CHARTERED ACCOUNTANTS, TAX CONSULTANTS & FINANCIAL PLANNERS

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# TAX NEWSLETTER JULY / AUGUST 2015

Welcome to this month's eNews.

Whilst schools are breaking up and our children are dreaming of the long holidays ahead of them, we find ourselves knee-deep in the unexpected Summer Budget announcements that will impact on many of our clients.

From changes in the tax treatment on dividends to the withdrawal of interest relief for residential property landlords, the changes demonstrate a clear intention to increase the tax take, despite the Conservatives' commitment to a tax lock on income tax, class 1 national insurance and VAT; increasing what is being charged to tax and how.

A number of new or further consultations is also underway, including looking at ways to address status issues, particularly those operating through a personal service company, and how to stop such operators benefiting from tax relief on travel and subsistence for journeys that are essentially ordinary commuting.

The proposals add yet more complexity at a time when HMRC service levels are declining and digital online accounts are meant to be the way forwards.

Whilst some of the measures are welcomed by businesses, such as the further reduction in corporation tax rates and the annual investment allowance improvement to £200K from 1 January, rather than the planned £25K, many of the proposals are currently not even backed by draft legislation, which just adds to the uncertainty for tax payers.

Who said tax doesn't have to be taxing? And how I wish Mr Osborne had started his summer break on 8 July! Happy holidays!

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## CHANGES TO DIVIDEND TAX

Significant changes were announced in the Summer Budget to the way in which dividend income will be taxed from 6 April 2016. Whilst the changes will mean many small investors are actually better off, owner managers of small companies will face major changes.

### Main changes

We expected last week's draft Finance Bill to include more detail but it now looks as though we will have to wait until Finance Bill 2016 is issued after this year's Autumn Statement. What we do know however is:

- Tax credits – the 10% notional tax credit added to a dividend paid out by a company will be scrapped, and you will now only be taxed on the 'net' dividend.
- Dividend Tax Allowance – the first £5K of dividend income will be tax free. It is not clear if this will then restrict the basic rate tax band or if it is a full additional exemption.
- Dividends will then be taxed at 7.5% in the basic rate tax band, at 32.5% in the higher rate band and 38.1% in the additional rate tax band. This compares with 0%, 25% and 30.56% on net dividend income now.

In addition to the above proposals, we have a new savings allowance of £5K from April 2015, and a new Personal Savings Allowance of £1,000 from 6 April 2016 for basic rate tax payers and £500 for higher rate tax payers. It is not expected that either of these allowances will be available against dividend income.

### What does this mean for me if I already operate through a company?

Whilst the rules are complex and unwelcomed by business owners, there are still savings to be had by operating through a company, although these are rapidly decreasing. The savings pretty much disappear where profits are £150K and over, unless you are able to share these with family members or can leave the profits in the company.

It is still likely to be beneficial to pay a small salary and take the balance as dividends, as it is now. It might also be appropriate to bring forward the payment of some dividends into 2015/16, possibly by crediting your loan account if cash funds are short, although this really does depend on your profit levels, distributable reserves and own personal circumstances such as tax credits claims, child benefit, pension contributions and other income sources.

Overdrawing on company loan accounts could also become more popular in the short term for higher or additional tax rate payers.

If you already operate through a company, costs of disincorporating are prohibitive and the decision to wind your company up should not simply be based on the change in tax rates on dividends.

### Further changes ahead?

The Conservatives have committed to a tax lock on the main rates of income tax, VAT and class 1 national insurance, but does this mean the dividend tax rate might increase further in later years, particularly given the proposed reduction to corporation tax rates?

Alternatively, will we see an increase to class 4 national insurance, which the self employed pay, making incorporations more attractive again? Only time will tell as the debate on what is the best business structure to use goes on.

If you would like a review of your position and how the new rules might affect you, please contact either AG Tax Consulting or your usual AG contact.

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## LOSING INTEREST IN RESIDENTIAL PROPERTY LETS

Many landlords have invested in residential property rather than in pensions, seeing this as the safer way to save for retirement and being able to benefit from increasing property values.

This may all change though with Mr Osborne's recent announcement that tax relief for interest payments will be phased out from April 2017 for higher rate tax payers, removing the 'unfairness' of homeowners not being able to claim tax relief on their mortgage interest payments.

But as we will see below, this is not as straight forward as it might sound and you might be affected even if you don't consider yourself to be a higher rate tax payer now.

