tax relief in a later year.

It is also important to note that child benefit is clawed back if 'adjusted net income' is above £50,000. Interest will not be deductible in the calculation of 'adjusted net income' from April 2017.

The personal allowance is reduced if 'adjusted net income' is above £100,000, and so more taxpayers will lose their personal allowance from April 2017.

Please contact us if you would like advice on how these rules will affect you.

Internet links: News | Examples

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HELP OUR FUTURE OLYMPIANS

With the Olympics in full swing, you may be inspired to support local sportspeople who could go on to become future Olympians. Gift aid donations to Community Amateur Sports Clubs (CASCs) can be a good way for taxpayers to support such people and save you tax at the same time. These donations allow the club to claim tax relief on the money they use to promote and provide facilities.

There are 6,800 clubs registered as CASCs and not everyone is aware that donations to these organisations qualify for gift aid relief in the same way as a donation to a charity. For every £80 donated, the club will receive an extra £20. Take care though, as non-taxpayers should ensure that they do not use gift aid when making these donations or they could receive an unexpected tax bill (see our article from the **June eNews**).

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DON'T MISS OUT ON THE MARRIAGE ALLOWANCE

According to reports, many couples have yet to make the claim to transfer any surplus personal allowance to their basic rate spouse. It is not clear why this is but there seems to be a lack of awareness and, an uncertainty as to how

the claim should be made, together with misleading guidance from HMRC.

The potential beneficiaries of this allowance are likely to be pensioners or families with young children where one spouse does not work or only has a small pension. The tax saving amounts to £212 in the 2015/16 tax year and £220 in 2016/17. The allowance works by transferring up to 10% of an individual's personal allowance to their spouse, thereby utilising any unused personal allowance of one spouse and increasing the tax free income of the other. In order to make a claim the following conditions must be satisfied:

- The claimants must be married or in a civil partnership.
- Both individuals must not be higher or additional rate taxpayers.
- The claimants must not have claimed married couples' allowance.
- The individual with the lower income, i.e. the 'transferring spouse', must elect for a reduced personal allowance
- The recipient of the increased allowance must not be using the remittance basis.
- The recipient of the increased allowance must be resident in the UK, Isle of Man or the Channel Islands, or a national of an EEA state.

Provided the above conditions are met, a claim can be made by the transferring spouse, either online, or via their tax return. Claims can also be made by telephone for those individuals who do not have access to the internet. HMRC will require both national insurance numbers as well as an acceptable form of ID for the transferring spouse.

The allowance can also be transferred between two basic rate taxpaying spouses, for example, where one receives dividend income taxed at 7.5% and the other receives rental, interest or employment income, which is taxed at 20%. Here, the saving reduces to £138, but may still be worth considering.

Provided the above conditions were also met in the previous tax year, you will also be able to backdate your claim to 2015/16. The claim could therefore be worth a total of £432 for both tax years and is really very simple to do. Apply now to avoid missing out! Alternatively, if you are unsure whether this would benefit you or would like any help making the claim, please contact us.

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TAX FREE CHILDCARE

Early next year we are expecting the launch of a new Government scheme to help working parents with the cost of childcare.

For every £8 paid into the new scheme, the Government will pay in an extra £2. Parents can receive up to £2,000 per child, per year, towards their childcare costs. This is increased to £4,000 per year for disabled children.

The scheme will be available for children up to the age of 12, or 17 for children with disabilities. Parents will be required to open an online account to pay for childcare from a registered provider.

To qualify, parents will have to be in work earning at least £115 per week each, and not more than £100,000 per year.

HMRC have published a factsheet entitled '10 things parents should know about Tax-free childcare' which can be viewed here: **http://tinyurl.com/ofcyzmx**

We will keep you updated with further details of the new scheme as and when they are announced.

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IHT - MAIN RESIDENCE NIL RATE BAND

Details of the how the much publicised main residence nil rate band will operate for inheritance tax purposes ("IHT") are now included in the draft 2016 Finance Bill, although this is not yet law as the Bill is still passing through Parliament.

As the proposed legislation stands, the headline addition to the transferable IHT nil rate band is being phased in from 2017/18, with the full additional allowance of £175,000 per person being available from 2020/21. After that, the allowance will increase by the consumer price index each year.

