TAX NEWSLETTER MAY 2017

Welcome to this month's eNews in which we report on the short Finance Act which was rushed through Parliament in advance of the General Election.

With the General Election fast approaching, all parties are putting forward their proposals for the future of our tax system. By this time next month, we will know the result of the election and will be able to provide a bit more insight into how the winning party's proposals may affect you.

In the meantime, there is already widespread speculation that there will be increases to capital gains tax, which may mean putting some planning in place now to protect future disposals, and we take a brief look at this, as well as a closer look at use of the cash basis of accounting, together with some changes to the 'off payroll working' rules that exclude some businesses from being unintentionally caught by the provisions.

If you would like further information on any of the topics discussed this month, please do not hesitate to contact us.

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ER CHANGES?

Most business owners would expect to qualify for Entrepreneurs' Relief (ER) if they sold their business. ER reduces your rate of tax on a sale from 20% to 10%.

Whilst the current Government has been broadly supportive of ER, whichever party wins the Election will find themselves looking to find additional tax revenues without increases in the headline rates of tax or hitting "real people", so some restrictions on ER might be on the horizon.

What are the soft spots of ER?

The ER rules could be seen to be too generous, and therefore restricted in the future, in a few aspects:

- Working hours could be set at a minimum level of say 25 hours per week.
- The current 5% minimum shareholding could be increased to say 25%.
- The lifetime limit of £10m could be reduced.

What can be done about it?

Some straightforward planning could be done to give you the ability to lock in the benefits of the current regime, even if the rules change, without crystallising a tax liability in the meantime. When you then come to the actual sale of the business, if the rules have changed then you would be protected from the effect of this, and if the rules haven't changed then no harm will have been done. In some ways you could view this as similar to a form of insurance in case ER is restricted.

Please contact us if you would like further information on this.

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GENERAL ELECTION AND THE FINANCE ACT

With the announcement of a snap General Election on 8 June the time available for scrutinising proposed legislation was short so the Finance Act was rushed through Parliament. Many clauses have not made it to the final legislation due to time constraints. These include the provisions to enable Making Tax Digital (MTD), changes for Non Domiciled individuals and corporate losses.

The clauses are likely to be reinstated after the General Election, when, hopefully, there will be more time to debate the measures in greater detail. Whilst the controversial MTD was dropped, it is likely the measures will be reintroduced in the Finance Bill expected post Election, but whether this will provide a delay to the planned introduction of April 2018 remains to be seen.

Internet links: **ICAEW news** I **Parliamentary Bill**

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CASH BASIS – IS IT WORTH A LOOK?

The Finance Bill included a provision for all rental businesses with turnover of less than £150,000 to prepare accounts on a cash basis, unless they elected to continue with the accrual basis. Whilst this measure was dropped from the final Bill, it is possible that the measure will be reintroduced in the Bill post Election, and possibly backdated to 6 April 2017.

What is it?

Accounts are generally drawn up under Generally Accepted Accounting Principles (GAAP) and are intended to show a true and fair view of a business, by ensuring that debtors, creditors, accruals, prepayments, stock and work in progress (WIP) are all included in the balance sheet, impacting on the profit or loss for the year.

The cash basis ignores all of the above and simply concentrates on receipts and payments during the period. With the move towards Making Tax Digital (MTD) and the use of bank feeds directly integrating with accounts software, it can be seen that the simpler cash basis may facilitate MTD more easily.

How does it work?

The aim is to make your record-keeping simpler by only having to record details of receipts and payments – if your business runs solely from a single business bank account, then all you need to do is track the entries on that account.

You would only be taxed on income when it was received, so there is no need to worry about amounts owed to you or having to make any bad debts provision. Conversely, you only get relief for expenses when they are paid – so delays in paying your suppliers would increase your profits and tax liability.

Who may use it?

The main criteria for determining eligibility to use the cash basis is the entry threshold, which from 6 April 2017 will be annual turnover of less than £150,000 (reduced proportionately for a shorter period). Once in (and you have to currently elect to use it on your tax return) you have to continue using it until you become ineligible – this could be once your turnover exceeds the exit threshold (£300,000 from 6 April 2017) – or if your circumstances change such that your accounts need to be prepared under GAAP.

