Safehands Accounting Ltd

Summer 2016

financial UPDATE

Dividends v salary for director-shareholders: the new rules

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A new approach to retirement saving

The new Lifetime ISA (LISA), which was announced in the March Budget and will be available from April 2017, will be a very attractive proposition. In fact, the LISA could even be a forerunner of how pensions might be in the future.

Age: LISAs can be opened by anyone over age 18 but under the age of 40. This compares with the upper limit of age 75 to invest in a pension. Funds in a LISA can then be used for retirement at age 60, rather than the current age 55 for pensions.

Investment limit: You will be able to save up to £4,000 a year into a LISA, and, until age 50, contributions will be topped up with a 25% government bonus, meaning that £5,000 is actually invested. This is equivalent to benefitting from basic rate tax relief and will come without any earnings requirement. That should be particularly attractive for non-earners given that the equivalent pension limit is £3,600. Higher/additional rate taxpayers will obviously benefit more by making pension contributions.

Flexibility: Pension savings are tied up until age 55, but savings within a LISA can be withdrawn at any time. You will lose the bonus (and any interest or growth on it) and also be charged a 5% penalty, but it could be a useful option in an emergency; and a partial withdrawal is possible.

Choice of investments: Qualifying investments in a LISA will be the same as for a cash or stocks and shares ISA, although not quite as wide-ranging as permitted for a pension.

On retirement: This is where a LISA comes into its own because withdrawals from age 60 are tax free. In contrast, only 25% of a pension fund can be taken tax free the remainder being taxed as income.

If you are self-employed, using a LISA for retirement saving will be particularly appealing. You can always run a pension scheme in tandem to benefit from higher tax relief in those years when you have more income. A pension scheme will also be a better option once the LISA top-up stops at age 50.

But be warned: a LISA is unlikely to be a good choice if you have a pension where you benefit from employer contributions. LISAs might also be inadvisable for anyone who would expect to use the savings as a readily accessible piggy bank.

Swings and roundabouts on employment allowance

The employment allowance was set at £2,000 for the first two years of its existence. For 2016/17, the allowance has been increased to £3,000.

So you can reduce the amount of your employer class 1 national insurance contributions (NICs) payable to HM Revenue & Customs (HMRC) by this amount throughout the year. It does not matter whether you are in business as a sole trader, partnership or limited company.

For example, if your employer NICs for 2016/17 will be £5,000, you will only have to pay HMRC £2,000. If the employer NICs are £3,000 or less, then nothing will be due. However, the allowance cannot be used to reduce any other NIC liabilities, such as class 1A NICs (paid in respect of employee taxable benefits) or self-employed NICs.

The employment allowance is targeted at businesses that support employment, and for 2016/17 will cover your NIC cost of employing four adult full-time workers earning the national living wage for those aged 25 or over. However, the allowance has never been available for employing someone for personal, household or domestic work, such as a cleaner, nanny or gardener. However, it can be claimed by employers of care and support workers.

What's more, from 6 April this year, you no longer qualify if you are the director and only paid employee of your company. In many cases, this will not make much difference. If the employment allowance had been available, then for 2016/17, you might well have taken remuneration up to the level of the personal allowance of £11,000, and then taken profits above that as dividends. Without the allowance, it is likely to be worth limiting your pay so that no NICs are due – i.e. to a level of £8,060 – and then taking more dividend income instead. The tax cost would be just over £200. So although there are measures you could take to avoid losing the employment allowance, it's almost certainly not worth doing so.

Qualifying employment

The situation is more serious for contractors. Regardless of whether or not the IR35 rules apply, contractors will often take a much higher level of remuneration. The after-tax cost of losing the full allowance for 2016/17 is £2,400. Just having employees or another director is, in itself, insufficient to continue qualifying for the allowance. You will only qualify if your earnings from the company are high enough to be subject to employer NICs. This means that an employee's weekly earnings have to be at least £156 (£676 monthly), while a director needs annual earnings of £8,112. The full allowance of £3,000 will be available provided you qualify at some point during 2016/17. But a word of warning if you think that simply employing your spouse or partner for one week is good enough: you cannot qualify for the employment allowance as a consequence of avoidance arrangements.