The changes will be phased in from April 2017:

- 2017/18 – claim 75% of your interest against profits, 25% relief at 20% only;
- 2018/19 – claim 50% of your interest against profits, 50% relief at 20% only;
- 2019/20 – claim 25% of your interest against profits, 75% relief at 20% only;
- 2018/19 onwards – claim relief at 20% only.

In all cases, the 20% relief is restricted to the lower of:

- Remaining interest costs;
- Profits of the rental business; and
- Total non-savings income over the personal allowance.

Interest includes interest payable on loans to buy the property, furnishings or fees incurred when taking out or repaying loans/finance.

**Example:**

David has two residential lets, income of £16.8K and mortgage interest of £12K per annum. He also uses a letting agent who charges David £1.8K and has employment income of £40K per annum. His tax position over the next few years can be summarised as:

| | Old | New | | | |
|---|---|---|---|---|---|
| | **16/17** | **17/18** | **18/19** | **19/20** | **20/21** |
| Salary | 40,000 | 40,000 | 40,000 | 40,000 | 40,000 |
| Rental Income | 16,800 | 16,800 | 16,800 | 16,800 | 16,800 |
| Less Commission | (1,800) | (1,800) | (1,800) | (1,800) | (1,800) |
| Less Interest 100%/75%/50%/25%/0% | (12,000) | (9,000) | (6,000) | (3,000) | - |
| Taxable Rental Profit | 3,000 | 6,000 | 9,000 | 12,000 | 15,000 |
| Total | 43,000 | 46,000 | 49,000 | 52,000 | 55,000 |
| Personal Allowance | (11,000) | (11,000) | (11,000) | (11,000) | (11,000) |
| Taxable Income | 32,000 | 35,000 | 38,000 | 41,000 | 44,000 |
| Tax @ 20% (32,000) | 6,400 | 6,400 | 6,400 | 6,400 | 6,400 |
| Tax @ 40% (balance) | - | 1,200 | 2,400 | 3,600 | 4,800 |
| | 6,400 | 7,600 | 8,800 | 10,000 | 11,200 |
| Less Interest Tax Credit 0%/25%/50%/75%/100% | - | (600) | (1,200) | (1,800) | (2,400) |
| Income Tax | 6,400 | 7,000 | 7,600 | 8,200 | 8,800 |
| Tax on Rental | - | 600 | 1,200 | 1,800 | 2,400 |
| Effective Rate on Ongoing Rental Profit | 0% | 20% | 40% | 60% | 80% |

You will see from the above that David has a normal rental profit of £3,000 per annum and he will need to service his capital repayments from this profit. Under current rules, his profit is covered by his personal allowance and so he pays no tax other than on his salary. As the rules change, he is pushed into higher tax rates and by 2020/21, when the rules are fully effective, he will pay additional tax of £2,400, i.e 80% of his normal rental profit of £3,000, leaving him only £600 out of which to service his debt.

The tax rate might be even higher if you have to take tax credits into account, or the higher income charge on child benefit or even the withdrawal of the personal allowance where income exceeds £100K.

David's portfolio might not be sustainable at these levels and he may need to think about selling the properties; perhaps transferring part ownership with his spouse, or even possibly incorporating (although see **Changes to dividend tax**); none of which were envisaged when he decided to build up a property portfolio.

The restrictions on interest relief will not apply to companies, furnished holiday lets or rental of commercial property.

If you have a property portfolio and you would like to know how the new rules might affect you, please do get in touch.

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## CAPITAL EXPENDITURE – IT'S ALL IN THE TIMING

Timing of capital expenditure can be very important.

Businesses can currently get 100% tax relief in the year of purchase when buying plant and machinery costing up to £500k per accounting year. However, the allowance, known as the Annual Investment Allowance ("AIA"), will be reduced to £200k from 1 January 2016, although this is a welcomed improvement from the previously proposed amount of only £25k.

Where accounting periods straddle January 2016, an apportionment of the AIA is necessary, but you may need to time the purchase carefully to make certain you get relief as early as possible.

**Example:**

John, a sole trader with a year end of 31 March 2016, is planning to buy a new lathe for £80k.

His maximum AIA for the year ended 31 March 2016 will be £425k (9/12 x £500K plus 3/12 x £200K), and if he buys the lathe before 31 December 2015, the AIA will be available in full against the purchase.

However, if he buys it on or after 1 January 2016, the AIA will be restricted to only £50k, with tax relief on the balance being at 18% in the same year, and then spread over 30 years for any remaining amount.

To ensure your purchase qualifies for the maximum AIA you should take delivery of the item before 1 January 2016 or earlier if your accounting year end is earlier. If you are buying on HP it is important to sign the contract and bring the asset into use before 1 January 2016.