There are some exclusions – companies; an LLP or a partnership with at least one non-individual (e.g. corporate partner) partner; Lloyds Underwriters; farmers who have made a herd basis election or wish to use the profits averaging rules; as well as other more specific exclusions.

Are there any particular rules relating to the cash basis?

Yes – although this is intended to be a simpler basis of accounting, there are still general tax principles to consider regarding the allowability of expenditure as well as other tax principles.

One of the major differences is that under the cash basis, capital expenditure on qualifying plant and machinery (not cars) will be allowed as a revenue expense rather than being subject to capital allowances under the normal basis (although the availability of the Annual Investment Allowance effectively gives this for other businesses subject to the expenditure limits). Similarly, disposal proceeds for existing assets are simply taxed as income. The existing capital allowance rules continue for cars.

One of the major disadvantages to the cash basis is that any loan interest paid is restricted to a maximum of £500 p.a. – this includes any related costs of obtaining the finance etc. If your business is funded largely by borrowing then this would probably be a major disincentive against using the cash basis.

A further disadvantage is that loss relief is more restrictive if using the cash basis, as any loss can only be carried forward against future profits (except on cessation) whereas under the normal basis, there is the potential to carry back losses against previous profits or to set them off against other income in the year, which can be very helpful during start up periods.

Finally, if you are using the cash basis when you cease trading, any closing stock or WIP (valued on a just and reasonable basis) must be brought into the accounts as a receipt.

How do I make the transition to the cash basis?

Assuming you are eligible and feel that you would be better off using the cash basis, there is one further aspect to consider.

When making the transition to the cash basis, any debtors, stock, WIP, prepayments, accruals, creditors etc. at the start of the year have to be considered, as all of these would have been taken into account in arriving at the previous year's profit calculated under GAAP. The net of all of the above items is either "adjustment income" (if positive) or "adjustment expense" (if negative) and is either added to or deducted from the profits calculated on the cash basis in year one. Broadly speaking if the assets mentioned above exceed the liabilities, you will end up with an expense which will reduce your profits, but if your liabilities outweigh your assets, it will result in an addition to profits in year one.

Finally, it is worth noting that any balance left on the capital allowance pools (except cars) which has not previously been claimed, can be claimed as an expense in year one on the cash basis. The position can be slightly different if there is outstanding hire purchase finance involved.

Is there a similar adjustment made when I leave the Cash Basis?

Yes, although there is one distinction – any “adjustment expense” is deducted in year one of the accruals basis (as on entry) but any “adjustment income” amount is automatically spread over six tax years, although there is the option to accelerate this tax charge (similar to the issues faced by solicitors when UITF40 was introduced).

In this case, an excess of assets over liabilities will result in “adjustment income” whereas if liabilities exceed assets there will be an “adjustment expense”.

The Million Dollar Question – is it appropriate for me?

Assuming you are eligible under the criteria mentioned above, you probably need to consider the following before making any decision:-

- Profits calculated under cash basis compared to accruals basis.
- The effects of making the transitional adjustment to the cash basis.
- Any restrictions (e.g. interest relief or loss relief) under the cash basis.

If your accounting system is already geared up for accruals accounting (e.g. using sales ledger and purchase ledger etc.) there may not be anything to gain from simpler record-keeping, but if there is hassle involved in calculating debtors and prepayments, creditors and accruals at the year-end as a one-off annual exercise, you might be able to benefit from using the cash basis.

Cash Basis for Landlords – a few differences

It was proposed that the cash basis would also extend to property owners from 6 April 2017, but these measures were dropped at the last minute. If they do come back in the next Finance Bill, the following differences should be noted:

- The use of the cash basis will be mandatory rather than optional.
- If landlords below the £150,000 threshold wish to continue to use accruals accounting, they would need to elect to use this.

The restriction of deductible interest to £500 p.a. does not apply to landlords, as there are of course the general restrictions in respect of interest claimed against residential lettings which came in from 6 April 2017.