Employing a seasonal worker for one or more weeks, however, would be fine, provided their earnings are high enough. HMRC also gives the example of a person who is the only UK-based employee of an international company. When it comes to the employment of a spouse, partner or family member, the employment needs to be genuine; in particular, HMRC will be less likely to query long-term arrangements. But remember, taking on an employee or another director will mean having to comply with the workplace pension auto-enrolment requirements.

If you do not initially qualify for 2016/17, but your circumstances subsequently change, you could claim the employment allowance later in the year – employer NICs that have already been paid will still count.

> **"You will only qualify if your earnings from the company are high enough to be subject to employer NICs."**

Dividends versus salary for director-shareholders: the new rules

The new dividend tax rules have reduced the benefit of paying dividends instead of salary for many shareholder-directors, but dividends still have advantages.

Since 6 April 2016, dividends no longer come with a 10% tax credit. Instead, all individuals receive a dividend allowance so that the first £5,000 of dividends are taxed at 0%. They then pay 7.5% on dividends that fall within their basic rate band, 32.5% in the higher rate band and 38.1% in the additional rate band.

These tax rates on dividends are lower than the income tax rates on earnings, but that's not the whole story. Salary payments reduce the company's corporation tax liability, but paying dividends does not. On the other hand, salary carries liability for national insurance contributions (NICs) – avoiding NICs remains one of the main attractions of dividends.

Individual circumstances

The difference that the new dividend tax rules will make to shareholder-directors will depend on their circumstances. It's important to look at the overall tax cost of paying a shareholder from the view point of both the individual and their company. A key variable is the amount taken as dividends compared with salary and bonus. Remember that salary/bonus is taxed before dividends, so your salary/bonus is set against your personal allowance first before your dividends are subject to tax.

For example, a shareholder-director takes a salary of £50,000 and has £40,000 of company profit available to fund a bonus or dividend on top. This person will pay no tax on the first £5,000 of their dividend and then 32.5% on the remaining £35,000, because their salary alone puts them into higher rate tax.

- **Salary:** £40,000 of profit would fund a salary of £35,149 after employer's NICs, which after 40% tax and 2% employee's NICs leaves a net salary of £20,386.
- **Dividend:** the company could pay a dividend of £32,000 after deducting 20% corporation tax. The first £5,000 would be tax free and then £27,000 would be taxed at 32.5%, leaving £23,225.

Some owner-directors take an annual salary of £8,060 to avoid employee's NICs, and draw the rest of their income as dividends. This is still worthwhile but the new rules for taxing dividends will hit them harder. After the first £5,000 tax-free allowance, they will now pay 7.5% on the dividends that fall within the basic rate band, compared with no tax previously because the dividend tax credit used to cover the basic rate tax liability. The higher rate for dividends remains at 32.5%, but there is now no tax credit to

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reduce it. In most cases, there is still a saving compared with salary, although it is marginal at the additional rate of tax.

The dividend allowance is valuable and it will generally be worth paying shareholders dividends of up to £5,000. Spreading shares among family members will add to the benefit. Remember, however, that companies affected by the personal services company rules (IR35) will be limited in what dividends they can legitimately pay.

Retained profits

Another way of saving tax is to leave profits in the company if you do not need to withdraw them immediately. Retained profits are subject only to 20% corporation tax and provide the company with working capital. You might be able to withdraw profits in a year when you are taxed at a lower rate. Alternatively, if you come to sell the company, they might end up being reflected in the value of the company's shares and in effect, be subject to capital gains tax at 10%.

One of the most efficient ways of benefiting from company profits is to make pension contributions as they are usually fully deductible in calculating the profits subject to corporation tax.

The best option in each case depends on several factors, so please come to us for advice tailored to your needs.

Advisory fuel rates dip

The latest update to HM Revenue & Custom's advisory fuel rates, effective from 1 March 2016, sees reductions to most rates.

Engine size	Petrol	Diesel	LPG
1,400cc or less	10p	8p	7p
1,401cc to 1,600cc	12p	8p	8p
1,601cc to 2,000cc	12p	10p	8p
Over 2,000cc	19p	11p	13p

These rates can be used where a director or employee is reimbursed for business mileage they drive in their company car, or where they are required to reimburse the cost of private travel.