The new band will be available where there is a death after 5 April 2017, but may apply to any sales of qualifying

homes that take place after 8 July 2015.

In particular, the calculation of the downsizing addition is very complex and does not necessarily work as you may expect. Downsizing can apply in two situations: where the person has previously downsized, replacing their home with a smaller property; and where there is no residential property on death, because they have sold a property before death and not replaced it with another one.

Where several properties have been sold, it is possible to nominate the most advantageous qualifying sale.

The calculation is complex and beyond the scope of this article, however, the important message is that detailed records of any sales made since 8 July 2015 should be kept, to enable the most beneficial claim to be made, possibly many years later.

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DIVIDEND PAYOUTS HIT RECORD HIGH

Prior to the new dividend taxation rules coming in from 6 April 2016, small to medium sized businesses paid out a record percentage of profits as dividends to take advantage of the old tax rates.

Total dividend payments increased to £28.3 billion in 2015/16, up from £17.5 billion in 2014/15. This represents a 62% increase on dividends paid over the previous year.

Under the new rules, the first £5,000 of dividends received in a tax year are now tax-free but anything over this will be taxed at 7.5% for a basic rate taxpayer, 32.5% for a higher rate taxpayer, or 38.1% for an additional rate taxpayer.

Planning how you draw remuneration from your personal company remains an important decision and if you would like to discuss how to extract funds in the most tax efficient way, then please do get in touch.

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WORKING IN HOT TEMPERATURES

With a promised heatwave on the horizon, ACAS have some guidance on 'hot weather' working. The guidance confirms that:

'In the UK there is no maximum temperature that a workplace is allowed to be, rather advice from the Health & Safety Executive (HSE) states 'during working hours, the temperature in all workplaces inside buildings shall be reasonable'. What is reasonable depends on the type of work being done (manual, office, etc) and the type of workplace (kitchen, air conditioned office, etc).

*The HSE offers further guidance on workplace temperatures including details on carrying out an optional thermal comfort risk assessment if staff are unhappy with the temperature - **Health and Safety Executive (HSE) - Temperature**.'*

The ACAS guidance also covers issues such as getting to work, keeping cool at work, fasting during hot weather, vulnerable workers and dress code during hot weather.

Internet link: ACAS website

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CLASS 1A NATIONAL INSURANCE PAYSLIPS

Although the P11D filing and payment deadlines have now passed, HM Revenue & Customs are still issuing payslips for class 1A national insurance. If you are satisfied that your business' P11Ds have been submitted and the class 1A national insurance payment has been made, the payslips can be ignored.

If we prepared your P11Ds and you want any clarification, please do get in touch.

Alternatively, if you would like to check with HM Revenue & Customs that they have received your payment, call HMRC on the employer helpline (0300 200 3200).

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UPDATED STUDENT LOAN DEDUCTION GUIDANCE

HMRC have issued updated guidance to employers on how to deal with student loan deductions via the PAYE system.

Employers should familiarise themselves with the guidance which has been updated to reflect the introduction of plan 2 loans which are repayable from a different threshold but at the same nine percent basis.

With effect from the 2016/17 tax year there are two plan types for student loan repayments:

- plan 1 with a threshold of £17,495 (£1,457 a month or £336 per week)
- plan 2 with a threshold of £21,000 (£1,750 a month or £403 per week)

The updated guidance includes the following advice on identifying the plan type:

'Start making student loan deductions from the next available payday using the correct plan type if any of the following apply:

- *your new employee's P45 shows deductions should continue - ask your employee to confirm their plan type*
- *your new employee tells you they're repaying a student loan - ask your employee to confirm their plan type*
- *your new employee fills in a **starter checklist** showing they have a student loan - the checklist should tell you which plan type to use*
- *HM Revenue and Customs (HMRC) sends you form SL1 'Start Notice' - this will tell you which plan type to use*

*If your employee doesn't know which plan type they're on, ask them to **contact the Student Loan Company (SLC)**. If they're still unable to confirm their plan type, start making deductions using plan type 1 until you receive further instructions from HMRC.'*

If you would like any advice or help with payroll matters please get in touch.

Internet link: Guidance

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Tracey Watts, Tax Partner

T: 01823 286096 E: tracey.watts@albertgoodman.co.uk

Tara Hayes, Tax Manager

T: 01823 286096 E: tara.hayes@albertgoodman.co.uk