In terms of transitional adjustments, for landlords who have previously been using the accruals basis, it is quite possible (particularly for quarterly rents) that at any given 5 April year end, there would be significant amounts carried forward as deferred income and these may outweigh any assets such as debtors or prepaid expenses (stock and WIP are not likely to be relevant in these circumstances). As such, there is likely to be a significant amount of “adjustment income” to add to rental profits in year one.

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OFF PAYROLL WORKING IN THE PUBLIC SECTOR RULES AMENDED

From 6 April 2017, new tax rules were introduced which potentially affect individuals who provide their personal services via their own companies (PSCs) to an organisation which has been classified as a ‘public authority’. Amendments have now been made to the definition of a public authority.

Where these rules apply:

- the public authority (or an agency paying the PSC) calculates a ‘deemed payment’ based on the fees the PSC has charged for the services of the individual.
- the entity that pays the PSC for the services must first deduct PAYE and employee National Insurance contributions (NICs) as if the deemed payment is a salary payment to an employee.

- the paying entity will have to pay to HMRC not only the PAYE and NICs deducted from the deemed payment, but also employer NICs on the deemed payment, which will be an added cost to the paying entity.
- the net amount received by the PSC can be passed onto the individual without paying any further PAYE and NICs.

The rules were intended to cover those engaged by public sector organisations including government departments and their executive agencies, many companies owned or controlled by the public sector, universities, local authorities, parish councils and the National Health Service.

However, prior to this amendment, private sector retail businesses including high street pharmacies and opticians would have inadvertently been within the scope of the off payroll working in the public sector measure. As a result, such businesses would have been required to consider whether the new rules applied to all contractors working for them through an intermediary. This was not the intention of this policy and the rules have been amended.

The rules operate in respect of payments made on or after 6 April 2017. This means that they are relevant to contracts entered into before 6 April 2017 but where the payment for the work is made after 6 April 2017.

We are aware that some authorities have advised PAYE/NIC should be deducted from all payments, even if someone is just a self employed sole trader, as opposed to operating via PSC. This incorrect application of the rules will unnecessarily use up tight budgets, by increasing NIC costs, which will place pressure on the public authorities.

If you would like any help with these new rules contact us.

Internet link: GOV.UK amendment

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NON-RESIDENT LANDLORD SCHEME

If you are non-UK resident and you receive rental income in the UK, you must register with HMRC under the Non-Resident Landlord Scheme (NRLS) regardless of whether you are an individual, trust or company. Otherwise your tenant or letting agent is responsible for withholding 20% tax from your rental payments and paying this over to HMRC.

As an individual, you may be entitled to a refund of the tax withheld if you are a citizen of the European Economic Area ("EEA"). As an EEA citizen, you are entitled to a personal allowance (currently £11,500) with any income within the personal allowance being tax free. If you are registered for self-assessment you can claim your repayment on your tax return. Otherwise, you have four years to make a repayment claim.

Alternatively, if you register with HMRC under the NRLS, you can request to receive your rental income without a deduction of tax. HMRC will write to your letting agent or tenant to inform them that they no longer need to withhold tax on your payments, which may help with cash flow.

If registered, you will still need to complete a tax return in order to disclose the rental income you have received and calculate any tax liability arising.

If you think this may affect you, please get in touch.

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HMRC'S SOFTWARE UNABLE TO COPE WITH COMPLEXITIES OF THE 2016/17 TAX CHANGES

In last month's eNews we referred to the fact that the complexities of the interaction of the dividend allowance, the savings starting rate, the personal savings allowance and the various different tax bands rates, which came into effect in April 2016, have meant that HMRC's own self-assessment software for 2016/17 contains calculation errors.

What are the errors?

The computation HMRC has published this year is incorrect in a number of scenarios, namely:

- Where a taxpayer has Chargeable Event Gains, taxed as income, with notional tax credits, and income taxable at the starting rate band for savings, the basic rate band is being incorrectly increased by the amount of the 0% starting rate band available.
- Where a taxpayer has non savings income (e.g. employment, pension or trading income) below £16,000, and savings income (excluding dividends) above the personal savings allowance of £1,000, the starting rate band (up to £5,000) for savings (at 0%) is not being made available. The tax cost could be up to £1,000.
- For some taxpayers who pay tax at the higher/additional rate, and have either non savings or savings income and dividend income, the higher rate band may be incorrect by the amount of the dividend allowance not used. The tax cost could be up to £280.
- Where a taxpayer is a member of Lloyds Underwriters, and they are entitled to dividend tax credits as their accounting period started before 6 April 2016, the dividend tax credited is being calculated but not included in the calculation as a credit.