After a period of lower fuel prices, recent increases are likely to be reflected in the advisory fuel rates when they are next reviewed from 1 June 2016.

Looking good for capital gains tax

The capital gains tax (CGT) measures announced in the March Budget are generally good news for investors.

Tax rates

For 2016/17, the higher rate of CGT has been cut from 28% to 20%, with the basic rate dropping from 18% to just 10%. If you are sitting on investments that have, for example, increased in value by £100,000, then the tax cost of selling them has just been cut by £7,112. The increase in the difference between income tax and CGT rates will make investing for capital growth, rather than income, even more attractive.

However, the CGT rates for property investors and landlords remain unchanged at 18% and 28%. That's not really surprising given the government's recent attitude towards this type of investment. These higher rates apply to any gain arising from the disposal of residential property that is not fully covered by the principal private residence exemption.

External investors in trading companies

Gains that qualify for entrepreneurs' relief are taxed at a flat rate of 10%, subject to a £10 million lifetime limit. To qualify, you must have a minimum 5% shareholding and also be an employee or an officer of the company.

The relief has now been extended to external long-term investors by the introduction of what is effectively a separate investors' relief. However, the qualifying conditions are not straightforward. For this new investors' relief, the shares must be:

- Newly issued, and acquired by subscription for new consideration wholly in cash – and the issue and subscription must be for genuine commercial reasons;
- In an unlisted trading company or an unlisted holding company of a trading group;
- Issued on or after 17 March 2016; and
- Held for a continuous period of three years starting on or after 6 April 2016.

For the investors' relief, the external investor must not be an employee or an officer of the company. Investors' relief comes with its own separate £10 million lifetime limit, running in parallel with the entrepreneurs' relief limit. Gains qualifying for investors' relief benefit from the 10% tax rate.

If the investor transfers shares to a spouse or civil partner, the transferee will be treated as if they had subscribed for and acquired the shares at the same time as the transferor.

Investors' relief does not benefit existing shareholders because the shares must have been issued on or after 17 March 2016. But if you decide to add to an existing shareholding and then make a partial disposal, the shares that qualify for investors' relief will be treated as disposed of in priority to non-qualifying shares.

For example, you have an existing shareholding of 10,000 non-qualifying shares, and now subscribe for 10,000 qualifying shares. When you come to sell 10,000 shares (after the three-year qualifying period), you will be treated as if you had sold the 10,000 qualifying shares. This gain will therefore be taxed at 10%.

Right to rent check – landlord's new obligations

If you are a residential property landlord, you should be aware that you are now required to check the right of your tenants to be in the UK before you rent out property in England.

Failure to check carries severe penalties of up to £3,000 per tenant, and the requirements even extend to sub-lets and lodgers. You need to check all adults who will live in your property before the start of a new tenancy; but you also have to be careful not to discriminate unlawfully. You should:

- **Obtain a tenant's original documents that allow them to live in the UK.**
- **Check the documents with the tenant present.**
- **Copy and keep the copied documents on file and record the date of the check.**

What's under the Panama hat?

The revelations in early April about offshore companies and investment funds based in Panama have turned the spotlight on tax avoidance and evasion, as well as secret financial dealings in general. The media has focused on politicians, but we can be sure that HM Revenue & Customs (HMRC) and other regulatory authorities will be scrutinising the data for wrongdoing by all companies and individuals within their remit.

There are several reasons why people hold funds offshore and it is not illegal to do so. You might hold one or more foreign currency bank accounts offshore because you have business or a property abroad. Offshore banking might make managing your affairs simpler or help protect you from exchange rate fluctuations.

An investment in an offshore life assurance bond makes sense for some people. Typically, the bond is registered in a jurisdiction with a favourable tax regime. Although potentially higher tax could arise when an offshore bond is cashed in, compared with an onshore bond, the investor might have retired abroad by then and might no longer be subject to UK tax. An overseas investment might allow high-income taxpayers to defer income until a time when they might only be basic rate taxpayers.

What is essential is that all income and gains are fully declared. A strategy that relies on HMRC not finding out is not legitimate tax planning but tax evasion. It's illegal and the penalties are high – up to 200% of the tax due. HMRC will pursue people who fail to declare overseas income and the information from Panama has undoubtedly supplied a lot of leads, as did details HMRC received from banks in past years about accounts held in Liechtenstein and some other European states.