For further advice on your particular circumstances please do get in touch.

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## THE FAMILY HOME AND IHT

The government has announced the introduction of a new transferrable nil rate band for the family home. The additional band will apply where a residence is passed on death to direct descendants such as a child or a grandchild. This will initially be £100,000 in 2017/18, rising to £125,000 in 2018/19, £150,000 in 2019/20, and £175,000 in 2020/21. The additional band can only be used in respect of one residential property which has, at some point, been a residence of the deceased.

The allowance is in addition to the inheritance tax nil rate band which is currently set at £325,000. By 2020/21 the total individual nil rate band will therefore total £500,000.

Any unused nil rate band may be transferred to a surviving spouse or civil partner. It will also be available when a person downsizes or ceases to own a home on or after 8 July 2015 and assets of an equivalent value, up to the value of the additional nil rate band, are passed on death to direct descendants. This element will be the subject of a technical consultation and will be legislated for in Finance Bill 2016.

There will also be a tapered withdrawal of the additional nil rate band for estates with a net value (after deducting any liabilities but before reliefs and exemptions) of more than £2 million. This will be at a withdrawal rate of £1 for every £2 over this threshold.

The IHT nil rate band is currently frozen at £325,000 until April 2018. This is to remain frozen until April 2021.

**Internet link: TIIN IHT**

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## PERSONAL SERVICE COMPANY UPDATE

It's an unsettling time for those operating through personal service companies (PSC), with the main issues being:

- The IR35 debate rages on and it is clear the legislation introduced 15 years ago is not working as HMRC hoped it would. Broadly, IR35 applies where, if you removed your company wrapper and were engaged direct by the end user, would you be taxed as an employee? If you would be, the income from that engagement should be taxed as employment income in your company under the IR35 legislation. However, few companies operate this as relationships are often subjective.

  HMRC see IR35 as failing to do its job and so a consultation has just been issued to address what HMRC see as 'disguised employment' issues. More can be read **here.**
- PSCs are currently being approached by employment agencies to provide certain information that is needed to be reported by them under new agency reporting rules, or 'intermediary reporting'.

  Here, an employment agency might provide workers to an end user who might not operate PAYE on those workers. Under the agency worker rules, if certain conditions are met, the employment agency should operate PAYE on the worker from April 2014. It will also have a new reporting obligation from April 2015 to HMRC.

  PSC operators will not have PAYE operated by any person who engages you due to your PSC wrapper, but payments made to your PSC by an agency might need to be reported by the agency.

  The agency might therefore need to collate information from you that it does not already hold. This covers personal information such as:
  - Full name
  - Address
  - Postcode
  - National insurance number
  - Tax payer reference (10 digit code)
  - Pay in period
  - Dates of engagement
- Your PSC itself could be an agency for these reporting purposes EXCEPT it is specifically excluded if you are the only worker being provided under any contract. Therefore, you will need to report if, say, your spouse is also such as worker, or you subcontract any of the work.
- The employment allowance (up to £2K credit against any employer's NIC due from the company, up to £3K from April 2016) is being withdrawn from April 2016 if there is only one director/worker in the PSC. You might therefore consider introducing your spouse into the business if you still wish to claim this.
- Travel and subsistence claims are being consulted on which will seek to prevent PSC operators from claiming what is essentially ordinary commuting (home to work every day) and we expect to see a further announcement on this later in the year. The consultation link may be viewed **here.**

- Finally, as if the above were not enough, the tax treatment on dividend income is set to change from April 2016. Assuming you are satisfied that you would never be treated as an employee if your PSC wrapper were removed, and so the IR35 salary calculation is not in point, you will take your money from your PSC as either dividends or salary or a mix. Even under the proposed changes, you will still be better taking a small salary of approximately £8K, plus the rest out as dividend income. This will not change under the new measures, although the savings will decrease slightly. If your spouse is able to become a shareholder as well, or if you do not need to take all your profits out, the position improves slightly.

As can be seen from the above, it is becoming increasingly difficult to operate as a PSC, despite this structure often being imposed on workers by end users. It is therefore vital that PSC owners keep up to date with the proposed changes and how this might affect their businesses. If you would like further information, please do get in touch.

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## NATIONAL LIVING WAGE

The government has announced the introduction of a new National Living Wage (NLW) for working people aged 25 years and above. The NLW will introduce a premium on top of the national minimum wage (NMW). Initially the premium is set at 70p above the current NMW although this will fall to a premium of 50p when the NMW increase comes into effect in October 2015. Further increases are to be recommended by the Low Pay Commission in order to achieve the government's objective of reaching 60% of median earnings by 2020.