Not only is this an issue if you are submitting your own tax return online to HMRC, but it is also an issue where third party software is used to calculate and file the self-assessment return. The third party software calculation is likely to be correct as far as the legislation goes, but because it disagrees with HMRC's currently incorrect calculation, the tax return will be rejected.

The relevant department at HMRC is working on a fix for the problem for 2017/18 tax returns; however, the current advice is to submit a paper return for 2016/17 in those specific circumstances, to avoid overpaying tax.

Where the paper return has not been filed by 31 October 2017 (the deadline for paper submissions for 2016/17), a claim for 'reasonable excuse' should be included alongside the paper return.

It will also be very important to carefully check your tax calculation issued by HMRC following submission of the paper return to ensure it has been processed correctly.

Unfortunately the problem cannot be easily resolved, as HMRC first need to correct the specification within their own software, before issuing any updated specification to all third party software companies, who will subsequently have to programme in a fix to allow electronic filing in those scenarios.

This obviously does not bode well for MTD and the aspiration of becoming the 'most digitally advanced tax system in the world' and if you would like any more information, or to clarify whether this might affect you, please do get in touch.

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CHANGES TO THE PAYE TAX SYSTEM USING REAL TIME INFORMATION – DYNAMIC CODING

HMRC have announced that from the end of May 2017 they will be using Real Time Information (RTI) to make adjustments to employee tax codes in-year as and when the need arises.

HMRC states that this change in procedures will:

- offer more certainty to employers and their employees
- reduce the instances of unexpected tax bills arising
- ensure that more employees end the tax year having paid the right amount of tax.

Details of the change in procedures can be found in the HMRC Policy Paper briefing 'Changes to our PAYE Tax System - helping customers pay the right amount of tax on time'. Further information about the changes can be found on page 4 of the Employer Bulletin April 2017 (Issue 65).

The Policy Paper confirms that individuals will be issued with a new tax code if their circumstances change. This

brings about a marked change from the current system which deals with adjustments after the tax year end and codes any underpayment out via a coding notice adjustment in a subsequent tax year.

Affected employees should shortly be in receipt of tax code notices explaining the changes to the system and what they can do if they need help and support to manage their taxes.

Under the new procedures, once HMRC are aware that an employee's circumstances have changed, they will amend the individual's tax code and follow it up with a notification of the amendment to the employee. A copy notification will also be sent to the employer. It is important for employers and employees to ensure that HMRC are made aware of any changes in an individual's circumstances as soon as possible.

Employers are advised to expect, from 1 June onwards, some employee enquiries relating to tax code changes. In the longer term, HMRC envisages reduced contact from employees regarding under or overpayments of tax.

If you would like help with Payroll or checking your tax code please contact us.

Internet links: GOV.UK Briefing | Employer Bulletin 65

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P11D DEADLINE APPROACHING

As mentioned last month, forms P11D, which report details of benefits and some expenses provided to employees and directors for the year ended 5 April 2017, are due for submission to HMRC by 6 July 2017. The process of gathering the necessary information can take some time, so it is important that this process is not left to the last minute.

Employees pay tax on benefits provided as shown on the P11D, generally via a PAYE coding notice adjustment or through the self assessment system. Significant changes were introduced to the rules for reporting expenses from 6 April 2016.

Some employers payrolled the benefits and in this case the benefits do not need to be reported on forms P11D, but employers should advise employees of the amount of benefits payrolled.

In addition, regardless of whether the benefits are being reported via P11D or payrolled, the employer has to pay Class 1A National Insurance Contributions at 13.8% on the provision of most benefits. The calculation of this liability is detailed on the P11D(b) form. The deadline for payment of the Class 1A NIC is 19 July (or 22 for cleared electronic payment). As 22 July is a Saturday, it may be appropriate to ensure cleared payment is made by Friday 21 July, unless you can arrange for faster payment.