The penalties are lower if a person makes a voluntary disclosure to HMRC rather than waiting for HMRC to catch up with them. If you think you might have overlooked declaring any offshore income or gains or you are not sure of your tax position, we can help you. HMRC says that over 90 countries have already signed up to new international agreements that will let HMRC see more about overseas accounts held by UK residents. And following the Panama disclosures, there have been further moves towards international cooperation and information-sharing to identify tax compliance risks and agree collaborative action.

Tax is not the only issue that arises from the Panama papers. Some of those who used Panama companies have reportedly engaged in money-laundering, misappropriation of assets, circumvention of sanctions and other wrongdoing. As a result, financial and professional service providers will come under increased scrutiny to ensure they comply with reporting obligations where their dealings with client affairs expose them to risk.

A political issue

For political leaders caught up in the allegations, a desire to limit reputational damage has led some politicians to publish their personal tax returns. The right to privacy of personal financial details, such as salaries, has long been protected in the UK, but that could change. In Norway, Sweden and Finland everyone's income and tax details are published every year and are available online.

The UK might not go that far, but anonymity can no longer be guaranteed. No security barriers are 100% effective against a determined hacker or a disaffected or greedy employee. And even if the UK does not go as far as the Scandinavian countries, calls for greater transparency might result in new disclosure requirements for trusts or share ownership. In the long run there might be no hiding place.

New lower exemption for employee shareholders

The take-up of employee-shareholder status, which was introduced in 2013, has been somewhat lower than the government hoped.

Although employee-shareholder style contracts have not been widely used by rank and file employees, they have been popular with start-ups with high growth potential. The capital gains tax (CGT) exemption is particularly attractive to key employees and directors because they have been able to enjoy the growth in share value in a tax-efficient manner.

The basic idea is that an employee-shareholder receives tax-advantaged shares in exchange for giving up certain employment rights. The employee-shareholder must receive shares in their employing company with a minimum value of £2,000, but can benefit from a CGT exemption on the disposal of up to £50,000 worth of shares. These are valued at the time they are received by the employee, and previously the exemption would have applied regardless of their increase in value – even if sold for millions of pounds. However, the amount of exemption is now subject to a £100,000 lifetime limit where shares are acquired under an employee-shareholder agreement entered into on or after 17 March 2016. Any past or future gains arising from prior shareholder agreements do not count towards the £100,000 limit. For example, an employee sells £50,000 worth of these employee-shareholder shares with a gain of £250,000. If the employee-shareholder agreement was entered into before 17 March 2016, the £250,000 gain would be exempt from CGT. If the agreement was later, £150,000 of the gain would be taxed.

Tax calendar 2016

Every month

If the due date for payment falls on a weekend or bank holiday, payment must normally be made by the previous working day.

1 Annual corporation tax due for companies (other than large companies) with year ending nine months and a day previously, e.g. tax due 1 October 2016 for year ending 31 December 2015.

14 Quarterly instalment of corporation tax due for large companies (month depends on accounting year end).

19 Pay PAYE/NIC and CIS deductions for period ending 5th of the month if not paying electronically. Submit CIS contractors' monthly return.

22 PAYE/NIC and CIS deductions paid electronically should have cleared into HMRC bank account.

Month end

Submit CT600 for year ending 12 months previously. Last day to amend CT600 for year ending 24 months previously.

File accounts with Companies House for private companies with year ending nine months previously and for public companies with year ending six months previously.

July

5 Last date to agree a 2015/16 PAYE Settlement Agreement (PSA) with HMRC.

6 Deadline for employers to make returns of expenses and benefits (forms P11D, P9D and P11D (b)) for 2015/16 to HMRC and provide copies to employees.

Deadline for online filing of 2015/16 returns for all employee share schemes, with online registration by this date (unless a reasonable excuse) for new schemes set up during 2015/16.

14 Due date for CT61 return for quarter to 30 June 2016.

31 Confirm tax credit claims for 2015/16 and renewal for 2016/17.

August

1 Penalty of 5% of the tax due or £300, whichever is the greater, where the 2014/15 tax return has not been filed.

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