John Cridland, Director-General of the CBI, commented:

*'Small shops, hospitality firms and care providers are the businesses that will face real challenges in affording the National Living Wage.'*

*'Delivering higher wages can only be done sustainably by boosting productivity. Bringing politics into the Low Pay Commission is a bad idea.'*

**Internet link:** CBI press release

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## PAYE LATE FILING PENALTIES

HMRC have now issued the first in-year penalties notices to employers with fewer than 50 employees who missed the deadline for sending PAYE information to HMRC.

Rather than issue late filing penalties automatically when a deadline is missed, HMRC have announced that they will 'take a more proportionate approach and concentrate on the more serious defaults on a risk-assessed basis.'

This approach is in line with the likely direction of HMRC's general approach to penalties, outlined in the HMRC penalties: a discussion document which they issued earlier this year. HMRC have confirmed that this 'risk-based' approach will apply to submissions that were late from:

- 6 March 2015 for employers with fewer than 50 employees; and
- 6 January 2015 for employers with 50 or more employees.

Penalties for 2015/16 will also continue to be risk-based.

HMRC had previously announced that they will not be penalising minor delays of up to three days.

HMRC are reminding employers:

*'Even if employers do not get a penalty, they are required by law to file on time and if they do not may be charged a penalty on a future occasion. The deadlines for sending PAYE information stay the same, including the requirement to send PAYE information on or before the time that employees are actually paid or due to be paid.'*

HMRC have confirmed the process employers should use to appeal a penalty using the using the Penalties and Appeals System (PAS) on HMRC Online. Employers who receive a late filing penalty notice for tax year 2014/15 quarter 4 but who filed within three days of the reporting deadline may appeal and should use reason code A as set out in the What happens if you don't report payroll information on time guidance.

Please contact us if you would like help with your payroll.

**Internet link: GOV news**

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## EMPLOYMENT ALLOWANCE AND CONNECTED COMPANIES

The Chartered Institute of Taxation (CIOT) are advising employers to act quickly where they may have inadvertently fallen foul of the rules for connected companies and charities, by claiming multiple Employment Allowances against their national insurance contributions (NIC).

Most employers can reduce the NICs they pay by up to £2,000 per tax year, by claiming the Employment Allowance (EA). However, where your company or charity is part of a group, only one company or charity in that group may claim the allowance.

The CIOT has stated that it understands there is a small window of opportunity for employers to correct their mistake through RTI without a penalty being charged: HMRC can easily identify groups claiming more than one allowance and those failing to correct the error themselves stand to suffer stricter penalties.

HMRC is already investigating avoidance cases seeking to exploit the EA through contrived schemes, which is quite separate from the above errors which may simply be because the payroll operator has not been made aware of other group entities.

Further information on EA may be found **here,** together with more information on **connected companies and charities.**

Please note that the Allowance will increase to £3,000 from next April but will be withdrawn for companies with only one employee on the payroll who is also the director/owner.

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## YOUR SPOUSE COULD SELL YOUR LETTING PROPERTY TAX FREE

If you sell your sole or main residence, you can do so, tax free. However, part of any gain might become chargeable if you have not lived in the property throughout, whether you let it in that time or not.

If you gift the property to your spouse, they usually take over your ownership history and their ownership will also therefore be tainted. However, this will only apply if, at the date of the gift, you are married and are living together, and the property being transferred is your (the couple's) sole or main residence.

Therefore, if you own a holiday home or let property, and you are considering selling it at some point which would mean part, if not all, of the gain would be chargeable to capital gains tax, you could transfer it to your spouse shortly before moving into it as a couple. The transfer would be at a nil gain/loss as it would be a normal inter spouse transfer. However, the history of the ownership (i.e. the holiday let or rental period) would not be transferred as you weren't living in it as your main residence at the date of the gift, with it only becoming your main residence when you move in at a later date. Any gain made on a subsequent sale could therefore be entirely tax free.

Please note that if you own a number of properties, you may need to put appropriate elections in place and you will also need to actually live in the property as your home in order for the relief to apply. It is always important to seek professional advice before entering into property transactions and if further advice is required, please do contact us.

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## AND FINALLY, DON'T MISS YOUR 31 JULY DEADLINE

Do not miss the deadline of 31 July for:

- Tax credit claimants renewing claims, as failure to do so may result in your payments being stopped.
- The second payment on account under self assessment becomes due from individuals for 2014/15.

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