HMRC produce an expenses and benefits toolkit. The toolkit consists of a checklist which may be used by advisers or employers to check they are completing the forms correctly.

If you would like any help with the completion of the forms or the calculation of the associated Class 1A NIC, please get in touch.

Internet links: HMRC guidance | Toolkit

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INVESTMENT BOND LAUNCHED

National Savings and Investments (NS&I) has recently launched a government-backed Investment Bond. The main details of the Bond are as follows:

- minimum deposit of £100
- balances on the account must be between £100 - £3000
- applications can only be made online and up to April 2018
- applicants must be aged 16+ years

- fixed interest rate of 2.2% for three years paid yearly and without tax deduction
- early withdrawals incur a penalty equal to 90 days' interest on the amount cashed in.

According to Moneyfacts, the NS&I offering is a market leader on the interest rate with similar three-year fixed term bonds having an average interest rate of 1.24%. Competitors' minimum investment thresholds are generally higher, typically starting upwards from £1,000 and caps on the maximum capital invested are significantly higher than the NS&I limit of £3,000.

Internet links: GOV.UK news | NS&I | Moneyfacts

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THE TRUST REGISTER AND FORM 41G(TRUST)

As part of government plans to make HMRC the most digitally-advanced tax administration in the world, the current paper process by which trusts are registered with HMRC is to be abolished.

The new Trusts Register will provide a single online point of access for trustees and agents to register and update their records, replacing the current paper 41G(Trust) and the adhoc process by which trustees currently notify HMRC of changes.

HMRC does not plan to launch the Trusts Registration Service until June 2017, despite their guidance stating the current paper form will not be accepted after the end of April. As yet, the plan for the intervening period is unclear, and it may simply be that any trust registrations have to wait until after the new system is rolled out.

All trusts with a UK tax obligation will need to be registered. Trustees will need to ensure the Trust Register is accurate and up to date, and guarantee their obligations under the Fourth Money Laundering Directive.

The register will require information on the following:

- Details of the trust assets, including addresses and values
- The identity of the: Settlor, trustees, people exercising effective control, beneficiaries or class of beneficiaries

Information required will be as follows:

- Name
- Date of birth
- National Insurance number (for UK residents) – unless a minor
- An address and passport or ID number for non-residents, where there is no NI number

Complex Estates

The Register will also provide online access for personal representatives and their agents to register complex estates and update their records online, replacing the current paper process. This is only required for complex estates, but will include those estates already registered with HMRC which are still being administered.

An estate is considered complex where:

- The value of the estate exceeds £2.5 million
- Tax due on the whole of the administration period exceeds £10,000
- The value of the assets sold in any tax year up to April 2016 exceeds £250,000, or £500,000 for deaths after April 2016.

New complex estates will be required to use the registration service to obtain a UTR and the information required will be as above for trusts, but for the Deceased and personal representatives, as opposed to for settlors, trustees and beneficiaries.

Where the estate is not complex, personal representatives can continue the informal procedures.

If you would like any more information regarding the Trust Register please get in touch.

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VAT FUEL SCALE CHARGES

HMRC have issued details of the updated VAT fuel scale charges which apply from the beginning of the next prescribed VAT accounting period starting on or after 1 May 2017.

VAT registered businesses use the fuel scale charges to account for VAT on private use of road fuel purchased by the business.

Please do get in touch for further advice on this or other VAT matters.

Internet link: **[GOV.UK fuel scale charges]**

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DON'T FALL VICTIM TO PHISHING SCAMS

There are many scammers who pretend to be from HM Revenue & Customs (HMRC) to try and extract money from you. Scams can be in various forms such as telephone contact or email contact.

We have recently been advised by HMRC that there is a new phishing scam you should be aware of. If you receive an email with the subject "Your 2016 Tax Report" with an attachment, **DO NOT OPEN IT.**

If you receive the email, HMRC ask you to forward it on to the following email address: **phishing@hmrc.gsi.gov.uk**

For more information on internet scams and phishing relating to HMRC, please follow this link to the HMRC website:

https://www.gov.uk/topic/dealing-with-hmrc/phishing-scams

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